Business Strategy: John Rountree

Ownership lessons for European biotechs

The influence that ownership has on both the performance and behaviour of pharma companies is profound. That much is easy to say. However it is the families and foundations that are prevalent in Europe's established pharma companies that reveal how. While a world of cheap capital has focused analysts' attention on stock markets and the venture capital and private equity firms that feed investors' desire for ever higher returns, it is the family and foundation-controlled companies that are leading the way in pharmaceutical innovation efficiency. This holds important lessons for European biotechs that are hungry for innovation and growth.

American pharmaceutical companies have fully embraced the significant capital that is available from their highly liquid stock markets as well as the associated venture capital and private equity model that relies on primarily stock-market listed companies to provide the exits they need. European companies by contrast have enjoyed a more sustained privately owned or controlled model. Behemoths like Roche Holding AG, Boehringer Ingelheim GmbH and Novo Nordisk A/S have shown the enduring value of private control at a large scale. And more than 70% of European mid-sized pharma companies (revenue from €50 million to €5 billion) are privately controlled, mostly by families and foundations.

We recently reviewed the R&D and commercial performance of 84 large and mid-sized pharmas in Europe. Our evaluation focused on the volume and commercial success of new drug applications (NDAs) for every company within the sample, with both US and EU-approved drugs (marketing authorisation applications or MAAs) included in the calculation. We also looked at new molecular entities (NMEs) as a subset of NDAs to establish the volume of approvals in more innovative classifications. 70% of the sample were privately held or privately controlled companies (where more than 50% of shares are privately owned). The remaining 30% were listed. The private companies tended to be smaller than their listed counterparts, with a mean revenue of €2 billion versus €7.5 billion for the listed companies.

Our analysis of the very different pharma company ownership models in Europe compared with the US revealed the value of private control in terms of innovation efficiency, measured by the output of NMEs per euro spent on R&D. By this measure, private companies have been generating an average of one NME in five years per €100 million of annual R&D spend, almost four times the output of listed companies. A similar story applies if productivity is measured as NME output per €1 billion of revenue. This is illustrated by the graph on page 9.

While the ability of privately controlled companies to commercially exploit their innovation efficiency appears from our analysis to be less strong than their typically larger listed peers that have access to deep capital markets, it is the innovation performance that reveals some interesting lessons for pharma and biotech alike.

From our experience of working closely with leadership teams at European mid-sized pharma companies, it's no surprise that R&D is more productive and efficient in private companies. It's their lifeblood. Private companies depend heavily upon having innovation within their pipelines – without it, they could quickly disappear. Moreover, since they don't have access to the capital markets to buy their way out of trouble, private firms need to be totally focused on innovation to ensure they remain sustainable. As a result, they tend to take a longer-term perspective than some of the more short-term focused listed companies that have to answer to analysts every quarter.

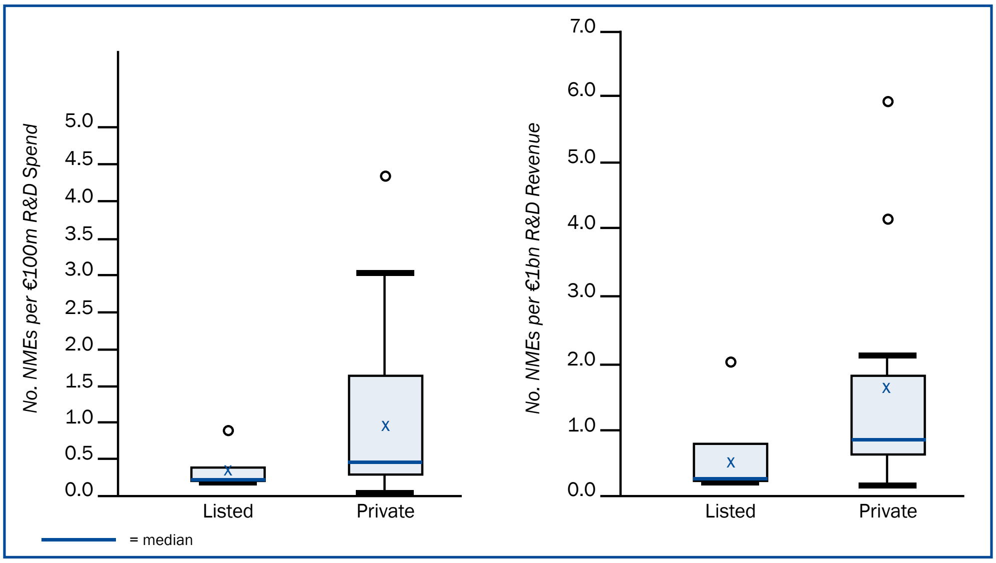
Three of the most productive R&D performers from our analysis are European mid-sized privately controlled pharma companies. The ownership, direction and active management of the two Chiesi brothers Alberto (president) and Paolo (head of R&D) has created a stream of successful innovation at the Italian company that bears their name. Chiesi Farmaceutici SpA has innovated in the respiratory therapy area and become an important player in a highly competitive category dominated by big pharma companies. It has been highly successful in securing approvals, not least in a triple combination therapy for chronic obstructive pulmonary disease (COPD), where it was the first company to receive EU approval.

