LEADERSHIP FO[R]
BOSS
FINANCIAL REVIEW
May 2017, Volume 18
AFRBOSS.COM.AU

TV TIMES
Reinventing SBS in the Netflix age

PR STORMS
How boards safeguard reputation

DIVERSITY
Why companies have it all wrong

GROWTH

CSL'S PAUL PERREAULT KEEPS HIS EYE ON THE LONG GAME

PUMP

GROWTH PUMP

STORY BEN POTTER **PHOTO** WAYNE TAYLOR

CSL CHIEF EXECUTIVE PAUL PERREAULT INHERITED A GREAT BUSINESS, THEN HE ROLLED THE DICE ON A RISKY ACQUISITION.

Paul Perreault was convinced CSL could make the struggling flu vaccines business it bought from Novartis hum.

If it didn't, CSL's profits and market darling status would be hammered. And his reputation would be shot.

The $275 million acquisition in 2015 has been one of Perreault's biggest bets after taking over the Melbourne-based blood products giant from legendary chief executive Brian McNamee in 2013.

CSL badly needed it. Its own global flu vaccines business, bioCSL, dates back to the 1919 Spanish flu epidemic that killed 50 million people. But it was languishing at sub-scale size, putting it in danger of falling behind scientific advances for an illness that still kills over 300,000 people a year.

The acquisition and merger with Novartis to create a new business, Seqirus, would vault CSL to number two in flu vaccines in the US, adding a potentially powerful second earnings engine to CSL's core plasma business.

Novartis had invested $US1 billion ($1.3 billion) in the vaccines plant at Holly Springs, North Carolina's research triangle. But when Novartis cast it off, it was bleeding $US200 million a year.

"When the Novartis people came on board, they were all good people and they were all working and doing things. It was the focus that was missing," Perreault tells *BOSS*.

The CSL chief is tall, polite, even courtly, far from the stereotypical brash US CEO. Although it's four years since he succeeded McNamee, he still doesn't bristle at the inevitable comparisons. But when tough business decisions are required, he is direct. "Let's say there's not a lack of clarity in the conversation," he says.

Perreault and a handful of his top managers spent the best part of a year figuring out why the Novartis plant was doing so badly. It has required strong nerves. The losses knocked CSL's net profit down to $US1.156 billion last year at the same time CSL took a bloody nose from shareholders who voted against Perreault's $10 million compensation package.

BIG BET

Perreault is acutely aware McNamee's are giant shoes to fill. By the time McNamee retired, he had taken CSL from a government health agency with sales of less than $200 million in 1992 to a global leader in blood products with sales of $US5 billion and a market value of $30 billion (CSL reports in US dollars; the shares trade in Australian dollars).

Under McNamee's leadership CSL returned 26 per cent each year for two decades, making it a standout among Australia's other large listed companies: banks, retailers, miners and Telstra that are now struggling for growth. Not so CSL, which is geared to the detection and treatment of rare immune deficiency and bleeding diseases. The demand for these products is increasing as nations spend more on health care.

McNamee built the core blood products business from its government laboratory origins to be a world-leader and oversaw the acquisition of Aventis Behring in 2004.

CSL Behring, the business Perreault previously ran, accounts for nearly 90 per cent of CSL's $US6.8 billion of sales revenue today. It collects more than 14 million litres of blood plasma a year, paying Americans $50 a pop for the privilege, and breaks it down into immunoglobulins, albumin and other proteins to make lifesaving immunodeficiency

"CSL's value has almost doubled on Perreault's watch ... the annual return since the company floated in 1994

and haemophilia therapies. Its research laboratories at Parkville, near the University of Melbourne, teaching hospitals and world-class health research centres, played a part in bringing Gardasil, the leading vaccine against cervical cancer-causing human papillomavirus, to the world market.

In 2015, Perreault was juggling multiple challenges: build the plasma business and extract more profit from it; commercialise more of CSL's research to add a biotech halo to its plasma crown; and successfully merge Novartis' flu business with CSL's bioCSL flu vaccines unit. If he could do all this, he would put his own stamp on CSL.

