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Changing winds: A wave of partnership, acquisitions and deals bring money back to biotech VCs

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The long-predicted surge of merger and acquisition activity has finally struck the highly fragmented life sciences sector. Merck & Co.'s \$400 million cash bid for GlycoFi Inc. and \$1 billion takeover of Sirna Therapeutics Inc., both in 2006, and Gilead Sciences' recent \$2.5 billion acquisition of its smaller biotech colleague Myogen Inc. are emblematic deals in an intensifying wave of partnership and acquisitions.

These deals—and many others—signal a change. Pharmaceutical companies today are more eager than ever to cut expenses and fill their pipelines with biotech innovations. They have affirmed their intention to cast off the old way of doing business and seize biotech's groundbreaking science that delves into the underlying genetic basis of disease. Many are focused on becoming favored co-development partners for biotech companies, even embracing young start-ups—reversing the long-standing trend of investing only in later-stage, less risky product candidates. And a handful of pharmaceutical companies have vocalized strategic plans to fill their shrinking pipelines through the acquisition of biotech assets.

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At the same time, the public equity market for biotechnology has remained highly selective. The option of raising money in an initial public offering is predominately available to later-stage companies. Add to that the disappointing valuations in both the public and private markets and many times buyout deals are simply more lucrative for biotech companies and their investors.

This *KnowledgeLine* explores the consolidation mania sweeping through the biotech industry—a trend that is already transforming how life sciences companies secure the resources needed to build sustainable businesses and develop innovative medical products. It begins with a look at M&A activity in the biotech sectors.

Blended families

History may well record 2006 as the year of the big biotech acquisition. According to a January 2007 *BioCentury* report, more than \$30 billion was spent on the acquisition of public biotech companies last year—a sum that is more than double previous years.¹ Moreover, *BioCentury* reports, deal sizes and the premiums paid for biotech companies were higher than ever. In 2006, there were eight deals that eclipsed \$1 billion, while each of the six previous years only saw between two and four \$1-billion-plus deals. It was not uncommon for biotech buyers to pay a premium of more than 50 percent for a public biotech in 2006. By contrast, among the five biggest biotech transactions each year between 2000 and 2005, only two produced premiums greater than 50 percent.

Yet, the recent wave of biotech deals is not only notable for its size and hefty price tags. Just a few years ago, pharmaceutical companies scouting for partners and acquisition targets among biotech companies would focus almost exclusively in the late-stage product space. Several very notable deals in 2006, however, involved pharma and even

top-tier biotech firms turning to smaller companies for fresh ideas and less mature drug candidates.

GlaxoSmithKline plc, for example, agreed to pay \$454 million to buy Domantis Ltd., a privately held company developing next-generation antibody therapies. Domantis was only six years old when GlaxoSmithKline made the lucrative takeout deal in December. Similarly, biologics company GlycoFi Inc. was also six years old when Merck & Co. agreed to pay its founders and venture investors \$400 million in cash to acquire the firm last summer. In two other examples, Pfizer reportedly paid hundreds of millions of dollars for Rinat Neurosciences, a neuropharma company founded in 2001, and Amgen Inc. plunked down \$290 million for Avidia Inc., a four-year-old private protein therapy developer.

Indeed, drug makers are rapidly adding to their pipelines by buying up developers with young, yet promising technologies and therapies. Earlier-stage companies are getting a second look when it comes to strategic partnerships and collaboration as well. In one such agreement, Wyeth said it would sink as much as \$800 million into Trubion Pharmaceuticals Inc. to access Trubion's drug pipeline and discovery technology. The two companies will jointly commercialize Trubion's lead compound, a Phase II rheumatoid arthritis candidate.

The “why now?” factors

Pharmaceutical industry watchers cite a confluence of events driving the hunger for biotech deals among big drug makers. One major factor is The American Jobs Creation Act of 2004, a law that gave US companies a one-time chance in 2005 to repatriate profits made overseas and pay only 5.25 percent tax on them rather than the standard 35 percent. The tax break helped pharmaceutical companies in the States reap more than \$100 billion in funds that can be used for investments, such as partnerships and acquisitions.²

¹ Edelson, Steve and Mike Ward. “2007 Financial Markets Preview: M&A Upside,” *BioCentury, the Bernstein Report on BioBusiness*, January 1, 2007.

