

Scrutinizing the part played by innovation journalists in a biotech bubble

A look at biotech IPO:s in Sweden 2000-2001.

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1 Introduction

In hindsight, it is obvious that the biotech companies that were listed on the Stockholm Stock Exchange in the years 2000 and 2001 offered the public widely overpriced shares. Given that all of the shares have fallen dramatically since the IPO:s (Initial Public Offerings), and that no one has been able to recover, it is probably fair to describe the period as a financial bubble. Months, years when the sentiment of investors shifted from risk aversion and conservatism to exaggerated expectations, built on hopes rather than a careful scrutiny of the real world.

The aim of this paper is to take a closer look at how journalists described the future of these innovation driven biotech companies, and the fairness of their IPO:s, in the midst of a bubble.

Clearly a lot is at stake. Financial bubbles (being part of a boom and bust pattern) distort capital allocation, make it more difficult for innovative companies to achieve enduring financing, harm the public confidence in important institutions (such as stock markets, banks, listed companies and innovations) and entice people into making poor investment decisions.

For journalists who cover innovation companies (or other listed companies), the very credibility of their profession is at stake. It is during a bubble that journalist's ability to remain an independent and reasonable voice is tested. Do journalists, in general, get carried away by the sentiments of a bubble, or do they keep their cool and integrity?

The most meaningful way to answer that question, in relation to biotech IPO:s in Sweden in 2000-2001, is in my opinion to study what recommendations were given by business journalists to their readers in regard to these IPO:s. In Sweden in 2000-2001 as well as today, the three leading business magazines were/are Dagens Industri, Veckans Affärer and Affärsvärlden. All three give their readers advice on particular stocks on a regular basis. Whether to buy or sell, or in the case of an IPO, whether to subscribe or not to subscribe.

I advocate this approach to the question, since it will not get stuck in semantics, there are only two possible recommendations. It allows a more or less objective evaluation of the role played by journalists during a financial bubble. I will of course also discuss the reasoning of the articles, leading up to the recommendation, to see what can be learned from this period.

When I set out to write this paper I also wanted to compare the recommendations and reasoning of journalists with that of investment bank analysts. Unfortunately, this didn't prove possible. Because of secrecy policies, the bankers whom I have approached have refused to release their analyses and recommendations of 2000 and 2001. Though the evidence is now hidden, we who were around during this period can say one thing: Banks, whose corporate finance department assisted companies with their IPO:s, never failed to let their equity analysts write favorable recommendations on the same IPO:s. The so called Chinese walls between equity analysts and corporate finance advisors were, in fact, non-existent. (This conflict of interest was discussed in Veckans Affärer, 30 Oct, 2000, "Börsens bilhandlare".)

This leaves journalists with a huge responsibility – being effectively the only independent judges of the fairness of IPO:s. Did journalists assume this responsibility?

1.1 A personal experience

It was a usual working day in the early summer of 2001 when I received an unusual phone call. The chairman of the board of a Swedish biotech firm wanted to ask me a few questions regarding an article I had written for Veckans Affärer, he said. And soon enough, he fired away:

Did I realize, he asked, that the IPO (initial public offering) of his firm was now hanging in the balance because of what I had written? Was I prepared to take that responsibility? Did I realize that investments in Sweden and Swedish job opportunities might be lost because of my article? On what hard evidence had I based the conclusions of my article?

Out of sheer surprise and bewilderment I probably failed to answer his questions with the persuasion and integrity that was warranted. But we had a long talk where I at least repeated the major arguments of my article, and explained why the IPO of his company – in my opinion – was widely overpriced. And why I had to recommend Veckans Affärer's readers not to subscribe to the offer.

What I should have said: IPO:s are not jeopardized by magazine articles, but by irresponsible CEO's, chairmen of boards, boardmembers, owners and investment bankers who overprice the share.

