Taking Biopharma's Pulse in a Tough 2020

Assessing COVID-19's wide and varied impact on pharma and biotech business in the first half of the year, and how it shapes market prospects ahead

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It has been both an exciting and a challenging year for the pharmaceutical and biotechnology industries in 2020.

On the positive side, the COVID-19 pandemic is showing a global audience that the biopharma industry serves a critical role in finding solutions to the current coronavirus crisis, whether it is vaccines, cures, or drugs, to reduce the severity of the disease for those who are infected. This is serving to blunt some of the very negative press that the industry has been subject to over pricing and other issues. Other positives include the new technologies that have been invented and the increasing number of new drugs approved and under development by pharma and biotech companies.

The emergence of a host of new methods, such as immuno-oncology, CRISPR, personalized medicine, and stem cells has been promising, albeit with the normal periodic setbacks such as the one we are seeing in CRISPR. In addition, there have been many proposed and implemented changes in US FDA and Chinese FDA policies with regard to drug approvals that are favorable. Time will tell if the actual results match the intent.

The life sciences industry has been rewarded with much stronger stock market valuations than many other industries. As a consequence, biotech companies have been able to raise considerable equity capital through private placements, IPOs, and secondary public offerings.

But the challenges are also visible as well. For pharma companies, the pandemic has had a significant impact on the availability of many drugs, the disruption of supply chains, and the ability to conduct clinical trials when so many people are sheltering at home and hospitals are forced to devote their resources toward the treatment of COVID-19 patients and less toward clinical trial activities and research. Other challenges include the relentlessly high cost of drug development, controversies around pricing, the scrutiny of orphan drug pricing, lower profitability relative to history, increasing price and formulary pressure from payers, weak pricing leverage outside the US, and structural changes in healthcare and government policies in large countries such as the US and China that are impacting pharma manufacturers. Biotech companies are facing some of the same challenges.

The rest of this article will look at what happened from an M&A, stock market, and financing point of view in the first half of 2020 and what we expect in the future. We will also comment on the implications of these trends for senior executives and investor decisions in the pharma and biotech industries.

PHARMA EQUITY MARKET PERFORMANCE

During the first half of 2020, global equity markets saw major declines followed by partial or full recoveries in direct response to the coronavirus pandemic and the market's assessment of what the relative returns are in different investment classes and locations.

The S&P 500 decreased 4.8% and the European markets also did poorly with the FTSE 100 decreasing by 18.9%.

The pharma industry performed far better than the market almost across the board. The Y&P US Pharma index decreased by 2.6%, the European Pharma index increased by 1.3%, the Y&P Specialty Pharma index dropped by 3.6%, and the Y&P Generic Pharma rose by 19.7%.

The average P/E ratios of the Y&P US and European Pharma indices have been strong, but saw slight declines in the first half of 2020. P/E ratios for the specialty and generics sectors have dropped consistently since 2014 due to bad news in their segments, but have rebounded moderately this year.

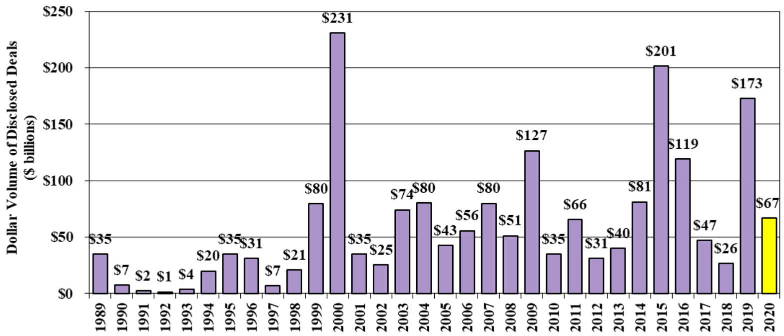
PHARMA EQUITY FINANCING AND M&A

Equity issuance dollar volume in the first half of 2020 totaled $14.3 billion, versus $12.6 billion for all of 2019. The primary drivers of volume were Sanofi selling a large stake in Regeneron Pharmaceuticals, Inc. and Amgen purchasing a large stake in BeiGene, Ltd.

