Patently a perfect storm

Recent Securities Institute professional development seminars focused on biotechnology investment and innovations in property finance.

The issue that threatened to scuttle the free trade agreement between Australia and the United States – patents on pharmaceutical products – was aired in a different light at a Securities Institute professional development seminar.

The seminar, ‘Understanding and Investing in Biotechs’, traced the relationship between the pharmaceutical and biotechnology industries, the changes that are occurring in their structure and subsequently in opportunities for investment.

The opening speaker, Richard Haydek of Burrell and Co., a US merchant bank and private equity investor, presented a global perspective on biotechnology investing and outlined trends in Australia.

Haydek said worldwide interest in biotechnology appeared to peak in 2000 with the completion of the human genome project, but enthusiasm then declined amid uncertainty about its future. It was, he said, a “dismal time” in which the equity value of biotech companies fell. However, confidence had rebounded in the past 15 months in conditions Haydek likened to a “perfect storm” – a combination of factors generating dramatic change and adding up to “a very rosy outlook for our industry”.

A chief factor in this change is patent expiration. In the next year pharmaceutical companies face the expiration of $US20 billion worth of patents over high-earning drugs, opening the market to much cheaper generic versions and threatening the revenue of major players which have invested huge amounts in research and development. “It is not unusual for a pharmaceutical company to lose 80% of revenue and 100% of profit when a patented drug is replaced by a generic product,” Haydek said.

This change represented a “dreary outlook” for big pharmaceutical companies in an industry where research and development costs were rising and production of new lines falling. But these effects were countered by a growing recognition of the biotechnology industry as an alternative source of product innovation – particularly given the opportunities for collaboration between the two industries. The pharmaceutical companies were embracing the biotech industry to gain growth and new technology.

New financial structures now made it possible to harness the financial power of major pharmaceuticals with the advanced research capabilities of smaller biotechnology companies to provide a stream of new products. The resulting partnerships, along with mergers and acquisitions, placed the biotech industry on “a very nice upward trend”, with new drug approvals and the development of new uses for existing drugs.

“Companies that are able to step in and fill the gap resulting from low R&D productivity and loss of patents will be well rewarded,” Haydek said. “Deal-making produces a different sharing of profits.” He observed that Australian biotech companies had many new developments about to embark on clinical trials and emphasised the importance of Australia’s comparatively low development costs.

Another speaker at the seminar, Queensland’s Chief Scientist Professor Peter Andrews, agreed that the role of drug development was shifting from the pharmaceutical industry to the biotech sector. Although the Australian biotech industry’s earnings were low at about $1 billion a year, it was a value proposition for investors – “long-term returns are exceptional,” he said. It was a long-term investment offering a sustainable competitive advantage.

“Australia will never have a major pharmaceutical industry but it does have the capacity, based on research, to build a substantial biotech pipeline.”

Public property, private profit

In another professional development seminar, speakers explained innovations in property finance such as commercial mortgage-backed securities, credit leases, pre-sale securitisation, mezzanine deals and public-private partnerships (PPPs).

Richard Featherby of Ernst Young, focused on the property opportunities provided by PPPs – long-term contracts between government and the private sector to build and maintain infrastructure. The complex funding and risk-transfer components of these arrangements make it attractive for developers to seek additional value from the projects.

An example was the significant opportunity for residential development associated with Melbourne’s Spencer Street Station PPP project. Another major opportunity was in Australia’s public housing sector. Long-term property investors could find good rewards in a sweeping government strategy to reconfigure public accommodation stock to cater for changing demographics. Private developers with a 30 year investment horizon would be needed to rebuild stock to appeal to smaller families, to reduce the concentration of public housing, to maintain its high quality and to manage risks formerly carried by government.

Audio tapes of Professional Development seminars are available by emailing: audiotapes@securities.edu.au