1.2 A personal bias

As the story above indicates, I was myself a business journalist at Veckans Affärer during the time of the biotech bubble, and indeed I did write three articles with recommendations on IPO:s of Swedish biotech/healthcare companies. Readers of this paper should keep that in mind, and I will help them by always stating openly when I quote or refer to one of my own articles.

2 Swedish biotech IPO:s in 2000 and 2001.

A total of five Swedish biotech companies carried out successful IPO:s and listed their shares on Stockholm Stock Exchange from the spring of 2000 until the summer of 2001. This might not appear to be an impressive number, but as a contrast, no Swedish biotech company has succeeded in bringing a successful IPO to the market subsequently. In this period three biotech companies (including one healthcare company, the definition of biotech isn't clear cut and I prefer a broad one) made unsuccessful attempts as well, their IPO:s were withdrawn from the market.

All four successful IPO:s prompted business papers to write analysis with recommendations – whether their readers should subscribe to the new share issues or not – and they are all included in the research paper. The companies are Bioinvent, Pyrosequencing (after mergers named Biotage), Tripep and Vitrolife. One of the withdrawn IPO:s came close enough to realization for journalists to write analysis, and this company, Carema, is also included in the study. Two companies, Medicarb and Personal Chemistry, are left out since their IPO:s were withdrawn at an earlier stage.

2.1 A look at the market climate

From October of 1999 till the climax of March 2000, the Nordic biotech index of Aragon (Swedish stockbroker firm) rose by 235 percent. (Dagens Industri, October 28, 2000 “Himmel och helvete på börsen”.) In the two and a half years to follow, the biotech index of Stockholm Stock Exchange would alone fall by 85 percent. A more obvious example of a boom and bust pattern, or a financial bubble, is difficult to find.

Turbulent and cyclical behavior is however the tradition of financial markets as far as biotech companies are concerned. Over time substantial expectations are built up, and when biotech companies later fail to fulfill the promises of their technologies, markets tend to be very harsh in their reaction. The failure of a few companies will then contaminate the whole sentiment of the market, and investors will shy away from biotech companies for a longer or shorter period.

Because of this cyclical pattern, biotech companies have often behaved like animals around an oasis in the desert. When the oasis springs to life animals will flock, when it dries out the animals know that the water they drank will have to sustain them for a long time. This would explain why a relatively large number of Swedish biotech companies completed, or attempted, IPO:s in the year following spring of 2000.

2.2 A closer look at the companies

As mentioned above, the companies included in the study are Bioinvent, Carema, Pyrosequencing, Tripep and Vitrolife. The aim of this section is to give a factual background to the companies, what journalists subsequently wrote about them will be discussed at length in the third chapter.

2.2.1 Bioinvent

Bioinvent is situated in Lund, develops antibody-based drugs (but had no project in clinical phase at the time of the IPO) and went public on the Stockholm Stock Exchange in June of 2001. The share price interval of the IPO was 60-75 SEK (\$1 = 6,75 SEK), giving Bioinvent a total market cap of 1,7-2,1 billion SEK. Finally, the price of the share was determined to be at the lower end of the interval. Hence the new share issue gave Bioinvent approximately 300 million SEK. As indicated in the stock chart, Bioinvent has seen a sharp decline in its share price after the IPO, only recently starting to recover.