² Weintraub, Arlene. “More Merger Mania Ahead for Pharma,” *Business Week*, January 29, 2007.



Meanwhile, dozens of blockbuster drugs are starting to come off patent and pharmaceutical makers are searching for new medicines to replace soon-to-be lost revenues. About \$12 billion worth of brand-name drugs lost patent protection in 2006, according to pharmacy benefit manager Express Scripts. Another \$11 billion in branded products go off patent this year, \$10 billion in 2008, and even more in 2009 and 2010. When a branded drug goes generic, it typically loses 40 percent of its sale price right away and the price plunges farther as other generic companies enter the fray.³

Diversification is another reason many pharmaceutical companies are scrambling beyond their own laboratories to find innovation. Most drug companies today rely on the performance of their blockbuster drug products that address high-profile health concerns. Acquisitions in the life sciences sector give those companies access to a broader range of products and indications without putting additional strain on tightening research budgets.

Show me the money

The lackluster IPO market for life sciences companies is playing an important role in the current wave of acquisitions as well. While takeovers from large healthcare corporations is not a new trend in the medical devices market, biotech companies have historically relied on the public equity markets to provide the capital resources needed to produce novel biomedical products. As the market for biotech IPOs has grown markedly more risk-averse in recent years, however, many biotech start-ups are finding pharma buyouts to be a more fiscally worthwhile scenario.

BioCentury counts 47 new public biotech issues in 2006, up slightly from the 44 deals in 2005 but less than the 52 IPOs in 2004. It was mostly good news for those who did make the jump to the public market last year. US companies ended the year with a 43 percent increase in market cap, while new issues in Europe were up 27 percent. Yet, the hurdle to get public is still very high. In the fourth quarter of 2006 alone, three biotech IPO filings were pulled, although six

³ Smith, Aaron. "Generics Win on Big Pharma's Woes: Party Continues for Generic Drug Makers in 2006, But It Probably Won't Be a Rager," CNNMoney.com, January 10, 2006.

companies made it out. Those who are making it out typically do so at the low end of their pricing ranges or reduce their prices to complete their offering.

What's more telling is the fact that worldwide shareholders in public and private biotech companies earned back more from M&A deals in 2006 than was raised in the public and private capital markets combined. Last year, biotech companies raised a total of \$29.6 billion, including \$23.9 billion in the public space.⁴ Corporate buyers in the same time period spent \$30 billion on the purchase of biotech assets.

Indeed, IPO selectivity and pricing pressures remain a barrier for many life sciences companies looking to access capital. Given the shift toward higher M&A premiums, more biotech companies are finding it is easier and more profitable to put themselves up for sale rather than seek an IPO. One analysis found that between October 2003 and July 2006—when the current IPO window for biotechs opened—67 private biotech companies have gone public, yet in the same time period six times as many chose to accept acquisition bids.⁵

Conclusion

The surge of biotech M&A activity seen in recent years will not wane anytime soon. With big pharma companies scrambling for new drugs and armed with billions of newly repatriated dollars, biotech companies will continue to look like good investments. Public-equity investors will also remain highly selective, opting for later-stage companies with big name collaborators, which means a growing number of biotech start-ups and small firms are going to establish their best valuation by an outright acquisition.

One consequence of the uptick in biotech M&A may well be a strengthening of venture capital in the sector. The move toward an acquisition model in biotech—similar to one seen in the medical devices sector in which start-ups are often absorbed into large healthcare companies—is welcome by many private investors. Clearly, in the absence of a strong IPO market venture backers are keen on any viable “exit” strategies that reward them for their early-stage investments. Lucrative acquisition bids, therefore, offer a convenient exit from early-stage investments and may well invigorate the biotech venture landscape.

This is especially true given that the demographic trends favor the growth of biotech markets, as does the increasing desire of the public and medical practitioners to obtain innovative medical products. In the end, an even greater number of high-quality life sciences companies will have access to the capital necessary to develop their novel products and meet the growing demand for medical innovations.

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⁴ Edelson, Steve and Mike Ward. “2007 Financial Markets Preview: M&A Upside,” *BioCentury, the Bernstein Report on BioBusiness*, January 1, 2007.

⁵ Hamilton, David P. “Biotech Start-Ups Increasingly Opt For a Sales to Drug Firms Over an IPO,” *The Wall Street Journal*, July 13, 2006.