

Biotech–biotech company mergers puzzle investors

Later this month, genomics specialist Incyte Pharmaceuticals (Palo Alto, CA) is expected to release the first product directly resulting from the company's December 1997 acquisition of Synteni (Fremont, CA). RatGEM is the first of nine chips based on Synteni's microarray technology that are due for release this year. It will contain expressed sequences from rat liver derived from Incyte's ZooSeq database. Although sales of the chips will themselves generate revenues, it is hoped the products will induce companies to buy subscriptions to Incyte's genomic databases: Only those companies subscribing to a particular database will be able to purchase the corresponding chip. Thus, Incyte's acquisition of Synteni provides perhaps the clearest and most market-oriented example of biotechnology companies adding value through merger or takeovers.

Even with such a shining example, the investor response to biotechnology–biotechnology mergers and acquisitions has been mixed. There have, of course, been several mergers that have been driven by financial necessity rather than any particular strategic planning. For instance, Seragen (Hopkinton, MA) was acquired by Ligand Pharmaceuticals (San Diego, CA) in May this year after debt financing and the sale of Seragen's production division to Boston University (Boston, MA) failed to rescue the company (*Nature Biotechnology* 16:121, 1998). However, the recent trend does seem to be toward strategic consolidation, particularly between platform technology companies. "The Sequana/Arris deal and the Pharmacopeia/MSI deal are both examples of putting technologies together to create a whole that is greater than the sum of the parts," says Marvin Brown, vice president of Agouron Pharmaceuticals (La Jolla, CA). So, too, he says, was Agouron's acquisition of the combinatorial chemistry company, Alanex, in 1997. "It allowed us to extend our technology base from the discovery end all the way into development," says Brown.

While platform technology companies in areas such as genomics, combinatorial chemistry, and screening have frequently entered into collaborative agreements with each other and with larger companies, the number of mergers and acquisitions has been relatively low. There are around 350 public and over 2000 private biotechnology companies worldwide. "The big mystery . . . is why there hasn't been more of a consolidation activity in a sector that clearly has spawned an awful lot of children, many of whom will never reach adulthood," says Jeremy Curnock Cook, head of venture investor, Rothschild's Bioscience Unit (London).

One answer, thinks Meg Malloy, biotechnology analyst at Hambrecht & Quist (New

York), is that mergers and acquisitions bear their own risks. "Most companies are capital constrained. Unless pipelines of both companies are well-balanced, mergers are hard to make work," she says. "It is a lot easier for the majority of companies to spread their risks by forming joint ventures than outright acquisitions." Marvin Brown thinks another explanation is that many platform companies are simply overvalued and therefore not attractive as takeover targets. "Investors expect a certain multiple return," he says. "The price tag of smallish companies to meet that expectation is pretty large."

Sue Rodney, spokesperson for combinatorial chemistry specialist Pharmacopeia (Princeton, NJ) concurs. She reckons that considerations of supply and demand will drive the value of single technology companies down. "Companies that focus on just one thing, for instance high throughput screening, are becoming commoditized," she says.

One company that has been consistently building through acquisitions is Oxford Molecular (Oxford, UK). It has made 10 acquisitions since its launch in 1989—three each in bioinformatics and cheminformatics, and four in molecular modeling—the most recent of which was the acquisition of another Oxford company, Chemical Design, in May. "What the market is telling us and what pharmaceutical companies are telling us is that they want a one-stop shop that provides the bulk of their core requirements," says Tony Marchington, Oxford Molecular president and CEO. "It doesn't matter if you work in a big company or a small biotech you've still got to test the same number of compounds across the same screens to get the same weak leads to get the same number of optimized leads to get the same number into clinical trials to get the same numbers out into the market."

Marchington feels that the number of acquisitions will increase. "If you look at the trends of the pharma industry as a whole, and you look at the way in which industries mature, biotechnology companies are going to follow."

Incyte CEO Roy Whifield agrees, and suggests there may be particularly strong activity in genomics. Genomics companies face problems of "economies of scale," he says, making it hard to be a marginal player and necessitating technology integration. "You'll see a common exit strategy for genomics companies—acquisition by larger genomics companies, such as Incyte," he explains.

Although the popular view appears to be that strategic consolidations are the way to go in biotechnology, the market has reacted erratically to the mergers. It liked the Incyte/Synteni deal: Incyte's stock price rose from about \$35

before the deal to around \$50 after completion (although the price has fallen back to the low- to mid-\$30s following expectations of its role in human genome sequencing (see "PE/TIGR genome project fails to impress Incyte, p. 610). Pharmacopeia's stock price also increased, leaping around 30% following the announcement of its acquisition of Molecular Simulations.

However, notice of the similar deal between Oxford Molecular and Cambridge Combinatorial caused no stock reaction, according to Marchington. The reason may have been that Cambridge Combinatorial was founded with a £2.0 million (\$3.2 million) investment from Oxford Molecular and is headed by Marchington's brother Allan. Tony Marchington, however, believes that the explanation is that the London Stock Market "is several years behind the US in its understanding of what's going on in biotech—London really is in the Dark Ages."

The market seemed not to like the merger of Arris and Sequana to form Axys Pharmaceuticals (S. San Francisco, CA) in November 1997 (*Nature Biotechnology* 15:1326, 1997). The company's stock price has fallen 40% since the deal was announced. John Walker, Axys' CEO believes that investors are not certain about the kind of "beast" the company is. "Certain investors are clearly focused on their investment dollars going into what would be described generically as product companies versus technology or platform companies. Axys incorporates both," he notes.

To facilitate mergers between biotechnology companies Rothschild's Bioscience Unit is currently setting up the Arrow Healthcare Technology Fund. According to Jeremy Curnock Cook, a target of \$200–250 million—raised by financial institutions in Europe and North America—will be put into merged enterprises. "[This] begins to play to the needs of the shareholders and bypasses some of the managerial problems that necessarily come about in any consolidation strategy," he says. Curnock Cook points out that consolidation sponsors have mainly been investment bankers looking for fees rather than a long-term commitment to develop the consolidated property. He thinks the new fund could help create around 20–50 sizable enterprises that would meet the needs of the pharmaceutical companies. "They want a problem-free relationship with smaller, creative, galvanic companies [that] actually understand the needs of the pharmaceutical industry."

Meg Malloy thinks consolidation is inevitable. "The reality is there simply won't be sufficient funding to provide for all the biotech companies out there."

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