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Funding, partnering lessons for biotechs

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Biotech leaders who want to stay in step with the trends need to rethink how to monitor and then effectively communicate with their investors and big pharma alliance management community

Recently, as I was interacting with CEOs and PE leaders, after conducting a round table on personalized healthcare opportunity in India, a leading CEO from a mid-sized biopharma company remarked that opportunities for the mid-sized companies in India for partnering and funding innovation are over. As one looks at the number of PE deals in India in the sector, they have steadily increased from virtually nothing in 2003 to around 30 in 2007 and reducing by half in 2008. On the other hand, different models for partnering and risk sharing emerged during the same time as large global pharma companies executed partnering models in Asia, including India, with 2007 being the peak of the partnering deals signed in India. In 2008, PEs were taken for a surprise, when access to capital and liquidity events was brought to a halt.
Biotech valuations were drastically reduced and firms were forced to inject additional capital into businesses that were seemingly predictable as the alliance managers of large pharma scaled down their ambitions. In 2009, there is a rebound in deals with a total of approximately $130 billion (about Rs 612,947 crore) have flowed from 321 deals in the first half of this year in the US alone. However, number of deals has lagged in India in 2009 as compared to the trend seen in the West. So, does this signal the beginning of an end of a dream, and the drying up of funding and partnering deals pipeline in India?

Key trends
A large number of companies were emerging in India in biotechnology, without the full resources to take the product through to full-scale development and global commercialization.
Investors and global pharmas demand for evidence for continued growth and endorsement of technologies.
Labor cost arbitrage for scientific and clinical talent to reduce the cost of drug development-to-launch.
Biosimilars segment offering huge potential for out-partnering with large biotech and pharmas to call back molecules.
Clinical biomarkers or diagnostics linked to gene expression profile of individual or sub-populations of patients is an essential feature of stratified or targeted medicine. This type of research attracts and often is best pursued by small biotech companies in India.
Collaborative development financing (CDF), where an investor provides capital and clinical expertise in exchange for licensing of a biotech's pipeline.
Non-profit foundations have adopted a more investor-like approachÂ¯early-stage funding for proof of concept and target validation, as well as project management support, and access to their network of scientific experts and research clinics critical in translating discoveries into the clinic.
The overall trends do validate that the key drivers for funding and partnering in India have not structurally changed to witness

the opportunities in biotech diminish as generally perceived in the short-term. But the most important ingredient for a healthy funding and partnering deals pipeline for Indian companies that offer a long-term growth at a compelling risk-reward ratio. The Indian companies in the small and mid-size sector should better prepare themselves for the upturn. Here are a few pointers.

Prep-up to these changes

Biotech leaders who want to stay in step with these trends need to rethink how to monitor and then effectively communicate with their investors and big pharma alliance management community. Most small-and mid-sized biotechs are looking at raising capital for immediate and short-term needs (round B or C), signing up strategic partnerships building capability base in India and their business development capability overseas, and preparing for target valuation for IPO or acquisition. Given the current scenario, it would be prudent to keep a buffer of 20–25 percent for the delays and uncertainty, and a lead time of anywhere between 9–12 months. Most importantly, it is imperative to research out and target your investors and learn about their preferences and the competencies they bring to the biotech. It would be wise to avoid those investors or firms with competing investments in other Indian or foreign biotech companies.

Partnering deal types

Most Indian biotechs are entering into deals that range from low-risk models such as fee for service, milestone-driven fees payment. Many of them have turned away highly risky models such as co-development, co-commercialization and joint ventures. Newer partnering models are emerging that balance the risks and outcomes for the partners. Most partnering arrangements have a deep impact on the biotech venture financing and its terms and sustainable future. It is time that these risk-reward issues are balanced out with the future stability of the company.

Valuation of IP or company

As new investors and larger pharma are getting more sophisticated understanding of the science and the principles of valuation based on factors such as IP, cost of clinical development, time to commercialization, size of the therapeutic segment, quality of clinical data, competitive factors, impact on other R&D programs, and royalty cash flows, newer valuation models have emerged to reflect reality other than traditional valuation approaches such as net present value (NPV), discounted cash flows (DCF), and internal rate of return (IRR).

Advisory board and subject matter experts

Nowadays, as alliance partners and investors are turning the due-diligence process on its head by using tools to research biotech companies in India, those same companies in India should consider similar moves. A panel of experts can provide invaluable information to an investor and similarly an expert panel can help the CEOs of the small and mid-sized biotech companies understand where they meet, and where they fall short on alliance and investor expectations. Once these companies understand how their partners and PE investors perceive them, they can then start working to fill in gaps, recast messages, better explain strategy, and so forth. The process could even result in changing scientific and business practices, as expert panels can bring a fresh perspective to companies that aren't realizing their full potential.

To be or not to be

As the line between biotech and big pharma blurs aside from mergers and acquisitions and partnering, pharma companies are starting their own initiatives. Pfizer pledged to spend $50 million (about Rs 235.75 crore) for a San Diego incubator; Lilly spent $560 million (about Rs 2,640 crore) to expand its biotech operation; and Roche in late 2007 announced that it would plow $255 million (about Rs 1,202 crore) into expanding its biotech research and development. Some of these plans have been scaled back last year in the wake of the economic downturn. The stake sale of Ranbaxy does signal questions in the minds of CEOs in the small and mid-sized Indian biotechs, as a stand alone, do they stand a chance with sustainable revenue models of growth for their innovation? The jury is still out there.