



Back on Track

The European Perspective

Back on Track

Europe's biotech industry is decisively back on track. After years of consolidation and relatively stagnant results, the industry's performance was markedly better on several fronts—from strong initial public offerings (IPOs) to significantly stronger financial performance.

Strong financial performance

The focus on consolidation and restructuring, while lengthy and painful, finally paid dividends in 2005. Fueled by a stronger pipeline as well as a higher number of companies with revenues, top-line growth accelerated significantly. Public company revenues increased by 17 percent in 2005, compared to a 5 percent *decrease* in the previous year. The overall industry also achieved higher growth rates of 7 percent, bringing the sector's revenues to a new high of €11.7 billion.

The industry's market capitalization rose by 26 percent, to €43.4 billion. Investor confidence has been boosted by the stronger performance of existing public companies, as well as 2005's IPOs.

Reflecting its increased confidence and optimism, the European biotech industry is investing strongly in the future, and is funding large increases in research and development (R&D). R&D expenses increased by 22 percent for publicly traded companies, and by 15 percent for the industry as a whole. More than any other development, this highlights the “back on track” theme and represents reason for hope. The declining R&D expenditures that characterized the consolidation years (R&D shrunk by 3 percent in 2004) had created many doubts about the industry's sustainability and future potential. The industry's long-term growth can only be secured through strong R&D activities. On average, publicly traded European biotech companies are reinvesting about a third of their total revenues in R&D—strong proof of their dedication to long-term growth.

The industry's net loss increased by 41 percent in 2005. For publicly traded companies, the net loss increase was even higher—131 percent. To a large extent, this was due to one-time events at some of Europe's larger companies. For example, the net income of

European biotechnology at a glance						
	Public companies			Industry total		
	2005	2004	% change	2005	2004	% change
Financial €m						
Revenues	7,922	6,787	17%	11,694	10,976	7%
R&D expenses	2,650	2,171	22%	5,350	4,672	15%
Net loss	1,574	680	131%	3,459	2,462	41%
Market capitalization	43,374	34,485	26%	—	—	—
Industry						
No. of companies	122	101	21%	1,613	1,664	-3%
Employees	33,340	29,310	14%	67,530	65,260	3%

Source: Ernst & Young
For companies reporting results in U.S. dollars, 2005 and 2004 year data were converted to euros at an exchange rate of 0.81 (euros per dollar)
The 2004 data have been restated for consistency with 2005 data and industry segments

specialty pharma company Shire was impacted by extraordinary costs related to the TKT acquisition. Serono took a hit to its bottom line because of extraordinary litigation payments, while other companies saw increased expenses from financial commitments related to strategic alliances. After adjusting for these extraordinary items, net loss increased by only 9 percent for publicly traded companies, and by 7 percent for the entire industry.

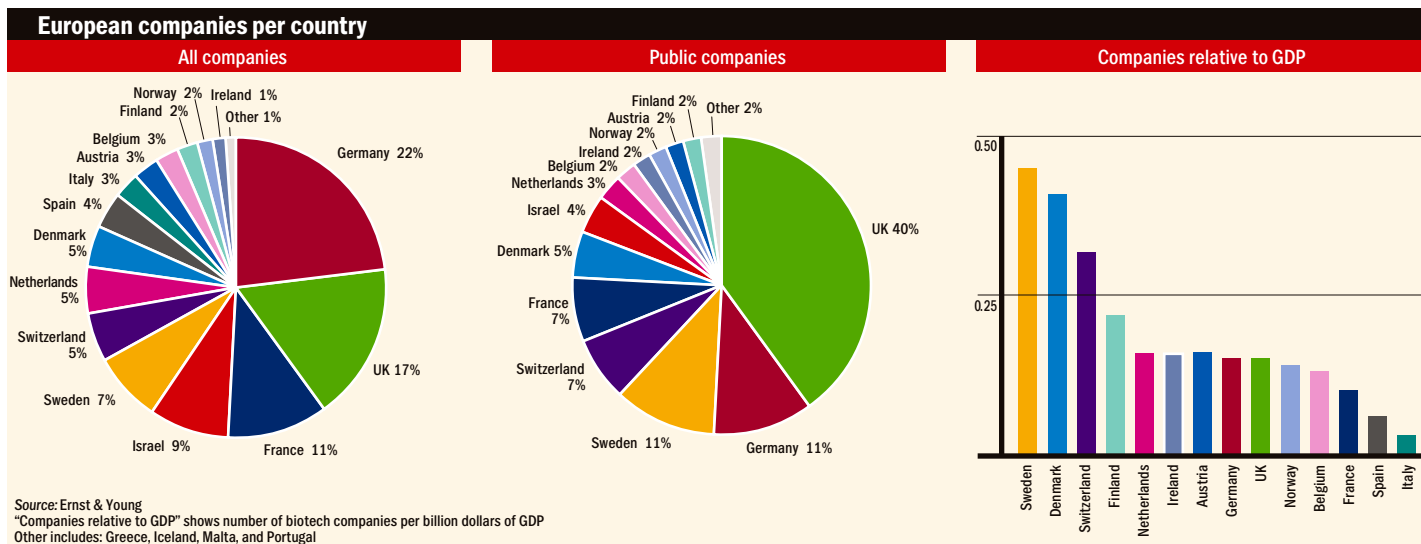
The number of biotech companies in Europe decreased slightly in 2005, falling by about 3 percent compared to 2004. While the industry continued to add new companies through the normal process of company formation, the sector also lost companies through acquisitions and insolvencies. To some extent, the net decline in number of companies is an indication that the process of restructuring and weaning out struggling companies is not yet over. However, the significant increase in acquisitions demonstrates new strength, as companies join forces to achieve their strategic goals.

