MEETING REPORT

# ANALYSTS TRY, TRY AGAIN TO VALUE BIOTECH

FORT LAUDERDALE, Fla.—High stock prices on Wall Street and high temperatures here led to an up-beat February meeting between members of the financial community and executives from biotechnology companies. The fourth annual Industrial Biotechnology Association (Rockville, MD) conference focusing on financial issues, the get-together was marked by optimism that this latest round of stock market enthusiasm will not be followed by a devastating crash. Biotech companies are more solid now than in 1983, the reasoning goes, with operating profits, products on the market, clearer patent positions, and more experienced business leadership on board.

Linda I. Miller, assistant vice president at PaineWebber (New York, NY), proposed that biotechnology stock investment cycles between promises, payoffs, and pitfalls. PaineWebber's biotechnology stock index gained 80 percent over the course of last year, she said, but she warned that payoffs had better follow this year from biotech's grand promises—otherwise, pitfalls could soon dominate the attention of the investors. Miller predicted that sales of biotechnology-derived products will increase to $400 million this year, as she looks for biotech stocks to outperform the stock market as a whole. Miller does not expect another 80 percent increase in biotech stock value for 1986, but she was quick to point out that a year ago she did not foresee such a large increase either.

With stock prices soaring, a major portion of the discussion once again was devoted to stock valuations—always a difficult proposition for R&D-heavy biotech companies. This year's task was to explain why the companies are worth approximately twice as much as they were last winter. Garen Bohlin, vice president for finance at Genetics Institute (Cambridge, MA), demonstrated the confusion by pointing to three valuation approaches he has seen used:

- The "Let's ride Genentech's coattails method," in which a company determines its own value by deciding that its projects are worth a certain percentage of those of Genentech.
- The "I'm a potential acquisitions candidate, too, strategy" where a company looks at the hefty prices paid for Hybritech and Genetic Systems and determines what a fair price for itself might be.
- The "Linda Miller rule of eights approach," based upon Miller's discovery that prices paid for Hybritech and Genetic Systems came out to 8–9 times their R&D spending. Using this multiplication factor, any company with good quality research (and what company doesn't believe that?) will be able to determine its actual worth.

On a more serious note, Bohlin said he perceives a market bias toward large size within the biotech industry. "Big isn't always best," he warned. Bohlin advocates a shift toward traditional valuation methods, making use of discounted cash flows (even though some of the necessary data don't exist yet). This sort of analysis is additionally difficult, added Miller, because the financial community still is not sure what a mature biotechnology will look like.

Bohlin, however, did predict where the biotechnology community itself is headed. Of the top 40–50 start-up companies, he expects that a portion will not be able to develop products and revenue streams. These will go out of business or limp along, but will *not* be acquisition targets. Others will develop products, and many of these will indeed be acquired or merge with other firms. The remaining 15–20 companies will remain as independent operating entities. Most of these will survive on royalties from licensed technology and products. The number of companies that can mature successfully into large, operating businesses with valuations greater than $500 million, he said, "can be counted on the fingers of one hand."

**—Arthur Klausner**

MEETING REPORT

# 'YOU *CAN* MARKET PRODUCTS IN JAPAN'

FORT LAUDERDALE, Fla.—"It *is* possible to crack the Japanese market," especially with new products that garner high reimbursement from the government, reassured Hemant K. Shah, vice president for research at Nomura Securities (New York, NY). He was directing his encouragement to the biotechnology executives gathered here in February for a meeting sponsored by the Industrial Biotechnology Association.

Shah pointed to the non-recombinant beta-interferon launched in Japan last year as an example of how profitable the Japanese pharmaceutical market can be. In Japan, the government determines the price at which it will reimburse companies for medicine, and it pegged beta-interferon at the unusually high level of $340 per patient-day.

If an American company is interested in marketing a product in Japan by the year 1990, Shah recommended, that company should start the lengthy negotiations process now. "American companies are a little arrogant," he explained. If a Japanese company wanted to penetrate the U.S. market, the firm would be in America constantly for five years.

He predicted that the next few years will see a restructuring of the Japanese pharmaceutical industry. According to Shah, Japanese companies are not well capitalized—they have high debt-to-equity ratios. He predicts that government reimbursements could contract about 20 percent by the end of the decade, so many Japanese drug houses will find themselves in serious financial difficulties. This could offer significant opportunities for drug firms abroad. A small company could license new products to boost revenues of a lagging Japanese firm. Also, larger firms could have the financial resources to make acquisitions at "fire-sale prices."

Shah noted that although Japan has made very few original discoveries in biotechnology, the country is not far behind in development. "History says they are capable of catching up in any technology," he said.

According to Shah, the Japanese view biotechnology with mixed emotions: they see the technologies as having enormous potential—especially in pharmaceuticals and for diagnostic reagents—but commercialization is taking longer than expected. Japan has already made some accomplishments in biotechnology. When Schering-Plough Corp. (Kenilworth, NJ) first needed to produce interferon in bulk in 1983, the American firm licensed production technology from Suntory (Osaka). As for products from Japanese firms, Shah predicted that Sumitomo Pharmaceutical (Osaka) will market recombinant human growth hormone by this summer, and Shionogi Pharmaceutical (Osaka) should bring recombinant human insulin to market about the same time.

**—Arthur Klausner**