



After the Hype: The Horizons for Biotech

Hanns-Peter Wiese at Global Life Science Ventures scans the future in his examination of likely funding scenarios for 2006

Hanns-Peter Wiese is a Partner of Global Life Science Ventures. He has 16 years' investment experience in private equity and life science venture capital. Since the inception of Global Life Science Ventures in 1996 he has been Managing Director of the Munich office. From 1993, Mr Wiese was a Director of Corporate Finance with HypoVereinsbank in Munich. Before that, he was a Director with Euro Synergies SA in Paris and an Investment Manager with 3i Investors in Industry plc in their Frankfurt office. Mr Wiese holds a Masters in Business Administration from the University of Hamburg.

Early last year, Critical I released a report on the European biotech industry, which concluded that the financing gap was the industry's biggest barrier, forcing many companies to close down after three to five years. With European companies far more dependent on venture capital than their US counterparts, which have greater alternative sources of funding, the concern has been that small European biotech companies are not receiving the support needed in order to remain viable. A year later, this financing gap is still very much present, and no one reasonably expects it to just disappear. Yet, there are cautious signs of optimism.

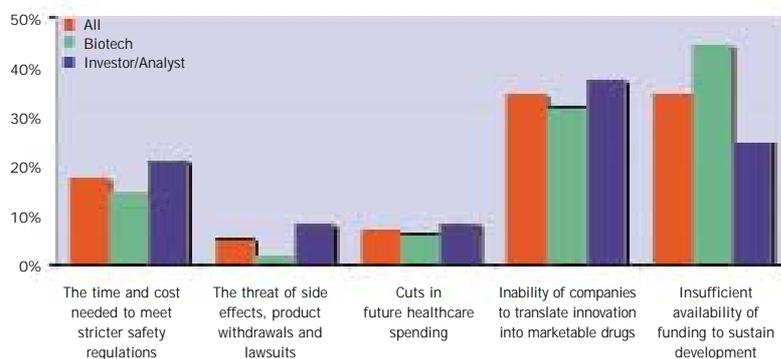
At the Sachs Bloomberg conference in Zurich last October, GLSV released the results of its Biotech Investment Barometer – a survey conducted among analysts, investors and biotech executives in Europe. Forty five per cent of biotech respondents mentioned insufficient funding as the greatest threat to the industry (see Figure 1). At the same time, close to half of respondents were more optimistic about the sector than

a year earlier (see Figure 2, page 18). As Tilman Dumrese of Bank Sal Oppenheim says, there is a very positive trend in the industry, reflected not just in the successes of giants like Genentech from the US, but also with smaller European listed companies like Intercell or Cytos, and the resulting favourable sentiment should make it easier to raise money in the future. This is supported by BioCentury's Bernstein Report on

BioBusiness from 2nd January: a comparison between the US and Europe in the number of biotech IPOs in 2005, the amount raised and their after-market performance surprisingly showed Europe to be ahead on all counts (see Table 1, page 18). Mr Dumrese's view is also echoed by Geraldine O'Keefe of Fortis Bank, who notes that more generalist investors are taking interest in the sector, recognising that value is added at each step along the way as a company matures and products move through the pipeline.

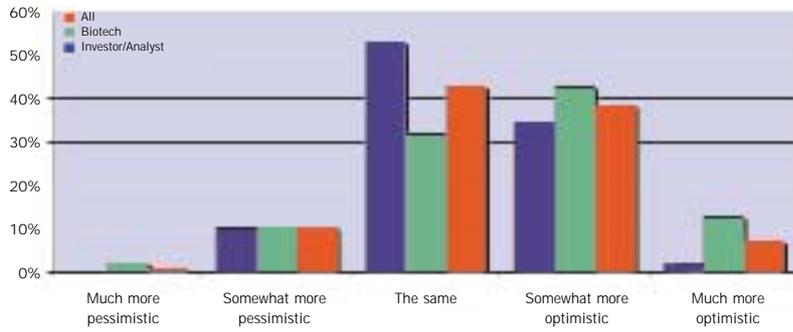
What is nonetheless clear is that the hype of a few years ago is long gone, and investors in biotech are much more

Figure 1: What do You Consider to be the Greatest Threat to the Biotechnology Sector?



Source: GLSV Biotech Investment Barometer, October 2005

Figure 2: How Does Your Current View of the Biotech Sector Compare with Your View 12 Months Ago?



Source: GLSV Biotech Investment Barometer, October 2005

Table 1: 2005 Biotech IPO Performance in the US versus Europe

	Number of IPOs	Raised (\$million)	Post-IPO (\$million)	12/30 Mcap (\$million)	Change
US	17	\$793.8	\$4,452.4	\$4,019.9	-10%
Europe	22	\$891.4	\$4,625.7	\$5,255.8	14%

Source: BioCentury, The Bernstein Report on BioBusiness (2nd January 2006)

conscious and calculating of risks than they used to be. European investors are even more risk averse than their US counterparts; for example, Denise Pollard-Knight of Nomura Phase4 Ventures favours biotech companies within 12 months from the clinic. The result has been a shift towards financing of later stage companies with products more likely to generate revenue in the foreseeable future, while companies based mainly on a technological platform will find funding very difficult. As one biotech executive also pointed out in GLSV’s survey: “The investment required to ensure that a company reaches maturity is increasing. I therefore predict that fewer companies will get funded, but those that do will have access to greater funds”.

