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Vantage Point - UK life sciences sector suffering from dire start to year

The UK life sciences sector has had a pretty dire start to the year. From Pfizer's exit of a huge research facility in Kent, costing thousands of jobs, to calamitous late-stage failures at two prominent smaller listed companies, Antisoma and Renovo, it is hard to find reasons for cheer.

However today's fundraising from AIM-listed e-Therapeutics, which tapped investors for £17m to fund early-stage clinical research, indicates investors have not completely lost their appetite for the space. The company's chief executive, Malcolm Young, tells *EP Vantage*many were more receptive than he was expecting. But signs are the sector is shrinking and British drug developers, just like their colleagues across Europe, will have to tell increasingly persuasive stories to get investors to part with their cash.

Not alone

It is important to remember that it is not only the UK's small drug developers that are feeling unloved.

"We're not suffering more than anyone else and if you speak to people in Switzerland, for example, they are feeling equally unsupported by their investor base," says one London-based life sciences banker. "There have been pockets of support but, overall, the sector is feeling pretty much beaten up all over Europe."

The decision last year by US bank Piper Jaffray to completely shut down its European life sciences business, a surprising move as it had a strong position in the sector, was not an encouraging sign.

However, the UK's public drug developers have had their fair share of disappointments in the last couple of years – before Antisoma and Renovo, names including Ark Therapeutics and Oxford BioMedica have all disappointed shareholders holding out for the riches a late-stage success would bring.

Of course companies in the public realm are exposed to macro trends and the credit crunch and global recession have taken their toll on what will always be one of the riskiest areas of equity investment. This, combined with setbacks for nearly all of the UK's biggest biotech hopes, has left the sector a shadow of its former self.

Public UK Biotech/Specialty	2005	2006	2007	2008	2009	2010	2011 (latest/estimate)		Total (05 - 10)	Change (latest vs. 05)
Market capitalisation (£bn)	3.3	3.4	2.5	1.5	2.0	2.4	2.1		n/a	-36%
Cash raised - equity offering (£m)	458	369	160	117	157	102	-		1,361	-78%
R&D spend (£m)	325	374	365	334	263	242	239		1,904	-27%
No. of employees	3,331	3,587	3,778	3,324	2,972	-	-		n/a	-11%

The analysis above shows that total stock market valuation of the UK's biotech and specialty peer group has declined 36% since 2005 and is currently valued at £2.1bn; although this in itself represents a recovery from the low point of £1.5bn at the end of 2008, the height of the credit crunch.

The amount of money flowing into public companies has plummeted over the last five years. Although the wider financial climate is in no small part to blame, a poor track record has not helped and there are now very few specialist investors, outside the venture capital community, active in the UK.

The £102m raised in 2010 was the lowest on record in recent years. Again since the credit crunch in 2008, the ability of UK companies to raise funds though the public markets has been severely restricted – excluding Proximagen's £50m investment in 2009 which accounted for one-third of the cash raised that year, the annual average is just over £100m in the last three years, compared to over £450m raised in 2005 alone.

New models

This is not to say there is no money to be had. e-Therapeutics' £17m financing today may not rank as one of the biggest rounds of the year but the company managed to raise a sum equivalent to its market value, at a small premium to its current share price.

Chief executive Mr Young says although most of potential investors he spoke to whilst trying to raise funds were generalists, they still understood the potential in the sector, particularly in the light of big pharma's need to fill its pipelines. And the reception he received was not as gloomy as he anticipated, something he put down to the company's comparatively less risky business model.

"What they are not looking for is the conventional story over and over again - we're going to suck in the money and spend it all on developing one or two assets," he says. "What they wanted to see was proper management of risk. If one can persuade them that you can properly mange downside risk and diminish the probability of clinical blow-outs they are still very interested."

What e-Therapeutics offers is a platform technology based on network pharmacology that has generated four clinical-stage compounds, all of which will report proof-of-concept data by the end of 2012 or early 2013. In a relatively short amount of time, the company's new investors will know if their money has been well spent – if only one succeeds the investment will still be justified, Mr Young believes.

It seems unlikely that one- or two-product companies will be able to attract decent financing anymore, and companies will have to find new approaches to manage the risk profile of drug development. This was probably the root of Proximagen's success which managed to raise cash on the back of a plan to build a very broad pipeline, and is now one of the few UK development stage companies being valued above cash (*EP Vantage Interview - Proximagen chasing smarter deals, February 15, 2011*).

Getting any easier?

However, for early-stage research companies, life is going to remain tough. Data from EvaluatePharma below, which tracks fully independent companies, reveals that the number of companies being established in the UK has been declining - just three UK companies set up last year, with Redx Pharma the only genuinely new creation alongside two spin outs in Convergence Pharmaceuticals and Pulmagen Therapeutics.

Meanwhile IPOs in the UK have all but dried up, Scancell the last company to go public in 2008, and that was only a listing on the PLUS exchange to raise a paltry £1.55m. Of the 39 UK companies to complete an IPO in the last ten years, two-thirds achieved the feat between 2004 and 2006 alone; heady days which must now seem like a lifetime ago.

"There is so little money kicking around, and very little risk taking going on," the life sciences banker says.

The sector "will continue to contract and it will get potentially quite small," Mr Young says, adding this phenomenon is not restricted to the UK. "There is very little appetite for early stage biotech start-ups or ventures, public and private. But it is going to be the case that a small number of companies will have huge cash reserves. If you can derive candidates capable of commanding a premium the values are eventually going to go up. I think there will be some record-breaking deals in the next three to five years," he says.

On another positive note, those pursuing a specialty pharma model in the UK have found fans – BTG's shares have almost doubled in the last two years and the company is now worth £700m. And there are certainly success stories to be found amongst the more traditional drug development companies – respiratory player Vectura for example, and GW Pharmaceuticals, which last year won approval for its cannabis-based pain drug.

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The sector is not going to recover overnight, but the companies that prosper in the future will probably be those with promising technology platforms similar to Vectura, Ablynx and Evotec, rather than the one-product companies," says Mick Cooper, analyst at Edison Investment Research.

Demands for lower-risk models seem likely to drive the shape of the sector in the coming years, a message that must be heeded to keep money flowing in. Whether this will improve the sector's R&D productivity - in the UK and elsewhere - remains to be seen.

UK Biotech & Specialty Pharma - count of companies emerging and IPOs over last 10 years													
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**10yr total**	**A T**
Companies Established	14	15	10	15	9	16	9	9	3	4	3	**107**	Priv
Company IPOs	1	2	1	4	8	9	9	4	1	-	-	**39**	Liste
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