Novasecta

INSIGHTS

Private equity: an opportunity biopharma should seize

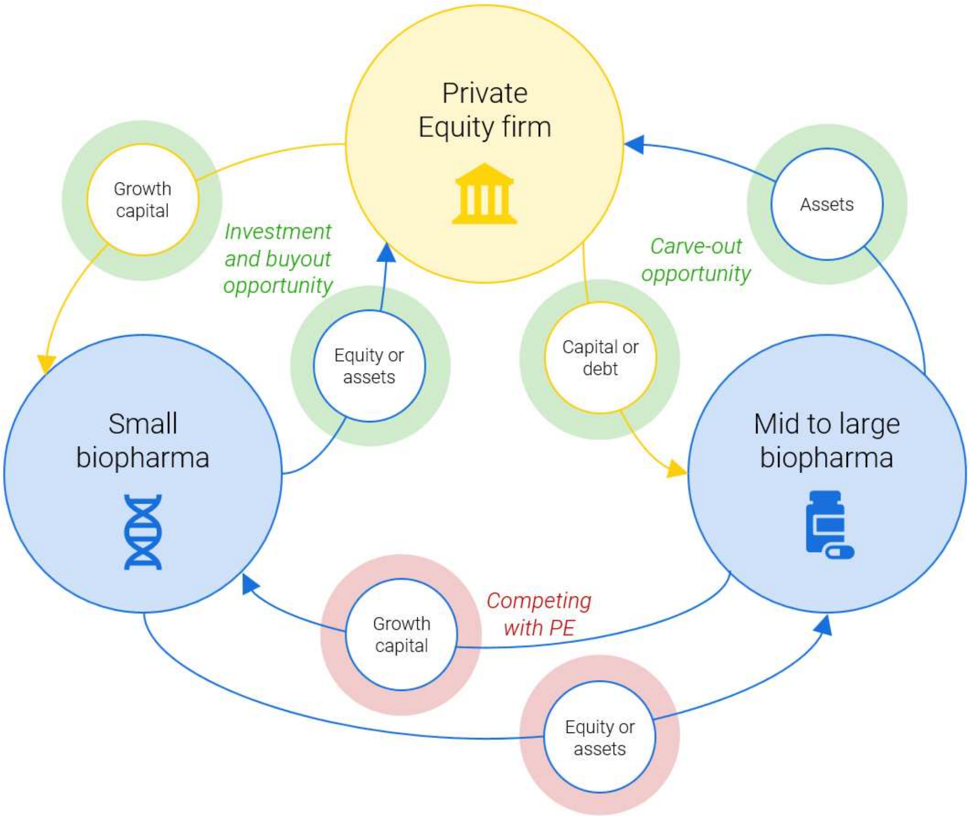
Private equity investment in biopharma is surging. Enterprising biopharma companies should seize this opportunity to focus strategically and accelerate growth.

Biopharma is a sector like no other; highly regulated, highly risk exposed, highly capital intensive and recession resistant. It is this last feature that makes the biopharma sector so attractive to investors. Typically, investment has come from two sources, capital markets and venture funding, but now there is the emergence of a new biopharma investor: private equity.

The appearance of private equity (PE) brings exciting new opportunities to the biopharma sector and it is vital that companies develop clear strategies as buyers, sellers, and competitors to PE funds to maximise the possibilities brought by this new wave of capital.

New opportunities for biopharma from PE activity

It is vital that companies develop clear strategies as buyers, sellers, and competitors to PE funds



The influx of PE into the relatively risky biopharma sector is unusual compared to safer and more reliably profitable sectors, but there are clear reasons for this trend.

PE has been experiencing a record-breaking five years of global investment returns and now sits on an unprecedented $2 trillion of uncalled capital, with more than two thirds of "dry powder" held by the industry's largest funds, each valued at over $1.5bn[1]; this combined with fierce competition for good deals in their traditional industrial and services sectors has caused them to explore new areas.

The healthcare sector is by no means a stranger to PE firms, which have regularly invested in hospital providers, equipment manufacturers, and pharma support services, but the combination of deal competition and vast sums of uncalled capital have driven them to hunt in an increasingly attractive subsector of healthcare: biopharma.

PE firms are under constant pressure to find attractive deals and previously overlooked sectors are an obvious way to find new opportunities – but why biopharma?