In the first half of 2020, 13 M&A deals were completed worth $66.9 billion, compared to 21 deals completed in all of 2019, totaling $172.9 billion.

Pharma M&A Glance

Dollar Value of Worldwide Pharma Acquisitions (through 06/30/20)



Only Deals > $25 million

Source: Young & Partners

Figure 1. Global M&A volume has been strong with periodic surges due to closed mega deals. We are at a slower pace in the first half of 2020.

This is higher on an annualized basis in terms of the number of deals compared to last year, but slower on a dollar basis, particularly since the acquisition of Allergan plc by AbbVie accounted for $62.3 billion of the $66.9 billion.

Clearly there are fewer large deals as the industry is focused on biotech acquisitions instead of pharma deals and on partnering and their own drug development. There is also the recognition that mega deals may have presented cost reduction synergies, but they have often been disappointing from product portfolio and drug development standpoints.

Of course, the start of the pandemic also was a disrupter of the M&A market as companies had to focus their attention on their operations, shifting many workers from their offices to their homes, and supply chain disruptions, etc.

The pipeline of deals appears to be modest. As of June 30, 2020, the deals announced but not closed totaled $132 million (three deals).

BIOTECH EQUITY MARKET PERFORMANCE

The Y&P Large, Mid, and Small Cap Biotech indices performed extremely well, increasing by 19.3%, 53.6%, and 79.6%, respectively. The positive news about biotech drug development and the positive perception of the biopharma industry due to its role in dealing with the pandemic has created a strong story in the equity markets, despite the partial offset from the negative publicity about drug pricing, payer pushback against orphan drug pricing, and the ongoing struggle to conduct and fund research and clinical trials.

BIOTECH EQUITY FINANCING AND M&A

There were 171 equity offerings worth $25.3 billion in the first half of 2020, versus 224 offerings totaling $23.8 billion completed in all of 2019. We are clearly operating a record pace. This year is on pace to exceed the record of 250 offerings in 2018.

In the first half of 2020, 31 IPOs were completed worth $6 billion. This compares to 56 IPOs worth $6.1 billion in 2019.

Activity has clearly increased as interest in the biotech sectors has strengthened.

Biotech M&A activity has been modest historically, with small spurts of activity from time to time. That has not been as true in 2020. In the first half of the year, 12 deals worth $23.2 billion were completed, versus 34 deals worth $19 billion completed in all of 2019. The number of deals was lower on an annualized basis, but the dollar volume is on track for a record year.

The dollar value of the pipeline of biotech deals as of June 30, 2020 was moderately strong at $3.2 billion (seven deals).

The acquisition of New Jersey-based The Medicines Company by Novartis accounted for $6.8 billion of the total.

OUTLOOK: PHARMA

Business. The business outlook for pharma companies is positive with regard to drug development, with promising drugs in the pipeline. The industry's R&D innovation and productivity has been moderate. However, combined with indirect development through the biotech industry, overall pipeline activity has been strong and should continue to be strong.

There has been a shift in emphasis toward orphan drugs, oncology therapies, innovations such as gene therapy, CAR-T, immune system solutions, CRISPR, etc.

The current pandemic has been a plus for the reputation of the industry, but a negative with regard to the ability to execute clinical trials and industry supply chains.

Generic pharma companies are under severe profit pressures and will continue to consolidate, cut costs, and try to push selectively into higher value and more protected product areas. They are under intense pricing and competitive pressure.

Specialty pharma were partnering, in-licensing, and acquiring to maintain growth and the strength of their overall business portfolios, but the business models of many have been failing.

The stock market prices and valuations of the ethical pharma industry companies have been stable due to the net effect of the positive news for the industry during the pandemic, the negative news around pricing, and the ongoing R&D and commercial challenges of the industry. We think there will be a continued counterbalancing of the positive news versus the business challenges for the biopharma industry.

