Understanding BIOTECH

Is biotech investment the next big thing for super funds? JOHN McILWRAITH writes it's crucial to understand the risk/return profile.

Australian super funds should consider investing more in biotech companies, recognising them as an important part of the porfolios allocated to higher risks and higher rewards, according to some analysts.

While the recent turbulence in the share market may not seem the ideal environment to embark on such adventures, some of Australia's biggest industry funds already have significant holdings in biotech, and analysts predict this field will be increasingly active in the next year or two, as new products come on the market.

There is a fear that unless the industry receives more support locally, many companies will be acquired by overseas groups – a course familiar in other parts of Australian industry.

Tom Wiggans, CEO of the biotech company Peplin Ltd, says superannuation funds should consider holding 3 to 5 percent of their funds in this sector and, in the case of more adventurous strategies, as much as 10 percent.

This would come under the category of higher risk, but also higher yielding investments, following the same strategy that was applied to a wide range of alternative investments.

It is true that this might take years, perhaps a decade, to mature but such "patient capital" is also a well recognised part of the profile of many funds.

Such long-term positions were appropriate where funds were building value for members which might not draw down their funds for 20 or 30 years.

Peplin is well advanced in developing a treatment for skin conditions, especially of the face and scalp, which can be a forerunner of skin cancers. It has strong equity support from major funds with an interest in biotechnical research.

Wiggans points out that the emphasis of many biotech companies on health matters, and the growing importance of these, should be an added incentive for investment by super funds.

Anna Lavalle, CEO of AusBiotech, says many managements and trustees in super funds find it "too hard" to understand the promise of biotech companies. The concepts are a long way from the conventional issues in superannuation investment decisions and the biotech industry would have to work harder to bridge this gap.

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AusBiotech represents the Australian industry, and the organisation has 3000 members, covering a wide range of research, including health products.

She acknowledges the difficulties of potential investors in coming to terms with a commitment that may require up to 10 years of patient investment but she notes that superannuation executives who are comfortable investing in mining ventures which may take years to come to fruition do not see the parallel in biotech.

Lavalle says that biotech companies in Australia are currently starved of capital and even a modest increase in investment from super funds could bring a striking improvement in the progress of many concepts.

She says that there are at least 15 Australian companies close to completing the steps needed to market products.

One positive in the current difficult environment for capital raising was that biotech companies were accustomed to existing on frugal budgets.

The current environment had accelerated trends towards mergers and acquisitions and other types of partnerships between biotech companies.

Lavalle notes past problems where some biotech companies were managed by scientists with little experience in the business world, and limited capacity to explain their discoveries to a wide audience. However this had been largely overcome with most leaders in the industry now adept at communication.

Matthijs Smith, an analyst with Shaw Stockbroking, a specialist in biotech companies, says the current financial

environment represents a "once in a lifetime" opportunity to invest in promising biotech shares for not only are a number of companies close to bringing new products to market, but their prices are depressed as part of the general collapse in the share market.

Smith points out that it usually takes up to 10 years for a new biotech concept to be devised, tested, approved and be ready for marketing.

The Australian biotech industry is little more than a decade old and only now are at least a dozen companies close to earning cashflow. They represent a wide range of products, and treatment delivery systems and could have global markets.

He makes no attempt to minimise the risks associated with the sector – as few as one in 10 biotech ideas may reach market – but says that prudent stock picking, and patience still makes the sector important as a part of any portfolio.

For the successful companies "the returns can be extraordinary".

He suggests there is some symbiosis between superannuation funds and the biotech industry, the former dealing with a membership which will experience the health issues associated with old age and the latter attempting to solve many of them.

Super funds could play an important role in enhancing Australia's global position in the biotech industry – or as David Blake calls it, the health care product sector.

Blake, co-editor of the industry newsletter *Bioshares*, says that few people realise that pharmaceuticals are already Australia's second biggest export industry and a major employer.

He suggested that a world wide dichotomy affected investment in Australian biotech – the desire of investors to pursue short-term rewards, and the needs of capital consumers to provide these in the medium and long term.

There was a tendency on the part of small investors, like members of super funds, to link their investments to fields which served them – for example, motorists who used toll roads on a daily basis would be more likely to invest on the companies which run them.

Similarly, super funds should recognise the link between members who would increasingly need health products and services in their later years, and the industries which provided them.

Super funds displayed little interest in the long-term investments, perhaps with the exception of infrastructure.

Blake's newsletter reveals the gloomy prospects for many biotechs.

Among 95 companies currently spending money on development, little more than $27 million was raised by listed companies in the sector in the March quarter. However this was 50 per cent higher than the previous three months, both periods of course part of the share market slump and economic decline.

The report suggests that at this rate little more than $100 million will flow into the sector this year. This compares with the heavy capital flows of 2007, when $943 million was invested in biotech, falling sharply to $212 million last year.

The Bioshares report warns that up to a third of the companies in this sector could fail.

GGS Venture Partners has more than $400 million for biotech investment, nearly all of it from more than 20 industry super funds. investing in one or more of its five funds.

Managing director Geoff Brooke confirms the difficult times facing the industry, although the firm recently completed a raising of $122 million. However this took considerable time in the current environment.

He pointed out that their total raisings had taken place over more than a decade, again demonstrating the challenging task of attracting investment to the sector.

He said that while the prime objective of the super funds investing in the sector was to earn strong returns for their members, altruistic motives were also in play – health benefits for the community, the support of research largely carried out with public funds (for most biotech products originated in university research).

The recent revival of interest in biotechs, while involving sums that would appear to be petty cash to the giants of the share market, could lead to the progress of a number of projects.

The money coming into the sector is not from mum and dad investors, but from professionals who understand the risks and, just as importantly, the potential rewards.

Strategic Life Sciences chief investment officer Graeme Kaufman said at a recent conference the local biotechnology industry presented vast investment opportunities for alert superannuation funds, but a lack of knowledge was preventing the conversion of interest to actual initiatives.

Several other drivers behind this reluctance also stem from a high-risk investment profile, small companies coupled with insufficient scale and a market cycle that favoured other industries over biotech and life sciences.

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$100 million company as it is. They'll probably look at investing in a $400 million [company] or thereabouts, because their own cost structures won't allow them to do anything else," said Kaufman.

But Kaufman believes that steering clear of niches and spreading funds across a spectrum of biotech initiatives form the basis of strong returns.

"You need to take a broad sector view, that means you have to invest in human health care, in diagnostics, devices and invest in industrial and environmental projects," he said. SF