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Easy act to follow

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Despite a faltering biotech IPO market, secondary offerings are still going strong for startups with good news and impeccable timing.

The biotech initial public offering (IPO) market in the US might be languishing for startups, but secondary offerings are going strong for those lucky enough to already have access to public markets, especially those with solid news and a quick reaction time (Table 1). Recently, Momenta Pharmaceuticals, for example, used a stock price bounce from positive news to push through a successful secondary offering. In June, a judge invalidated the patent held by Paris-based Sanofi-Aventis for Lovenox, a blood-thinner, which cleared the way for Momenta to introduce its version onto the market. The market pushed Momenta's stock price up from around $10 to a high of almost $30 within a month.

> "'I think it's a good market for follow-ons,' says Grant Harschbarger, managing director of health care-oriented investment bank Caris and Company."

Even though the company had just gone public in June of 2004 and was projected to have enough cash to sustain itself through 2007, Momenta was able to take advantage of a shelf registration it had filed with the Securities and Exchange Commission that made it eligible to conduct a secondary offering anytime after June 2005.

"We decided that because of the favorable movement of the stock price we would try to get it through in July," says Richard Shea, Momenta's chief financial officer. "If we waited until September, there's no telling what could happen." Seizing the moment, Momenta issued a follow-on offering almost as soon as it was able to in July, which was priced at $27 a share, raising a total of $130 million with less than 5 million shares.

Vertex Pharmaceuticals and Rigel Pharmaceuticals issued secondary offerings in the last few months by taking advantage of favorable news. For both companies, timing was crucial. The $175 million Vertex offering in early June and the $76 million Rigel deal in mid-July both came after positive clinical trial reporting had significantly increased each company's stock value making it advantageous not only to issue a secondary offering, but also to conduct an even larger one than initially planned.

Without news flow, secondary offerings are a more difficult proposition. "I think it's a good market for follow-ons," says Grant Harschbarger, managing director of healthcare-oriented investment bank Caris and Company. "But companies that have positive clinical news can obviously pursue a follow-on more aggressively than ones that have had a disappointment or are in a no-news time frame. Those companies are doing PIPES."

Contrary to what investment bankers often say, however, there are extenuating circumstances that should give biotechs pause. Kosan

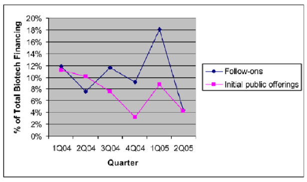
Bioscience wisely pulled its secondary offering in mid-August after it issued disappointing clinical trial results for an anticancer treatment, rather than continuing with its secondary plans in hopes that the market would look beyond the news. Investors rarely look beyond bad news. Kosan's share price fell within a few days from around $10 to about $7. The company might have been successful in completing the follow-on offering, but at a dramatically lower valuation.

> “The average annual European total amount raised via IPOs has been about one-third that in the US over the last decade.”

Valuation was certainly on the mind of management at Sirna Therapeutics, which opted for a PIPE rather than pursue a secondary offering. In early July, they raised $28 million through a PIPE because even with positive research news, Sirna shares have been hovering in the $1 to $6 range. "Sirna's stock at the moment is in my mind undervalued," Sirna CEO Howard Robin says. "Doing a full-blown secondary offering, when we believe the company is undervalued, isn't wise."

In the US, the secondary market has remained hearty and may even continue to improve (Fig. 1). But in Europe, although the biotech IPO market actually eclipsed the US market in the amount of funds raised during the first half of 2005, there have been only four follow-on offerings compared to 31 in the US[1]. Over the last 10 years, European secondary offerings have, on average, only raised about one-tenth of what follow-on rounds in the US raise (Fig. 2). Historically, European follow-ons have simply been a much less effective means of raising money than IPOs. The average annual European total amount raised via IPOs has been about one-third that of the US over the last decade.

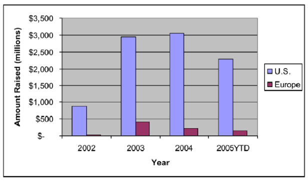
Figure 1: Follow-ons and IPOs as a percentage of total biotech financing.



Follow-ons typically comprise more of total biotechnology company financing than IPOs, even during an IPO window.

Source: BioCentury, Burrill & Company

Figure 2: Amount raised in follow-on financings.

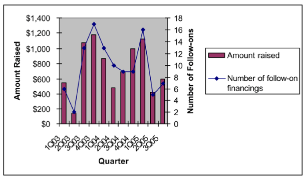


European secondary offerings for biotechnology companies are consistently only a fraction of what they are in the U.S.

"I think in Europe you tend to see either very large offerings that are competitive or smaller ones that would have trouble raising capital in the US," Harschbarger says, even though IPOs in Europe are on their way to a banner year.

As for the remainder of this year, IPOs will remain the financing option of choice for biotechs in Europe, while follow-ons will probably remain the focus in the US. There is reason to believe that the secondary offering market will kick in even stronger at the end of this year if the market improves as some anticipate. (Fig. 3)

Figure 3: US secondary financing market.



The second quarter is typically the weakest for follow-on offerings, whereas the first and fourth quarters have been strong. Data as of August 15, 2005.

Source: BioCentury

"There have been a lot of companies that have held off (on a follow-on) waiting for a better climate, so there's a strong line up," says Harschbarger. "Now that the second half looks better, they're considering it."

Table 1: Top Five Follow-on Offerings of 2005YTD

Company Name	Date Completed	Amount Raised (millions)	Underwriters
Amylin Pharmaceuticals	1/21/2005	$202	Morgan Stanley, Goldman Sachs, Banc of America Securities, JPMorgan, Wachovia
Vertex Pharmaceuticals	6/7/2005	$176	Merrill Lynch, JPMorgan, UBS
Valeant Pharmaceuticals	2/4/2005	$173	Bear Stearns
CV Therapeutics	6/29/2005	$158	Lehman, Merrill Lynch, Piper Jaffray, SG Cowen, First Albany
ZymoGenetics	8/4/2005	$135	Merrill Lynch, Pacific Growth, Bear Stearns, Piper Jaffray

Source: BioCentury

Web links

Websites referenced:

- BioCentury
- Momenta Pharmaceuticals
- Caris & Company
- Sirna Therapeutics
- Kosan Biosciences

References

- Lawrence, S. Looking at US versus European exit opportunities. *Bioentrepreneur*, published online 12 August 2005, doi: 10.1038/bioent876.