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Success ingredient



The great experiment

Benson Tsang recounts the risky challenges of taking a mainland pharmaceutical company to the world's biggest bourse, writes *Helen Luk*

Photography by Qilai Shen in Shanghai



The pharmaceutical industry is a risky business – millions of dollars poured into years of research may well yield nothing in the end.

Eight years ago, when a scientist and his three business partners founded the mainland company, WuXi PharmaTech, to take on research outsourced by top foreign drugmakers, few were optimistic about its prospects – some predicted bankruptcy in two years.

The experiment has worked. Today, the Shanghai-based company's staff size has ballooned from about 40 to nearly 3,500. It also took the risk – and succeeded – to become the first and only Chinese contract research organization listed on the New York Stock Exchange, the world's biggest bourse. Last month, WuXi reported impressive second quarter earnings, with net revenues jumping 134 percent to US\$70.8 million compared with the same period last year.

The company's prime financial mover is Benson Tsang, its 44-year-old chief financial officer. Tsang orchestrated the initial public offering shortly after he joined WuXi in July 2006, knowing from the start it would be a mammoth task to prepare a Chinese company to list in the U.S., the most stringently regulated market in the world.

"I started the preparation to review the financials and get the team ready, to start the ball rolling," Tsang tells *A Plus* in an interview at his Shanghai office. "There was quite a bit of pressure on the finance team. I went through Hong Kong listings before as a reporting accountant, but the pressure and the workload under a U.S. listing was significantly higher. The rules are a lot more stringent.

"Throughout the process, there were times I had to make very, very tough decisions and had direct confrontations with the board to really put my foot down to get some issues resolved," he says.

IPO hurdles

In terms of the financial aspects, Tsang says the company adopted international accounting standards and engaged one of the Big Four as its auditor from the beginning, but coordinating investment bankers, valuers and lawyers, and converting IAS into U.S. GAAP remain big challenges.

"Language is an issue. The documentation was all in English, not Chinese. Even very smart accountants in China would still take a while to get used to U.S. GAAP. And while you were preparing U.S. GAAP accounting stuff for the listing,

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you still have to maintain your books here for local purposes,” he says.

Similar to other mainland Chinese companies, not all of WuXi’s records satisfied U.S. requirements. “If you went back to F1, our filing document, we were not that perfect. For example, the U.S. always focuses a lot on evidence and documentation. But under the IAS or the Chinese legal rules, as long as something such as an internal discussion was documented briefly, even if there were no formal board minutes, it was still good, but not under the U.S. rules.”

Tsang says going through a U.S. listing is more draining on a company’s resources than doing it elsewhere such as Hong Kong. He cites as an example the accountant’s report: In Hong Kong, auditors and management work closely to put the report together. That responsibility lies solely with the company under U.S. rules, and the auditor, to maintain its independence, only performs an audit on the financial statements. “In the U.S., basically there is a firewall. They don’t want to get involved to help you to do the financial statement preparation,” he says.

So why did WuXi decide to stick it out and pick New York over Hong Kong or London?

“The industry we are in is unheard of in Hong Kong. It is not that easy to explain our revenue model. We don’t really have a physical product to sell. To a certain extent, we are very similar to the Big Four, which sell accounting,

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tax, IPO services. We are selling drug discovery, non-human subject testing and drug manufacturing services.

“In London, yes, they probably understand our industry. But most of our investors and customers are listed on the NYSE. We believe if we move to the States, the potential pool of investors would be a lot bigger there,” he says.

The U.S. listing also helps WuXi prove it is serious about all areas of compliance – financial and otherwise: “By staying on NYSE, we show to our customers that we maintain the highest standards and let them know we have proper internal controls. If a company can comply with Sarbanes Oxley requirements, they won’t just look at financial controls. They will gradually look into all operation controls and that’s exactly what WuXi PharmaTech is doing.”

When WuXi eventually kicked off the roadshow for its IPO in July last year, the timing could not have been worse: It coincided with the breaking news of the U.S. subprime crisis.

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My company chairman Dr. Li [Ge] and I were like, ‘Should we continue or should we just call the deal off and get home and try to get some sleep?’ After the first couple of days, the book was not really building. We didn’t know how it would end up and it was quite frustrating,” he says.

The team persisted and finished the roadshow with the institutional tranche 14 to 15 times oversubscribed. “We were happy. And I remember the pricing was done on 8 August. That night I was very tired, of course. But I think what was in my mind was it didn’t really matter what happened. Let’s just wait for another 12 hours and we would know. On 9 August, it ended up quite well and after the celebration dinner, I was in the hotel all by myself and I looked into the mirror, and I told myself, ‘Benson, you did alright.’”