Similarly Swiss Helsinn Healthcare SA is a highly prolific producer of NMEs per €100 million in our sample, with an enviable record of FDA approvals for the scale of its company. The business has been highly focused on innovation, securing approval for drugs that it can subsequently distribute through commercial partners. Helsinn is a great example of the value of focusing on R&D value from a business. Such has been its success that it has more recently introduced its own commercial sales force in the US.

French Ipsen SA is another high producer of NMEs per €100 million of R&D spend. It is privately controlled by the Beaufour family and has a stock market listing. Ipsen's approach has been to secure approvals for some clever innovations on the backbone of some relatively old specialist products. Coupling this with a more recent move to commercialise one of its recent innovations in the US and then acquiring complementary products, has resulted in significant stock price appreciation.

Taking the long view is a key characteristic of private ownership or control. Family controlled companies and particularly foundations, place a high value on sustainability for the next generation or the foundation's trustees. For example, Roche chief executive Severin Schwan says that being family controlled gives his company an important edge and allows it to think about the long term. Roche, he says, thinks in '30-year cycles' that afford it the luxury of making decisions that may not produce tangible benefits for 10-15 years. This philosophy is unlikely to fly in many listed companies.

Like successful venture-funded biotechs and listed pharma companies, family and foundation-controlled businesses were all ultimately created by strong entrepreneurs with a will to



Notes

- 19 companies generated NMEs in the past five years and comprise the analysis above (six listed and 13 private)
- Revenue and R&D figures are five-year averages across 2012-2016
- Privately controlled companies (more than 50% shares privately owned) are included in the category 'Private'
- Mean of sample shown as "x", outliers (more than 1.5 times the interquartile range above the third quartile) shown as "o"

have also retained a founder-entrepreneur influence over many years. Representing almost the entire crop of European biotechs that have more than €1 billion market capitalisations, these six all have a CEO or Chairman who is one of the founders.

Now boasting a market capitalisation of more than €10 billion, Danish biotech Genmab A/S's CEO Jan van de Winkel was the chief scientific officer at Medarex in 1999 when Genmab was created from the basis of that company. After being CSO for 11 years he became CEO of Genmab in 2010. Simon Moroney, CEO of German Morphosys AG, founded his company in 1992, and 26 years later it has a market capitalisation of nearly €3 billion. Onno van de Stolpe, the similarly long-standing CEO of Belgian biotech Galapagos NV, founded his company in 1999, and is a fierce proponent of keeping the company independent. His company now has a market capitalisation of €4 billion. UK biotech GW Pharmaceuticals Plc's current chairman, Geoffrey Guy, founded GW 20 years ago, and his company now has a market capitalisation of more than €3 billion. French DBV Technologies SA now has a valuation of more than €1 billion despite a recent disappointing clinical trial result of a lead compound. Again the founder in 2002, Pierre-Henri Benhamou, is still CEO today, 16 years later. Finally the most recently created European biotech success story is the Dutch company Argenx SE, founded in 2008 by its current CEO Tim Van Hauwermeiren and now 10 years later claiming a valuation of over €2 billion.

build. It is these entrepreneurial origins that point to a new type of private influence on today's biotechs. Here too, the evolution of European biotechs provides a fascinating contrast to the evolution of their US counterparts.

US biotechs have access to capital that many European companies envy. Professional venture capital companies with major funds in the US are more than willing to deploy the capital they raise into exciting biotechs in large tranches of funding that are rarely seen in Europe. Furthermore, the Nasdaq market offers the promise of significant further innovation capital through initial public offerings (IPOs) or secondary listings. The combination of venture and Nasdaq capital has undoubtedly fuelled many of today's fabulous US biotech success stories.

By contrast European biotechs have had to take a different path to sustaining their businesses. There are many fewer biotechs with more than €1 billion valuations in Europe than in the US, yet there are remarkable similarities between these unusual companies in terms of entrepreneur influence. More specifically six of Europe's currently more than €1 billion biotech stars all share a common feature: the long-standing commitment from an entrepreneur that resembles the long-standing commitment of today's much larger family-controlled pharma companies and the origins of the largest pharma companies of today.

Perhaps the most visible success story of Europe's successful biotech founder-entrepreneurs was the two Clozels and their company Actelion Pharmaceuticals Ltd. Exhibiting much of the entrepreneurial qualities of the best family businesses, Jean-Paul Clozel and his wife Martine founded Actelion in 1997 and built the company over 20 years until receiving an offer of $30 billion to be acquired by Johnson & Johnson Inc that their other shareholders could not resist. As part of this deal they also managed to negotiate $1 billion in funding for their next entrepreneurial biotech venture, Idorsia Pharmaceuticals Ltd.

Remarkably six other highly successful European biotechs

The pharmaceutical industry has always been a long game. The years it takes to reap the success of innovation, the risks involved in doing so, and the significant capital required to take those risks, require a fortitude, resilience and entrepreneurship that is still visible in Europe's family and foundation-controlled pharmaceutical companies. Such behaviour works, as evidenced by their superior R&D productivity per €100 million of R&D spend compared with their listed counterparts.

Europe's more recently founded crop of more than €1 billion valued biotechs are following in the footsteps of both the eponymous founders of the oldest pharma company of all, Merck & Co Inc, and today's European mid-sized family-founded pharma companies. Strong founders and a long-term commitment suit the industry. In today's world of cheap capital resulting in M&A fever and a temptation to join the highly capital-rich and risky US biotech scene, they are a welcome reminder that it takes more than capital liquidity to be sustainably successful at pharmaceutical innovation.

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