Collective Intelligence

Life Sciences

A view from the City of London

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Brunswick Healthcare & Life Sciences

May 2023

BRUNSWICK

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Interview with Dale Raine, Managing Director and Co-Head of European Healthcare Investment Banking at Lazard.

After years of plenty – culminating in the largesse of 2020/21 when COVID-19 turbo-charged investment – pharma and biotech companies now face tougher times. The first-ever restrictions on pricing in the lucrative US market plus a slew of patent losses will make 2025-30 an especially challenging period. Yet the pace of biomedical innovation is still accelerating. Indeed, greater understanding of the genetic and molecular basis of many diseases, including, but not limited to, cancer, makes this a golden age for research. Navigating this evolving landscape requires biopharmaceutical companies to tell their value-creation stories with an unprecedented level of sophistication. Dale Raine sat down with Brunswick's Charis Gresser and Ben Hirschler to discuss sector dynamics.

How do you think about industry growth prospects?

Big Pharma is going back into a period of lower growth, and two things are driving that. Big Pharma is facing into a looming patent cliff. Approximately a third of 2022 revenue is at risk from patent expiries over the next six years. So, that's over $200 billion of revenue that will need to be replaced. The second issue, which is getting a lot of airtime, is the US Inflation Reduction Act (IRA) and the impact that will have on drug pricing in the world's largest and most profitable pharma market.

Under the IRA, Medicare will be able to negotiate drug prices 9 years after the FDA approves a small molecule New Drug Application (NDA) and after 13 years for a biological drug (BLA) – and by negotiate we mean reduce prices. You can think of it like a synthetic patent expiry. Given the 9-year versus 13-year differential for a small molecule versus biologic, there could be a skewing of investment decisions further toward biological drugs and commercially reimbursed populations, although we expect pharma to continue to follow the best science.

The implications for clinical strategies and resulting resource and capital allocation could be significant. For instance, consider the impact on label expansion strategies; the IRA disincentivizes the classic approach of "get to market in a targeted patient population and then build" and incentivizes getting to market in bigger commercial markets from the "get go."

While the IRA is focused on high-spend drugs by Medicare, there are concerns that this is the thin end of the wedge and we could see a bleed-through into commercial pricing over time. Pharma is reflecting uncertainty on drug pricing in their valuation models but the debate is how hard and fast the impact will be felt.

What are the implications for deal-making?

If you put all this together, the pharma industry needs growth, and it needs to source external innovation. Right now, pharma companies have very large war chests that can be deployed for acquisitions and business development. Many have cash balances of over $10 billion, and if you include debt capacity, some of them have firepower ranging anywhere from $20 billion to almost $100 billion.

Some expected there would be a buying spree last year given the precipitous sell-off in biotech share prices. However, we expect that pharma will stick to fundamental investing and will move when they have conviction, and that's typically on the back of data. Our annual survey of global healthcare leaders found that most predicted there would be an increase in the amount of bolt-on M&A as well as in partnering and alliance activity. We are now seeing this translating into announced deals with 2023 YTD biopharma M&A transaction volumes already in line with full-year 2021 and 2022.

Are biotechs ready to do deals at today's valuations?

Generally speaking, the later-stage biotechs continue to be well financed and their valuations have not been as impacted as the earlier-stage companies. However, the earlier companies are certainly more open to a range of strategic alternatives, including earlier M&A. They're also more open to partnerships – licensing or research collaborations – to bring in nondilutive capital. Most companies still want to hang on to US rights because that's what will ultimately drive their M&A exit, but they're more open than they were on regional partnerships. And companies are also more open to exploring horizontal mergers with other biotechs. Those deals can be difficult: companies need to agree on relative value and governance, and very few biotech CEOs have merged and integrated companies.

How can pharma communicate to ensure deals land well with investors?

One of the challenges is sometimes the "sticker shock" of high biotech take-out premiums compared with other sectors, so it's worth reminding people that this is just how it works in this sector. If you look at the premium to spot since 2018 for biotech deals ranging from $500 million to $10 billion, the average premium has been 95% and the 75th percentile premium has been over 110%. And for what we term "fallen angels" or companies trading at less than 50% of their 52-week high prior to an announcement, the average premium was 129% and the 75th percentile premium was 143%. Premium, of course, is an output, not an input, and what's important is fundamental value. However, regardless of whether it's a high premium or a low premium, the deals that are best received are those where the buyer clearly articulates why it is the best owner of an asset. That might be the ability to leverage their global commercial infrastructure or strength in a particular channel to expand the sales potential of a product – or it might be the significant R&D expertise and resources pharma can bring to bear to accelerate time to market, maximize probability of success and target larger patient populations from the beginning.

How are biotechs managing through the funding crunch?

We estimated last summer that just over 50% of small and mid-cap biotechs in Europe and the US had cash until the end of 2023. When we redid that analysis earlier this year, it suggested that just over 50% had cash until mid-2024. So, many companies have bought themselves an extra six months, and they've done that through restructuring their cost bases and prioritizing lead programmes. Some of them have also raised capital because, although the biotech IPO market effectively remained closed, in the second part of last year, the follow-on market has been liquid. So, for example, what we saw was actually a surge in smaller financings: 2022 was the busiest year in 10 years in terms of registered directs (smaller placements) and the fifth-busiest year in 10 years for private investment in public equity.

Any views on the biotech landscape in Europe vs. the US?

The science in Europe is phenomenal. There's no discount on the quality of science in Europe versus the US, and Europe has gotten much better at company formation. The quality of start-ups now, in the UK and Europe, is world-class and the talent pool is growing. But what we really lack in Europe is scale-up capital. That remains the single biggest issue in my mind and we've not seen enough progress on this.

Thoughts on a recovery in biotech valuations?

The question that we get asked a lot is: do we expect to see a sharp recovery like we did on the back of the global financial crisis or on the back of the sell-off early in the pandemic? The simple answer is no – mainly because the macro picture is completely different. Post the global financial crisis and post the pandemic sell-off, we had low inflation, low interest rates, huge stimulus and capital was cheap. Now, it's very different and capital is no longer cheap. We expect the recovery will likely take longer and be more fragile.

Which therapy areas are the markets and industry focused on?

For most of the past decade I could summarize pharma's top three priorities as "oncology, oncology and oncology." That's borne out if you look at where business development and R&D dollars went. Today, oncology is still absolutely a top priority, but I think there's a more balanced picture emerging, with a strong interest in immunology, rare diseases and a strong resurgence of interest in therapeutic areas that underpin societal mega-trends, such as obesity, diabetes and cardiovascular disease, as well as ageing more broadly and neurodegeneration more specifically.

To hear the view from the boardroom, read our interview with Dr. Annalisa Jenkins.

To continue the conversation:

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