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Investors tout Biofrontera, Kiadis merger as consolidation model

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Investors say that increased M & A activity among startups is required for healthy growth of the highly fragmented biotechnology industry.

The mid-February merger of two European biotechnology firms, Biofrontera Pharmaceuticals GmbH (Leverkusen, Germany) and Kiadis BV (Leiden, Netherlands; formerly Screentec) to create Aliga Pharmaceuticals AG (Leverkusen, Germany), may signal the beginning of mass consolidation among private biotechnology firms. Investors believe that many current private biotech companies will be unable to access the public markets unless they consolidate in a similar manner.


Gerard Dijkstra was tapped to lead Aliga Pharmaceuticals AG, which was created by the merger of Biofrontera and Kiadis. Consolidation may be the only option for private companies wishing to access the public markets.

Tremendous amounts of funding in 1999 and 2000 created a large, fragmented biotechnology industry: according to Ernst & Young (New York), there are currently over 3,600 unquoted biotechnology companies worldwide. But no biotechnology firm has completed an initial public offering (IPO) since BioDelivery Systems International (Newark, NJ) raised $10.9 million on June 25, 2002. The ability of biotechnology firms to raise money on public markets is virtually nonexistent, and therefore they have relied on venture capital to keep them funded until the opening of the next IPO window.

To understand why these trends have set the stage for consolidation among private biotech firms, executives need to remember two things as they trundle along, hoping for success: venture capitalists (VCs) hope to get at least a 500% return on their investments, and public market cycles wait for no one.

When biotech firms accept additional funds from VCs, then the amount they need to raise with an IPO increases exponentially. Chris Evans, chairman and founder of venture capital firm Merlin Biosciences (London), says that while the IPO markets may return in 2004 or 2005, biotechnology firms will not be able to get away with the $25-50 million IPO values that were achieved in the 1990s. (Note that the years 1998-2000, which saw 33 IPOs of over $100 million, were clearly outliers and not the standard of the decade.) "When the IPO markets return, they will expect $250-400 million valuations," says Evans. "To build a company worth $400 million through pure, organic R & D and excellent clinical progress isn't easy, and takes seven or eight years as a minimum if starting from scratch."

But public markets are finicky and clearly operate in cycles[1]. A private firm cannot go public when it deems itself ready; a company can only complete an IPO when the market is ready, and if it misses a funding window then it will need to hunker down for a few more years until the next window opens.

Evans thinks that not even 3% or 4% of existing private biotechs will be able to go public in the next five years. He says that if the rest hope to create the valuations necessary to catch the next public funding window, they need to "Merge now for mass, money, molecules, and management or be murdered later. Wouldn't it be better to look at merging smaller 2 to 3-year-old biotech assets together and accelerate yourself up that curve?"

Wolfgang Stoiber, principal and cofounder of JSB Partners LP (Grünwald, Germany), agrees with Evans in that private biotechs need to attain critical mass any way they can, and most will never do this without M & A. Other factors that attract investors are diversified risk within a company's portfolio and complementary technologies, both of which can be achieved through consolidation. "The bigger a company's portfolio of compounds, the less risk," says Stoiber.

The executives at Biofrontera and Kiadis were obviously on the same page as Evans and Stoiber, and their merger should be seen as a model for other private biotechnology firms. Biofrontera's target-generating platforms nicely complement Kiadis's compound identification capabilities, and now Aliga is much better poised to reach critical mass before the public markets open. The new entity is focusing on CNS diseases and pain management, with one compound in phase 2.

A key factor in the successful completion of the merger was the willingness of Hermann Lübbert, CEO of Kiadis, to accept the position of CSO of Aliga and allow Gerard Dijkstra, CEO of Biofrontera, to be the CEO of Aliga. This willingness likely comes from the fact that both men come from the pharmaceutical industry: Lübbert from Novartis AG (Basel, Switzerland) and Dijkstra from Solvay Pharmaceuticals (Brussels, Belgium). Evans says, "Big pharma guys are probably less entrepreneurial than most of the startup CEOs and more realistic about what their respective businesses lack, which may explain why Biofrontera and Kiadis came together so easily."

Stoiber agrees, saying that researchers are very creative, but developers have to be disciplined. In order for consolidation to really take off among private biotechnology firms, Stoiber says that the scientific founders, managers, and investors need to accept a change in attitude. If this happens, then Evans predicts, "We are about to witness the dawn of an era of mass mergers of biotech startups."

References

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