FOCUS

Fast-forward to late 2016. Perreault and executives led by company veteran Gordon Naylor – who had integrated Aventis Behring into CSL and was made president of Seqirus in 2015 – had examined Novartis under the microscope for long enough.

Their diagnosis: an acute lack of focus. The problem was staff were spending a lot of time and money on interesting research and development projects with the US government at the expense of getting enough flu vaccines out the doors of the huge plant to make a profit. The business was spending a quarter of its revenues on R&D, compared to about 10 per cent for CSL as a whole.

But because flu vaccines were barely 1 per cent of its $US50 billion turnover, the business didn't get the attention it needed. If Novartis missed budget at Holly Springs, it was a rounding error for the wider group.

"The culture change was, 'Look. Here's why we're here. Let's all get aligned on what the deliverables are. Let's not get entertained with things that are interesting but will never see the light of day or are not going to deliver the seasonal flu vaccine,'" Perreault says.

"The first thing we have to do is get the seasonal flu out. That's how we're going to compete. Then we can think about the investments in some of the other areas and work with the government on some of these other projects."

MANAGEMENT

The culture change necessitated management and staff changes at Seqirus. Some research staff left because they were pursuing non-flu projects that CSL wasn't interested in.

The Holly Springs plant manager, who spent a year on the transition, left last year along with several key executives who reported to him. Perreault and Naylor brought in bioCSL general manager John Anderson and four other managers from CSL to run the plant while they worked on a plan to break even by 2018 and earn $US200 million trading profit by 2020. Some Novartis executives stayed in key leadership roles; a few were hired from outside.

From left: Former CSL chief executive Brian McNamee; flu vaccines being produced at CSL's Parkville site in 1945; Seqirus's state-of-the-art facility in Holly Springs, North Carolina, US.

The R&D spend is being wound back slowly as non-flu projects are completed. The focus is shifting to completing clinical trials of new vaccines that Seqirus needs to compete with rivals GlaxoSmithKline and Sanofi Pasteur, and improving the plant's yield.

Like CSL's core plasma business, successfully manufacturing flu vaccines requires high efficiency, low costs and large, commercial volumes. Unlike CSL's other flu vaccines plants in Parkville and Liverpool, UK, Holly Springs manufactures vaccines from cells rather than eggs. It is a promising new process that is yet to reach optimum efficiency.

"They languished a bit trying to get those yields because they had these other projects going on. And we said, 'OK, you need to focus on finishing clinical trials on flu and yield improvement,'" Perreault says.

His updated diagnosis: Seqirus is on track to deliver on CSL's 2020 profits target.

FEATHER

CSL's value has almost doubled on Perreault's watch. In just four years, the annual return

has increased to 27.6 per cent and the company has tightened its grip on its core blood products market."

since the company floated in 1994 has increased to 27.6 per cent and the company has tightened its grip on its core blood products market by relentlessly expanding its plasma collection and global manufacturing networks.

The company's shares, priced for exceptional growth at more than 30 times current earnings, took a cold bath last (southern) spring after the company forecast lower than expected profits for fiscal 2017. From a record level of nearly $121 in July the share price slid to $92.10 in December. But they've been on a rampage since, surging 40 per cent to new highs of $132 as *BOSS* went to print, valuing the company at nearly $60 billion.

Several factors have fuelled the surge. CSL has progressed new therapies for "secondary heart attacks", inflammation in type 2 diabetes sufferers and hereditary angioedema (swelling similar to hives). In January it sharply upgraded profit guidance. Weeks later CSL's interim results showed the company hoovering up market share in immunoglobulins and speciality products thank to rivals' supply problems.

Top brokers CLSA and Credit Suisse expect net profits in the range of $US1.8 billion to $US2 billion by 2019 given the potential for immunoglobulins such as Privigen, CSL's blockbuster immune deficiency treatment, and the company's superior capacity to collect plasma, extract products from it at scale and meet growing demand.

STANDOUT

CSL is benefiting from growing expenditure on health, but it is more than that. Sales of its therapies for rare diseases are growing as the rates of detection improve.