PE firms typically seek to make returns within five years, something that has been difficult to achieve in the past given biopharma's long clinical development timelines, expensive late stage studies and high failure rates. These conditions haven't changed but there are wider market trends that are making the sector attractive to PE firms:

- Returns from the sale of private US and European biopharma companies have climbed up to five times upfront transaction values[1]

- There are many more potential deals available as emerging biopharma companies delay IPO in order to grow organically and scale first via private investment

- Big pharmas are more willing to divest aging or non-core assets

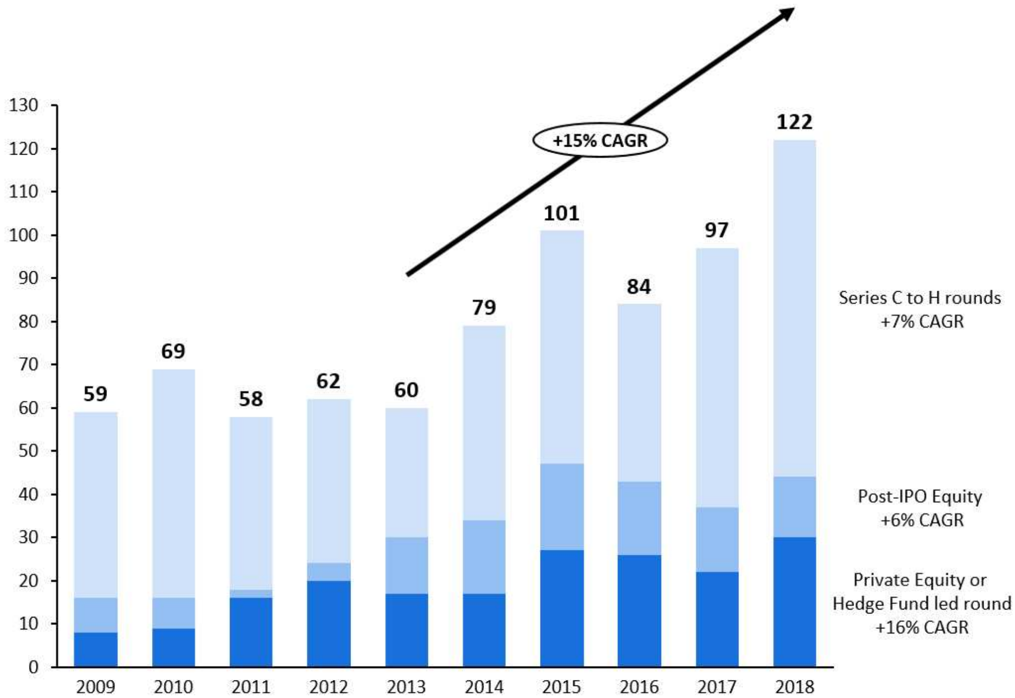
There is no question that pharma companies are still expensive to acquire; the average premium paid for public US and European biopharma companies was 64% in 2014-2018[2]. Now though, PE firms have the uncalled capital and debt facilities to fund larger deals and amplify returns through leverage. Highly leveraged buyouts are increasingly common with leverage levels now around pre-financial crisis levels. It suggests PE firms will continue to have a major role to play both in growth capital and buyouts.

Growth capital

Investment in biopharma has traditionally followed a pattern – seed funding, followed by venture funding then public market offerings when pipelines are credible in the eyes of retail investors or products are being commercialised. PE investment is increasingly important to help plug the funding gap between venture funding and public money. Once an emerging biopharma company has outgrown early-stage venture capital and is reaching a critical late-stage development or growth juncture the PE firm can inject substantial capital and give strategic guidance in return for a minority equity stake.

This type of investment activity has grown substantially: since 2013 there has been double-digit[3] annual growth in the number of PE firms participating in biopharma late stage equity funding rounds.

The number of biopharma minority equity transactions involving PE has more than doubled since 2013[2]



In recent years PE firms looking to acquire minority stakes in biopharma companies have targeted commercial stage enterprises with innovative, well-validated products that address a clear unmet need. Novo Holdings announced, in May 2019, plans to buy a 10.1% stake in Oxford Biomedica for £53.5m.

Exciting new gene and cell therapy platforms that are already generating revenue like Oxford Biomedica's will benefit from the extra capital to fund platform and product development.

