

John Collar quote highlighted below:

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## Bumpy roads ahead

The biotechnology industry has been hard-hit by present economic conditions, putting pressure on the industry's leaders to make tough choices.

by Joshua Slatko

## *Bumpy roads ahead*

The days of rising stock prices and easy equity fund-raising in the biotechnology industry have come to a shuddering halt. With investors running hard from risk, the traditional high-risk, high-reward profile of most biotech companies is becoming harder to sell. With almost half of public biotech companies holding less than a year's worth of cash on hand, executives are faced with tough choices about dollars and priorities – how to find badly needed capital, what projects to focus on, and which employees to keep.

The numbers for the biotechnology industry were decidedly grim in 2008. Through the first 11 months of the year, funds raised from IPOs almost disappeared, falling 97% from the previous year. Follow-on/secondary offerings decreased 56%. Through Nov. 30, total capital raised by the industry fell 56%. One hundred and twenty public biotech companies, or 30% of the total, were trading with less than six months of cash on hand by year-end, a jump of 90% compared with the end of 2007. One hundred and eighty companies had less than one year of cash remaining, 65% more than at the end of 2007. Just 10% of the 370 public U.S. biotech companies had positive income.

The market has clearly noticed this state of affairs. More than a third, or 35%, of the 270 biotech companies with less than \$1 billion in market capitalization are trading below their cash value – they have more cash on hand per share than the market value of their companies. This level has gone up by five times as compared with the average during the past five years.

All this financial pain has led to operational pain. Twenty-four small public biotech companies laid off workers in the eight weeks between Oct. 1 and Dec. 5, 2008. And in September, October, and November, many promising drug-development programs were shelved by biotech companies in a number of therapeutic areas, including Alzheimer's disease, multiple sclerosis, diabetes, and various cancers.

According to the leaders of the industry's largest trade organization, the end result of all this may be catastrophic for patients. "The credit crisis is drying up the pipeline, so the progress of getting therapies to patients will be delayed," says Ellen Dadisman, managing director, communications, BIO (bio.org). "Not all companies have been adversely affected, but in some cases, we could lose a generation of therapies."

Lacking the capital resources of larger pharmaceutical companies, many smaller biotech companies have been driven into a danger zone. "On the public side, stock prices have fallen

dramatically for most small biotechs," says David Collier, a managing director of CMEA Capital (cmea.com), a venture capital company that focuses on life sciences. "Many of these are nearly out of cash and are running out of options. We will likely see a wave of bankruptcies – never before seen in biotech – and distressed mergers."

Many life sciences venture capitalists believe that the storm is unlikely to abate any time soon. "The challenging funding environment should be expected to continue through at least the first half of the year and perhaps much longer," says Richard Blaylock, a biotech partner at the law firm Pillsbury Winthrop Shaw Pittman (pillsburylaw.com). "Investment in both public and private biotech companies is down by about a third in 2008 compared to 2007, and we shouldn't expect an uptick before the markets have had a chance to assess the plans of the new Obama administration together with the unfolding financial crisis."

With cash growing tighter every day, some biotech companies are narrowing their focus. "Many companies are abandoning their second and third drug-development programs and focusing all their cash and effort on only their lead," Mr. Collier says. "Stronger private companies are reopening previous rounds of financing to new investors at the same pricing as before in order to build their cash reserves to weather the crisis."

The first step, however, is admitting the problem. "Many execs have not accepted the new reality and are still on cruise control expecting to be able to raise money at attractive prices or sell their companies at huge profits," Mr. Collier says. "They are in for a rude awakening when they next approach investors or potential acquirers."

Funding, as the statistics have shown, is not so easy to find in the present environment, and that is beginning to have a Darwinian effect. "There has been an overall slowdown of funding of private biotech companies and a nuclear winter of funding public biotech companies," says Brent Ahrens, a general partner at Canaan Partners (canaan.com), another venture capital company with a focus on healthcare. "On the private side, good companies are still being funded, but the funding is clearly taking longer than it did 12 or 24 months ago. Also, terms, conditions, and prices may be much harsher than in previous times. As tends to occur during most economic crises, there is a clear separation of the stronger companies from the weaker companies."

