Joseph Schwartz

Straight talk with… Joseph Schwartz

On 17 May, Human Genome Sciences (HGS) formally rejected a $2.6 billion unsolicited takeover offer by GlaxoSmithKline. The Maryland-based biotech firm had long partnered with the UK drug giant to develop drugs including Benlysta (belimumab), HGS's first drug on the market and the first new medicine approved to fight lupus in 50 years. But, at $13 a share, GSK's bid was deemed "inadequate" by the HGS board. Recent history in the biotech sector shows how high the stakes are in such negotiations. Since last November, six biopharma buyouts have exceeded $1 billion each, with Gilead Sciences' purchase last year of the hepatitis C specialist Pharmasset topping the charts at a whopping $11.2 billion, the highest ever paid for a clinical-stage biotech and an 89% premium to its share price at the time. More recently, in April AstraZeneca paid $ 1.3 billion for Ardea Biosciences, a company with cancer and gout drugs in the pipeline but nothing on the market.

One person watching the upward clime of such deals is biopharma analyst Joseph Schwartz, a managing director at Leerink Swann in Boston. **Mark Ratner** sought out Schwartz, who was named the top stock picker for pharmaceuticals in the last year's FT/StarMine Analyst Awards, for his views on what's behind the recent buyout spending.

Why are drug giants paying such high premiums for biopharma assets?
All deal are financial. But more deals are strategic now, too, especially with respect to the acquirer's market position, because of scarcity issues within the sector. We always hear that the easier targets have been exploited.

There are also many more fully integrated biotech companies now at all levels of the market capitalization spectrum. In most cases, the companies will need to build or already have a sales force. Wall Street factors in the negative net present value of those expenses. The greater those synergies, the more premium a buyer can offer. Any banker will tell you that synergies and premiums are inextricably linked. There's hidden value that a pharma buyer is able to unlock.

What are some fundamental deal drivers at work now?
You have vectors on both the demand and the supply side. We think a lot of larger players are struggling for growth and have finally come to terms with the need to acquire their way to innovation. On the supply side, the emerging biotech landscape is maturing. There are now many examples of smaller companies that have developed drug candidates to an advanced enough stage to have products that could address gaps within the franchises of larger companies. The companies have a fiduciary duty to maximize shareholders' return on investment and try to add as much value as they can before they have to pass on the reins.

Can you point to a recent example from the universe of companies you cover?
Ardea Biosciences is one. I think the company has been interested in selling for a long time; that would be its natural evolution. The indication for Ardea's lead drug, gout, is a primary-care market that requires a lot of selling resources to develop. That is not Ardea's strength. The company might have left some money on the table by selling before phase 3 data. But otherwise, it could have found itself in a stalemated position: with great data yet unable to carry out an exit that would have made their shareholders as much money. In such situations, the tables turn because the biotech needs a partner more than the partner needs the biotech. AstraZeneca is buying Ardea early, well ahead of the launch, and taking some of the risk. But it was probably the best scenario for Ardea.

Is the interest in mergers and acquisitions (M&A) being reflected in increased stock prices of other biopharma companies?
There are companies we cover that people think are rational or natural takeover candidates because of the disease area they address or the business model they are pursuing. Amarin Corporation, for example, has an omega-3 fatty-acid therapy that addresses a very large potential primary-care market—if an acquirer can develop that market. Orphan drug–company models are also seen as very attractive.

Some of the more prominent deals have involved companies with drugs that treat hepatitis C virus (HCV) infections. Why is that, and which other therapy areas have been a focus of recent M&A activity?
A lot of players expect different drug combinations to be used for HCV. It's an expanding market, so it makes sense to invest there. Other areas of interest are those which would fit into the existing strengths or reinvigorate past strengths of a pharma company: areas like cardiovascular, rheumatology, neuroscience and oncology.

You mentioned rheumatology. GSK is attempting to take over Human Genome Sciences, its longtime partner in the development of the lupus drug Benlysta (belimumab). Why is GSK acting now?
Clearly, the launch of Benlysta has disappointed public investors. Human Genome Sciences' stock was approaching the mid-single-digit range, where it hadn't been since before Benlysta was de-risked with positive phase 3 data and regulatory approval. So now that expectations are low, GSK might believe it's bottomed or close to bottoming and that now is a good opportunity to buy low. By doing so, they can consolidate full rights, slash some costs to justify the investment with synergies, and perhaps participate in any upswing in Benlysta sales by owning 100% of the rights.

There's also been a lot of M&A activity in the generics space. Do you see any commonality in rationale with the buying of biotech companies?
Generics acquirers have been focused on assembling various pieces to the supply and delivery chain. Regional players are trying to become large global players by acquiring local leaders in the space: Indian companies buying European companies with established distribution capabilities, for example. Some large biotechs are thinking this way, too.