

BUSINESS AND REGULATORY NEWS

Incyte SNPs up Hexagen for new firm

On August 17, Incyte Pharmaceuticals (Palo Alto, CA) announced the formation of a new pharmacogenetics business, Incyte Genetics, resulting from the acquisition of Hexagen (Cambridge, UK) a private company specializing in analysis of human genetic variation and its relationship to disease. Although the news has been greeted poorly by investors—Incyte share price dropped 38% in the two weeks following the announcement—the apparent market for pharmacogenetic information coupled with the infancy of the field is expected to benefit Incyte in the long term.

Incyte will buy Hexagen for \$5 million in cash and 1 million shares of Incyte stock, a transaction value amounting to almost \$38 million on the day of announcement. Through the acquisition, Incyte gains technology to identify single nucleotide polymorphisms (SNPs), small variations in human DNA that may correlate with an individual's susceptibility to disease or response to drugs. This technology will be the cornerstone of Incyte Genetics. There is "very intense market interest in this area [pharmacogenetics]... the only missing piece for Incyte was the SNP discovery area which we've now added," says Incyte CFO Denise Gilbert.

However, the market has been less than enthusiastic: Although Incyte is acknowledged as one of the most successful genomics companies, registering a consistent profit through sales of genetic information to over 20 pharmaceutical companies through annual subscriptions to its genomics databases, its share price fell from \$30 on the 17 August to reach \$18.50 per unit by 1 September. That reaction is in direct contrast to that in January 1998, when Incyte share price rose to around \$50 following the acquisition of Synteni.

Paul Boni, genomics analyst at Punk, Zeigel & Knoell (New York), notes that the Hexagen purchase has made it clear to investors that "[Incyte] needs to freshen its technology base in order to keep the business going." Although he notes that Incyte has a "practically monopolistic" business in selling sequence information, he points out that investors are often wary of the time, expense, and risk involved with acquisitions—things compounded by the poor state of the market. It is "a very negative market, at this point very hypersensitive to change," says Kevin Tang, BT Alex Brown (New York) analyst, "...and as [Incyte] did not announce [the acquisition]

together with the signing up of a pharmaceutical company, investors saw the expense without seeing any of the potential upside... in a rotten market environment, that tends to drive stock down."

Gilbert agrees that negative investor reaction resulted from a "a very uncertain stock market." In addition, she points out that whenever a company adds complexity to its capital structure, it takes time for people to understand the implications. "We provided a lot of complexity all at once," she says, "both in understanding the technology behind the new business unit as well as the financial structure."

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Mark Bodner: acquisition of Hexagen will favor development of SNP technology.

There are more fundamental concerns about the company's business strategy. "We feel it's best to invest in genome companies that are developing patented products from the genomic information they discover. For example, HGS [Human Genome Sciences] with drugs, or Myriad Genetics with diagnostic tests," says Matthew Murray at Lehman Brothers (New York), which rated Incyte as a "hold." "The risk with [Incyte's] business model is that as more genomic information becomes publicly available, so the price pharmaceutical companies are willing to pay for that information is likely to go down. This is less likely to happen if you have a patented product."

However, some analysts praise Incyte's move, viewing it as far-sighted and essential for any company wishing to be dominant in the area of genetic information. Hexagen is a "very important and extremely valuable acquisition," notes Richard van den Broek of Hambrecht & Quist (New York). Incyte could have continued in its present form and made money, says van den Broek, but the identification of SNPs has greater value in the long-term. "It would have been a very short-sighted strategy to ignore the SNP area, and in the long-term it would have been more costly."

Tang, who upgraded Incyte to "strong buy," says, "We think Incyte today is the foremost provider [of genetic information] to the industry and bolting on this kind of capability

really makes tremendous sense." Investors will see the sense of the acquisition in the future, noted van den Broek, "My suspicion is that once the Incyte and Hexagen technology is combined the investor community is going to be pleasantly and positively surprised."

And the market is apparently there: SNP information is so sought after that analysts have reported rumors that ten or so pharmaceutical companies were preparing to set up their own consortium to obtain SNP information. The consortium would have had to spend \$150–200 million on developing SNP databases, according to analysts, and to do that they would have had to contract out work to such companies as Incyte and Hexagen. But with the Hexagen acquisition, pharmaceutical companies should soon be able to buy SNP databases directly from Incyte. Tang thinks it will be important for the new Incyte division to sign up pharmaceutical partners—something he thinks could happen in the next few months. "Then people will really focus on the potential upside rather than the expense," he says.

The initial aim of Hexagen was "to seek licensing and technology transfer deals and stay independent," says Hexagen CEO Mark Bodner, but discussions with Incyte led the company to see "an opportunity to build something that was much broader." According to Bodner, the likelihood of independently assembling those resources—bioinformatics capabilities, large-scale sequencing, and the customer base of over 20 pharmaceutical companies—was extremely remote, and acquisition favored the development of the technology to its greatest capacity.

There has been some speculation that the state of the markets and their unwillingness to fund small biotechnology companies was another factor, but Bodner refutes this, "in the longer-term [finding financing for an IPO] may have been a consideration," although a [private] second round of financing was planned earlier this year, these plans were dropped when discussions began with Incyte, and the availability of financing was never fully tested.

Although reaction to the acquisition has been mixed, many analysts think that because genomics is still in its infancy, it remains wide open with no obvious leader. "This field is still in its exploratory phase and it is not entirely clear what will be necessary to be successful," says Boni.

The acquisition is scheduled to be finalized in October.

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