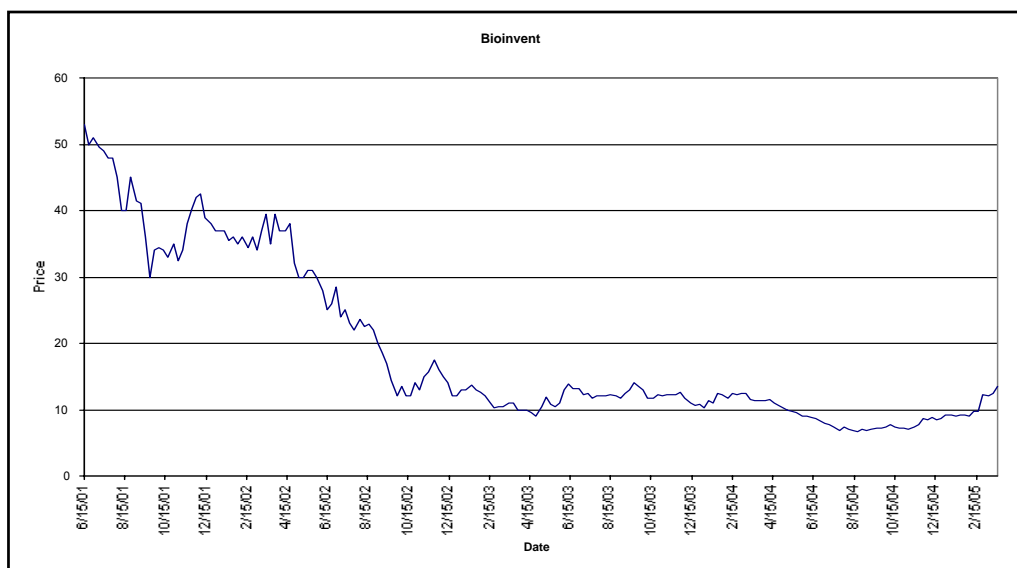


Table 1: Stock chart of Bioinvent, source: JCF.

2.2.2 Carema

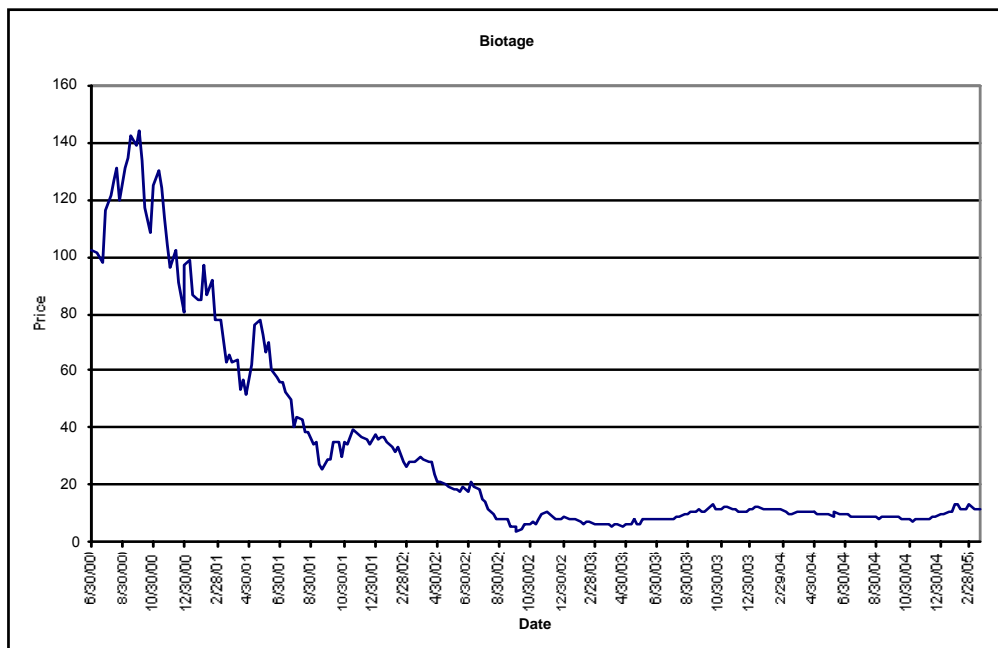
Carema is a healthcare company situated in Stockholm, primarily focused on geriatric care. (This certainly stretches the definition of biotech, but since they were affected by the same market sentiment as the other companies in my study, and since biotech and healthcare are related, I have decided to include them.) The company didn't make a new share issue in connection to its attempted IPO in May of 2000, but previous owners intended to sell out 12,5 percent of their shares at 45 SEK each. The total value of the offer would have been 550 million SEK. However, the IPO failed and had to be withdrawn. The CEO of Carema, Peter Weiderman, was quoted blaming the giant IPO of Telia (Swedish government controlled telecom

company) for Carema's failure. (Dagens Industri, May 28, 2000, "Floppade emissioner skylls på Telianotering".)

