

The Unlikely European Biotech Poker Game

Good Hands, but No Bets!



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Biotech companies in Europe outnumber those in the US, yet the European public universe is severely lacking critical mass: 100 companies weighing a total of €40 billion is less than Amgen alone! Closer inspection shows that over 50 per cent of these companies weigh less than €200 million, representing in aggregate only 10 per cent of the industry total market value. European IPOs are also scarce: only 12 have been completed in Europe since 2004, in contrast to over 30 in the US.

As a whole, European investors perceive biotechnology as too much of a gamble and tend to shy away from investments in the industry. Many factors have led to their disillusion, but the lack of success stories since 2000 has largely disappointed. Now,

more than ever, Europe needs 'Actelions' to restore trust and demonstrate the industry's full potential. As it happens, a fair number of companies are already waiting in line to go public and secure the necessary financing to complete late-stage trials and eventually commercialise their drugs. These may be Europe's future market leaders. If European investors do not bet on them, who will and at what price?

THE TOUGH GAME OF EUROPEAN IPOs...

Even if you think you have a good hand, think twice. Only 12 companies managed to get a listing on a main European market within the last 18 months (see Table 1). Most of these obtained a listing under difficult market conditions (on average at a 17 per cent discount to the mean of their

Table 1: Overview of Selected European IPOs (January 2004-15th June 2005)

IPO Date	Company	Business Model	Status	Market Cap (€ millions)
03.03.04	Ark Therapeutics (UK)	Vascular disease, cancer	Market	199
25.03.04	Basilea (SWI)	Infections, dermatology	Phase III	392
08.07.04	Biomerieux (FRA)	<i>In vitro</i> diagnostics	Market	1,500
19.07.04	Epigenomics (GER)	Molecular diagnostics	PC	106
11.02.05	Paion (GER)	Thrombotic diseases	Phase II	118
01.03.05	Intercell (AUS)	Vaccines	Phase II	176
04.03.05	Ardana (UK)	Endocrinology, urology	Market	98
04.05.05	Arpida (SWI)	Bacterial infections	Phase III	158
05.05.05	Galapagos (BEL)	Drug discovery	Platform	60
05.06.05	Devgen (BEL)	Crop protection/human Rx	PC	107
10.06.05	ProStrakan (UK)	Bone diseases/women's health	Market	275
10.06.05	TopoTarget (DEN)	Cancer	Phase III	119
Average				276

Source: Company Filings, Company Press Releases, Bionest estimates

Table 2: Financial Performance of Selected European IPOs (January 2004-15th June 2005)

IPO Date	Company	Pricing Range	Final Price	Percentage Discount	Current Price	Percentage Discount
03.03.04	Ark Therapeutics	£1.20-1.46	£1.33	0%	£1.08	(19%)
25.03.04	Basilea	SFr90-115	SFr98	(4%)	SFr82	(16%)
08.07.04	Biomerieux*	€26.90-31.25	€30.00	3%	€38.01	27%
19.07.04	Epigenomics	€11.90-14.50	€9.00	(32%)	€6.50	(28%)
11.02.05	Paion	€11.00-14.00	€8.00	(36%)	€7.48	(6%)
01.03.05	Intercell	€6.75-8.50	€5.50	(28%)	€5.25	(5%)
04.03.05	Ardana	£1.53	£1.28	(16%)	£1.21	(5%)
04.05.05	Arpida	SFr18-22	SFr18	(10%)	SFr15	(17%)
05.05.05	Galapagos	€8.00-10.00	€7.00	(22%)	€6.71	(4%)
05.06.05	Devgen	€7.50-10.00	€7.50	(14%)	€7.70	3%
10.06.05	ProStrakan	£1.50-1.65	£1.00	(37%)	£1.02	2%
10.06.05	TopoTarget	DKK20.50-25.50	DKK22.50	(2%)	DKK23.80	6%
Average				(17%)		(5%)

*IPO included Wendel Investissement trade sale and share issue for employees at 20 per cent discount

Source: Company Filings, Company Press Releases, Bionest estimates

Table 3: Overview of Selected AIM IPOs (January 2004-15th June 2005)

IPO Date	Company	Business Model	Status	Market Cap (€ millions)
13.01.04	Eirx Therapeutics (UK)	Drug discovery	Platform	6
26.04.04	York Pharma (UK)	Dermatology	Phase III	14
28.04.04	BBI Holdings (UK)	Diagnostics	Market	29
30.06.04	Norwood Immuno (UK)	Immunology	Phase II	59
02.07.04	Vectura (UK)	Pulmonary diseases	Phase II	119
02.08.04	Evolutec (UK)	Allergy, inflammator	Phase II	19
11.10.04	Allergy (UK)	Allergy	Market	87
11.10.04	Sareum (UK)	Drug discovery	Platform	5
14.10.04	VASTox (UK)	Drug discovery	Platform	78
26.10.04	Synairgen (UK)	Drug discovery	Platform	41
20.12.04	Physiomics (UK)	Services	Platform	2
21.03.05	Plethora (UK)	Urology	Phase III	36
29.03.05	Proximagen (UK)	CNS	n/a	42
Average				41

