7 Tips for Biotech Companies Seeking Capital in a Volatile Market

Xconomy National (February 28, 2019) – Last year was a remarkable year for biotech companies going public. Not only did an unusually large number of biotech companies go public, but a significant number of early-stage biotech companies went public at premium valuations relative to their later-clinical stage peers.

There were approximately 58 biotech IPOs in 2018 (excluding offerings with under $25 million of proceeds) for total gross proceeds of $6.3 billion [1], of which a significant number were early-stage companies — either in preclinical development or conducting ongoing Phase 1 clinical trials. Biotech IPO valuation trends have been strong year-over-year since 2015, and significantly more so among early-stage companies, which hit an all-time high in 2018 [2].

Despite the overall robust markets of 2018, early-stage biotech companies face a lengthy and highly uncertain road to an FDA-approved product, even with a favorable regulatory environment that is increasingly willing to accelerate approvals of innovative drugs. Aside from the challenge of demonstrating that their innovative science and technology has the potential to generate approvable drugs, these companies also face the significant challenge of financing what is, by all accounts, an extremely expensive development pathway.

In 2019, early-stage public companies will face strong headwinds in accessing the significant capital that they require to successfully execute their development strategies. The large number of biotech IPOs in 2018 — and the anticipated number of private companies that will be looking to go public in 2019 — means that an ever-expanding list of public companies will be competing for limited investor attention and cash. There are also legitimate fears that the amount of such capital may contract in 2019.

While 2018 was a very favorable environment for early-stage companies going public, the markets in the fourth quarter and the first weeks of 2019 have been significantly more volatile. All but two of the 58 biotech IPOs in 2018 priced prior to October 31, 2018 [3]. And by the end of the year, many of these newly public companies experienced significant drops in stock price as a result of macroeconomic factors, such as rising interest rates, which have led to a broad market sell-off. The SPDR S&P Biotech ETF (XBI) hit an all-time high in August, but October was its worst performing month (down 17 percent) since January 2016 [4]. More than half of the biotech companies that went public in 2018 are currently trading below issue price [5]. That trend is not new — several of the biggest biotech success stories have traded below their IPO price at one or more points along their development path — but the real possibility that conditions causing the current volatility may continue, or even increase, has many biotech executives looking nervously at their cash runway.

That said, there remains reason for optimism. During a recent webinar hosted by WilmerHale and BIO, several industry experts noted that while there is no silver bullet to ensure success, early-stage public companies — both those that have
recently gone public and those that aspire to go public in 2019 — can position themselves in ways that will maximize their ability to keep investors engaged over the long term and execute financings from a position of strength despite the headwinds.

1. **Innovative ideas supported by strong and validated scientific rationales.**
   
   No matter the market conditions, possessing groundbreaking data remains the golden ticket for an early-stage biotech company to access the markets at the time of their choosing. But, prior to receipt of data, early-stage companies can potentially garner great success in capital raising by relying on big ideas that offer the potential for major breakthroughs that could significantly impact patients. The 2018 IPO class had several of these big ideas, including early-stage companies with mRNA-based therapies, novel therapeutics delivery platforms, new gene therapies, and genetically-engineered T-cell therapies. That said, big ideas are good, but executives need to make sure those ideas are supported. In order to get traction with investors, innovative ideas that have not been proven in the clinic must have a strong scientific rationale and be validated by scientific leaders. It is essential for early-stage companies to establish and maintain relationships with key opinion leaders who are recognized experts in the relevant field or patient population.

2. **Solid platform that serves as a foundation to produce clinical assets.**

   The early-stage companies that command premium valuations are typically not one product or one indication companies – they are platform companies, based on interesting and innovative technology, with significant growth potential. One panelist, Ricky Sun, a partner with Bain Capital Life Sciences, described the ideal platform as a “flywheel” that can produce multiple clinical assets based on the same underlying science or technology. This enables companies to build a flexible and scalable modular platform that serves as a foundation for targeting new indications in a cost-efficient manner. A scientifically valid and cost-efficient platform helps de-risk the investment in minds of investors. A solid platform can also provide opportunities for creative collaborations with deep-pocketed partners, which can enable companies to get non-dilutive capital and outside help to maximize the potential of their platform.