Equity markets. The stock market prices and valuations of the ethical pharma industry companies have weakened as the negative pressures on the industry continue, in spite of a mixture of R&D and commercial successes. It is our expectation that the negative news will continue to counterbalance the positive news for the biopharma industry.

Specialty and generic pharma company share prices have modestly rebounded, but they will continue to suffer as these companies deal with serious business issues/pressures.

Equity financing. We expect the equity financing market for pharma to be modest, but very healthy. The pharma industry tends not to raise new equity very often unless an individual company has to raise equity to repair their balance sheet after an acquisition.

M&A. Young & Partners expects M&A activity, with the exception of a handful of mega deals, to continue to be solid for the reasons mentioned because normal strategic fill ins will continue, with much of the focus on medium to large deals. It is not clear if there will be any mega deals other than the already completed AbbVie-Allergan deal.

Even without mega deals, there will be plenty of large and medium-sized deals with a strategic rationale or a theme around adding new and growing technologies and products being pursued.

Separately, pharma companies are focused on acquiring biotech companies, which is affecting the biotech M&A volume. But pharma is also heavily pursuing in-licensing arrangements, partnerships, and joint ventures with biotech organizations and other pharma manufacturers.

OUTLOOK: BIOTECH

Business. The development capabilities of biotech companies have been and will continue to be positive overall. Although there will be successes and failures by individual companies, biotech companies have demonstrated their ability to develop new drugs at a faster pace than the larger pharma organizations. This trend will continue for the rest of the year and well beyond.

Equity markets. The stock market performance of biotech companies has been strong in the first half of 2020. The biotech industry is now in favor because it is less affected by the pandemic and its image has become more positive. We expect the positive view of the biopharma industry and the regular announcements of successful R&D discoveries and successful clinical trials will continue to fuel the positive stock market treatment of the biotech industry.

Equity financing. Biotech companies will continue to tap the equity markets, partnering, licensing, and royalty monetization for funding and for shareholder liquidity. Secondary equity offerings have been strong and should continue to be strong and IPO volume will continue to be solid in terms of volume and strength.

M&A. M&A volume in the biotech sector has been solid and will continue to be through 2020. The pipeline of deals announced but not closed is consistent with a forecast of increased biotech M&A activity this year. Much of the volume will be larger deals done by big pharma.

However, the buyer interest will be focused on specific targets in favored therapeutic and technology areas and on biotech companies that have made significant clinical progress.

IMPLICATIONS FOR SENIOR MANAGEMENT

For ethical pharma companies, there will continue to be a wide variety of tools to acquire revenues and pipeline drugs, but the M&A valuations will remain challenging, particularly for companies with promising drugs in late-stage clinical trials or awaiting FDA approvals. The challenge for life sciences organizations will be to pick the right overall mix of M&A, licensing, and partnering to accomplish corporate strategic goals and defend and deliver shareholder value.

For the specialty pharma companies, the key will be a rethinking of their strategies since it is not clear that the pursuit of niche and orphan drug markets will continue to bear fruit in the same way that they have in the past. The high price of acquisitions and the pressure on drug pricing, even for orphan drugs, will have a disproportionate impact on specialty pharma companies.

Generic pharma organizations will face a number of remaining industry challenges. This will result in a continuation of the current industry consolidation and selective strategies around diversification. CEOs of the generic pharma companies must be prepared to shift to very different strategies to survive and to thrive.

For biotech companies, public and private, the future is exciting from the drug development side in terms of the product approval environment and innovation and the improvement these companies have seen in the IPO, secondary equity financing, and M&A markets. However, prosperity or disappointment will vary by the story of each company.

Unfortunately, the markets have been volatile and have played favorites with regard to therapies, technologies, and stages of development.

The key for biotech organizations will be to properly assess their cash-flow requirements and to create and execute a flexible financing/M&A plan that properly assesses how much capital and at what cost of equity the various alternatives will provide, whether it is private placements, partnering, IPOs and secondary offerings, royalty monetizations, or sources of non-dilutive financing. PE