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Feature: Biotechs prepare for life after the GFC
Tim Dean 16:53:00

The global financial crisis has battered the Australian biotechnology sector, but the signs suggest the storm is passing and the sun could be set to shine again.

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What a year. First, the Federal Government knocks the Australian biotechnology industry to the floor by axing the popular Commercial Ready scheme as part of its May 2008 budget. Then the global financial crisis (GFC) bursts onto the scene a few months later, planting the boot into an already bruised and battered sector. In fact, Dr Anna Lavelle, CEO of AusBiotech, calls it the "perfect storm" for biotechs.

What followed was a virtual freeze on new funds entering the market – both public and private – as investors squirreled away their savings into the relative safety of cash, government bonds or blue chip stocks. The biotech sector, with its reputation for high risk and long lead times before turning a profit, was avoided like the plague it's trying to cure.

But, astoundingly, it wasn't all bad news. At least, not as bad as it could have been. In between all the doom and gloom, many biotechs were quietly beavering away, producing compelling products, announcing positive results from trials and even, in the case of Pharmaxis, building its own manufacturing plant (see 'Pharmaxis breathes easy', page 42). The upshot, if current indications are anything to go by, is that the worst of the storm has passed and those biotechs that are still left standing could be set to enjoy the coming sunshine just starting to peek through the clouds.

That's not to say the next 12 months will be easy; there are sure to be more challenges ahead. But there are also emerging opportunities upon which Australian biotechnology companies could capitalise, particularly across Asia.

Downs and ups

One could hardly provide a retrospective of the last year in the biotechnology sector without reference to that 800 pound gorilla, the GFC, which chose to sit squarely on the world's financial markets last September. The All Ordinaries began the '08-'09 financial year at 5,247, already having suffered a slide from December to March, and ended at 3,872 twelve months later, down 26 per cent. Ouch.

The life sciences indices, however, fared relatively better, with the S&P/ASX 200 Health Care index shedding only 4.2 per cent over the financial year. And of that drop, a lion's share was thanks to CSL's wobbles after its failed takeover bid for US firm, Talecris. Market capitalisation for the sector at year's end was around the $31 billion mark, which is only marginally higher than it was two years prior. Of that, the Big Three – CSL, ResMed and Cochlear – still contribute over 85 per cent, representing $26.5 billion, with the rest contributing $4.5 billion.

The main impact of the GFC on biotechs was the sudden scarcity of money, says PricewaterhouseCooper's Craig Lawn. Commercial Ready was gone, IPOs ground to a halt and venture capitalists – a scarce commodity in Australia at the best of times – withdrew to safer territory.

"Not all companies in this space, but a significant number, are high return and high risk. In the earlier stage, if you get it right, you're sitting on an absolute gold mine. But at the same time it's early stage, so there are material risks to deal with. When things got bumpy, some investors that aren't committed to a company – the more speculative, in and out investors – retreated to safety. They went to cash or safer stock – they effectively put it under the mattress."

As a result, says Lavelle, many biotechs were forced to reassess their plans and hunker down for the duration of the storm. "Some biotechs have reacted by dropping staff, cutting right back on their burn, so they can survive until things improve and finance loosens up. Others – the privately held non-listed companies – have gone dormant, waiting to see when the private market starts to reinvest and they will start to re-energise their programme. Others have delayed clinical trials or cut back on the scale of the clinical trials, or perhaps doing one instead of the two that were planned in that year. All have used different strategies to make their dollar last longer to get across the drought period until money becomes more available."

Frost & Sullivan's Singapore-based global vice president for pharmaceuticals, Rhenu Bhuller, has seen first hand the desperation of biotech companies to find funding in recent months. "The number of companies that have approached us to find partners has doubled over the last six months or so," she says.

Return to form

The good news, according to PricewaterhouseCooper's most recent BioForum report, is that the black clouds appear to be fading. The ex-majors (i.e. everyone but the Big Three) outperformed the All Ordinaries in recent months, with the last quarter seeing the ex-majors grow by an impressive 21.4 per cent. This is largely off the back of the pharma/biotech subsector, with medical device ex-majors rising just 5.2 per cent.

"That was a very strong result," says Lawn. "I'm not saying we're out of the woods, but on an annual basis the life science index out performed the All Ordinaries. We're at least back to where we were 12 months ago. The market was hit hard and early, but there's a return to confidence."

A "return to confidence" sounds promising, and there are signs that money is starting to flow back into the sector. However, if the dearth of IPOs in the last quarter is anything to go by, it'll be a while before things get back to the heady days of 2006-2007. "This trend illustrates how difficult it is for companies to raise equity capital in an environment where investors are cautious about supporting new listings," states the BioForum report. "In the past year, there has been only one biotech IPO in Australia and one medical device IPO in the US."

However, secondary financing is clearly on the up, going from $39 million to $129 million. "Although raisings in Q3 are traditionally slower, investors responded in Q4 to more realistic pricing in companies that they know. A similar trend has been seen in the US, where secondary financing doubled over the quarter to $1.3 billion."

