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Battening Down the Hatches

It Will Get Better, But Experts Say Take Your Medicine Now

By Trista Morrison
Staff Writer

At the third annual BIOCOM Investor Conference, held last week in San Diego, former Cowen & Co. vice chairman Stelios Papadopoulos gave the industry reason to believe that this, too, shall pass.

Papadopoulos presented an analysis showing that, while the biotech market suffered for three years after the crash of 1987, it bounced back with a vengeance in 1991, propelling the amount of money raised in biotech IPOs four times higher than pre-crash levels. After the markets fell in 1998, a similar bounce-back occurred in 2000. Yet Papadopoulos argued that the market has yet to truly bounce back from the post-2000 correction, and when it does, it may result in "unprecedented numbers in terms of interest in biotech."

The bad news is "it might actually get worse before it gets better," Kurt von Emster, general partner with MPM BioEquities, said during a panel at the conference.

Evan McCulloch, portfolio manager with Franklin Templeton Investments, agreed that there is "a lot less money in the system" – especially for public biotechs, as hedge funds come under pressure. But private biotechs are likely to feel the pinch as well – despite the fact that venture firms have money to invest and tend to protect their own.

"There are going to have to be some orphans and some kids we have to kick out of the family," von Emster said. "We are going to have to redeploy assets where we can make the money back." Von Emster advised any companies still crossing their fingers and hoping that things will get better before they run out of cash to "take your medicine now."

Bob More, general partner with Frazier Healthcare Ventures, offered similar advice, warning companies to "make damn sure you have things lined up for a long period of time."

To be sure, many biotechs are doing just that. Several have secured guaranteed access to cash through committed equity financing facilities (CEFFs), including Dyax Corp. and XOMA Ltd. in the past month. Others have formed joint ventures with Symphony Capital Partners LP, as Oxigene Inc. did last month. Still others have stayed afloat by selling royalties, issuing convertible notes, or turning to private investors.

McCulloch recommended that companies "pursue multiple avenues toward raising cash" and keep a shelf registration statement active to allow "maximum flexibility."

Todd Wyche, managing director with Brinson Patrick Securities Corp. agreed that companies should be "evaluating all of these things on a proactive basis." He added that keeping a shelf open allows companies to utilize financing vehicles like Brinson Patrick's Dynamic Offering of Common Stock (DOCS).

DOCS, which have been used in real estate and energy but are new to biotech, involve selling shares off a shelf into the market in small chunks, which Wyche explained allows companies to raise funding as needed and adjust the price throughout the process. Additionally, with no placement agent calling around to gauge interest in the deal, DOCS can minimize the negative market impact that often precedes an offering, Wyche told *BioWorld Financial Watch*.

Brinson Patrick helped Avanir Pharmaceuticals Inc. raise about $16 million through a DOCS in 2006 and 2007, and Wyche said the bank has used the approach to raise $150 million this year. But he noted that DOCS are dependent on liquidity, which means companies need to plan ahead and not wait until they are down to their last quarter of cash.

Another financing option often overlooked by public companies is the inside round. "Talk to your largest investor – find out what they like and if they are willing to put in more money," said Matthew Perry, portfolio manager with Biotechnology Value Fund LP.

Like a DOCS, an inside financing round may help avoid the short-selling that often drives down a company's stock price just ahead of an offering. Repros Therapeutics Inc. tried the approach last month, cutting a deal with its largest investors for $15.5 million up front and another $10 million in the future. The company priced the deal at a premium to its market price, although its stock had dropped in the months prior to the financing.

Just as important as raising new cash is being smart about spending existing cash, the experts said. McCulloch said companies should "take a critical look at every single program," and slash the burn rate "as far as you can without cutting muscle" – a sentiment echoed by the other panelists. It's a recommendation many biotechs have already taken to heart. October saw belt-tightening by Maxygen Inc., EPIX Pharmaceuticals Inc., Adventrx Pharmaceuticals Inc., SemBioSys Genetics Inc., Cell Genesys Inc. and others, with Cytokinetics Inc. jettisoning its entire oncology research program in late September.

But despite the cost-cutting, nearly half of unprofitable biotechs are operating with less than a year's worth of cash, according to some estimates. It seems inevitable that more will follow in the footsteps of AtheroGenics Inc. and file for bankruptcy. And some bankers have suggested cash shells also should consider bankruptcy as an alternative to merging with early-stage companies whose pipelines do not match the risk tolerance of the shell's investors. (See *BioWorld Financial Watch*, Oct. 13, 2008.)

While bankruptcy is a frightening concept to biotechs – which usually manage to avoid such a drastic end by reinventing themselves – it does offer a silver lining. "What this industry really does need is consolidation," Perry said. "If any good comes out of this, it is going to be a healthier biotech industry."

And that healthier industry will be ready to strike when the markets rebound and investor interest swings back to innovation. But innovation will be key. "If we don't innovate, it's going to be over" – the money will go to another high-growth sector like wireless or high-tech, Papadopoulos said.

Past market booms supported antisense and gene therapy in the early 1990s, then genomics and proteomics in 2000. As to what biotech innovations will drive the next window, Papadopoulos suggested stem cell technologies or biological platforms for alternative energy. More hopes he can't predict the next innovations because he's looking for entrepreneurs who can surprise and excite him, but he said now is "about the best time in history" to start a company. ■