A significant increase in the number of IPOs in 2005 led to a 21 percent increase in the number of public companies—bringing the total to 122, an all-time high for the industry. The company distribution across Europe has not changed significantly. Germany still leads the overall count, while the UK has the most public companies and the most mature sector. The Nordic countries and Switzerland have the most companies relative to their Gross Domestic Product (GDP), demonstrating their strong commitment to biotech. The

same countries also lead in the European Innovation Index. (See *European Year in Review: Public Policy*.)

Total employment increased by 3 percent. Private-company employment fell as the number of private companies dropped because of IPOs and consolidation. However, public companies increased their headcount, so that the total industry's employment numbers increased slightly.

As the biotech industry matures, distinct business areas have evolved with different market access and success factors. Reflecting this development, this year's report includes a categorization of companies by industry segment. The biggest segments in the European biotech sector are therapeutics, followed by genomics, proteomics, and enabling technologies. These major categories still represent the backbone of the industry, which started out from technology platforms based on molecular biology and leveraged resulting therapeutic innovations into promising drugs. Distribution across the entire industry is markedly different from distribution of publicly traded companies. Almost 60 percent of public biotech firms are involved in developing therapeutics, compared to 37 percent for all European biotech companies. This reflects the strong push toward product development in more mature companies, at the expense of technology platform focus and drug discovery services. New fields are emerging, including innovative industrial biotech that focuses on renewable resources, with closer links to agricultural biotechnology. Among



the major countries, UK, Switzerland, and the Nordics have a strong emphasis on therapeutics. In contrast, Germany, France, and The Netherlands are still more involved in technology platforms and have stronger positions in white and green biotech. To some extent, this reflects different stages of maturity. It also might be related to a stronger presence of big pharma in countries like the UK, Switzerland, and the Nordics, whereas in countries like Germany and The Netherlands, big players in the chemical industry are boosting industrial biotech and renewable resources.

Financing

Europe's train also is back on track on the financing front. Investors showed increasing confidence in the sector, buoyed by stronger financial performance. 2005 was the best financing year ever for the European biotech industry, excluding the outlier year of 2000, when the industry was in the throes of a genomics bubble that saw many irrational decisions, especially in the public market. European biotech companies raised a total of €3.2 billion, reflecting greater success at raising capital from both venture capital and public equity markets.

The story was particularly strong for initial public offerings, which even topped the U.S. biotech industry. For years, the markets were relentless in demanding increased product orientation, and companies responded by increasing their focus and restructuring. In 2005, those efforts resulted in a new wave

of companies that were able to float on the public markets. Some companies went public without issuing new shares, or used reverse takeovers of companies already listed in various markets.

A public secondary market with different financing instruments, such as PIPEs, seems to be evolving in Europe—an essential element for supporting publicly traded biotechs on their way to profitability.

Venture capital was strong, as private equity investors were encouraged by improved exit options through IPOs, mergers and acquisitions (M&As), and strategic alliances. It will have to be seen whether this development can be transformed into sustainable growth in the future.

Products

The increased maturity of the European biotech industry is vividly illustrated in the increasing numbers of products—representing a 38 percent increase in 2005—that are currently passing final hurdles in clinical development. A total of 242 late-stage products are currently being tested by publicly traded European biotech companies in Phase II and Phase III clinical trials. Also, 14 new drug applications for products developed or co-developed by European companies have been submitted for approval at European and international registration authorities. Most drugs in registration are characterized as biological, including vaccines and anti-infective agents that leverage knowledge derived from

genomics activities, as well as antibodies, and other recombinant therapeutic proteins. Today, the European industry is demonstrating its maturation by bringing to market products based on the proprietary technology platforms of its companies.

Deals

The advanced product pipeline of European biotech companies has made them increasingly attractive for partnering and M&A transactions. Deals grew significantly in 2005, with about 60 percent increase in M&As. The year's M&As featured more cross-border deals between European countries, and relatively fewer transatlantic mergers. Also, there were relatively more biotech-biotech mergers compared to pharma-biotech combinations. Once again, these trends reflect the increased confidence and strength of the European biotech companies, which are turning to each other to combine strengths and meet strategic needs.

For several years, European deals have been characterized by a strong preference for late-stage product acquisitions between pharma and biotech. In 2005, building on a trend that started in 2004, there is a growing willingness to structure deals around products that are further back in the development pipeline. The change in mindset is at least partly explained by the availability of better prediction tools and more sophisticated methods for objective risk determination, as well as big pharma's continuing need to replenish its

product pipelines.