Armed with the funds raised from the IPO, WuXi has some grand expansion plans ahead. It has allocated US\$40 million for expanding its manufacturing facility in Jinshan, an hour from Shanghai, and another US\$40 million for building a 267,000-square feet drug safety evaluation centre in Suzhou so the company can continue expanding into non-human subject testing.

The importance of being modest

"Being arrogant will lead you nowhere."

It's a message that Benson Tsang, a Canadian chartered accountant and a member of the Hong Kong Institute of CPAs, has reiterated a few times during the interview. He should know because he learned it the hard way.

"Having worked at a Big Four, I used to be really arrogant," Tsang says. "I wouldn't listen to people if they said I was wrong. I always told them, 'I have strong technical expertise and it would be foolish of them to argue with me.' I didn't really respect others. This attitude has given me a lot of trouble in my career."

Tsang began his career as an auditor at Deloitte & Touche in Canada in 1988 and moved to Coopers & Lybrand in Hong Kong in 1993 before joining Imaton Hong Kong, a data storage media manufacturer, as finance and administration manager for Greater China. He has since specialized in the technology sector, working for Global Tech Holdings, a Hong Kong and Singapore-listed company, and as PCCW's China CFO. His jobs have taken him to Taipei, Beijing and now Shanghai, so he's well-adjusted to the culture shock that many

executives might experience when working for a mainland company. But he advises Hong Kong managers to remain humble when managing mainland staff.

"Sometimes we may unintentionally say things that make local colleagues feel bad. And that can become a scar when we have to deal with them in future," Tsang says.

Mainland employees are catching up quickly, especially with the return of many who are educated overseas, and he says it won't be long before Hong Kong accountants lose their advantages. "The gap is closing," he says. "Luckily, the market can still swallow this huge pool of talent now and have some leftover space for Hong Kong accountants. But many of the Big Four are training very good professional accountants locally right here. Five years from now, many of them will be equivalent to partners or even more senior. They can easily take my job unless we can really demonstrate our value."

As a CFO, he says the most important attributes are common sense, interpersonal and problem-solving skills, all of which he developed during his days at accounting firms. "That's really all I have," Tsang says with a laugh.

Tsang also believes an accountant should exercise discretion in deciding whether something is a legal or business risk. "In the real world, there are many issues where you are operating in a not-so-clear area. For a legal risk, there will be no compromise. But if something is a business risk, then your professional judgment is very important. Is the business risk so high that you have to drop a decision? Or can you take precautions to prevent it? In the past, I'd say 'no' to just a little bit of black. But when you don't know how to compromise, it will also lead you to a dead-end."

For now, Tsang says he is really enjoying his time as WuXi's CFO, a position he has taken on since 2006. "The hours I put into this job are unbelievable, consistently over 15 hours a day. But I just love it. I enjoy every single minute. It's kind of like whatever I learned in the past 20 years, I can basically use it here," he says.

But where does he see himself in five years? "Retired. My dream is to be a professor," he says. "I am planning to write a book to share with people the mistakes I made throughout my career and what difficulties I went through to become what I am today. When I finish this book, hopefully some university would take me as a lecturer."

The expansion strategy seems right as WuXi rides the wave of drug research and manufacturing projects outsourced to China from foreign pharmaceutical companies, thanks to constant cost-cutting. WuXi already counts nine of the world's top 10 drugmakers as its clients, most notably Pfizer and Merck. Globally, the estimated US\$15 billion contract research organization market is expanding at a rate of 15 to 16 percent a year, but China's CRO market is anticipated to grow much faster, according to research by Citigroup.