GPs receive scant training in immunology, says Perreault, and often don't join the dots between repeat infections. They're trained to look for horses when they hear hoofbeats, not zebras. When they diagnose pneumonia, strep throat or ear infections they may prescribe antibiotics to cure the symptoms without looking for the underlying cause, he says. Some immunodeficiency patients can be sick all their lives and not get diagnosed until they are in their 40s or 50s, if at all.

"You're still finding new patients and new cohorts of patients around the globe every day. I think we're still undeveloped in our developed countries in terms of the awareness, the diagnosis and then the treatment of these disease states," Perreault says.

Thirdly, while the processes by which CSL extracts immunoglobulin and albumin from plasma may be patented, the products aren't, which means the company doesn't face a "patent cliff" like some big pharmaceutical firms, which will see their profits evaporate when their most lucrative drugs can be made by other companies.

Above: CSL chief executive Paul Perreault (left) with CSL manufacturing assistant Lanie Hynninen and former Victorian premier Denis Napthine at the new biotech manufacturing facility in Broadmeadows in Melbourne.

Organic growth in plasma products is helping to fund research and development of new therapies that can only be reproduced from cells, such as Idelvion and Afstyla for haemophilia, he says. But for primary immune deficiency or "boy in the bubble" disease, there is no cell-based therapy that's going to replace immunoglobulin in those patients, at least in his lifetime, he says.

For these products, CSL's huge, efficient plants and raw plasma supply chains give it a near impregnable edge.

"If you look at the top 20 big cap stocks it's probably the standout in terms of growth," says Jason Beddow, managing director of listed investment fund Argo Investments.

CREDIT

Perreault, a native of Orlando, Florida, arrived at CSL via Aventis Behring, which CSL bought in 2004 to make itself the world number two in blood products after Baxter. Some of the challenges of this merger foreshadowed those facing the Seqirus flu business.

"The focus that Brian [McNamee] and others brought to this was, 'Look, we have

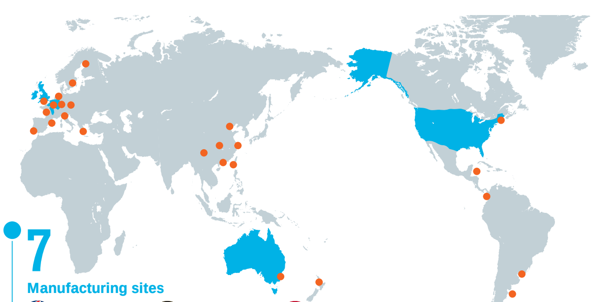
From left: Gardasil developer Professor Ian Frazer at the launch of the vaccine on the National Immunisation Program Schedule; production of immunoglobulin therapy at CSL Behring in Victoria.

CSL AROUND THE WORLD

30+ Countries of operations

$US 6.0+ billion In annual revenue

16,000+ Employees around the world



7 Manufacturing sites

Australia · Germany · Switzerland · UK · US

$US 2.3 billion In R&D investments in last 5 years advances exciting pipeline

1100+ R&D employees

140+ Plasma collection centres across Europe and North America

SOURCE: CSL

"Everybody in business schools wants to be a leader but nobody wants to manage, and I think it takes to make tough decisions but there's a future here'," Perreault says.

"He knew the three key items to make the business turn around: you have to be operationally efficient and low-cost producer. You have to innovate and differentiate your products and you need to scale."

A year or two before he retired, McNamee decided to shift CSL from a network of manufacturing "fiefdoms" to global manufacturing to spread the risk. An example is that the Privigen plant in Broadmeadows is a duplicate of the one in Bern, Switzerland.

"For our largest product you don't want to have all of your eggs at one basket," Perreault says. Now they're expanding Broadmeadows to produce albumin for export to China and a self-administered immunoglobulin, Hizentra.

PLASMA

The immunoglobulin market is growing at a double-digit pace in China, but there are limitations on imports. It will take time to find a way in. Growth in rich countries gives CSL the time it needs to refine a strategy for China.

Immunoglobulin sales are growing at 9-12 per cent per annum in the US, Australia and Canada, which have the highest per capita usage, say Credit Suisse analysts Saul Hadassin and David Bailey in a report in April. They expect this to continue. The per capita usage in other rich countries, such as France, the UK, Germany, Spain and Italy, is half the US rate or less.