3. **Communication and results on the path to validation.**

   It is essential for early-stage companies to identify their major value inflection points – where they can present data that is meaningful to the scientific community, the clinical community, and investors — and to generate that news flow to keep investors interested in the stock. According to Terry-Ann Burrell, managing director of the Healthcare Investment Banking Group at J.P. Morgan, major catalysts will ideally be nine to 12 months after the IPO rather than the usual 12 to 18 months, giving investors the timely opportunity to assess their investment decisions and, ideally, confirm their support. Companies that have flexibility in the timing of the IPO have the benefit of planning ahead for the first major announcement as a public company. Only real data events will attract the interest of investors. (Fluff does not work.) And the importance of this factor is magnified in volatile markets. Jeff Urlich, a managing director of Health Care at Cowen, noted that it is very difficult to get investors to pay attention and evaluate new investment opportunities when volatility spikes and as a result, in 2019, companies may have a higher bar and fewer opportunities to get the attention of investors. Companies that set clear value inflection points and deliver on those will be best positioned to capitalize.
4. **Employ credible management teams with a strong track record.**

A major building block for a successful early-stage company is its management team. According to Kyle Kuvalanka, a financing consultant and life sciences executive, the best early-stage companies have a management team with a track record of operational excellence that can build an organization with a full set of capabilities to research, develop, and advance product candidates through clinical trials and into the marketplace. Investors will also look for management teams that have demonstrated that they can build investor syndicates and will be able to effectively raise the capital needed to execute their development strategies.

5. **Credible initial backers offer cash and validation.**

Early-stage companies that have a pre-IPO shareholder base consisting of recognized investment firms, or pharmaceutical companies with a track record of supporting companies, will have two key benefits: (i) sufficient cash to execute financings from a position of strength, both in terms of pricing and aftermarket support, and with optionality as to timing of financings, and (ii) key validation of the investment thesis. These benefits may signal to prospective investors that the company will be financially supported through its development cycle, including through more challenging markets.

6. **Post-IPO cash management is key.**

A critically important, but often overlooked, aspect of success after an IPO is strong cash management. Companies aiming for success should strive to have 12 to 18 months of cash beyond their major inflection points. As Ms. Burrell remarks, while managing dilution is important, strong investors are playing for the long game. Companies need to be willing to look beyond short-term dilution and set themselves up for success by raising and maintaining enough cash to bring them beyond those key inflection points. Managing your cash and taking the long view in terms of what is best for the company gives you optionality, both in terms of when you raise capital and with whom.

7. **Consider strategic collaborations.**

Collaborations with leading pharmaceutical companies can provide cash and valuable external validation of a company and its technology. Executing a deal that provides significant upfront investment while retaining rights and control of key product candidates substantiates both the validity of the science and management’s capabilities to execute complex transactions. Collaborations can also serve as an attractive source of capital in unfavorable equity markets or when the company is between major catalysts. Management should ensure that they have a business development team that is constantly looking for opportunities, building relationships, and raising awareness of the company’s technology and progress. As Mr. Kuvalanka stressed, successful collaborations often take about 18 months from inception to close, so if a need for capital arises, it is essential to have established relationships that foster discussions to shorten that path. Like raising capital, executing a deal from a position of strength will be far more effective than trying to execute when the chips are down. Strategic collaborations are likely be very attractive to companies looking for funding in 2019 as an alternative to capital markets transactions. Pharmaceutical companies may also be more active in making investments if continued volatility leads to more challenging valuations.

Having all of these elements of success does not guarantee that companies will be able to raise money with ease, but big ideas, broad platforms, effective and timely communications, experienced and well-respected management teams with
meaningful relationships, and the flexibility that comes along with a strong balance sheet will certainly help keep early-stage biotech companies moving at full capacity through volatile markets.

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[2] Source: Cowen and Company, ECM Analytics (as of November 16, 2018)
[3] Source: Cowen and Company, ECM Analytics; BioPharmCatalyst.com
[5] Source: Bloomberg