Today, the onus is very much on the biotech company to prove its worth to potential investors. In a sector that has still not

attained overall profitability, exciting scientific concepts are not enough to lure hardened investors. While an innovative technological platform remains a key ingredient, serious product candidates addressing large unmet medical needs or defined niche indications, as well as a competent management team – ideally with big pharma experience in clinical and business development, regulatory affairs and marketing – are elements that investors are expecting to see before they decide to part with their cash. The situation is frustrating for fledgling companies struggling to stay alive long enough to crank out product candidates, but it does at least ensure that the limited amount of capital available is used to support the drug candidates most likely to reach the market.

In this respect, a biotech company’s success in raising capital, whether at inception or through various follow-on rounds of finance up to the IPO level, is more about the story they have to tell than any other factor. As Sam Fazeli of Piper Jaffray puts it, trying to

evaluate whether an IPO window is currently open or shut is in some ways meaningless: you only find out whether it is open by trying, and the result is very much dependent on the company’s specific situation.

This is not to say that timing is simply irrelevant for a promising company looking for new sources of funding. Depending on the phase of their funds, VCs may be focused on managing their current portfolio and have to wait to realise returns on previous investments before being able to make new ones. There is also no doubt that, hard objectivity notwithstanding, a particularly successful exit or product launch tends to make investors more positive about the sector as a whole, while a failed IPO, even for reasons linked more to the biotech company concerned than to external factors, can send a chill throughout the industry. But the wide swings of the pendulum seen in the past are likely to be more subdued in the future as the industry matures and attains a certain stability.

The increased interest of big pharma in establishing partnerships with and acquiring biotech companies in order to fill their pipelines

A continuous stream of innovative new technologies in the life sciences is essential for the future of the European biotech industry and the development of new therapies for diseases. If innovation is not encouraged, life sciences in Europe will wither while they flourish in the up-and-coming Asian markets. At the same time, from an investor's perspective, the biotech industry is subject to the same rules as any other industry; namely, investments have to be based on an acceptable risk profile that will lead on average to healthy returns.

is also providing an attractive alternative to IPOs, allowing companies to finance their development, while providing VCs with returns on investments that help fuel further investment cycles. A much-cited, award-winning example is of course last year's purchase of GlycArt by Roche for CHF235 million.

The reverse situation, in which big pharma companies spin off entities that do not fit into their core portfolio, can also lead to the creation of viable new biotech companies with solid management expertise and a product pipeline. Examples include BioXell, a Milan-based company spun off from Roche to exploit a library of vitamin D analogues, and Nabriva, recently spun off from Sandoz, Vienna, to develop a new generation of antibiotics.

Local market conditions can also play a role in the availability of funding. For example, Geraldine O'Keeffe believes that funding has become tougher in the UK than elsewhere in Europe, perhaps because investors there have learned from experience to become more risk averse. In France, the shortage of VC investment in biotech companies became even more dramatic in the past year. On the other hand, there are definite glimmers of light on the European landscape. According to an article in Germany's *Süddeutsche Zeitung* on 2nd March, citing a report in *Transcript* magazine, VC investment in German biotech companies climbed 38 per cent from 2004 to 2005, reaching a level of €345 million that matched the boom years 2000/2001.

Given the trend amongst VCs to focus more on later-stage companies, what are the implications for ambitious start-ups high on innovation but without any products in the clinic? Will Europe's biotech pipeline eventually run dry? The picture is not as dire as that. First of all, as suggested by Ernst & Young's William Powlett Smith in a recent issue of the *European Venture Capital Journal*, universities are likely to hold onto their intellectual property and bring their new technologies further along in development before spinning off private companies. Increased collaborations between universities and biotech and pharma companies will also help more established companies with products in the clinic and on the market feed their pipeline

with new, innovative technologies. And there is an increased awareness at European and national levels of the need for increased public funding to help launch innovative biotech companies. Switzerland affords an excellent paradigm for the role to be played by public funding in bringing start-ups to the point where they can attract VC interest, mentions Tilman Dumrese. In fact, publicly sponsored incubators throughout Europe are providing a breath of life for fresh start-ups. A good example is Geneva-based Ecllosion, an incubator for new life science companies that combines state-funded infrastructure and management support with private sector investment. Furthermore, there remains a definite interest in seed funding by VCs, several of which have replenished their coffers by raising new funds recently. However, according to Sam Fazeli, for reasons of timing and availability of new funds for investment, it may simply be another two to three years before momentum in VC seed investments picks up.

A continuous stream of innovative new technologies in the life sciences is essential for the future of the European biotech industry and the development of new therapies for diseases. If innovation is not encouraged, life sciences in Europe will wither while they flourish in the up-and-coming Asian markets. At the same time, from an investor's perspective, the biotech industry is subject to the same rules as any other industry; namely, investments have to be based on an acceptable risk profile that will lead on average to healthy returns. As previously noted, the European biotechnology industry is now in good shape, with the elements for success in place. Still relatively sheltered from the issues of patent expirations and generic copies that are posing difficulties for big pharma, the industry as a whole is expected to become profitable in the not-too-distant future. If European governments further facilitate the access of start-ups to seed funding, while allowing Europe to function more like a single capital market, innovative entrepreneurs should be able to raise the capital they need to successfully bring new drugs from the laboratory to the market, and the European biotech industry will thrive. ♦

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