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Life-science battlers have a spring in their step

Big pharmas consider Australian biotechs sound investments

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HAVING endured the nuclear winter of the financial crisis and a number of late-stage drug failures, the listed biotech sector is enjoying a surge of popularity as company after company signs lucrative deals with big-pharma firms.

Given the dollar signs involved, it's not hard to see why the life-science battlers have a renewed spring in their collective step.

At last, it seems, investors are willing to overlook trial and approval delays and the outright failure of some players (notably HIV drug developer Avexa) to commercialise their pills and potions.

"The biotech orchard has reached a point where the fruit has matured and the bow is ripe for the picking," Bioshares industry analyst David Blake says.

If there was a single turning point in the local sector's fortunes, it was Acrux's announcement on November 24 of a minimum \$670 million tie-up with Eli Lilly to market Acrux's roll-on testosterone treatment Axiron.

Two weeks later, stem-cell therapeutics house Mesoblast unveiled a distribution deal with Cephalon of the US, involving \$1.7 billion of milestone payments.

And Cephalon injected an immediate \$220m of capital by taking a 19.9 per cent stake at a massive 45 per cent premium.

Cephalon returned last month with a \$225m, 70c-a-share offer for ChemGenex, which had had problems securing Food and Drug Administration approval of its leukemia drug Omapro.

"This is a good outcome for ChemGenex, given the challenges faced by the company in the past 12 months or so," Blake says.

On April 1, flu drug developer Biota announced a \$230m deal so

favourable that chief executive Peter Cook was moved to assure analysts it was no April Fool's joke.

The funds are to be provided by an arm of the US Health Department to fund the commercialisation of Biota's next-gen, single-dose flu drug Laninamivir.

Not to be outdone, tuberculosis diagnostic outfit Cellestis revealed on Monday a \$340m, \$3.55-a-share offer from Frankfurt-based Qiagen.

Driving the trend is the desire of global drug companies to refresh their product repertoire as a slew of big-name drugs go off-patent in the next few years.

For instance, Pfizer is about to lose the patent on two popular drugs: Viagra (erectile dysfunction) and Lipitor (cholesterol).

When the companies lose patent protection they lose revenues to generic alternatives and the only way to shorten the tortuous lead time for new drugs is to buy a company or two.

"They are on a burning platform and they need to move rapidly," AusBiotech chief executive Anna Lavelle says.

According to Lavelle, big pharma companies have discovered their own R&D efforts have not yielded the next blockbuster drugs.

"So they're looking around for clever stuff from biotechs globally," she says.

"Australian biotechs are seen as having sound intellectual property and are seen as sound and capital efficient."

Cellestis co-founder Tony Radford, who will reap \$40m if the scheme of arrangement is approved, says the time has come for this technology to come to fruition.

RBS Morgan biotech analyst Scott Power describes the "patent cliff" as a global trend: Cephalon was at least partly motivated by the fact its blockbuster drowsiness drug Provigil goes off patent next year.

Cephalon, in turn, is under a \$5.5bn hostile takeover attack from Canadian drug house Valeant Pharmaceuticals.

"They are snapping up appropriate companies globally," Power says. "It just happens a band of Aus-

tralian companies have matured nicely over the past couple of years."

Lavelle says there are other reasons why the eyebrow-raising deals have followed in quick succession.

"A cohort of maturing companies have done extremely well and are becoming very attractive," she says.

Lavelle says the time frame is consistent with the usual maturation period for drug developers.

The winning biotechs share a similar time line because their genesis was in the same era of generous government grants for the sector.

"It's perfectly predictable," she says. "We are starting to reap the fruits of these early investments."

Behind the good news about lucrative deals, there is some disquiet that founders of innovative technology are selling out too cheaply for short-term gains.

The Cellestis deal faces an early backlash from a group of investors claiming to account for about 30 per cent of the register.

Blake says there will always be a conflict between venture capitalists, who want to "flip" an asset in the short term, and companies that

want to develop their drugs to a more advanced stage and perhaps even retain marketing control.

"It takes longer but at the end of the day they are sold for a better return," he says.

"There is a conflict between being a business and getting rid of it at a seemingly good price but well below the potential of the business."

Power is more sanguine.

"It's a global industry," he says. "It's appropriate that these things get into the hands of larger players. For example, ChemGenex has taken it as far as makes perfect sense."

Lavelle says there were objections when Cephalon paid \$318m for Arana Therapeutics in 2009.

"But Cephalon paid a 70 per cent premium at the height of the GFC," she says.

Lavelle says she has heard few complaints about Acrux's \$100m



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special payout to patient investors. "I'm just delighted to see a dividend paid," she says.

Blake says multinational companies usually prefer to buy cash-generating businesses, but the bar is being lowered in terms of development stages of targeted companies.

Mesoblast's technologies, aimed at treating bone and cartilage disorders, eye disease and diabetes, are far from proven, let alone commercialised.

"It was a huge surprise to see them secure a licensing deal in addition to Mesoblast making a 19.9 per cent investment," Blake says.

He says buyers are more open to seasonal products such as vaccines and antivirals, which might depend on a pandemic for decent sales.

In the case of Biota, there is little dissent about the worth of the deal: the company gets funding for getting Laninamivir to market, with-

out having to cede a cent of equity or any ownership or manufacturing rights over the drug.

Blake says the deal is "absolute recognition about building capability in the face of many detractors who say it's not worth it".

In short, the biotech is hot property, but it is far from a case of a rising tide lifting all boats.

As with our two-speed "miners versus the rest" economy, there is a danger many of the 100 or so listed biotechs will be left behind.

For every biotech that taps the mother lode, there are a dozen early-stage stragglers.

According to newsletter *Bioshares*, 47 biotechs have market capitalisation of less than \$20m and four are valued at \$1m to \$2m.

Its quarterly survival index lists 29 companies with insufficient cash to last more than 12 months at current burn rates.

Lavelle is concerned about the minnows that don't enjoy the same government support.

"Early funding has been quite difficult to get since the GFC in 2008" she says. "It really was a perfect storm for them and some have never recovered."

In an unusual approach, Aus-Biotech organised a presentation by 18 companies to a Perth gathering of 100 or so mining investors.

"They have a similar risk appetite and might want to diversify their portfolio," Lavelle says.

Given that success breeds success, she hopes recent deals will bring renewed interest from "quarters not usually motivated about life sciences investment".

Lavelle expects big pharma to become more creative, not just buying licences on a royalty arrangement, but seeking broader equity or partnership arrangements.



The R&D efforts of global drug groups have not yielded the next blockbuster drugs and they need to refresh their product range as many big-name drugs go off-patent