Commentary: Juliette Audet

Biotechs shift priorities amidst financing challenges

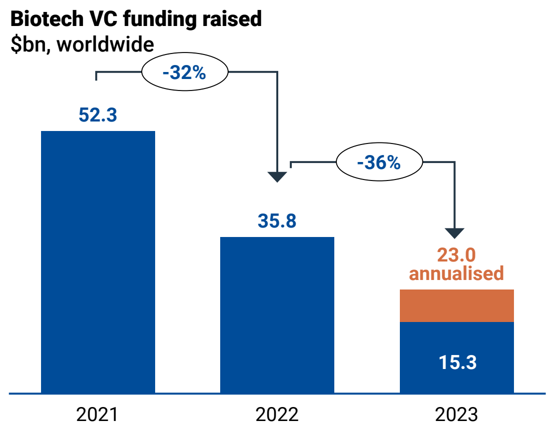
Biotechnology companies and investors are currently facing a different financial landscape than the one they were accustomed to just two years ago. A rise in interest rates, geopolitical uncertainty and the failure of Silicon Valley Bank in March are some of the major events that together created uncertainty on the public and private markets. This has driven activity levels lower, creating challenges for the industry. This is not an irrecoverable situation, but companies need to be agile to identify new opportunities in a shifting market.

In this commentary, we describe the changing landscape and what biotech companies need to do to survive and prosper. The basic conundrum is that biotech companies, often pre-revenue need capital in order to pursue the important work of discovering and developing new medicines; However since 2022 this capital has become much less available especially in relation to the previous year.

Figure 1 illustrates the magnitude of this shift. In 2021, money raised from initial public share offerings amounted to $35.2 billion. In 2022, the collective raise by the industry plummeted, giving a figure of just $4.5 billion. This represented a staggering decline of 87% in just 12 months.[1] In the period from January to August 2023, the value of IPOs was $2.8 billion.[2] On an annualised basis, this figure is $4.2 billion. This is a stark illustration of the new reality: we cannot yet speak about a recovery of the market but rather, more of a glacial thawing.

Companies attempting to raise public money using the IPO route are not the only ones to be encountering difficulties. Secondary, or follow-on offerings, have also been affected. As shown in Figure 2, there was a precipitous 41% drop in the amount of money raised in follow-on offerings between 2021 and 2022.[3] In fact, the entire public market was affected by this crisis. There is some evidence that the public markets started to recover in late 2022 and continued a modest upswing during the first seven months of 2023. This is illustrated by the handful of IPOs launched during this period, starting with Prime Medicine Inc, which raised $175 million in October 2022. This was followed in 2023 by Structure Therapeutics Inc with $161 million; Mineralys Therapeutics Inc with $220 million; Apogee Therapeutics Inc, with $345 million; and Aceleryn Inc which raised the largest amount – $540 million.

Figure 3



In contrast, the private markets continue to experience the ripple effect from the sharp drop in public market values in 2022. Funding for biotech companies from the global venture capital industry declined by 32% to $35.8 billion in 2022. As Figure 3 shows, VC funding had reached $52.3 billion just a year earlier. Contrary to what is happening in the public markets, VC funding on the private markets does not appear set to recover – just yet. The industry is experiencing a knock-on effect from the 2022 public market crisis. As Figure 3 shows, only $15.3 billion has been deployed in the private markets as of August this year, or $23 billion on an annualised basis. Many of the rounds have been either flat or down rounds, with 21% of life sciences deals in the second quarter of 2023 being down rounds[4], compared with almost 0% in 2021.

We are also seeing an increase in the number of insider-led rounds with a 2023 annualised number of these events close to 19% of all VC rounds. This ratio was 15% in 2021.[5] The public market crisis is still working its way through the private sector. This is expected to continue because the availability of capital for VCs has also been impacted. As illustrated in

Figure 1

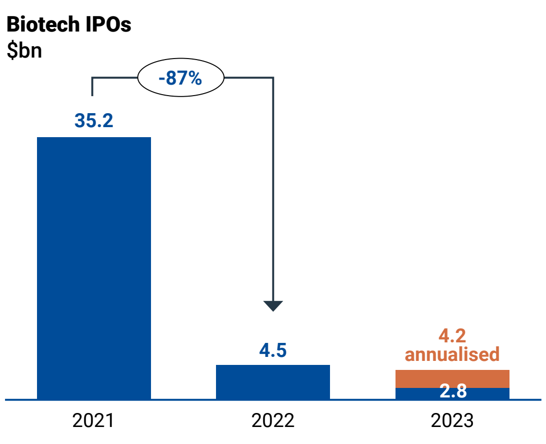
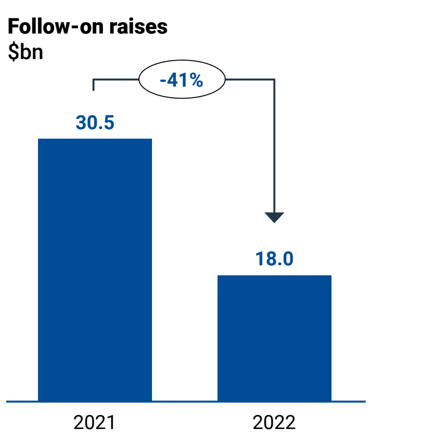


Figure 2



Source: data for all figures have been sourced from Bioequity McKinsey report, May 2023. 2023 numbers are sourced from BCIQ- August 2023.