Roche's takeover of the Swiss biotech company, Glycart, for €153 million (\$185 million) demonstrates that even breakthrough-enabling technology—as provided by Glycart's antibody glycosylation platform—can have significant strategic value for a pharma company with a rich antibody pipeline.

Deals were also driven by a trend toward increased consolidation within the tool and solution provider business. Global players like Qiagen and Invitrogen expanded their

global reach as well as their access to new technology fields.

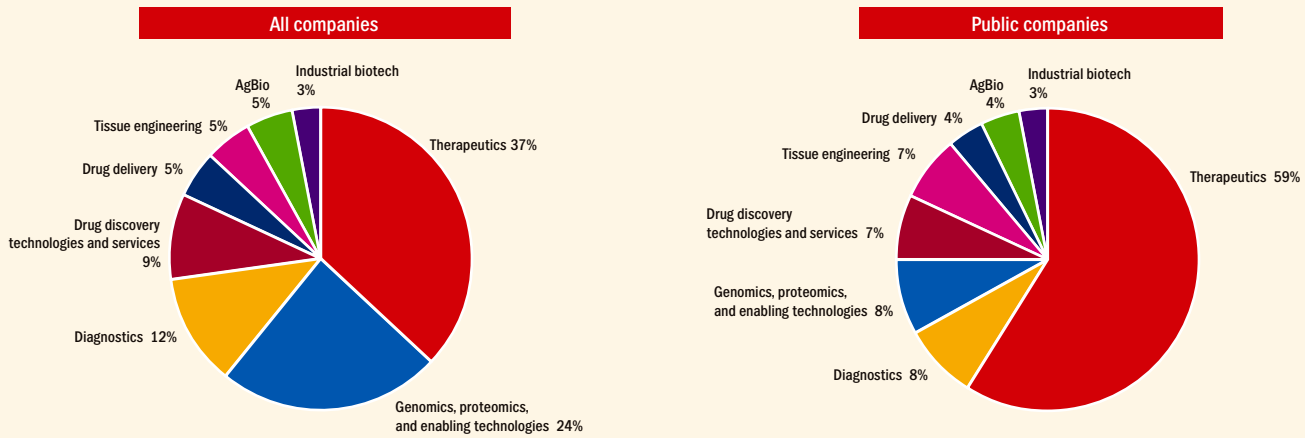
Outlook

Increasing financial strength, strong IPOs, growing investor confidence, booming deals. The recent performance of the European biotech industry brings much to celebrate.

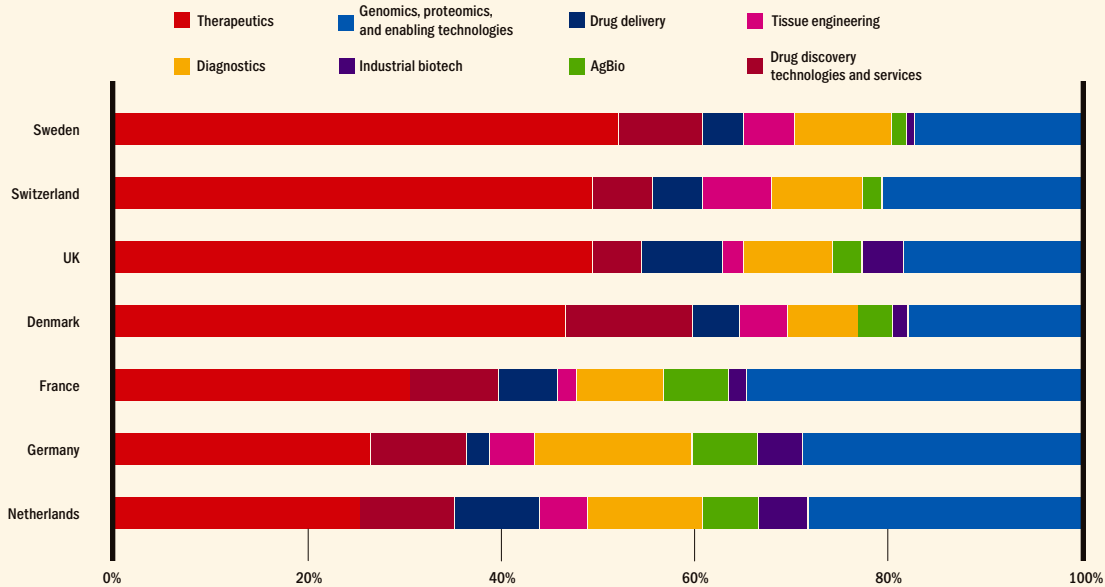
In many ways, Europe is finally recovering from the bubble of 2000. Like the U.S. biotech industry, the European sector was forced to restructure and consolidate after the

bubble burst, and investors became more risk averse and increasingly focused on products. The European recovery has taken longer, and it has required more focus and patience. But the U.S. experience also demonstrates what is possible. With continued financial discipline and focus on commercialization, the good news of 2005 could be leveraged into sustainable growth and the creation of a profitable industry in the years to come. ■

Distribution of European companies by segment



Major European markets



Source: Ernst & Young
Some companies are active in more than one segment

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