

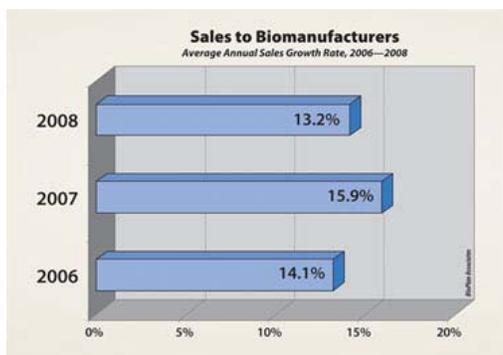
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Feature Article

## Budgets Shifting in Biopharma Manufacturing

### Financial Priorities Are Impacting New Purchases

Eric S. Langer



Fear of impending financial calamity can create an environment of cautious budgeting, which can turn into a self-fulfilling prediction. In this year's 6th Annual Report and Survey of Biopharmaceutical Manufacturing, we evaluated the extent to which global manufacturing and vendor budgets are being squeezed or eliminated.

Trade groups and analysts describe the impact of the global financial crisis in no uncertain terms: IPOs have fallen to zero this year, and a recent BIO report showed that 30% of publicly traded biopharmaceutical companies have less than six months cash on hand.

Though private funding is more or less consistent with previous years, analysts are predicting a tough year for both public and private companies, with more than 6,000 employees laid off from over 100 companies since the crisis began. And for vendors, the impact appears to have increased over the past six to nine months.

By using budget projections as an early indicator of financial strategy, our study attempts to quantify how these fears may translate to budget contractions. The results included in my report provide a global view from executives at 446 biopharmaceutical manufacturers and CMOs. The survey provides data on 12 in-depth manufacturing areas and associated trends. The study covered biopharma companies and their suppliers in 35 countries.

We asked respondents: "Considering the current economic situation today, by about what percent do you believe your budget and funding will change over the next 12 months."

Respondents (as recently as January 2009) are indicating that most budget areas are likely to remain unchanged over the next 12

months. Good news for departments and their vendors. The bad news, for some vendors at least, is that some of these budgets are going to be spent more carefully than they had in the past.

While healthcare tends to enjoy a degree of insulation from economic troubles, decision makers are being more cautious about committing to new purchases. This perception may be a reason that vendors' only budgetary increase was in their sales staff (who may likely be earning their pay as they convey value to more selective buyers).

Vendors' experience may be a bellwether for industry growth as a whole. Decision makers' cautious buying may result in delayed purchasing and a wait-and-see attitude among buyers. Vendors are beginning to experience the pinch as their customers try to predict the economy. Despite indications of limited budgetary changes over the next 12 months, some vendors are rightly concerned.

## **Purchasing Environment**

We examined areas of greatest change in biopharma companies' budgets to assess where these effects, both positive and negative, are most prevalent. We found that process development is the area where the greatest budget increases are likely (3.8% on average). Following that is budget increases for new technologies to improve efficiencies for downstream production (2.5%). These shifts both mirror general trends toward more up- and downstream productivity in biomanufacturing.

Despite the leaner purchasing environment, downstream areas are still being funded. Not unexpectedly, the areas of greatest budgetary decrease are in new facility construction (down 6.2%). Interestingly, the change in budgets for new capital equipment appears to be relatively flat (-0.6%).

There appears to be something of a bimodal distribution, where some companies are planning to eliminate budget items, while others are planning significant increases. This may suggest that decisions on capital equipment expenditures at some companies could have been made months or years prior.

Similarly, we found that while 8.8% of companies planned to eliminate their new facilities budget, 9.4% planned large increases (more than 20%). Apparently, expenditures on long-term items may be dependent on budget cycles and when construction decisions were made. Other areas targeted for budget elimination included hiring of new scientific staff (5.8% of respondents) and hiring of operations staff (4.5% of respondents).

Areas where there may be significant budgetary increases (greater than 20%) included new facility construction (9.4%) and new capital equipment (8.4%). The budget data for outsourced biopharmaceutical manufacturing exhibited no substantial swings, but did indicate a modest decline of 1.3%.

To evaluate the impact of the current economic situation on vendors to this industry, this year we also queried 140 vendors regarding their average annual growth rates. This establishes a derived demand for products used by the biopharmaceutical industry, which in turn, provides insight into the growth rate of end

users of these products.

In our study, we found relatively robust growth for 2008: on average, vendors reported an annual growth rate of 13.2%. Whether this is sustainable in 2009 is problematic. Trendwise, this represents a slight flattening of growth from the previous two years (Figure).

While it is clear that current growth rates to the industry are declining, we believe these data show that the biopharmaceutical segment remains healthier than other segments into which these vendors may also be selling.

We believe that vendors' strategies will include stretching their current budgets to achieve goals, while keeping their new product R&D pipeline appropriately stocked to ensure growth when the economy turns the corner.

### **Summary**

Healthcare segments, including biotech, have generally enjoyed a certain degree of insulation from economic troubles—aging populations, long product cycles, and the need to treat diseases, help ensure the segment's ability to weather downturn economies.

Despite this, the current economic situation is having an impact. Caution among decision makers to commit to projects and purchases means that some vendors will see lost sales. Some of these companies are attempting to generate business by increasing sales efforts. At the same time, some are reducing prices. This has led to a spiraling effect where buyers begin to expect price declines and will delay making needed purchases (a classic formula for a deflationary economic situation).

While purchasing agents may welcome the prospect of falling prices, wide-scale price declines will accelerate the economic downturn. Deflation worries led the U.S. Federal Reserve to cut interest rates to near-zero in January to avoid a deeper economic catastrophe. On the other hand, biotechs continue to secure capital. The private markets for biotech funding appear to be relatively healthy, and consistent with previous quarters.

M&A activities have grown as the market for IPOs has shrunk over the past two years. It is likely that these will continue as larger companies find good science investments at later-stage companies. It's also likely that earlier-stage companies are going to need compelling science if they are to attract necessary capital. Valuations, as a result, are going to be down. This, of course, is going to impact how budgets are spent at smaller companies even more significantly.