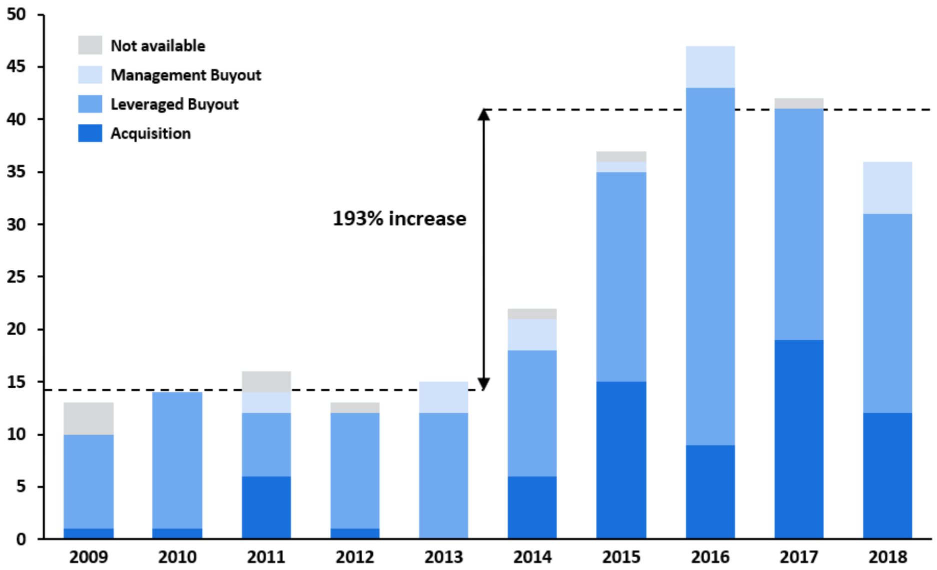
Such minority stakes in rapidly growing biopharma companies can yield impressive returns for PE investors: ChrysCapital earned 10 times its original investment following the sale of a 10% stake in the Indian pharmaceutical manufacturer Intas Pharmaceuticals in 2017.

Buyouts

Private Equity investment has typically prioritised healthcare subsectors where returns are easier and faster to capture. Deal targets tended to be hospital providers, equipment manufacturers, and pharma support services where returns could be achieved quickly via balance sheet optimisation or inorganic growth.

In recent years there has been a surge in buyouts of biopharmas by PE investors. This new trend of PE-backed acquisition and buyouts of biopharma companies is illustrated by an almost doubling of the annual number of deals seen during 2009 to 2014[3].

Figure 3 Step change increase in number of Private Equity acquisitions and buyouts of biopharma companies[3]



PE is increasingly targeting five types of biopharma opportunity for buyouts:

1. *Family-controlled companies with growth ambitions*

Family controlled biopharmas needing growth capital or an exit will always be attractive to PE, even if they are often hard to acquire. CVC bought a controlling stake in Recordati from its founding family for €3bn in 2019 through a leveraged buyout. CVC aims to expand Recordati's very attractive rare disease business.

Recordati will keep Andrea Recordati as chief executive, allowing them to maintain momentum towards becoming the global leader in orphan and specialty care.

2. *Public companies in need of transformation*

Publicly traded biopharmas with successful late stage data and operational challenges represent a second attractive category for PE investors. Delisting and taking the company private enables the management team to focus on transformation and implementation.

In 2019 Waypoint Capital acquired Stallergenes Greer for €730m, representing a ~43% premium on the share price. Stallergenes Greer had started a financial and operational transformation, and under PE guidance will be able to go ahead with regulatory submission for their novel allergy immunotherapy.

3. *"Buy and build" opportunities*

In niche specialty pharma PE firms are able to build successful platforms via strategic inorganic growth and in-licensing.

Essex Woodlands Healthcare Partners (EW) was the founding investor of EUSA Pharma, a specialty pharma company in critical care. Since 2006 EW built EUSA's sales and marketing infrastructure in the US and Europe and supported it through four acquisitions.

EW sold EUSA Pharma to Jazz Pharmaceuticals for £700m in 2012 before buying EUSA again when it was spun-out from Jazz in 2015.

