

## Special Reports

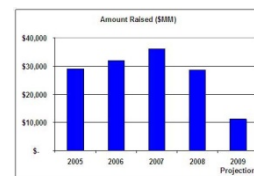
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### How Biotech Unions Could Save Companies and Revitalize Pipelines

**Impetus for such mergers comes from the drying up of venture funds and pharma consolidation.**

Joseph Baron

Although the acute phase of the financial crisis may be over, for emerging biotechnology companies in need of funding the financial picture is unlikely to improve dramatically anytime soon. Since 2007, the venture capital industry has been contracting at an accelerating rate. Furthermore, large pharmaceutical companies, the traditional development partners or acquirers for biotechs, are consolidating, which limits the available field of potential partners.



Capital raised by venture funds fell by 60% from 2008 to 2009.

Taken together, these factors will stretch biotechnology companies on both ends—they will have less capital available to fund development activities and fewer exit opportunities. An emerging trend may help biotechs weather this financial storm through a process of consolidation and mergers within the biotechnology sector. These mergers permit a rationalization across company product pipelines and a more efficient allocation of capital. Shareholders should encourage these combinations as they have the potential to create long-term value.

While many early-stage companies have seen a decrease in venture capital investing, a more troubling statistic is evident in the venture capital industry's fundraising activities. As shown in the *Figure*, the venture capital industry may raise only \$11 billion in 2009, according to the [National Venture Capital Association](#). These figures show a steep decline; new capital raised by venture funds fell precipitously by 60% from 2008 to 2009.

### Uncertain Times for Securing Traditional Financing

These signs point to cloudy venture funding prospects in 2010 and 2011 for biotechnology companies. In parallel, venture capitalists recognize that in the current environment their portfolio companies will require more investment for a substantially longer period of time because they may need to advance their products further into the clinic or even onto the market before a potential exit. Venture firms consequently have to make difficult choices to fund some

companies and let others be liquidated. All emerging biotechnology firms will be pushed to do more with less.

The common wisdom is that pharmaceutical merger and acquisition activity will continue unabated in the near future because the well-documented impending patent cliff has created a need within this sector to revitalize their internal pipelines. As mega-mergers like those between [Pfizer and Wyeth](#) or [Merck & Co. and Schering-Plough](#) play out, partnership transactions between pharmaceutical moguls and innovative biotechnology companies will be put on hold or abandoned altogether.

In fact, larger pharmaceutical companies are actually terminating some development partnerships. For example, just one year after entering into a [\\$195 million deal with Hydra Bioscience](#) to develop TRPV3 antagonists for pain, Pfizer ended the alliance as part of broader cost-cutting measures.

### **Biotechs Should Turn to Each Other**

The challenge then for biotechnology companies in this financial environment is to find new sources of funding to continue development of their most promising programs. The answer may not lie with the venture community or the pharmaceutical industry.

An emerging trend finds biotechnology companies seeking each other out in some nontraditional ways. For example, NeuroMed, which focuses on pain drugs, and CombinatoRx [recently merged](#). Archemix, an oligo therapeutics firm, [attempted to merge](#) with NitroMed, a developer of cardiac therapies.

Why would companies with such different therapeutic interests merge when, traditionally, development-stage company combinations simply lead to more significant losses and higher cash utilization? Perhaps these recent mergers among biotechnology firms are pointing toward a larger trend.

Consider a common type of biotechnology firm that has three to five programs in development and enough cash for a year. Only one of the company's programs is really promising, but investors and management are unwilling to risk the company on a single program. In this situation, capital is inefficiently deployed on the remaining low-value programs.

Here's how a biotech-on-biotech merger could theoretically work, given the hypothetical combination of a mid-staged inflammation company with a mid-stage oncology company. Let's say that the inflammation firm has five clinical programs, an annual spend of over \$50 million, and slightly over \$60 million of cash on hand (roughly the industry average). The oncology company has three clinical programs, an annual spend of \$40 million, and slightly over \$20 million of cash on hand (again, roughly the industry average).

In the current financial environment both companies will need to liquidate in a year or less if no new capital is raised. If these two companies merge, however, they could rationalize their combined pipelines and sell off noncore assets. The merged entity would then possess over \$100

million in cash, which includes cash obtained through the sale of various assets. This should suffice for perhaps two years or more. The new entity would also utilize existing capital more efficiently against their more promising programs, with an estimated annual spend of about \$50 million.

Unlike a reverse listing, which simply provides access to cash or a public vehicle to raise funds, new biotechnology combinations have the potential to create long-term value for shareholders. This value is released through a long-overdue evaluation and rationalization of products across both pipelines resulting in a more productive allocation of capital to the most promising products.

With continued impetus from the financial crisis, next year could see a surge in merger activity among biotechnology companies as the venture community continues to contract and as the pharmaceutical industry continues to consolidate. The biotechnology companies that capitalize on this trend early will thrive, while those that pause for too long will find few attractive prospects.



Joseph Baron is a partner at Extera Partners, which provides innovative life science companies with interim senior management, business strategy consulting, and hands-on implementation of growth strategies in the U.S. and Europe. Email: [jbaron@exterapartners.com](mailto:jbaron@exterapartners.com).