Source: Company Filings, Company Press Releases, Bionest estimates

Table 4: Overview of Selected AIM IPOs (January 2004-15th June 2005)

IPO Date	Company	Pricing Range	Final Price	Percentage Discount	Current Price	Percentage Discount
13.01.04	Eirx Therapeutics	n/a	£0.05	n/a	£0.03	(35%)
26.04.04	York Pharma	n/a	£0.25	n/a	£1.05	320%
28.04.04	BBI Holdings	n/a	£0.47	n/a	£0.94	101%
30.06.04	Norwood Immuno	£0.95	£0.38	(60%)	£0.33	(13%)
02.07.04	Vectura	£0.70-0.84	£0.56	(27%)	£0.76	35%
02.08.04	Evolutec	£1.65	£1.25	(24%)	£1.29	3%
11.10.04	Allergy	£0.98	£0.73	(25%)	£0.95	30%
11.10.04	Sareum	n/a	£0.02	n/a	£0.01	(49%)
14.10.04	VASTox	£1.48	£1.35	(9%)	£1.70	26%
26.10.04	Synairgen	£1.16	£1.30	12%	£1.30	0%
20.12.04	Physiomics	n/a	£0.02	n/a	£0.01	(75%)
21.03.05	Plethora	n/a	£1.35	n/a	£1.12	(17%)
29.03.05	Proximagen	n/a	£1.48	n/a	£1.43	(3%)
Average				(22%)		25%

Source: Company Filings, Company Press Releases, Bionest estimates

pricing range). Even more worryingly, most are now underwater, trading on average at a five per cent discount on their final IPO price). Epigenomics and Ark Therapeutics are the worst performers, with a 28 per cent and 19 per cent discount respectively (see Table 2).

NEW HOPES REST IN THE AIM (UK) AND ALTERNEXT (FRANCE) PLATFORMS

Although relatively young, the Alternative Investment Market (AIM) has grown rapidly to become the main European market for emerging companies: 355 admissions in 2004, two-thirds of which were IPOs. Market access requirements are relatively light and UK-based investors benefit from potentially substantial tax benefits (capital gains tax taper relief, inheritance tax, and so on). Not surprisingly, the AIM market quickly gained notoriety, particularly in the life sciences sector. Since 2004, 13 biotech companies have gone public on the AIM market (see Table 3). However, these companies also face tough market conditions. Even Plethora, with a Phase III compound in the pipeline, trades at a 17 per cent discount to its IPO price (see Table 4).

In May 2005, Alternext was launched in France to facilitate the entry of emerging companies into a regulated market, just like AIM. A handful of companies have already listed on the platform, but no biotech companies so far. There is however considerable potential, and Bionest is currently investigating the feasibility of an Alternext listing for several companies.

TO LIST OR NOT TO LIST!

Why did so few companies manage to go public within the last 18 months? While the European biotech industry may not be as mature as its US counterpart, there are quite a few companies boasting innovative products in late-stage development. BioXell (Phase II) recently announced its intention to list. BioAlliance (Phase

III), Jerini (Phase III), Newron Pharma (Phase III), Wilex (Phase III), Micromet (Phase II), Neuro3d (Phase II) and several others also show good potential, having late stage products with demonstrated proof-of-efficacy. However, Europe's relatively poor IPO track record leaves little hope for these companies. Several have already postponed their listing (see Table 5).

Date	Company	Country	Therapeutic Areas
May 2005	Speedel	Switzerland	Cardiovascular and metabolic
May 2005	Renovo	UK	Scar prevention
June 2004	IDM	France	Cancer vaccines
June 2004	Microscience	UK	Vaccines
July 2004	Cyclacel	UK	Cancer

Source: Company Filings, Company Press Releases, BioCentury

There is one common deal breaker for each of these failed offerings – valuation. Let's, for example, consider the Speedel case, which sheds some interesting light on the matter. Following its series six private round, Speedel was valued at CHF660 million (€430 million). Even if the company had gone public with no step-up, its valuation would have exceeded that of all recently listed companies (except for French diagnostics player Biomerieux). At this price, Speedel just did not convince already sceptical public investors. In fact, Speedel has probably been private for too long now. Throughout six rounds of financing, venture capitalists played in their own little world: they kept investing funds at an increasingly high – but fair – valuation. And now that Speedel's lead product is in Phase III trials, they expect an equally fair valuation from the public markets. But who still sincerely believes in the market being fair? Speedel was not willing to accept the substantial discount demanded by institutional investors and eventually pulled the plug. ProStrakan also had to learn the lesson: one day into its roadshow, the company's indicative pre-money valuation had to be slashed by 25 per cent, from £220-240 million to £160-190. ProStrakan subsequently managed to go public, at a pre-money valuation of £146 million. Now that the 2000 bubble