4. Generics and OTC players

Strong brands and reliable, high quality manufacturing represent an opportunity for PE firms to drive margin growth in generics and OTC players. Despite the price erosion caused by customer consolidation in the US, the volume and penetration of generics are continuing to increase. PE firms' diligence and global operational guidance enables generics businesses to grow their manufacturing footprint, optimise supply chains, and capture economies of scale. Consequently, PE firms are willing to pay high prices for such opportunities: Bain Capital and Cinven paid an EBITDA multiple of ~13x when they acquired Stada for €5.3bn in 2018.

The potential for sustained growth means that one generics business can have a series of PE owners. CVC acquired DOC Generici in 2016 from Charthouse and is negotiating to sell it this year to ICG for an estimated €1.1bn.

In 2018, Bain Capital acquired DSM Sinochem Pharmaceuticals for $700m and aims to make it the global leader in generic pharmaceuticals, expanding from API manufacturing into finished dosage form.

5. Carve-outs from big and mid pharma

Several larger pharma companies have set a strategic focus on innovation and are consequently more willing to divest aging assets with declining sales, non-core assets in development, and entire generics/OTC portfolios. This year, Esteve engaged Lazard bank to sell Pensa, its generics business, and Novartis has been rumoured to be considering selling its generics business Sandoz.

PE firms are likely to be keen buyers for generics and OTC spin-outs; only last year Advent International bought Zentiva from Sanofi for $2.3bn and CVC acquired Theramex from Teva. This year a consortium led by private funds EQT and ADIA offered to purchase Nestlé Skin Health, a subsidiary of Nestlé that has OTC, aesthetics, and prescription dermatology brands.

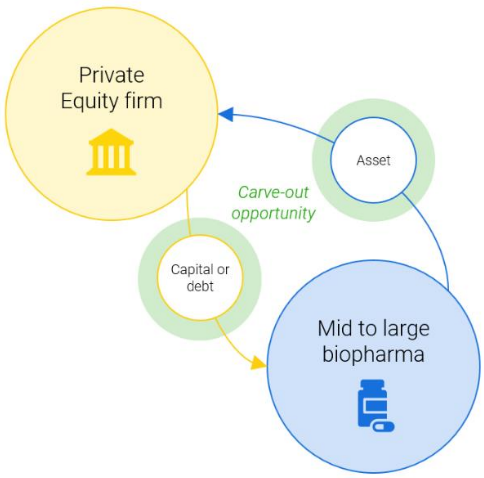
On the face of it, these carve-outs may not seem attractive: it can be complicated to disentangle operations from the parent company and put in place new manufacturing and sales arrangements. However, carve-outs also play to PE firms' strengths in optimising balance sheets and working capital such as scrupulous product rationalisation, contract negotiation, and plant consolidation.

Implications for biopharma companies

It is clear that PE funds are becoming increasingly active in biopharma, so it is crucial for companies in the sector to consider the implications of this new wave of capital and develop strategies as sellers, buyers, or competitors to PE.

Seller opportunity

As a seller, mid to large biopharma can spin-off or out-license non-core assets to enable greater strategic focus. To ensure success, such biopharma companies should first make the opportunity more attractive to PE firms and other buyers by making the parts of the company that are non-core both sustainably valuable and easy to buy. Implementing a business unit structure with separate management and systems, clear accountability, and visibility of cost and profit is an excellent way to increase an assets' attractiveness.



The following example shows how bespoke, strategic guidance helps biopharma decide whether a carve-out is right for its business:

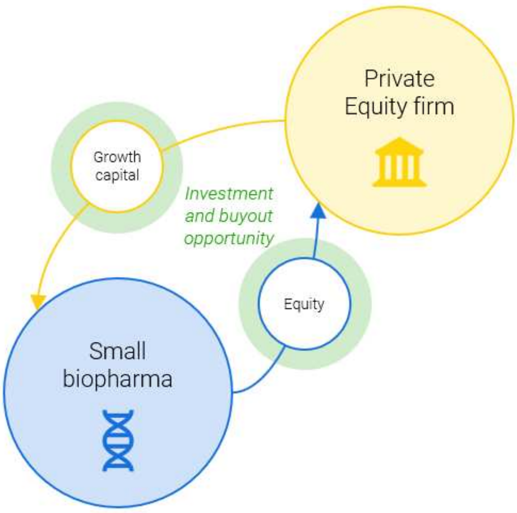
Case study: supporting a German Mid-cap specialty pharma company to prepare a non-core asset for spin-out

The pharma company refreshed its strategic vision and decided to progress the development of a non-core asset in a new entity. They asked Novasecta to carry out an integrated and defensible analysis of the top-line potential and value of the asset in two indications.