2.2.3 Pyrosequencing

Pyrosequencing is situated in Uppsala and develops research tools within genetic engineering. Subsequently, after two mergers, the name has been changed to Biotage. The IPO in June of 2000 had a share price interval of 85-105 SEK, finally (after bidding) determined to 100 SEK which gave the new share issue a total value of 900 million SEK. The company has failed so far in the commercialization of its Pyrosequencing technology, has added new technologies through mergers, and the share price has dropped substantially in the years following the IPO.

Table 2: Stock chart Pyrosequencing/Biotage, source: JCF.



2.2.4 Tripep

Tripep is a drug research company situated in Stockholm, and had one project (against HIV/Aids) in clinical phase II at the time of the IPO in June of 2000. The new share issue was priced at 90 SEK giving it a total value of close to 200 million SEK. The drug substance, GPG (against HIV/Aids), subsequently failed to show efficacy in phase II and the stock lost most of its value in one single blow.

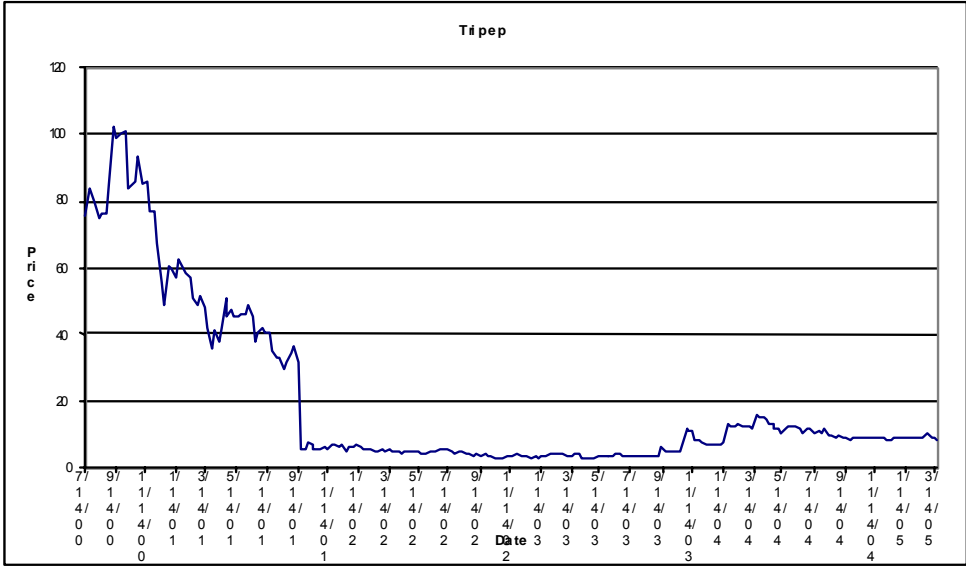
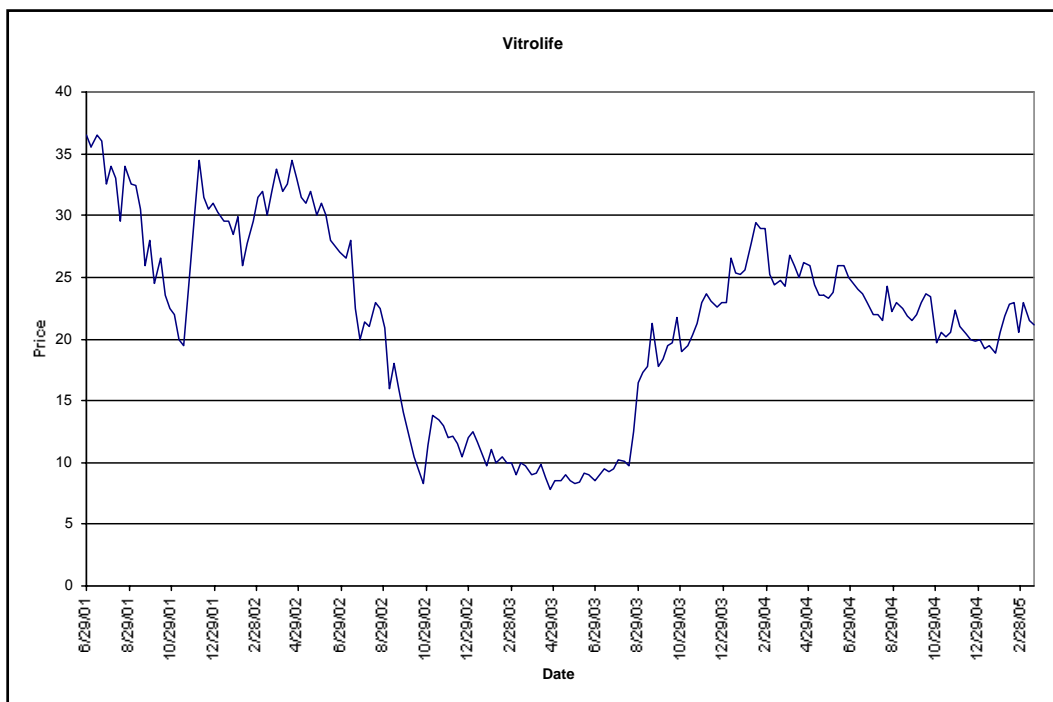


