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Finance/Funding

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# The new financing event

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**Will 2006 bring a new set of expectations about M&A among entrepreneurs?**

To a growing number of entrepreneurs and VCs, IPOs [initial public offerings] have become financing events rather than liquidity events.

BioAdvance

Constant gardener: Barbara Schilberg, CEO of the BioAdvance 'greenhouse'

New biotech offerings have been struggling to maintain their share price, forcing venture capitalists to hold onto their shares for three or even four years after an IPO rather than getting out after a year or two as was previously the norm. And biotech company valuations for an initial public offering remain low, making it seem hardly worth the wait.

Instead of trying to go it alone, many investors are pinning their hopes on alliances with big pharma and biotech. In the past few years these have largely taken the form of research partnership and licensing deals which saw a sharp up-tick last year of about 60% to reach a value of $17 billion for announced deals with disclosed terms, according to data from San Francisco, California-based investment bank Burrill & Company. But although these transactions can provide a financial and research boost to a young biotech, they don't offer an exit for investors anxious to cash out.

Given these limitations, acquisition by a large biotech and pharma firm has become an increasingly attractive option for investors in biotech startups. And it fits nicely with the needs of the potential acquirers who are looking to fill their pipelines by any means necessary. The data on mergers and acquisitions reflect these converging interests; in 2004, the value of mergers-and-acquisition deals doubled to $55 billion and the number of deals increased by almost 40% to 226, according to data from industry research group Recombinant Capital based in Walnut Creek, California.

Seaflower Ventures

Trendspotter: Alex Moot, general partner of Seaflower Ventures

Competition to fill pipelines with the most desirable candidates has pushed large biotech and pharma firms further up the pipeline to execute deals[1], [2]. This means that even the youngest startups have a chance to be snapped up at relatively high valuations for investors, particularly if they have a novel platform.

Large biotech and pharma companies are becoming "more willing to take a risk on earlier stage products," argues Alex Moot, general partner of Seaflower Ventures, a life sciences venture capital firm based in Waltham, Massachusetts. "That's one of the forces driving the increased number and value of acquisitions."

In recent years, these large biotech and pharma have worked to rationalize their research process, tipping the preference away from automatically accruing to in-house programs and toward whoever can deliver research results.

"Products that are purchased as well as the companies that are acquired tend to have a higher success rate in the clinic," notes Zach Jonasson, senior principal of Seaflower Ventures. "And revenues tend to be slightly higher or equivalent. It's a pretty effective strategy."

> "'Previously most M&A was with late-stage products in phase 2 or phase 3,' argues Alex Moot, general partner of Seaflower Ventures."

Take monoclonal antibody company Cellective Therapeutics as a recent example of acquisition trends. Founded in 2003 by Duke University researcher Thomas Tedder, the startup was acquired last September by Gaithersburg, Maryland-based MedImmune for a healthy $158 million. With only five employees and three preclinical programs in monoclonal antibodies targeting B-cell antigens, that's a pretty remarkable sum.

Cellective first came to the attention of MedImmune when it invested through a venture arm in the startup's first round of venture capital. The startup's capabilities were simply a good fit with what MedImmune needed. "We had a very high interest in jumpstarting our capabilities in B-cell biology," says Ed Mathers, senior vice president of corporate development for MedImmune.

To hedge its bet on Cellective, MedImmune used an acquisition deal structure that resembles a research partnership. Payment is not just upfront, but also in a series of back-loaded milestone payments contingent on the outcome of continuing clinical research. High profile and costly early-stage deals like the New York-based Pfizer purchase of Angiosyn for $527 million early last year have used a similar structure.

This is an increasingly common strategy as the number of early-stage acquisitions grows. It allows large biotech and pharma firms to corner the market on the research of a particular startup, provide resources and guidance for the execution of later stages of research, and mitigate some of the potential risk—all for a cost that might actually be less than a research partnership in the long run.

> "'Now, for the first time, VCs are advocating virtual companies,' argues Barbara Schilberg, CEO of BioAdvance."

"Previously most M&A [mergers and acquisitions] was with late-stage products in phase 2 or phase 3," argues Moot. "But as pharma has needed to dig a little deeper in the pipeline, they are structuring it more like a partnership deal with milestone payments."

"These are companies that don't have to be acquired; they have the option of an IPO. But it's a lot less expensive than going public these days," he concludes. "With Sarbanes Oxley it costs a lot to pull off an IPO and there's not an immediate payoff for shareholders. Acquisition is an easier path for companies that don't want to create the infrastructure."

Barbara Schilberg, CEO of BioAdvance, a regional life sciences greenhouse near Philadelphia, agrees that acquisition has become a core exit strategy. In three years of investing in very young startups, they have already had three acquisitions out of 20 investments.

"VC's [venture capitalists] don't even want a company to be talking about an IPO," says Schilberg. "They want to talk about where's your exit—your corporate partner, your acquisition."

"Now, for the first time, VCs are advocating virtual companies," she argues. "A few years ago people wanted to have the whole complement. But now, since they're going to sell the company, they don't want the full infrastructure."

And venture capitalists have effectively telegraphed their priorities to the executives of their biotech startups. "Management seems more willing to sell; five or ten years ago you seemed to see management that was afraid of losing their jobs," observes Bob Rech managing director of London-based Ferghana Partners, an investment bank specializing in biotech.

"If you make your owners money, you'll never have to worry about a job," he concludes. "CEOs are plugged in much tighter now that it's their job to maximize the value for the owners. Selling the company doesn't mean you've done a bad job."

### References


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## Web links

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