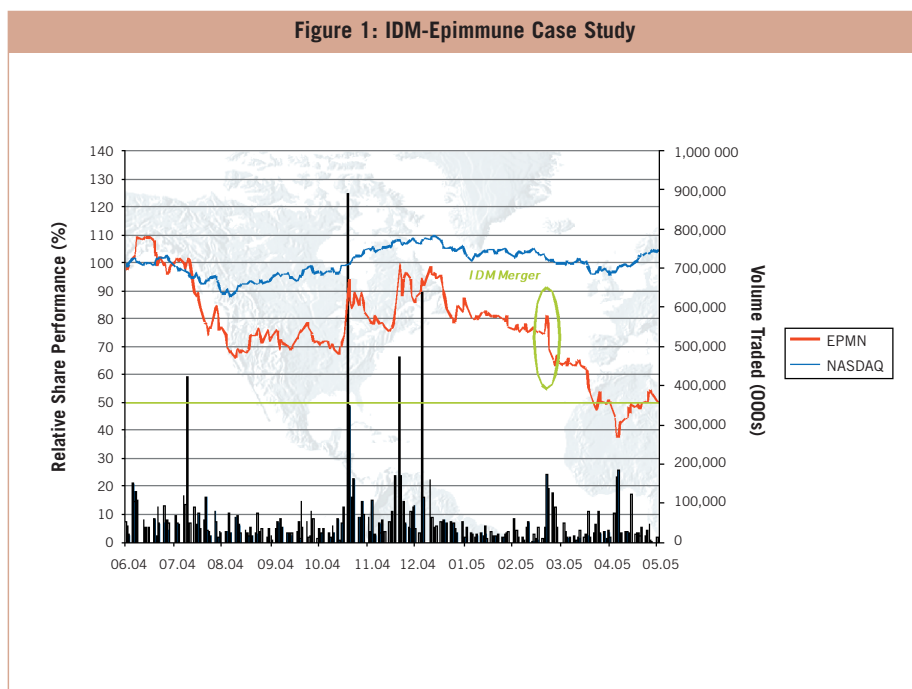
has burst, accessing the public markets does not come cheap. Is that so bad? Where is the harm if you are convinced your company can deliver its promise? You will be rewarded in due time!

IS IDM SHOWING THE WAY?

French-based Immuno-Designed Molecules (IDM), one of Europe's most promising biotechs, was planning an IPO on Euronext's Nouveau Marche in June 2004. However, when the process was well underway, local investors decided to walk away. The classic domino theory scenario ensued, with foreign investors turning cold as well. The lesson learnt was a harsh one: no local believers, no believers at all! IDM had no choice but to withdraw its offer and explore further alternatives.

IDM's subsequent merger with US-based Epimmune, eight months later, enabled the company to get a NASDAQ listing. But at what price? Some quick sums show that IDM probably had to agree to a fairly significant discount to its proposed IPO valuation. Indeed, while IDM's preliminary prospectus indicated a pricing range of €10.50-12.00, IDM received the equivalent of 3.77 Epimmune shares at \$2.23 (€1.68) each, that is, €6.33 per share – a 40 per cent discount!

Figure 1: IDM-Epimmune Case Study



Did the market believe in the transaction at least? Not quite. Today, Epimmune trades below \$1.00, further impacting IDM's valuation. IDM went from a maximum valuation of over €250 million in its proposed IPO in June 2004 to €100 million when it announced its merger with Epimmune in March 2005. Today, IDM owns approximately 80 per cent of the new entity, trading at a €60 million market capitalisation: newly NASDAQ traded IDM is now worth €50 million! Puzzling, considering the fact that the company raised a total of €100 million privately prior to the merger. Is this what the European biotech industry deserves?

...biotech companies pursue IPOs in order to gain access to a large pool of capital so that they can take their product pipelines through to commercialisation. Companies that cannot secure enough financing are bound to relinquish at least some control to a partner who has the ability to fund expensive Phase III trials. Danger! If only few IPOs can be sustained over the long term, biotech companies will only be able to take their products through to Phase II and have to forego most of the value arising from their portfolios.

VALUATIONS, VALUATIONS, VALUATIONS: WHY BIOTECH MUST LEARN TO LOSE A BATTLE

Let's step back and try to understand the stakes involved: biotech companies pursue IPOs in order to gain access to a large pool of capital so that they can take their product pipelines through to commercialisation. Companies that cannot secure enough financing are bound to relinquish at least some control to a partner who has the ability to fund expensive Phase III trials. Danger! If only few IPOs can be sustained over the long term, biotech companies will only be able to take their products through to Phase II and have to forego most of the value arising from their portfolios. Is this fair? In addition, earlier and later stage companies would be directly competing for financing in an obscure private little

world. And since venture capitalists are likely to dedicate an increasingly large portion of their funds to the less risky bets, many companies would have to struggle to even survive. Is this fair?

Biotech companies, whether young or more mature, should not be restricted to Phase II drug supply: they deserve to reap the fruits of their innovation. They also deserve a chance to turn into the 'Amgens' of this world. This is why biotech IPOs are so vital, particularly in Europe. If they come at a price today, so be it. Valuations must fall for biotech to rise! ♦

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