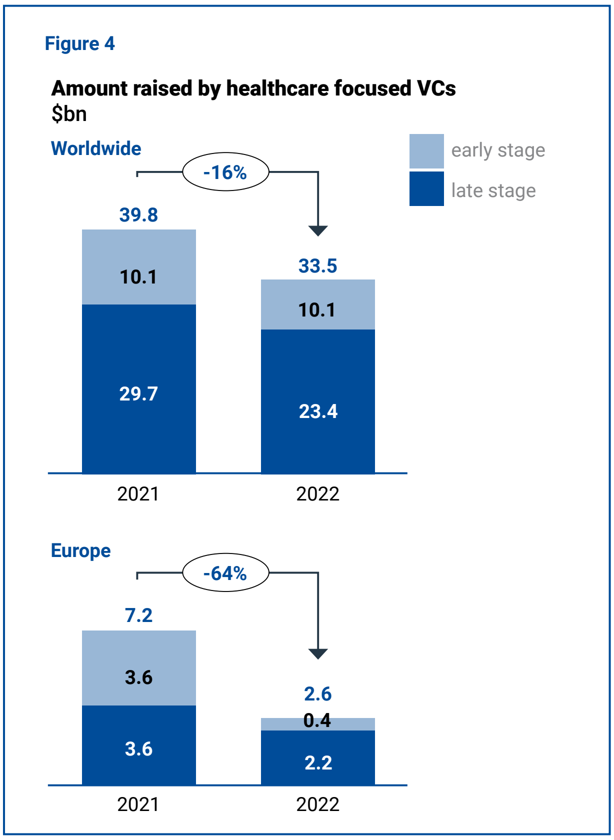


Figure 4, the sum of funds raised by healthcare-focused VCs globally decreased by 16% per annum from 2021 to 2022.[6] This trend has been even more severe in Europe with a decline of 64% from 2021 to 2022. As a result, less money is available in the private sector for biotech and there is no sign yet of a recovery.

The increasing role of M&A

While traditionally less involved in the direct financing of biotech VCs, big pharma companies play a critical role in the overall market dynamic: historically these companies have provided the main exit for biotech companies. The influence of big pharma on the industry, whether through therapeutic areas of interest, the development stage of a drug, or specific targets, shapes the willingness of VCs to fund certain companies.

Big pharma companies urgently need new assets. In 2022, 41% of the revenues from big pharma companies were obtained from products with a patent expiring within six years.[7] These large pharmaceutical conglomerates are facing imminent patent cliffs. M&A is one of the levers at their disposal to replace these sources of revenue. There has never been so much dry powder available for M&A as now. McKinsey & Company estimates, for example, that this figure is currently close to $380 billion.

All the ingredients are therefore in position for a recovery of M&A activity and this year has already shown signs of an upswing. The first seven months of 2023 saw M&A spending top $103 billion on acquisitions[8], or $177 billion annualised. There is therefore the promise of an upward trend compared with spending of $127 billion in 2022. It is worth mentioning that most of the deal making is now at the later stages of a drug's development. Out of the 13 companies acquired by big pharma since the start of this year, nine had their lead asset in either Phase 2 or 3, or on the market, and two had completed a Phase 1 study.[9] The revenue replacement needs to happen fast. The large pharma companies are looking for clinically de-risked assets and a short time to market.

For biotech companies the writing is on the wall. First, with less public capital available, companies have to stay private longer in order to generate data to de-risk their lead assets. Second, with less VC funding available, companies have to effectively manage the cash that they have and show convincing progress in order to successfully raise new funds. Third, the uptick in M&A is focused mainly on later-stage assets which have been clinically de-risked. The message comes from different sources but is always the same: biotech companies have to manage their budgets very effectively and be very intentional about where they spend their cash. They should focus on de-risking and progressing their assets.

Companies that once relied on the IPO route as leverage during an acquisition negotiation process, a so-called dual track exit process, are now compelled to adapt their strategies. The lengthened timeline for going public or securing an acquisition, requires a shift in thinking. As a consequence, many companies are developing long-term private financing plans as well as alternative (non-dilutive) financing.

The new financial realities

With the new market dynamics, we are seeing a distinct separation between "best-in-class" companies with differentiated assets and strong management teams. At Forbion, we are supporting our portfolio companies in the strategic prioritisation of assets and spending, but also in leveraging alternative sources of financing. We are encouraging our portfolio companies to really hone in on their differentiation and build financing plans that enable true value inflection points. At the height of the frothy market of 2021, many financings were based on milestones, but not necessarily value inflection points. For example, for a new target or mechanism of action, an Investigational New Drug application is a very important milestone. However, by itself, the application doesn't validate the drug's relevance in humans. The new financing reality is bringing these issues back to the table. We believe that companies can leverage this new environment to their benefit by crafting careful financial as well as clinical development plans.

Overall, the biotech funding landscape is undergoing a significant transformation, marked by reduced availability of public market capital, shifts in private market dynamics, and an evolving role of M&A. Companies are finding themselves in uncharted territory, requiring adaptation and strategic rethinking to extend their cash runway and demonstrate further progress in developing their assets.

References: 1. BioEquity McKinsey report, May 2023. 2. BCIQ, August 2023, 3. Ibid, BioEquity McKinsey report. 4. Q2 2023 Venture Financing Report, Cooley. 5. Cooley data, August 2023. 6. Ibid, BioEquity McKinsey report. 7. Ibid, BioEquity McKinsey report. 8. Stifel, July 2023. 9. Ibid, BCIQ.

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