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Biotech buyout action likely to continue

Pharma's appetite for biotech stays strong as weak dollar, pipeline woes likely to drive deals

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NEW YORK (Associated Press) - A buyout bull's-eye will likely remain on biotechnology companies over the next few years as major pharmaceutical companies continue taking advantage of a weak dollar and a surplus of cash to buy pipeline additions.

Billion-dollar deals are not unheard of in the drug development industry, but even Roche surprised the market when it offered \$44 billion for biotech giant Genentech Inc. Switzerland-based Roche already owns a majority stake in the South San Francisco, Calif.-based company, which sells the blockbuster cancer drug Avastin.

Meanwhile, New York-based Bristol-Myers Squibb Co. has offered \$4.5 billion for its partner, New York-based ImClone Systems Inc., which makes the cancer drug Erbitux. In both cases, the biotech companies have lucrative treatments on the market and a varied pipeline of developing products. The biotech companies also consider the buyout proposals too low.

"There's a fair bit of money in the industry today, almost creating a pent-up capacity to do deals," said Terry Hisey, who leads the life sciences practice at Deloitte.

The money, coupled with a small rebound in the market, a weak U.S. dollar and the need for new products have set up an environment for a reasonably long period of M&A activity, he added.

Meanwhile, the major drugmakers have been hit with a series of key patent expirations, and subsequent generic competition is eating away at revenue. There is no system in place for approving generic versions of biotechnology-based drugs, leaving open the potential for more time on the market without competition, and thus more revenue.

Biotech drugs are developed using living organisms and are harder to replicate, whereas traditional drugs are made using chemical compounds.

Going forward, buyout valuations will likely remain high on future offers as companies in effect take an educated guess at what the future revenue potential of a certain drug might be.

"There will be no MBA school analysis that makes any of these (deals) look intelligent," said Erik Gordon,

associate dean at the Howe School of Technology Management in the Stevens Institute of Technology in New Jersey. "It's simply a bet of blockbusters coming out of the purchased pipelines."

A continuing trend in the buyout market is the emergence of foreign companies buying U.S. biotech firms, as they have more purchasing power with the weakened U.S. dollar. Earlier this year, Japan's Takeda Pharmaceuticals bought Millennium Pharmaceuticals, for \$8.8 billion, while Britain's GlaxoSmithKline PLC bought Sirtris Pharmaceuticals for \$720 million.

The newest offers, including Roche's \$89-per-share bid, helped push Genentech shares up 20 percent to more than \$98, implying that investors expect a higher offer. The stock closed at \$81.82 July 18, the session before Roche made the offer. ImClone Systems Inc.'s stock surged 38 percent to \$63.93 July 31, after Bristol-Myers offered \$60 per share. The value has hovered at around \$64.

Many large pharmaceutical companies have been cutting jobs and other costs as blockbuster drugs lose patent protection and face subsequent generic competition. Bristol-Myers has already announced its intent to focus more on biotechnology research and development while cutting 10 percent of its workforce and shuttering manufacturing plants.

The move to buy another company's product pipeline is inherently risky, considering the price tag is based on something as hard to measure as future revenue on a drug that still has to make it through a rigorous Food and Drug Administration review.

But, the risks may be worth it for an industry already relatively comfortable with risk, Gordon said. Many are developing drugs for tough-to-treat cancers and other conditions, and there have been several high-profile drug development failures in the past few years.

While a failed drug candidate means hundreds of millions of dollars wasted, a successful blockbuster drug has the potential to make a company, bringing in billions of dollars per year.

"M&A in the biomedical field will be like this over the next few years," Gordon said. "You're in the land of gigantic risk." ■

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