The report also points to the return of venture capitalists to the US biotech market, where they're particularly keen on big pharma companies. "In the past, such activity has been a good lead indicator for trends in Australia. We are yet to see this trend mirrored among local VCs, but it is pleasing that funding increased generally across the biotech/pharma sector."

Government intervention

'What were they thinking?' That's the sentiment that still pervades the biotech sector when it comes to the controversial decision to bin the Commercial Ready scheme in the May 2008 budget. "Biotech companies on the whole are permanently bruised by that decision," says Lavelle. "They cannot understand why the government took that decision."

According to Lavelle, it was just a bad call, plain and simple. The government took to heart the following statement made in the Productivity Commission's 2007 report: "There is robust evidence indicating that the Commercial Ready program supports too many projects that would have proceeded without public funding assistance."

However, as Lavelle points out, the Productivity Commission wasn't advocating scrapping the programme outright, just placing a stronger filter on grants. "The productivity commission report that's often been quoted as the reason the scheme was axed took in the whole Commercial Ready programme, including non-biotech businesses," she says. "Our strong view is that if you isolated biotech the performance would have been very strong against the investment, in fact leveraging something like one to six. So nobody can really fathom what the economic argument would have been for cancelling that programme."

Still, it's gone. Even the considerable noise made by AusBiotech has failed to persuade the Honourable Kim Carr, Minister of Innovation, Industry, Science and Research, to reinstate the programme. Instead, we have the Climate Ready grant and the R&D tax credit in its place. In terms of the former, it's not so bad if you can make a case that your research positively impacts the environment, such as some agriculture biotechs can (see "Blooming biotech", page 44). But for the lion's share of biotechs, Climate Ready is a square peg.

The Research and Development Tax Credit, on the other hand, does present some sterling opportunities for biotechs. The shift from a tax concession – which didn't much help early-stage companies – to a tax credit is a big step, says Lavelle. If you have a turnover of less than $20 million, you can claim 45c for every dollar spent on R&D (40c in the dollar for companies with more than $20m turnover) on your 2010-2011 tax return. "For small companies it's the best news in a long time," she says.

Lawn agrees: "The R&D Tax Credit will be a huge stimulus to the industry. Unfortunately it won't start until July next year, then you have to lodge your return. It's a beacon on the hill, but it's a fair way off until you get that cash."

In the interim, the R&D expenditure cap on the tax offset from the previous scheme has been raised from $1 million to $2 million, giving an added incentive to throw a little extra into R&D this year.

Competition and cooperation

What about other silver linings? With the economy picking itself up off the floor and investment beginning to return, there are new opportunities emerging that Australian biotechs could do well to focus on. One big one is Asia.

Over the past few years, Asia and the subcontinent have been investing staggering sums into biotechnology, says Lavelle. “The money pouring in to biotech and life sciences is breathtaking: billions of dollars. The opportunities for Australian companies there is real. It’s imminent.”

The pundits all agree, the match between Asia and Australia is a compelling. While our market and economy are relatively small, we punch well above our weight when it comes to a range of other attractive areas for foreign biotechs.

“What we have in Australia is talent that people want in other countries,” says Lavelle. “We have a way of doing business here very efficiently and effectively that people want. They also want the way Australians think, which is seen to be less structured and more comfortable trying something out, being a maverick, if you will. That’s a good thing when you’re trying to be at the cutting edge of science. We also have a great legal system; we’ve got stable politics; we’ve got a good regulator; we’ve got top class hospitals to do clinical trials in; we’ve got good clinicians; all the ingredients are here.

“What we don’t have are the large populations that they have in Asia for large scale clinical trials. Also we don’t have a large amount of capital, and they have that too. There’s a marriage there. We have elements that would be enhancing for other countries, and they have things that we need as well. I see that in the next five years there will be more activity between countries in our region and each other and Australia. It’s inevitable.”

According to Bhuller, Australian biotechs need to embrace these opportunities by actively engaging with Asian governments and private biotech companies. We can’t assume the business will come to us without some effort made to promote our strengths. “There is room for Australia as a country to increase its profile in the life sciences sector in Asia, to actually be the leader that it could be.”

Cautious optimism

It’s been a rough 24 months for the biotech sector, but there are signs that things might be about to turn. Between increased confidence in the market, the return of venture capitalists, the upcoming tax credit and burgeoning opportunities in Asia, there are good reasons to start thinking about growth again rather than just survival. That’s not to say caution isn’t still advised, nor that the market is guaranteed to bounce back in the next six months. But the experts agree that we seem to be through the worst of it.

“The rest of this year will still be difficult,” says Bhuller. “But we do foresee a slight upswing coming in next year. Not in the next six months, but probably beyond that in the next 10 to 12 months or so there should be a sign of a turning.”

Lawn’s advice is to be ready for when the market does turn. “The ruling wisdom is that good companies never stop talking to the market. They’re poised, ready for opportunity as and when it comes. They’re ready for the upswing. But is that right here, right now? I’d say that’s still not clear.”

Over the long term, however, Lavelle is convinced it’s only a matter of time before the market wakes up and realises the importance of biotech once more. “The fundamentals haven’t changed. The world needs biotech. The investors will see this after they get over the shock of the last 12 months.” All you have to do is be ready for when that day comes.