Table 3: Stock cart of Tripep, source: JCF.

2.2.5 Vitrolife

Vitrolife develops and sells products within cell and tissue engineering, predominantly media products for in vitro fertilization, and is situated in Gothenburg. The IPO was completed in June of 2001 and the new share issue had a price interval of 40-48 SEK, finally determined to 40 SEK, giving the issue a total value of 160 million SEK. Since the IPO, Vitrolife has sold out unprofitable operations and is now profitable. The development of the stock has been somewhat less disastrous than the other companies, but still the share price has dropped 50 percent since the IPO.

Table 4: Stock chart Vitrolife, source JCF.



3 What journalists wrote – articles and recommendations

In this chapter, I will take a closer look at what business journalists wrote about the Swedish biotech IPO:s in 2000 and 2001, and, more precisely, what decision they encouraged their readers to take. As previously mentioned, the study is restricted to Veckans Affärer, Dagens Industri och Affärsvärlden, the three most prominent business magazines in Sweden.

3.1 Journalists writing analyses

Swedish business magazines have a longstanding tradition of letting journalists, especially stock market reporters, write analyses about shares and IPO:s. And to advice readers to buy or sell shares, or in the case of IPO:s, to subscribe or not.

For the same purpose, investment banks hire experts at enterprise valuation, should really journalists meddle in this trade? Well, first of all, most stock market reporters have some expertise in business economics and management. Secondly, they have the most important asset of any journalist, their independence and integrity. As stated before, bank analysts know that every company is, or could be, a customer of the bank, and consequently, bank analysts never write negative analyses about an IPO where the corporate finance department of the bank acts as an advisor. This has never happened – and will never happen.

But in the end, independence and experience is hardly enough for journalists. To justify their role as adviser to readers, journalists must also endure scrutiny of their track record, one of the purposes of this study.

3.2 Approaches to enterprise valuation

The most conventional method to calculate the value of a company is to estimate its future cash flow, and to discount that cash flow to present value. This method is especially useful for companies that have been around for a while, you can see their historical growth, their profit margin, how they behave in different business cycles, and extrapolate that information into the future. Many journalists, as well as most bank analysts, use this approach.

