- WHERE BUSINESS MEETS POLICY -
PharmExec.com

Hot and Cold: Biotech M&A and Financial Trends

May 26, 2015
By Peter Young, President and Managing Director, Young & Partners

Every day the newspapers are filled with stories about the biotech industry. Many are very positive, with reports of breakthroughs and novel approaches to solving difficult health issues, the commitment of the industry to attack some of the most difficult diseases and break through a myriad of structural roadblocks and escalating development costs, and a flood of capital going into a large number of biotech companies.

Much of the criticism seems to be directed at the pharma companies, particularly around issues related to drug pricing, the seemingly endless stream of high profile take-overs, and the rush towards orphan drugs.

But the overall impression is that the biotech industry is doing a great job inventing new drugs and treatments and that, for the moment, strong companies are getting the funding they need. However, not everything is positive, as we will explain.

Introduction: Biotech

Biotech companies continue to pursue a variety of business and financial strategies, clustered around specific technologies or diseases.

M&A volume has historically been very modest and that has continued in 2014 and early 2015. Although volume has been higher than ten years ago, it has been relatively subdued. Biotech companies have other ways to garner funding or achieve liquidity. In addition, a combination of high stock market valuations and the bidding up of prices for late stage biotech companies has partially dampened pharma's pursuit of certain biotech companies.

Licensing, partnering, private equity placements and IPOs are all important sources of funding and business progress for these biotech companies.

In the stock market, biotech companies are now clearly in favor and the share prices of biotech companies have benefited. Investors are excited about the new products and technologies and are strong believers that the biotech business model is working.

In terms of biotech financing, debt issuance continues to be at a virtual standstill as the debt markets have shunned the biotech sector. However, the situation has been quite the opposite in terms of equity offerings since early 2013. The strong overall IPO market, coupled with the stock market's love affair with biotech, has resulted in a high level of equity issuance, including IPOs.

These are the highlights from the "Biotech Strategic, M&A, and Financial Trends Report" recently completed by Young & Partners that covers through the first quarter of 2015 and the outlook for the future.

Biotech Stock Market: Strong Performance

The stock market continues to have a love affair with the biotech industry.

Against the backdrop of the flat S&P 500 performance in the first quarter and the surge in European market indices in the first quarter, the Y&P Large Cap Biotech, Y&P Mid Cap Biotech, and Y&P Small Cap Biotech indices did well against the S&P 500 and not as well versus the STOXX Europe 600, increasing by 6.7%, 5.7% and 9.2%, respectively.

For a long time the market sentiment towards the biotech industry was decidedly mixed, except for established biotech companies and companies with positive late stage data. But the sentiment changed in early 2013 and investors have fallen in love with the industry again.

There is a heavy debate about whether the biotech company valuations are too high and whether they are a bubble that will burst spectacularly at some point. In the meantime, biotech companies are aggressively raising equity funds.

Biotech Mergers and Acquisitions: Consistently Modest

Biotech M&A activity has almost always been modest historically, with small spurts of activity from time to time.

In the first quarter, the annualized pace of the number of deals completed picked up, but the dollar volume was down considerably on an annualized basis. In the first quarter of 2015 there were 8 biotech M&A deals completed worth $2.0 billion. This compares to 27 deals worth $12.7 billion completed in all of 2014.

All eight of the deals completed in the first quarter were under $1 billion in value.

How about the pipeline of M&A deals? As of March 31, 2015, the value of deals announced but not closed was very modest at only $1.25 billion (4 deals).

Overall biotech deal activity tends to be driven by the need of pharma companies to expand their pipelines. Part of the explanation for the low M&A volume has been the use of partnering, licensing and other similar non-M&A methods.

However, high stock market valuations and the bidding up of prices for late stage biotech companies have also acted as a partial constraint. In addition, biotech companies have exercised the IPO alternative since early 2013 as both a funding and liquidity alternative, giving them a healthy alternative to a sale of the company.

Biotech Debt and Equity Financing: High Volume of IPOs

Only $113 million of non-bank debt was issued in the first quarter of 2015 compared to $927 million for all of 2014. This supports the historical trend that very little debt is issued by biotech companies.

Equity issuance in the first quarter of 2015 was quite the opposite, with 78 equity offerings worth $8.0 billion completed compared to 167 offerings worth $14.1 billion in all of 2014, an all-time record for the biotech industry. This is clear evidence that the biotech equity offering environment continues to be exceptional.

The IPO market as a subset of all equity offerings has been exceptionally strong, fueled by a surging stock market and the very positive performance of biotech shares. First quarter issuance included 15 IPOs that raised a total of $1.1 billion.

This is a continuation of the strong IPO performance last year. 2014 issuance included 72 IPOs totaling $5.7 billion, the highest total in biotech history. This was a huge increase over the 36 IPOs totaling $2.6 billion completed in 2013.

Although there have always been long periods of dormancy between periodic and short biotech IPO peaks, it is not clear how long the current peak period will last since there are driving factors that are different this time around. A lot depends on the state of the overall IPO market as well, that was slowing down in the spring.

What will the future bring? Biotech

The development capabilities of biotech companies will continue to be positive overall. Although there will be successes and failures by individual companies, biotech companies will continue to demonstrate their ability to develop new drugs at a faster pace than the larger pharma companies.

The primary biotech M&A theme will continue to be pharma and big biotech acquisitions of biotech companies for pipeline enhancement. The most promising biotech companies will attract significant interest and high prices. However, biotech companies will use a whole host of other avenues to either raise capital or achieve liquidity such as IPOs, partnering deals, licensing, etc. Similarly, pharma and big biotech will also continue to use non-M&A methods to achieve their pipeline goals. As a result, M&A dollar volume will continue to be modest.

What are the implications for biotech companies? First and foremost, make wise choices with regard to the strength of your drug development technologies and approaches to development to make sure you have something that is sufficiently unique that is coupled with a development path that is realistic and financeable. Second, be very thoughtful about how you finance your development path and your choice between private funding, partnering, initial public offerings, and non-dilutive sources of funds. There is no set rule about what sources one should use and in what order or combination and the condition of the financing market changes constantly. Third, assume that one day the IPO market will shut down and venture capitalists will shut their doors and plan accordingly, because history tells us that it will happen and often very suddenly. Last, try to have at least two shareholder liquidity paths or more as part of your plans if you are not already public.

Peter Young is President and Managing Director, Young & Partners, Life Sciences Investment Banking www.youngandpartners.com
To reach the author, call 212-682-5555 or emailpyoung@youngandpartners.com