

CLOSE CONCERNS

Diabetes Close Up, V 2, #4
February 10, 2003

Hullo! It's a beautiful evening in San Francisco and I hope you are keeping well! I wanted to highlight to you a couple of recent interesting items from the diabetes world.

- **This week's *New Yorker* highlights recent islet cell progress** with an article by noted writer Jerome Groopman on islet cell technology and potential race for a cure. In this piece, stem cell progress is positioned as the big hope that will unlock the islet cell technology puzzle and cure diabetes; interestingly/strangely, xenotransplantation¹ is given more potential than any other source related to islet cell expansion supply (apart from stem cells). It's unsurprising to me to see that visibility of diabetes continues to expand, given the "state of the state" - even if I wouldn't agree with all conclusions of this article (I find parts of it strikingly reductive), broadly speaking Groopman does a brilliant job at getting at the curse of the illness for Type 1 types and the impetus for the recent investments (the NIH recently announced it would fund Type 1 "cure" research \$150 mm per year for five years, due largely to JDRF efforts). Ultimately, Groopman's piece strikes me as a good sign that a cure for Type 1 might be somewhere in the offing. Although as I always say "*I've been hearing at the ADA for nearly 20 years to expect a cure within seven ~*" I actually think in 2003, we might be looking at a better world in this vein by 2010. That's something, that. (FYI, a link to a terrific interview with Dr. Groopman is at <http://www.theatlantic.com/unbound/interviews/ba2000-03-08.htm>.)
- **Diabetes valuations continue to look strong** - Roche announced its intention to purchase Disetronic's insulin pump business this morning for \$890 million, net. Given that Disetronic is not the leader in the insulin pump business (in the U.S. it stands at #3 behind Medtronic and Animas, although it does have the highest market share in Europe) and doesn't appear to have the most sophisticated pipeline of the players, it seems this price is a good one and reflects lots of interest in diabetes broadly speaking. Roche clearly is upping the ante in its quest to be a diabetes power, and it'll be very interesting to watch what the company does on the continuous monitor and artificial pancreas fronts². Shorter term, will be intriguing to see what they do on in combining blood glucose monitor data and pump data to make patient management easier (a la Minimed/BD).

¹ As defined by the FDA, xenotransplantation is any procedure that involves the transplantation, implantation, or infusion into a human recipient of either (a) live cells, tissues, or organs from a nonhuman animal source, or (b) human body fluids, cells, tissues or organs that have had ex vivo contact with live nonhuman animal cells, tissues or organs.

² At the Diabetes Technology meeting in Atlanta last November, Bruno Reihl led a very interesting discussion and showed a "live case" from Switzerland showing the newest implantable monitor/pump combo.

- **Pump penetration to increase?** Key questions are how much pump penetration will increase due to better pumps, pumps that are easier to teach/learn, and bigger salesforces? Penetration will be key to watch over the next year, especially with new partnerships, entrants, and technology.
- **It is worth noting that this Disetronic sales multiple was far below the multiples for which MiniMed and Inverness Medical sold.** While Disetronic had trailing 12-month revenues of approximately \$175 million, implying a 5.1x trailing revenue multiple and a 4.4x forward revenue multiple assuming 15% growth, MiniMed and Inverness sold to Medtronic and J&J respectively for multiples of 10.5x and 11.3x respectively (on trailing 12-month sales)³. I was asked several times today whether this implied multiple contraction for diabetes companies – no, I would say rather that MiniMed and Inverness both struck me as powerhouse leaders in their respective businesses (insulin pumps and glucose monitoring strip manufacturing) at the time of acquisition and thus more worthy of higher such multiples. Other multiples can be equally if not more important, of course, such as cash flow multiples, earnings, etc.

Kelly L. Close
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Note: Kelly L. Close is a specialized consultant to the medical technology/pharmaceutical industries. All observations expressed are Kelly's opinions alone and should not be viewed as recommendations to investors on any companies in the industry. If you prefer not to be included on Diabetes Close Up mailings, or if you know others who would like to be on the mailing list for future occasional observations, please send a message to info@closeconcerns.com.

³ Let me know if you'd like the more detailed spreadsheet on this.