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Drugs - Biologics - Devices

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After Launching Corporate Venture Fund, WuXi Shifts Attention To China's Domestic Market: China Earnings Roundup (Part 2)

China's leading CRO grows revenues 24% in Q3, and establishes corporate venture fund to invest in homegrown innovation

China's healthcare industry saw slower growth in the third quarter due to price cuts and policy headwinds. In a recurring feature, PharmAsia News combs through earnings reports to bring you highlights of China's leading pharma companies and how their efforts affect different sectors of the industry. In the first part, we took a closer look at leading local pharma Sincere Pharmaceutical Group ("Facing Pricing Pressure And Generic Erosion, Sincere Shifts To Innovative Products For Future Growth: China Earnings Roundup (Part I)" — PharmAsia News, Nov. 22, 2011 6:00 PM GMT).

Leading Chinese contract research organization WuXi PharmaTech Inc. has established a corporate venture fund capitalized at up to \$50 million. The purpose is to invest in China-based companies and technologies that will bolster WuXi's service capabilities, disclosed WuXi CEO Ge Li during the company's Nov.11 earnings call.

Another purpose is to fund budding Chinese innovators and help commercialize their breakthrough ideas, Li said. By helping "great minds to realize the potential of their technologies and intellectual property," WuXi expects to generate new revenues and benefit from increased access to its integrated service platforms.

"Our aim for this VC is to invest in the technology and the capabilities which will enhance WuXi's technology and capabilities and also to invest in people," Li told investors. Investing in people, he added, creates a win-win situation because it "will help them to grow their entrepreneurial spirit and desire and to actively use WuXi's platform to realize their knowledge and experience."

WuXi had a robust third quarter, growing revenues by 24% to \$104 million. Performance was driven by continued explosive growth in contract manufacturing services,

which grew 183.8% on the back of active pharmaceutical ingredients for Vertex Pharmaceuticals Inc.'s new hepatitis C drug Incivek (telaprevir). Under one analyst estimate, WuXi stands to book roughly \$17 million in revenue for every \$1 billion in telaprevir sales ("China's Leading CRO WuXi Looks To Utilize Manufacturing Capacity With Telaprevir" — PharmAsia News, May 16, 2011 10:00 AM GMT).

WuXi's core laboratory services, accounting for 80.9% of the revenue during the quarter, grew 9.2%. Lab services in China continue to be strong, growing 10.7%, while the company's U.S. revenues grew 5.1%.

The full year revenue is within the \$402-406 million range, including about \$1.5 million from two months of revenues for recently acquired Abgent and MedKey Med-Tech Development Co., WuXi said ("China's Leading CROs Go On Shopping Spree To Become One-Stop Vendors" — PharmAsia News, Oct. 27, 2011 11:00 AM GMT).

Investing In New Drug Discovery Models

The first investment WuXi's newly formed fund made could potentially illustrate what the company is looking to gain in return. Founded by Li Chen, former chief scientific officer of Roche's China R&D center, Hua Medicine is aiming to bring "breakthrough" innovative drugs from the West to China. The company, with an initial team of eight people, plans to do much of the development work with CROs on a fee-for-service basis ("Meet China's New Innovators: Hua Medicine Looks To Take Flight With U.S. Venture Backing (Part 1)" — PharmAsia News, Sep. 19, 2011 2:00 PM GMT).

Using Chinese resources to discover drugs more cost effectively and efficiently, the business model seems to be

gaining traction. In its recent round of financing, Hua garnered \$50 million in commitments from an international group of VCs; WuXi's CEO is also an investor.

And Hua will certainly add revenue-generating activities for WuXi. "We believe this model may represent the future of how drugs will [be] discovered and developed," said CEO Li. "It is a viable model."

When asked whether the move was a way of paying for contracts, Li said Hua will use WuXi services as a preferred vendor, paying market prices, but is free to choose other vendors if it wants.