But when evaluating high tech companies, based on research and innovation, cash flow analysis may be less useful, especially if the company hasn't commercialized its technology yet, or is in the early stages of commercialization. Theoretically, the analyst would instead need to look at the likelihood of a successful commercialization, combine that with an estimated value of the potential market, and derive the future

profits of the company (and discount them to present value). Because the margins of error are so great here, this approach generates enterprise values that are only haphazard approximations – and most good analysts would acknowledge that.

Since the difficulties in calculating the value of innovative companies are so great, analysts are often tempted to use relative valuation. That is to compare a company to its competitors, especially with regard to sales, profits or – where they are non-existent – technology value (market cap minus net cash) in relation to number of employees or research budget. But this method is flawed, and should be used with a lot of caution. Companies are seldom comparable, even when they compete on the same market, and furthermore, in a financial bubble the values of every share would be inflated. Hence, a relative valuation would only affirm the bubble.

3.3 Bioinvent – “high risk, do not subscribe”

Affärsvärlden describes the share price of Bioinvent’s IPO as expensive and recommend their readers not to subscribe. The journalist uses relative valuation to underscore his point. Other companies, with antibody technologies similar to Bioinvent’s, have a lower technology value (compared to research budget) than Bioinvent and the magazine lists four such companies. (May 30, 2001, “Ännu en dyr bioteknikaktie”)

Veckans Affärer questions why Bioinvent would need to make a new share issue at all, given a solid financial position. The journalist argues that Biovent is a high risk venture and that profits – if any – are several years away. Finally, the magazine uses the same kind of relative valuation as Affärsvärlden, with the same conclusion, recommending readers not to subscribe. (June 5, 2001, “Human affärsida’ med hög risk”)

3.4 Carema – “expensive, do not subscribe”

Veckans Affärer (my own article) argues that there are limits to the profitability of Carema since the public sector is the only end customer, and questions whether the company will reach its financial targets. According to the article, the price of the share is too high, even if Carema would reach its targets, the share would be close to its fair value. The advice is not to subscribe. (May 22, 2000, “Kursen bör kureras”)

Dagens Industri compares Carema to a major Swedish competitor, Bure Hälsa, and finds that Carema is less productive. The share price is expensive, in relation to profits, and not justified since Carema hasn’t proven its ability to grow, argues the journalist, and the advice is not to subscribe. (May 25, 2000, “Carema väl positionerat men... aktien dyr”)

3.5 Pyrosequencing – journalists disagree

Dagens Industri recommends readers to subscribe to the IPO but adds that they may be in for a bumpy ride if the stock market loses interest in the biotech sector. (Direkt, June 15, 2000, “Teckna, men varning för skumpig resa”)

Affärsvärlden predicts that Pyrosequencing won't be profitable in the foreseeable future and will need to make more new share issues. The share price is too high according to the magazine and the advice is not to subscribe. (June 15, 2000, “I dyraste laget”)

Veckans Affärer (my own article) isn't willing to estimate the probability of Pyrosequencing succeeding in its commercialization, but argues that too much of a success is already reflected in the share price. Hence, the risk for new investors is too high and the advice is not to subscribe. (June 19, 2000, “Succen är redan intecknad”)

3.6 Tripep – “risky but promising”

Veckans Affärer sees promising research results and an experienced management team as reasons to subscribe to the IPO. But only investors willing to take a risk should subscribe, according to the magazine. (June 26, 2000, “Medel mot Aids med potential”)

Dagens Industri sends out mixed signals. The advice for risk-taking investors is to subscribe, for risk-averse investors to refrain from it. (June 30, 2000, “Tripep ska knäcka HIV”)

3.7 Vitrolife – total disagreement

Affärsvärlden argues that two of the four business areas in Vitrolife together have a value of 600 million SEK, while the value of the other two are difficult to estimate. But since the technology value is 550-650 million SEK, the share price is not too high, and given product launches in the next year, there is room for a higher valuation. The advice is to subscribe. (June 13, 2001, “Provrörsbarn till börsen”)