The engagement consisted of three phases, first to value the asset, then identify and evaluate financing options, and finally create the pitch deck to attract and approach investors. This included:

- Literature review and competitor research to identify patient segments
- Interviews with Key Opinion Leaders to understand prescribing behaviour and compare target product profiles with standard of care per indication
- Quantitative analysis to model treatment patterns, US insurance coverage, and market share
- Preparation of valuation based on NPV, revenue and cost forecasts
- Development of compelling pitch deck
- Screening for suitable investors and direct approaches

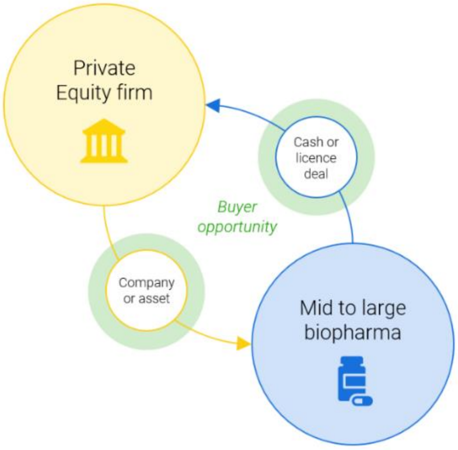
Our analysis and investor outreach enabled the owners to engage in serious fund-raising discussions with several blue-chip investors



For small biopharma companies, ‘going public’ via IPO is viewed by the press and public as the key signal of high performance and entrepreneurial achievement. However, access to cash is the underlying rationale and floating on the stock market comes at a heavy trade-off: IPOs consume significant executive time dealing with regulations, reporting requirements, and the demands of public investors. Delaying IPO in favour of selling equity to a private investor (or consortium) with sector-specific expertise enables the senior management team to maintain growth momentum and work closely with a small group of trusted business advisors who have skin in the game. The returns from a future sale should also be greater. Novasecta has advised a number of its long-term clients on future ownership options, acting as a critical and important counsel to CEOs and shareholders.

Buyer opportunity

As a buyer of assets and profitable businesses, mid to large biopharma companies can see PE firms as a rich source of assets to support their growing portfolios. Assets may become available when pipelines and portfolios are rationalised, and PE firms may provide early visibility into exit timelines and in-licensing or partnership opportunities. Previous PE ownership generates a reassuring track record and reduces risk.



To make the most of this opportunity, biopharma companies need to put thought into their pipeline and portfolio strategy and consider building an active strategic partnership with a sector specific PE firm.

First, the executive team must be clear on the role that transformative M&A plays in their corporate strategy versus in-house innovation and organic revenue growth. The following case study illustrates a structured way to approach this:

Case study: creating a corporate strategic framework for a European Mid-cap specialty pharmaceutical company to guide future investment decisions and grow the business

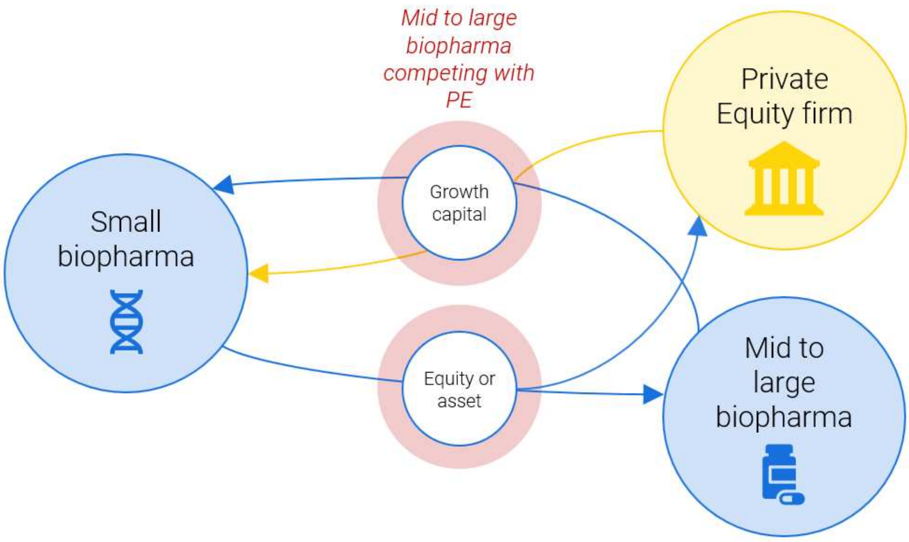
Despite a market leading position, the company faced high risk given a narrow therapeutic area focus and a commercial footprint overly reliant on a single market. In the face of significant generic competition to its lead product in its key market, the company needed to urgently diversify to secure its future success. However, executives were not aligned on the company's vision and required clarity on the future direction that would bring the greatest value, including where to focus M&A activity.