In terms of investment style, WuXi intends to make investments in tandem with reputable VCs, and keep each deal small.

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– WuXi CEO Ge Li

"We are not going to just do our own investment. We're working with very reputable VCs together. And most investments we'll make will be very small. And, it's not going to be consolidated [on WuXi's financial statement]," noted CFO Edward Hu.

The investment decisions will be selective and will deliver strategic value to WuXi, Hu said.

Hua's other investors include ARCH Venture Partners, Fidelity Biosciences, Fidelity Growth Partners Asia, Venrock, and Sino-Alliance International Ltd.

Shift To Domestic Market

The recent acquisitions of Abgent and Medkey highlight the company's slight strategy shift to China's domestic market, Deutsche Bank analyst Jack Hu wrote in a same-day note to investors.

Abgent is an antibody maker of biological research reagents for drug discovery and basic research, while Medkey launches WuXi into the clinical CRO space ("*From Biologics To Corporate Venture, China's Leading CRO Continues To Evolve*" — *PharmAsia News*, Oct. 21, 2011 11:00 AM GMT).

The shift will enable WuXi to "capture China domes-

tic healthcare sector growth while reducing [foreign exchange] risks," said Hu. The case is particularly strong for MedKey, which up until now has largely focused on multinational companies.

As the Chinese government is keen on growing the domestic biopharma industry, leading CROs like WuXi have seen a steady increase in demand for services from domestic drug makers.

"We see a gradual pickup of service needs from domestic companies," CEO Li said. "And we do believe within the next few years the demand will be significant, as the China government invests heavily in the life-sciences industry."

Both of WuXi's newly acquired entities have grown faster than WuXi's existing business, noted Deutsche Bank's Hu.

"We'll continue to strengthen MedKey to meet the growing need for clinical development services by multinational and Chinese pharmaceutical companies in China," said Li.

With three facilities in China, Medkey extends WuXi's service lineup from discovery through testing in humans. WuXi disclosed a price tag of \$30 million for the two acquisitions.

And, with increased outsourcing of R&D to China, WuXi said its China lab services performed well this quarter. Expecting no impact from macroeconomic factors, WuXi estimates the fourth quarter will see its lab services business grow 18-20% and 14-15% for the full year.

That growth is largely driven by WuXi's integrated medicinal chemistry business, and other downstream services in toxicology, pharmacokinetics, pharmacodynamics, formulation, and bio-analytical services.

Despite concerns about an economic slowdown outside of China, pharmaceutical R&D spending is not seeing a material impact, according to a recent survey conducted by investment bank William Blair & Co., which projected overall growth in R&D spend between 1-2% from 2011 to 2012.

Winning Strategy = Broadest Service + Local Knowledge

The projected uptick in R&D budgets, competitive pricing and pipeline growth have brightened the outlook for the CRO industry. However, only large CROs with "the broadest capabilities and geographic footprints" are best positioned to benefit from the trend, noted the Blair report ("*Large Chinese CROs To Benefit From Continued Outsourcing Trend, CRO Surveys Say*" — *PharmAsia News*, Oct. 28, 2011 10:00 AM GMT).

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As the Chinese domestic market appears to offer the fastest growth opportunity, more multinational CROs like Quintiles Transnational are also entering the clinical space in China.

But WuXi's Li doesn't appear to be worried. WuXi will be competitive on the quality of its integrated services, he said, and most importantly on its local knowledge of China.

"How do we compete with other competitors in certain areas? Again, it's always competing with quality and also with our fully integrated capabilities," said Li. "And plus, we're local. We know China."

A stable, high-caliber local team is vital to WuXi's success, Wang Jin, CEO of Hangzhou-based Manhattan Management Consulting told PharmAsia News in a previous interview.

Large CROs like WuXi will build on their existing client bases to expand clinical services toward becoming a one-stop shop, while small CROs will have to rely on their cost advantage and develop in niche areas, according to Wang.

By Brian Yang

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