Veckans Affärer (my own article) claims that the share is widely overpriced, the fair value is in the range of 15-20 SEK, and not 40-48 SEK as in the IPO. The magazine bases its valuation on a cash flow analysis with conservative estimations of future growth and profitability. (June 18, 2001, “Dyr fruktsamhet”)

4 Conclusions

In the introduction to this research paper I argued that business media was effectively the only institution independent enough to evaluate the fairness of IPO:s in Sweden during the biotech bubble of 2000-2001, and there are no indications that this situation has changed subsequently. I emphasized the importance of this task, because of the long-term costs of financial bubbles, to the society as a whole, to investors, to corporations and to the credibility of journalists if we fail to keep our cool and integrity when other actors of the stock market get carried away.

I concluded with a question: Did journalists assume this responsibility?

Table 5: Swedish biotech IPO:s in 2000-2001 and the advice of journalists. Seven cases of “do not subscribe”, one ambiguous and three recommendations to subscribe.

Magazines and recommendations	Veckans Affärer	Dagens Industri	Affärsvärlden
Bioinvent	Do not subscribe	-----	Do not subscribe
Carema	Do not subscribe	Do not subscribe	-----
Pyrosequencing	Do not subscribe	Subscribe	Do not subscribe
Tripep	Subscribe	Mixed signals	-----
Vitrolife	Do not subscribe	-----	Subscribe

I also suggested that an evaluation of the magazine journalists’ advice to their readers would provide the most clear-cut answer to the question. I chose the magazines Veckans Affärer, Dagens Industri and Affärsvärlden, where journalists give categorical recommendations in regard to IPO:s (Whether to subscribe or not to subscribe) to free my study from semantic ambiguity.

As shown in table 5, journalist's verdict on the Swedish biotech IPO:s in 2000 and 2001 was pretty decisive. In seven cases the advice was: "do not subscribe", in one case the message was conflicted and in three cases journalists recommended their readers to subscribe to IPO:s. Abbreviated, 7-1-3. After looking at the stock charts in chapter three, one could argue that the advice should have been 11-0-0, and in a perfect world it would have been. But what is easy to see in hindsight, was less obvious in the midst of a financial bubble. One should remember that four out of five companies were able to complete their IPO:s, and this wouldn't have been possible unless investors, among them institutional investors with highly paid biotech experts and fund managers, had subscribed to them. In 2000 and 2001 all options were open, or so it seemed at least.

That's why I see the findings in table 5 as a relatively strong testimony to the independence and critical attitude of business journalists.

It's not within the scope of this paper to study the effects of the recommendations, but I included one personal experience (in chapter 1.2) to give a hint on how businessmen in powerful positions can react to negative publicity. I am often surprised – and encouraged – by their reactions, of how seriously they take it. I find it quite possible, even probable, that negative publicity contributed to stopping the IPO of Carema, and contributed to lowering the share price of other, successful IPO:s.

It could be argued that business journalists do not have the same resources as bank analysts, cannot dedicate even close to as much time to every single company, and perhaps should refrain from giving advice. But, as I believe that table 5 confirms, business journalists often have the time, the resources and skills it takes to do a good enough job. And more importantly, they have their independence and integrity.

In the framework of innovation journalism, I think this is an important lesson. Journalists are often inferior to the experts, with whom they deal when trying to understand the advancements of science. But so are investors. And citizens. And politicians.

Journalists must never let a sense of inferiority prevent them from being independent and critical. Knowledge can – at least to some extent – be acquired, even in a short time. And together with integrity, that knowledge can be powerful.

When journalists dare to make use of it, they will sometimes be wrong (as experts are known to be on occasion), and they will often provoke and annoy entrepreneurs and innovators, but also make an important contribution to society.

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