The company engaged Novasecta to align the company on its long-term strategic direction and facilitate executive level decision making. Novasecta combined qualitative and quantitative approaches to understand executive perspectives on the current situation and future of the business, define and value alternative strategic paths to diversification, identify the key drivers of value within each alternative path, and develop a strategic framework to support the key diversification decisions that the company needed to make. Our approach included:

- Interviews with executives to understand their perspectives on the business
- Creation of strategic alternatives through facilitated workshops with executives
- Evaluation of strategic alternatives using NPV modelling
- Development of a corporate strategic framework using insights from modelling

The new strategic framework created alignment on the future direction of the company and provided it with the confidence to launch a new asset in an adjacent therapeutic area in its key market and begin its journey to diversification.

Competition for assets



When competing, biopharma companies can differentiate themselves clearly from PE firms for attractive M&A opportunities. For this, a clear M&A strategy and compelling position can emphasise the greater strategic value, infrastructural benefits, and more integrated capabilities that biopharma companies can offer compared to PE firms, which enhance synergy and value for the acquired business.

In addition, corporate buyers tend to demonstrate strengths in managing the people and cultural issues caused by integration – such as retaining talent or navigating management conflicts. A biopharma company may be a better “adoptive home” than a PE firm that is focussed on cost savings and paying down debts.

Biopharma should ensure their in-licensing processes are integrated efficiently and enable deals to be closed quickly.

Case study: supporting a Japanese Mid-cap pharmaceutical company to redesign its Business Development function for in-licensing

The client's BD team set an ambitious target to close three in-licencing deals between 2018 to 2020; however, their current approach was resulting in missed opportunities. They engaged Novasecta to design an integrated scientific, clinical, and business approach to ensure consistent and efficient execution of deals.

Our methodology combined multiple sources of insight for a holistic assessment of the current in-licensing process and to co-design the new approach. This included:

- Interviews across R&D, finance, and BD
- Workshops with the core team to map processes
- Application of lean six-sigma principles
- Challenge from external pharma experiences

We identified four types of inefficiency in the current in-licencing approach:

Duplication of effort	+	Waiting	+	Rework	+	Siloed working
• Lack of consistency in screening and prioritisation • Poor documentation and tracking • Disruption from reacting to in-bound queries		• Assembly of evaluation team • Management sign-off of terms • Budget approval • Final due diligence and liability assessment		• Lack formal strategy • Repeated discussion with corporate management		• Reliance on informal relationships • Ad hoc input from Commercial and Finance • Lack of time to negotiate terms

Novasecta facilitated development of a new integrated in-licensing approach which has increased feedback loops, transparency to management, and consistency in capturing information and tracking decisions. The BD team adopted this process, an implementation roadmap, and several tools designed to embed new ways of working.

Conclusion

The influx of PE capital provides opportunities for strategically minded biopharma companies as buyers or sellers. However, biopharma companies must also recognise the competitive threat. This might be just the motivation large businesses need to accelerate internal margin improvement and apply capital discipline to achieve sustainable growth. Indeed, spending like an investor is an imperative for today's biopharma companies.

It is clear: PE is now in biopharma and is here to stay. The responsibility is now on biopharma to seize this opportunity, attract funding and deploy new capital effectively.

Novasecta is a specialist strategy consulting firm for pharmaceutical companies.

E info@novasecta.com
W www.novasecta.com
T +44 203 384 3850

References: 1. Preqin Press Release 17 January 2019 2. HBM Pharma/Biotech M&A Report 2018 3 Crunchbase Inc. database and Novasecta analysis.
Footnote: Figure 3 – the 193% increase refers to the increase in average number of Private Equity acquisitions and buyouts of biopharma companies between 2009 to 2013 (mean = 14) and 2015 to 2018 (mean = 41)