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Equity financing for biotech – current opportunities and challenges in fundraising

Hosted by Penningtons Manches and organised by One Nucleus on the 25 November 2015, this breakfast meeting gathered finance experts in life science to discuss the key drivers behind the current healthy backdrop for equity fundraising in the UK biotech and drug development industry. It also reviewed the opportunities and challenges for biotech companies looking to raise equity capital and potentially go public.

The speakers included:

- **Ross McNaughton**, Penningtons Manches
- **David Hignell,** Northland Capital Partners
- **Vadim Alexandre**, Northland Capital Partners
- **Tom Hinton**, SyndicateRoom

Summary of the key points

The financial context has been very good in the last 2 – 3 years:

- Good private capital activity e.g. Immunocore's record fund raising (£205 M)
- Good IPO activity e.g. Circassia (2014) and others, and companies successfully floating on AIM, and UK companies also looking at the LSE's main market as a credible alternative to Nasdaq
- Good M&A activity e.g. recent record breaking deal between Pfizer and Allergan

The main driver of optimism lies in a shift in perception of the sector, **the main factors** in which are:

- Investors have an appetite for risks if ROIs are promising. Biotech is now perceived as a good high return investment overtaking some sectors like oil and gas and mining which have suffered in recent years. It remains the only sector where you can have x10 and x100 returns
- Governments are showing positive signs with more support (e.g. tax incentives), and there is regulatory support (e.g. better FDA approval rates and the introduction of the Generating Antibiotics Incentives Now Act in the US)
- Specific sectors, like immuno-oncology, are attracting a lot of attention due to their very innovative potential – new drugs are tending to be 'better' from an earlier stage
- Big names such Neil Woodford are increasingly interested, which drives attraction to the sector. Institutional-sized investors, who previously would not have looked at the sector, are now regularly funding IPOs and M&A deals

So how does this reflect on the public markets?

Pre-requisites for IPO

Ideally the issuer's pipeline would be in or entering phase 2 (at least one program, preferably more), but there is no set rule. What's important is to have milestones and a set plan to reach them. At IPO, companies should seek to raise enough to see them through to the next valuation inflection point and be able to show that they have achieved something with the capital they have received. Once a milestone is achieved (e.g. a FDA approval), it's a good time to envisage a follow-on raise and companies should have a follow-up story (c.t MotifBio a company which raised £22m 3 months after its IPO following FDA approval to commence phase 3 trials). The main problem for companies is that if they miss milestones, the next rounds are difficult to fund, this is however a common story in any sector not just biotech.

Which market to choose?

The biggest markets are more likely to raise more but are more difficult to get on, so all will depend on the company's size and goals. It is significantly cheaper and less burdensome to be listed on AIM than on Nasdaq, and there is less likelihood of delisting. The main market of the LSE is another option and has attracted interest from potential issuers (e.g. Acacia, Shield Therapeutics) in recent times following Circassia.

With regard to follow-up rounds of investment, AIM is sometimes perceived as a more static market (compared to NASDAQ, where follow-on rounds are expected). However, in reality, AIM is set up for secondary fundraisings – whether the capital is there will depend on there being the right follow-on story and appetite from investors. From the point of view of private investors, a listing on AIM is not always perceived as an exit event as they are still subject to a lock-up and may suffer from a relatively low level of liquidity in the market preventing them from to sell out a large stake. For venture capitalists, this can be a risk, particularly as an investee company going on to AIM would require the private investor to take ordinary shares and give up any liquidation preference. Floating on AIM should be perceived more as a step towards an exit, rather than an exit in itself.

The dynamic M&A market is a good thing for the sector. Even if mainly driven by the US, it reflects on all public markets. It generates cash and gives credibility in asset valuations, as due diligence is undertaken by the pharma rather than just analysts and investors.

Liquidity

Liquidity is a factor that should be taken into consideration more by market participants as it is key to establishing a relevant market price. It is all the more important on AIM where issuers may tend to have a relatively illiquid stock if they have a small free float and are backed by long term cornerstones and EIS investors.

It is important to bear in mind that the listing journey is made up of market capitalisation hurdles – the more thresholds a company passes, the more interest there will be in its stock, which in turn drives liquidity. For example, a company reaching a market cap of $50M on NASDAQ is a big one as some investors will not invest in companies below that.

Crowd funding

Specificities of crowd funding for biotech companies at the earlier stage of their journey investors have basically the same criteria (lead investors, management team, good equity story...). The difference probably lies in the fact that they do not have strong exit strategy requirements, which could make it easier go public if this is part of the strategy. Private investors can be put-off investing in crowd funded companies because of the number of shareholders and the lack of visibility on them. Platforms are now organising the shareholder lists so that they are represented through a single nominee.

Innovation in the investment market

One big trend lies with "patient capital", which has recently been reported to have overtaken VC investment. The main innovation is that these investors step in at any time from the early stages to post IPO and are not constrained by traditional VC time constraints. Their approach signifies a return to investing to build companies rather than just to fund projects. Having a long-term or patient capital cornerstone investors when coming to market would likely be regarded as a pre-requisite for a biotech IPO.