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Scared Australian investors miss out on big biotech returns



Offshore investors are snapping up stakes in emerging Australian biotech firms such as Mesoblast, Prima BioMed, Viralytics and Spinifex Pharma.



by [John Kehoe](#)

In the late 1990s, scientists at the CSIRO invented a gene therapy that showed potential to treat incurable diseases such as hepatitis via a single injection.

The invention was acquired by Benitec Biopharma, listed on the Australian Securities Exchange and today has a value of about \$70 million.

But when Benitec went looking for tens of millions of dollars in extra shareholder funds this week to underwrite its development, the biotech firm bypassed Australian investors and raised the money in the US.

The US is proving a happy hunting ground for biotech firms looking for cash.

The huge capital market is prepared to punt on early-stage biotechs which are trying to develop and commercialise breakthrough drugs and treatments.

On the Nasdaq, firms with no approved drugs are valued in the billions.

Offshore investors are snapping up stakes in emerging Australian biotech firms such

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Hedge fund guys are getting away

as Mesoblast, Prima BioMed, Viralytics and Spinifex Pharma.

Meanwhile Australian fund managers who don't understand the intricacies of drug development stick to their knitting and favour blue-chip stocks like banks, miners, telcos and utilities.

Benitec Biopharma chief executive Peter French says he receives "blank looks" from Australian investors.

"There is a much bigger appetite for gene therapy and gene sciences in the US, and much better understanding than in Australia," French tells *AFR Weekend*.

AUSTRALIAN INVESTORS MISSING OUT

By overlooking biotech stocks, Australian investors are missing out on big returns, says Jason Kolbert, the US head of healthcare research at Maxim Group.

"Australian institutional investors look at biotech as voodoo, when in reality it has outperformed every other sector in the [US] marketplace over the last five years," says Kolbert, whose investment banking colleagues assisted Benitec on its initial public offering this week.

The Nasdaq biotech index has surged more than 350 per cent in the past five years, even allowing for a 11 per cent correction in recent weeks and a big sell-off on Thursday in the US.

Last year, the top 40 Australian biotech shares on the ASX declined 4 per cent.

MLV & Co senior equities analyst for life sciences, Vernon Bernardino, says smaller American biotech firms on the Nasdaq have "really performed like crazy".

"So Australian biotechs are internationally cheaper than American and European biotechs," Bernardino says.

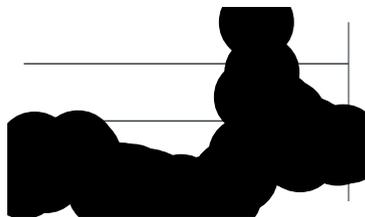
This difference in valuation has created an arbitrage opportunity that's been seized on by US investment funds. They take a stake in a listed Australian firm and punt that it will eventually seek a secondary listing on the Nasdaq and command a higher price, or get taken over by bargain-hunting drug giants.

It's a new take on the familiar brain drain problem that sees many of the country's clever ideas get commercialised offshore.

What's driving the sky high valuations of biotech stocks in the US?

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As well as growing confidence in possible life-changing treatment breakthroughs, low global interest rates have increased the attractiveness of riskier biotech stocks because of the possible high returns.

In 2014, the 79 biotech IPOs raising \$US5.8 billion, returned 73 per cent on average, Renaissance Capital calculates.

On July 28, the shares of US cancer therapy NantKwest firm soared 39 per cent on their first day of trading, even though the firm is yet to have any drugs approved by regulators

While the pay-offs can be handsome, biotech firms are often speculative. Many firms are years away from generating real revenue, let alone profits.

About one-third of US biotech initial public offerings (IPOs) since January 2014 are trading below their IPO price.

"While US investors have a love affair with many biotech IPOs thanks to the strong returns, not all biotech IPOs are successful," says Renaissance Capital principal Kathleen Smith.

TALK OF A BIOTECH BUBBLE

Talk is rife in the US markets about a possible biotech bubble, emulating the dotcom bubble that crashed in 2000.

French, who has just returned from three weeks in the US where he hosted 42 investor meetings, admits investors seemed "spooked" by the recent market turbulence emanating from China and Greece.

"Unlike three months ago, investors are prepared to wait longer and pay more to de-risk their investment by waiting for more clinical data," French says. "[But] they like our technology," he adds.

Benitec was forced to downsize its IPO on the Nasdaq to \$US13.8 million (\$18.8 million), considerably lower than the original goal of raising up to \$US65 million. Demand was stronger last year, when 10 US institutional investors ploughed \$31 million into Benitec.

Via a gene-silencing single injection, Benitec is hoping to treat hepatitis C, hepatitis B, eye disease known as age-related macular degeneration, lung cancer and a rare form of muscular dystrophy. The hepatitis C treatment is the most advanced at the clinical trial stage

Meanwhile, leaders of Australian-listed biotech firms, such as the Lucy Turnbull-chaired Prima BioMed, are frustrated that local investors are failing to recognise the potential value of their emerging life-saving technologies.

Marc Voigt, the chief executive of Prima BioMed which is developing immunotherapeutic products for the treatment of cancer, says "local support in Australia is really not as strong as it could be".

"There is increasing interest in Australian biotech companies in the US," Voigt says.

In May, Prima Biomed raised \$15 million from US healthcare

hedge fund Ridgeback Capital Investors. Almost one-third of Prima BioMed's shareholders are US-based, up from 5 per cent a year ago.

One theory advanced as to why Australian investors are leery of the biotech sector is a lack of knowledge about science.

Many US stockbroking analysts have PhDs in science and medicine and can earn up to \$US1 million a year.

LIMITED NUMBER OF QUALIFIED ANALYSTS

In Australia, there are a limited number of analysts and institutional investors able to make educated calls on the likelihood of success of biotechnologies.

Prima BioMed's Voigt admits for outsiders it is "very difficult to predict success".

Underlining the valuation gap, analysts at US brokerage firm Ladenburg Thalmann have a price target of \$US52 for stem cell therapy pioneer Mesoblast's American Depository Receipts, which were trading at \$US12.62 in the US on Thursday. Though not directly comparable to the ADRs, Mesoblast shares on the ASX closed at \$3.24 on Friday, with local brokers at Goldman Sachs and Macquarie recommending clients sell the shares.

US pharma giant Celgene, boasting a market capitalisation of \$US103 billion, [entered into a strategic partnership with Mesoblast in April, after buying \\$58 million of the stem cell pioneer's stock](#). Mesoblast could become the first biotech firm in the world to have approved the cell therapy to treat graft-versus-host-disease (GVHD), a potentially fatal complication of bone marrow transplants.

In June, Swiss pharmaceutical giant Novartis International agreed to pay \$US200 million (\$262 million) upfront and up to \$US500 million in milestone payments to acquire Queensland drug developer Spinifex Pharma, [after promising results of clinical trials with patients suffering ongoing neuropathic pain following a bout of shingles](#).

Despite the promise, the Australian biotech sector still needs to achieve commercial success beyond the established names of world-leading companies CSL and Cochlear.

"Australia has not yet put up a critical success, but I believe between Benitec and Mesoblast that may change," Kolbert says.

And investors will need to assess whether they may be buying into a risky bubble.

MLV & Co's Bernardino admits there are "pockets of frothiness" in the US.

"Overall biotech shares are not in a bubble," he says.

"The innovation is alive and there are still investment opportunities, but there is probably up to three years more before we see people shaking their heads at valuations."



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