Backing away from one or two projects is not exactly a pleasing option for executives trying to stay focused on the long term. "We have begun to see companies making deals which undervalue the asset, or subject of the deal, to generate a revenue stream as an alternative to funding," says Diane Romza-Kutz, the chair of the life sciences practice group for Neal Gerber Eisenberg LLP (ngelaw.com). "In the long run, as the economy begins to heal and the present value of that deal decreases over time, the cost to underselling the asset will have a great impact on the company's financial health."

Companies have also begun to shelve technologies, according to Ms. Romza-Kutz. This allows the company to become dormant so as to not generate costs during the time that funds are scarce. Patent terms continue to run, however, taking away market exclusivity and devaluing the asset and return on investment.

Mr. Ahrens has been telling his own biotech companies to step with care and be prepared to make tough choices. "With our current portfolio companies, we are advising teams to husband their resources with a heightened degree of awareness," he says. "The manifestation of this process differs across our portfolio. Some are reducing the number of projects under way. Others are scaling back their organization selectively or are taking advantage of the overall market conditions to upgrade in certain areas. If cash is available from equity and debt players, most companies are giving serious consideration to taking the money. Naturally there is significant

discussion about the cost of capital, but the will to survive is often a trump card, and companies that can raise capital will generally do so."

Ms. Romza-Kutz believes that biotech companies and related developing companies need to take steps to conserve, look for partnering opportunities, and take a fresh look at their business plans with the current economic realities in mind. "It makes a certain amount of sense for companies with more than one asset in development to concentrate on one more than the other," she says. "Companies need to evaluate their financial resources, the patent life remaining on a particular asset along with where the asset is in development in order to make decisions on how to continue to move their company forward strategically. The remaining assets that are not of the highest priority can be partnered out in either a co-development deal or a licensing deal."

But she warns about selling assets short to make deals for a quick buck. "Financial pressures may drive the value of the asset down, but a well written co-development or license arrangement can be written to allow for the current economic downturn as well as an 'upside' when the economy turns around," Ms. Romza-Kutz says. "One of the greatest risks to these biotech companies is reactive management, which merely reacts to the current financial market without a plan for moving through the current crisis. Resources should be expended on revamping these companies' business strategies both short and long term in order to preserve assets and future opportunities."

**The biotech industry does have one inherent advantage in tough times – some of the world's most innovatory leaders. "Bioscience companies are renowned for excellent management teams," says John Collar, executive director of the Colorado BioScience Association (cobioscience.com). "They, of course, will keep a tight eye on the fundamentals of cost management and implementing innovative lean operational measures, while narrowly focusing on developing products and services with significant market potentials. Firms that bring innovative, lower cost, and more effective products and services to market will not only survive these times, but will be the powerhouses of the industry going forward."**

These companies must widen their funding horizons if they are to survive. "The resourceful biotech executives will broaden their search for near-term funding and examine sources such as SBIRs, contract work, angels, CRO partnerships, and other alternate sources of funding," says Rick Williams, chief business officer for the Hamner Institutes for Health Sciences (thehamner.org).

On the bright side, large pharmaceutical companies are even more desperate than usual to stock their pipelines as a result of the downturn. "[Biotech companies are] fortunate that this downturn is occurring while big pharma companies struggle and are on a shopping spree looking for new drugs," Mr. Williams says. "Thus, biotech companies have more partnership opportunities with big pharma than ever before, yet may have less negotiating power."

However they choose to face the whirlwind, biotech executives need to face it soon; the marketplace will not wait for them. "There are no magic formulas," says Ken Aldrich, CEO, International Stem Cell Corp. (internationalstemcell.com). "It is very easy, however, to delay making hard decisions, whether about staffing, funding of new projects, or cutting back existing ones until it is too late to respond. All of us need to guard cash and avoid losing focus so that our concentration remains fixed on our core competency and on those products or research projects that show the greatest promise."