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Funds Are Not a Constraint

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Funds Are Not a Constraint

Biotech entrepreneurs are looking for funds. Similarly Venture Capitalists (VCs) are also looking at newer areas of investment opportunity to reap maximum returns. Biotechnology is one of many newer areas VCs are eyeing.

"Companies with a Level of Predictability on Cash Flow Have Been Preferred"

Prasanna Desai, director, corporate finance, KPMG India Pvt Ltd

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...ception on this sector?

Although biotechnology includes other sectors, most investors have focused on biopharmaceuticals. Investors have preferred companies with a level of predictability on cash flow. Hence, it is critical for pure research companies to have a well-defined business model to monetize the research. Understanding the industry is a key factor for the investors as the companies look at different levels of funding. The most important factor which is pulling the investors towards biopharmaceuticals is the opportunity and scope to invest in a growing industry. India known for its research and talent pool is another factor that is supporting the investors to look at Indian biotechnology companies.

Greater level of awareness about the latest developments in the biotechnology front, education, believing in sharing risk and reward, a well defined exit model, result oriented research which should deliver and building the business for the company will help the investors to fund the companies in biotechnology.

What are the five key considerations?

Business model, background of the promoters, strong management, the exit model for the investors, and structure of the investment that includes risk sharing by both investors and the promoters

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A small start-up company, in the field of nanotechnology promoted by a technocrat, started looking for funds after working on the pilot scale-up facility to increase the production capacity. It approached many financial institutions through its financial advisors and held discussions with banks, financial institutions, and venture capitalists for a few crores. Venture capitalists expressed desire to fund a minimum of Rs 10-20 crore but the promoters were not so eager on such an amount and did not want to take so much of a risk. On the other hand, the promoters were approached by a socio-cultural organization based in Bangalore to support the company by funding to tune of over Rs 10 crore.

India's first biotech fund initiated by a public-private partnership, APIDC-VCL raised Rs 150 crore, five times more than the Rs 30 crore envisaged from different financial institutions in a span of just a little over a year. Even local venture capitalists have raised Rs 3,000 crore from local financial institutions like insurance companies, commercial banks, mutual funds and government bodies. The allocations from these institutions have increased from Rs 10-20 crore to Rs 50-100 crore this year.

According to the Indian Venture Capital Association (IVCA), domestic and foreign venture capitalists invested $774 million in 2003 in India up from $590 million in 2002. In 2004, till November, VCs and equity funds invested over $820 million in Indian companies. TSJ Media, a Chennai-based firm that tracks VC investments, reported that less than 10 percent of this money has found its way in the start-up companies. The momentum has just started to pick up after 2000-01 and Indian VCs have undergone a fundamental change.

This clearly shows that there are investors who are really looking at investing in upcoming technology companies like nanotechnology and biotechnology. So money is not a constraint as far as investors are concerned. Then what is it that is stopping them from making investments? Is there a disconnect between the industry and the VCs? Both have valid reasons and apprehensions.

The Association of Biotechnology Led Entrepreneurs (ABLE) arranged a meet between investment bankers, research analysts and CEOs of biotech companies on December 5, 2004 on Mumbai. The meet, sponsored by Biocon, deliberated on the key facts and parameters of investing in biotechnology driven enterprises and to exchange views.

The investors point of view was that it is the risk factor, lack of readily available information on biotechnology, strong management, clear exit model, lack of technical skilled people and experts who can guide VCs as some of the factors making them very cautious. However, they are convinced that India will be the next technology center and research hub owing to intellectual capital, skilled manpower and value addition and that it has sustainable comparative advantage over China.

VCs are looking at tie-ups between Indian and Chinese companies where the Indian product design team can have close relationships with manufacturing teams in China. India and China as a combined market opportunity can weigh much more than they do separately. This model will provide an edge for VCs to invest in India and China against US. Such model is already in place in the field of IT, where the VCs marry two sets of people in the US and India to form a team. The US team brings in the product management and customer interfacing skills and the Indian team brings product design and execution skills.

Utkarsh Palnitkar, head, life sciences, Ernst &Young, who is closely tracking the industry, noted that biotechnology would enter profitability by 2008. VCs are looking at biotechnology with caution in spite of several opportunities in biotechnology i.e., biopesticides, biofertilizers and diagnostics. Indian companies have a lot of opportunities, if risks are broken down into smaller parts. Bundle of ideas are lying in cold storage. To make it a reality and take up risks, sharing of risks is very important. Proper blueprints should be developed for implementing ideas into projects that ultimately deliver results.

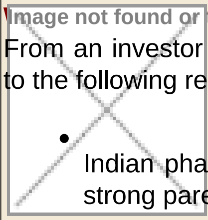
Undoubtedly everyone recognizes that biotechnology is an evolving and emerging industry. About 60 percent of the drugs the world over are monoclonal antibodies (MAbs). The process of developing the present available MAbs was started way back in the 1970s. Kiran Mazumdar Shaw, chairman and managing director, Biocon India observed, "The success for Biocon India didn't follow in a day. It took years for us to reach this stage. We did projected insulin in our business plan sometime back in 1999 but it was realized in 2004. High risk will pay back high returns. We showed that product is predictable. Still investors look for predictable products from biotechnology companies."