Under Perreault, who lives near CSL Behring's head office near Philadelphia but spends 18-20 weeks a year in Australia, CSL has aggressively expanded its plasma collection network over the past three years to meet this growth and is now reaping the benefits.

JP Morgan analysts David Low and Nick Legrand estimate CSL now collects nearly one-third of all US source plasma and will account for 35 per cent of global plasma collected in 2017 as it continues to roll out new collection centres faster than rivals.

As well, CSL has increased its blood separation capacity at about 10 per cent per annum, compared to about 7.5 per cent for rivals Shire and Octapharma.

Sales of plasma-derived therapies increased 12 per cent in fiscal 2016 to $US5.2 billion, which equates to a 32 per cent global market share, JP Morgan estimates, far ahead of Shire-owned Baxter, the number two.

CSL extended its number one position in immunoglobulins and plasma-derived products. Sales growth accelerated to nearly

Above: Paul Perreault (centre) caddying for children with bleeding disorders in CSL Behring's annual golf competition; Paul and Beverly Perreault at an event celebrating CSL's centenary in Melbourne in 2016.

both. You have to be a leader and you have to be a manager. And managing people is difficult."

17 per cent in the December half-year as Shire and Octapharma suffered from product and plasma supply problems.

Thanks to its investment in capacity, CSL was the first to meet the shortfall. The JP Morgan analysts expect it will be able to hold on to "a significant portion of these gains".

LEADERSHIP

Perreault, whose French-Canadian grandfather was a physician and whose father was a pharmaceutical salesman, knows from experience that being able to supply these life-saving products makes an impression on patients and their families. Early in his career there were shortages of plasma products.

"I had mothers calling me. I had congressmen in the US calling me because patients were getting sick, hospitalised, and some were dying. And I would actually source product from competitors for them and tell them how to get it through the system in order for them to get treatment.

"And then when we came back to the market they remembered. And today, I still get notes and calls and pictures from their graduations and weddings. So it's personal, you know. And that's the passion that you have to have in a business if you're really going to make a difference."

A chief executive will say these things, yet he seems genuine about his connection to patients. They fire his passion for the business, and if he can win their loyalty it's good for the company. "If you take care of the patients, the business should take care of itself," he says.

In his first job as an eager young district sales manager in the 1980s, he put up signs saying, "The eagle has landed" – it was after a series of moon landings – and described how he was going to turn things around.

"It went over like a lead balloon. So they're like, 'Who is this young guy?'"

As the second of eight children, Perreault learnt to find his motivation from within. For others, it's a matter of aligning people around a mission: in CSL's case, patients and the health of humans around the globe.

And letting them know where they stand.

"Everybody in business schools wants to be a leader but nobody wants to manage, and I think it takes both. You have to be a leader and you have to be a manager. And managing people is difficult."

PIPELINE

CSL is investing heavily in R&D and has lifted its spend from $US370 million in fiscal 2012 to $US614 million in 2016. In its pipeline of products are new flu vaccines that will be used to battle GlaxoSmithKline and Sanofi Pasteur; Perreault says it's not a market for the faint-hearted.

The standout among the new breakthrough medicines is CSL112, a previously unused plasma component that can prevent often fatal "second heart attacks" in patients with acute heart disease. Nothing has reduced mortality in that population for 20 years, Perreault says. CSL112 has successfully completed human clinical trials.

This year CSL starts human trials of three new therapies. CSL346 is an antibody to control glucose absorption in insulin-resistant type 2 diabetes patients – there are more than 420 million people in this group globally – and diabetic kidney disease. Pre-clinical results have been fantastic, Perreault says. The third – CSL312 – is a new treatment for hereditary angioedema.

The R&D pipeline is one reason Perreault doesn't worry too much about acquisitions, which means CSL's regular share buybacks of $500 million to $1 billion a year look safe.

"We don't have to buy our way to additional growth," he says. "The next three years, I think, we'll deliver extremely well. We've got new product launches. We've got new product development. We're launching into new geographies ... we've got a good game plan."