Earlier stage biotechs attract partners

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Pfizer, who recently acquired Idun Pharmaceutical, has, like many other big pharma, been focusing on earlier stage biotech companies.

Even as the environment for going public remains hostile to most biotech companies and their investors, some are discovering that favorable financing alternatives still exist. A spate of recent acquisitions and a continuation of early-stage deal making signify that there are still appealing ways for many companies to sustain their drug development programs, especially given the needs of potential acquirers and licensees.

For biotechs whose lead programs are at or near the phase 2 clinical trial inflection point that validates proof of concept, potential partners increasingly are considering acquisition. "People are far more willing to consider acquisition than they used to be," notes Roger Longman, managing partner at healthcare business information specialist Windhover Information. Plus, he says, "biotechs today may be willing to cut their upside for a present-day payout."

Indeed, most companies don't have that kind of product visibility with which to appeal to public investors. Five firms have gone public so far in 2005, to a lukewarm response in terms of the initial public offering (IPO) price and after-market reaction. Moreover, an IPO, unlike an acquisition, is not necessarily an exit. "It's a financing opportunity," Longman points out. The level of financing an IPO often provides is especially important for companies that need capital to take a product to the end stages of commercialization, leading to an increase in valuation without further fund-raising. Among the recent class of IPOs, Eyetech Pharmaceuticals, Pharmion, Nitromed, and Corgentech (had its product worked—it recently failed in phase 3) are all companies that went public for that reason, more so than to give private investors an exit.

The vagaries of going public are one part of the reason more and more biotechs are considering a big pharma buyout—an option several have already chosen in 2005, including San Diego-based Idun Pharmaceutical and Syrrx Pharmaceutical (by Pfizer and Takeda, respectively), TransForm Pharmaceutical and NeoGenesis, both located outside of Boston (Johnson & Johnson and Schering-Plough), and in 2004, metropolitan New York area-based Aton Pharma (Merck).

Acquisition is also an alternative to the old biotech standby—the big corporate deal. "The question of whether to buy or ally is always a trade-off," notes Steve Sands, an investment banker with Lazard Freres in New York City. In the past, the trend in pharma and biotech was always to form an alliance. But a broad alliance is basically like giving away the company anyway, he suggests, and many alliances that went south—in some cases because long-term social issues arise when working together for extended periods—should have been acquisitions. Moreover, at the board level, potential licensor/acquirees are now thinking about acquisition earlier and in a more organized way, he says.

With most late-stage product candidates—those that have been validated in phase 2 proof-of-concept clinical trials—either already spoken for or very pricey, pharmaceutical companies have also become more interested in earlier stage alliances. "Late-stage deals, while expensive, sometimes do not provide the optimal ratio between price and the probability of success," contends venture capitalist Jürgen Drews, former president of R&D at Hoffmann-LaRoche. Big pharma also now has better tools in-house to make fast go/no-go decisions on whether to take products forward, in turn enabling them to take more 'shots on goal' before investing in costly last-stage drug development—an argument in favor of early-stage alliances as well as acquisitions of companies with early-stage programs.

Thus at Pfizer, according to Martin Mackay, senior vice president worldwide research & technology, "we tend to go earlier because we have good predictive tools, to be able to get to a decision point as quickly as possible." This was a large part of the rationale behind its acquisition of Idun, a developer of caspase modulators, which are proteins involved in apoptosis but that remain unproven as a drug target. "Idun has built up a know-how that we'll seek to understand," he adds. With scale, Pfizer believes it can quickly ascertain the potential for caspase-targeting compounds, which Idun is developing for a broad range of disorders including liver diseases, cancer and inflammation.

Given the uncertainties around availability of future financing and the overall costs of drug development, "conversations for potentially important products often get to the obvious point of considering an acquisition," summarizes Anthony Evnin of venture capital firm Venrock Associates. "With IPO valuations and timing uncertain now, it requires you to think more profoundly about acquisition. I do think there are elements that begin to feel like a trend."

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