

## Funds galore for biotech startups

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The new year has started on a firm note for the biotech industry. The fledgling industry has several small and medium enterprise companies and most of them are struggling to get funds for expansion. "The government is keen on developing this sector. And it is considering setting up a Rs 1,000-crore fund for science research. It will remove all conflicts from Department of Science and Technology, Department of Biotechnology etc. We are also looking at setting up a \$2-billion technology acquisition fund. Besides, the budget support for R&D has been growing. At present it is 1.2 percent of the GDP and it would reach 2 percent in next few years," said Dr MK Bhan, secretary, Department of Biotechnology (DBT), Government of India.

Any announcement by the governments to dedicate funds to promote the industry is a welcome step. And such announcements will have a rub-on effect. The ministry of chemicals and fertilizers is in discussion with the Planning Commission to increase the corpus of the R&D fund to Rs 2,000 crore. According to reports, the government is seriously considering the proposal and sanction the same within this financial year. No final decision has, however, been taken. And it is planning to model the fund on the lines of research funds offered by governments of developed countries by inviting private participation - like financial institutions and venture capitalists to create a workable fund. The Gujarat government has announced the setting up of Rs 50-crore Gujarat Biotechnology Venture Fund. This 12-year close-ended state fund set up by Gujarat Venture Finance (GVFL) Ltd will invest in the biotechnology start-ups in the state.

Despite the bullish feeling, the investor community is still shy of this sunrise industry, which is looking at seed and early stage funding. The biotech industry now needs to understand the expectations of investors and VC community and vice versa. The Association of Biotechnology-Led Enterprises (ABLE) organized "BioInvest" in Mumbai on March 11th. This was a meet to

get a first hand account of the investors' views and their perceptions about this industry. The investor community, comprising people from the capital market, commercial banks and venture capitalists, participated in the meet to share their outlook on how to attract funds at early stage.

According to Sarath Naru, managing director, APIDC-VC, 13 early-stage and 90 late-stage deals with investments worth of \$2,197 million were signed in India in the last 24 months. Amongst these, eight deals saw \$1 million or lesser in investments, about 43 deals were in \$3-10 million range, and those above \$10 million were 45. Coming to life sciences vertical during the same period, 17 deals were finalized with a total investment of \$557 million at an average size \$26 million. Only four deals were for early-stage investment, the rest were in the late stage of funding.

### **Early-stage biotechs hit hard**

Early-stage biotech companies need to use different models to start with in addition to investment by early stage VCs i.e., they do not only depend on VCs. This is important considering that there are few VC Funds (APIDC-VC's and GVFL's biotechnology venture funds) doing early stage VC," said Sarath Naru.

There are many hitches coming in the way of the VCs. These include lack of knowledge about this space, tightfisted valuations, slow decisions, shortage of value-adds, frightening documentation, divergent timeframes etc.

It is not only the VCs even commercial banks are also hesitant in offering loans to the biotechnology industry. This is mainly because of the size of the companies, funding requirements, uncertain business models and financials, lack of assets for security purposes, lack of vibrant VC community to develop strong VC-commercial banking partnerships to reduce the required due diligence by banks and preference of banks to look at asset backed lending vis-a-vis cash flow based lending. However, a couple of commercial banks like Canara Bank and Syndicate Bank are offering personal loans to biotechnology professionals along with IT professionals.

Commenting on the biotechnology sector from commercial banking perspective, Alok Gupta, country head, life sciences and biotechnology, Yes Bank Ltd said, "Not only in India, even globally the number of banks involved in financing early stage companies is very small and pure debt funding is more suited for medium or late stage companies with sustainable profits and positive cash flows. Increasing the awareness can lead the banks to look favorably at the biotechnology sector."

### **Increased interactions the need of the hour**

To overcome the challenges several action points have been suggested. Some of the more important ones include educating the investors and VC community, government support to the bonafide early stage VCs, providing time management lessons for VCs, conduct of joint workshops by the Indian Venture Capital Association (IVCA) and ABLE to understand the norms of the industry, and government's support for VCs with operating backgrounds. Naru observed that ABLE can make a big impact on VCs if it can go to the investors and the VC funds in India and tell them to support only VCs who are truly early stage and have investment management team members that have experience working with early stage companies and have biotech experience. ABLE's working with the Investors into Funds, and with institutions like TDB and NIMITLI will support the qualified VCs.

Further, the entrepreneurs need to come up with big ideas that start small. "We as early stage VCs are looking for 'business propositions' that can become billion dollar companies in five to 10 years," said Naru. At the same time he called upon the investor community and VCs to understand the space better, to work to add real value and to take on more risk.

A healthy venture capital industry is crucial to the industry. It provides the impetus to the entire financial chain, creates strong partnerships between VC community and proactive banks. Banks normally consider warrants to take advantage of the potential upside, thereby improving the risk-reward returns. Alok Gupta suggested encouraging banks to fund R&D initiatives, to provide channels for the banking finance to be routed into R&D and related areas, technology venture funds, infrastructure-BT parks, incubators etc.