Why are investors still cautious? "Investors look at biotechnology as a pharma industry. They look at predictable products of pharma companies. Considering the excitement in biotechnology space, India can leverage on its advantages by co-development, by entering into tie-ups with global companies, focusing on quality and innovation. Although drug development is very expensive, India can play a key role in this sector. Therapeutics and monoclonal antibodies are the products of the future and are emanating from biotechnology. India is known for developing diagnostic kits at lower cost. Opportunities are there in diagnostics sector too," she asserted.

Dr BV Ravikumar, managing director of XCyton Diagnostics, who is looking for funds for expansion noted, "Multinationals are investing heavily on developing newer kits. Instead of depending on such kits, why should we not start developing such kits for ourselves and export to other countries. One has to make a beginning. Let us start ahead to lead the path. For this we do need funds."

Dr Villoo Morawala Patell, founder and CEO, Avesthagen, has a point. She believes VCs should have technical staff and research analysts who have expertise in life sciences and legal issues to guide decision-making, as biotechnology is a heterogeneous and diverse sector unlike the IT industry. Agrees Alok Gupta, country head, Life sciences and Biotechnology, YES Bank Ltd and observes, "We couldn't afford to recruit technical people with PhD background. India still lacks technical people with knowledge on legal and licensing issues whereas in the USA there are many people and experts in licensing." He reiterated that there is enough money/funds available for the biotechnology industry.

"There Is Need to Deepen Early Stage Financing"
- **Alok Gupta, country head, life sciences and biotechnology, Yes Bank Ltd.**



W[illegible]spective as an investor?
From an investor perspective, the opportunities in the Indian biotechnology industry are looking increasingly attractive due to the following reasons:

- Indian pharmaceutical companies are foraying into biotechnology (starting with generics)-financing is supported by strong parent balance sheets
- Overseas companies are establishing R&D facilities and contract manufacturing facilities and network in India. They have strong parent balance sheets, but need advisory handholding (regulatory, operational and management) for expediting India plans.
- First generation entrepreneurs are establishing a base in India and are setting up contract services operations, with a strong linkage with global MNCs ensuring a sustainable market demand in the formative years of the company.

Overall, there is an increased focus on India as a business location for manufacturing and contract services. Hence, investment opportunities in the country are looking attractive.

Which are the five main hindrances? Explain!
Business model: A large number of early stage biotechnology companies in India have little uniqueness and novelty (of product, of business model etc.); consequently, this makes it difficult to justify funding such me-too companies.

Early stage investing: Most early stage biotech companies need angel/seed funding in order to attain a critical mass and attract investor interest. This channel of funding needs development in India. Further, early stage companies need to have a clear road map of product development/business plan, with capital infusion, timing and exit routes.

Technology: Most interesting biotechnology companies are based on novel technologies, products or platforms that will provide the necessary differentiation to the company. Most funds do not have a deep understanding of the technology or applications of this technology and hence are looking to validate the product/business model through US-based VCs, which have the necessary expertise in evaluating such companies

Cash flows and valuations: Most biotech companies (particularly product companies) have fairly long gestation periods before they commence significant cash flow generation-this is an area of concern for investors and consequently valuations and dilution becomes an area of concern

Risk factor: Biotechnology companies are typically in a high risk-reward situation whereby success of failure of a product can imply survival or collapse of the company. So investors are selective about biotech investments.

Exit strategy: The Indian markets do not offer the depth or flexibility of exit options to investors. For example, the capital markets and strategic investor interest in the US markets leads to a lot of different exit options for financial investors.

Another issue that is coming in the way is sharing of intellectual property (IP) with the investors. In Western countries, the companies do propagate the sharing of IP. Swiss biotech companies are successful in bringing funds from the US. But Indian companies are reluctant to share the IP. Indian companies are unable to attract the interest of the US investors.

Sonia Dasgupta, vice president, J M Morgan Stanley Pvt Ltd, observed, "Sometimes the entrepreneurs become very exited about their concepts. They are even carried away by the ideas. But they fail to work on the realistic valuation of the project. They are also reluctant to share the failures and risks involved in the taking up the projects. The projects involve long gestation period and it is necessary for entrepreneurs to prepare a proper contingency plan for the project. The companies should be realistic about the product discovery and the market potential. We are answerable to the investors. We do need a lot of information to understand the depth of technology and concept."

Considering the opportunities, Prashant Jain, chief investment officer, HDFC Asset Management Company Ltd said, "Biotech companies should look at a derisked model, developing a strong product pipeline to seek funds from the venture capitalists. This can be achieved only by having a strong management that should try to meet the expectations of the foreign funds as the benchmark for foreign funds and local funds differs."

Clearly, from what transpired at the meeting, VCs are eager to invest in this sector, but lack of information has made them adopt a wait and watch policy. The entrepreneurs need to look at different models and be ready to share the minimum information necessary for the investors to take the risk. The investors and industry should work together and an industry body like ABLE can play a collaborative platform and mitigate some of the doubts. ABLE's intent to schedule the first ever bio-investors meet in January is a right step in that direction.

Narayan Kulkarni