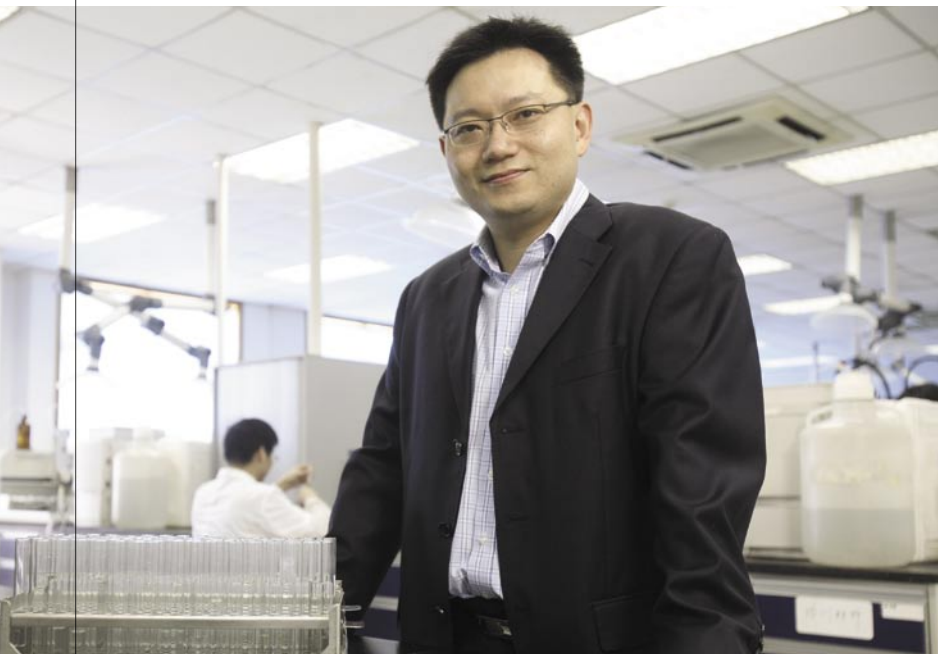
Tsang believes Chinese pharmaceutical companies are catching up with their western counterparts. "The Chinese pharmaceuticals are getting more international and the U.S. and other western countries are making more investments in China. Although the costs we charge for drug discovery are not cheap, they will start to realize they will be much better off outsourcing to us because of the scientific capabilities we have. We can help them shorten the time. The shorter the time, the more costs you can save and the quicker you can send drugs to the market to make profits."

Acquiring U.S. assets

This year, WuXi has joined other Chinese companies that are having so much fun snapping up unbelievably cheap foreign assets, as the global credit crisis pushed valuations lower. Ministry of Commerce figures show that Chinese companies' overseas investments surged to US\$25.7 billion in the first half of 2008, up 229.5 percent compared to the same period last year.

In January, WuXi bought AppTec Laboratory Services of St. Paul, Minnesota for US\$163 million. It was the biggest Chinese takeover

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“If we can demonstrate to people that we can acquire, integrate and execute, the next acquisition we do will definitely be a positive signal to the market. If it doesn’t work, we learn from the mistakes. Hopefully by the end of this year, we can share with the market that the integration is successful,” he says.

In another step towards internationalization, WuXi is planning a joint venture with a leading U.S. pre-clinical drug researcher, the New Jersey-based Covance. Together, the firms will establish a contract research firm in Suzhou, China.

“We are trying to finalize everything by the end of this year. In terms of the initial set-up, each side will inject about US\$30 million. We believe this will be a pretty significant joint venture, which will provide significant financial results to both sides,” he says.

Fighting competition

Contract research organizations, like call centres a decade ago, are now springing up in low cost countries around the globe and competition within the industry is getting keener. How will WuXi fend it off?

“If you talk about competition from the U.S., the cost advantage will easily still be there for four to five years. If you talk about competition from this part of the world, I think we are on equal ground, though we are more expensive than India. For other competitors in China, we are not competing with them on price but on the quality and reliability of our services,” Tsang says.

Looking ahead, Tsang says WuXi will continue to expand its services, including human clinical trials, in future. “We have the right attributes to become a blue chip-type company in the CRO industry. So we are working towards that goal,” he says. **A+**

of a U.S. company since Lenovo Group’s US\$1.75 billion purchase of International Business Machines Corp.’s personal computer business in December 2004. The acquisition will allow WuXi to expand into biotechnology-based medicines and medical device testing businesses through AppTec and give AppTec access to its big pharmaceutical clients.

“The biologics capability is something we don’t have at all. We see the acquisition as a good fit to the strategic development of the company,” Tsang says. If the marriage works out, he says it will turn WuXi AppTec into the world’s biggest contract research organization offering one-stop drug discovery and non-human subject testing services.

Critics, however, have questioned whether a mainland Chinese company can successfully integrate with a U.S. firm thousands of miles away. Analysts have already expressed concerns over whether AppTec will drag down the gross margin of WuXi (its manufacturing

side’s gross margin stood at 39 percent last year vs. AppTec’s 16 percent).

Tsang says since AppTec has a lower gross margin than WuXi, the margin is bound to fall when the two figures are combined. “I would rather look at what is the cash I can generate from the business I acquired and the payback period and return of my investment. That would make more sense,” he says.

Last month, WuXi announced that net revenues from laboratory services increased to US\$45.2 million, up 80 percent from the same period in 2007, while that from manufacturing services grew almost 400 percent to US\$25.6 million. Tsang, however, declined to disclose separate revenue figures for AppTec’s laboratory and manufacturing services.

Tsang acknowledges that integration is not something that can happen overnight and the companies’ management teams need to build trust. “The challenge is there, no doubt, but the management teams will put in the effort to make it work.