### **Do it yourself**

Most the biotech entrepreneurs, who are basically from academic background, enter the business with big ideas. As time passes they start looking for funds from banks to VCs to run the show. Their background pulls them back to look at various options before approaching the VCs. One among the key factors is valuation of the company.

Valuation is one of the key components that VCs consider while considering the proposal of biotechnology entrepreneurs. Valuation has many uncertainties and complexities. Ronil Sujan, executive director, Rabo India Finance noted, "Biotech industry is at a nascent stage. It has very few valuation benchmarks available. Surrogates such as stock price volatility are unavailable in the Indian biotech market and Biocon is the only exclusive biotech company listed on Indian stock exchanges. The changing regulations and government policies in the biotech sector are also creating problems in valuation of a

company."

Ronil Sujan pointed out different parameters to value the company. The parameters include type of company - size, type of product base, business model, current life cycle stage; quality of management; number of products under development and stage of product development; survival index - ratio between cash on hand and burn rate (rate of expenditures required for R&D); level of intellectual property protection; government policy stability; domestic and international market dynamics; market sentiment (stock market, economy trends); insurance reimbursement trends; current and future availability of product substitutes) and collaborative partnerships with big pharma or larger or more established companies.

### **Business plan**

Venture capital funding is different from lending. As biotechnology is a hi-tech area, it requires a careful analysis of the project reports before the final sanction for the projects. Selective approach is very much essential. The VCs look at the proposals for proper and detailed business plan, which gives a clear road map about the company.

"Clarity of business plan is more important rather than the form of the business plan. Clarity of the business idea where the values come from and competencies of the team should be clear. The plan should also include how to augment the gap that exists in individual teams and enhances the team's strengths," said Ajay Kumar Kapur, chief executive officer, SIDBI Venture Capital Ltd.

How to prepare a business plan? "First identify the objectives, outline the business plan that includes executive summary, market analysis, company description, operational model, products and services, management and ownership, funds requirement and its uses, financial data and exhibits, review the outline, write the business plan, review the plan and update the plan," observed Utkarsh Palnitkar, industry leader, health sciences, Ernst & Young.

### **Yet lucrative**

Biotechnology is still attractive. Nitin Deshmukh, director, ABLE noted that biotechnology like any other industry is a volatile business, yet it has had a positive ending in 2004. The life sciences sector in the US attracted \$5.6 billion by way of venture capital in 578 companies - the largest dollars and deals in the last four years. This was 27 percent of all VC funding in 2004.

One key factor to be noted is that the definition of biotechnology today has moved away from a narrow one of the products developed involving recombinant genetic engineering to technology in life sciences involving genomics, combinatorial chemistry, SNP's proteomics, systems biology etc. This has been extended to the development of products for human healthcare, agriculture, environment, bio industrial processing and bio suppliers. Young drug discovery companies have been increasingly getting identified as biotechnology companies.

Making comments on the capital market, which is very important for the investors, Sanjay Bajaj, vice president, equity capital market, JM Morgan Stanley, said, "Despite the recent bull run Sensex does not appear to be overvalued as compared to global markets and the Indian market has been among the best performing markets over the last six months.

The markets have reacted favorably to the Union Budget. Even the FII inflows were very strong with net FII inflow crossing \$8.5 billion in 2004 and the flows were not restricted to only large cap companies. Even mid-caps attracted good FII interest. In 2005 too, FIIs have so far have pumped in more than \$2.5 billion. Investor participation in the Indian new issue market continues to be extremely robust with recent offerings attracting many high-quality foreign investors. The Indian markets have matured to absorb large public offerings and investors have made good returns in recent IPOs."

"Investors are uncertain about biotechnology. It is an ideal option to look at creating shared facilities in all the major cities to provide a common platform to support innovative R&D. Even the R&D spend in the country has gone up and people are becoming comfortable with utilizing the new technologies and things are now looking better. Ideas are floating around. The government feels that in the long run, the subsidy is not a viable option hence it rather looks at investing in R&D i.e., through public-private partnerships model," added Dr Bhan.

VC funding is available but seed stage and early stage funding is still a day-dreaming for entrepreneurs. Vishnu Varshney, CEO, Gujarat Venture Finance Ltd said, "The government has a much greater role to play in the growth of biotechnology in India. Besides developing a robust regulatory framework and setting up biotech parks, I believe that an incubation fund for the early entrepreneurs can be started to whet their technology and processes before these entrepreneurs can approach a VC for a larger fund."

"Definitely venture capital and private equity support are picking up in the country and innovation lead growth of the economy is a good sign. It is an essential thing to happen because venture capitalists can now balance the risk and thereby the business ideas will flourish with the support from the traditional finance," noted Ajay Kumar Kapur. n

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