

# Life Science Leader

Connect. Collaborate. Contribute.

MAY 2022

FINANCE

DEALMAKING

## Is Biopharma Poised For Bigger Deals In 2022?

BENET O'REILLY

*After total deal value in the biopharma industry dipped to \$108 billion in 2021 — its second-lowest level in eight years — it's natural to speculate whether that trend will continue in 2022. Will we see a resumption of transformative dealmaking? Or will we continue to see a high level of lower-value deals featuring bolt-on transactions, partnerships, and alliances?*

**B**iopharma companies are sitting on roughly \$1.2 trillion in firepower, according to a recent report by Ernst & Young (E&Y). But firepower to spend on deals — which includes cash, existing debt, and market capitalization — won't necessarily translate into multibillion-dollar transactions, at least in the short term. Large-scale deals will depend at least in part on broader market conditions. As the conflict in Ukraine shows, market conditions can swing quickly.

The rapid changes in the biopharma industry — including capital supply and allocation — also make it harder to rely on the past to project future dealmaking prospects. Historically, for example, large multinational pharma and biotech companies have served as the most frequent and reliable acquirers of innovative upstarts. To keep their pipelines full, prominent companies essentially outsourced a significant portion of their R&D operations to younger and nimbler upstarts.

The combinations were mutually beneficial. The capital, marketing muscle, and distribution networks made big pharmaceutical companies attractive partners to smaller companies. Those upstarts, often with few employees, typically would take a product as far as possible — frequently through early clinical trials. At that point, they needed a well-capitalized partner to absorb the cost of ushering a drug through subsequent phases. Beyond financing trials, big pharmaceutical companies could also offer well-oiled distribution networks that could efficiently get drugs to consumers and hospitals. They also had large marketing budgets.

### NEW AVENUES FOR CAPITAL

That kind of symbiotic relationship still exists today. But compared to just five years ago, there are many more pathways for smaller companies to pursue capital. Special purpose acquisition companies (SPACs), IPOs, private equity, and royalty stream investors have all offered appealing exit and financing opportunities in recent years.

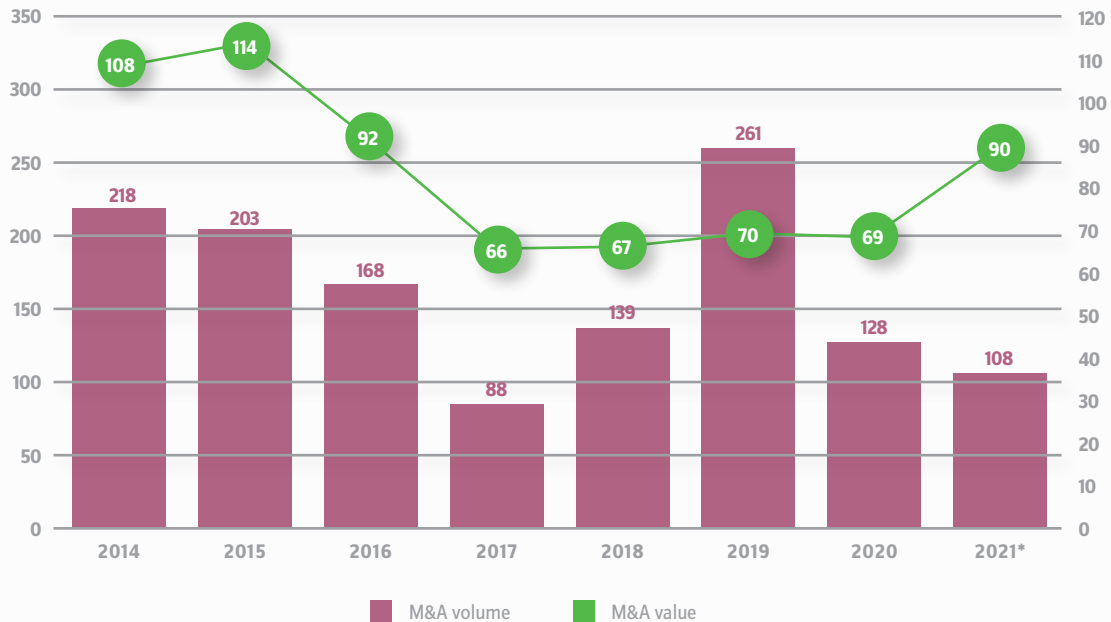
The rising sea of capital has been good news for young innovative companies. Many have seen their valuations — and their leverage over potential investors and acquirers — rise as a result. At the same time, however, lofty valuations have made buying them more expensive and riskier.

Those high valuations may help explain why we've seen more "toe-dipping" in the form of alliances and partnerships. Roughly 1.5 times more was spent on alliances than M&A since the start of 2020, according to E&Y. Those kinds of transactions, which have historically preceded buyouts in many cases, have allowed companies to manage risk and maintain their independence.

We've also seen some big pharmaceutical companies reassess and transform their core businesses. That has led to significant divestment activity. As those companies settle on their future, which may mean selling off more noncore or less profitable assets, they will likely return to a more acquisitive mindset, focused on building scale in their core therapeutic areas. Ultimately, we may see a resurgence of large-scale dealmaking, particularly as investments in digital technologies begin to pay off and lead to differentiation in capabilities.

## TOTAL BIOPHARMA M&amp;A VALUE AND VOLUME (2014 - 2021\*)

In 2021, biopharma M&A was a volume story, as total deal value was one of the lowest on record.



\* Data as of December 15, 2021

SOURCE: EY, Capital IQ

## VARIABLES THAT WILL SHAPE M&amp;A ACTIVITY

Buyers may encounter a less frothy market for potential targets in that environment. Startup valuations, which reached dizzying heights in 2021, have shown signs of softening in recent months. SPACs have also been hit hard. While companies still see SPACs as viable pathways to the public market, investors are now less enthusiastic about pouring money into them. Still, institutions have been pouring money into biotech VC funds, which in 2021 broke 2020's then record-breaking fundraising totals by 26%. So while the tide of capital may have receded, it's unclear to what extent.

The business models of emerging companies could also play into how much M&A we'll see in the short term. Companies specializing in cell therapies, for example, have developed highly specialized and expensive treatments. Those kinds of companies may view the traditional advantages held by big pharmaceutical companies — large distribution and manufacturing capabilities — as less essential than startups in the past.

Ultimately, for major deals to go through, CEOs must have confidence. When markets dive, CEOs tend to become more risk-averse and less willing to make a major acquisition even though those conditions may be ideal buying opportunities. CEOs often find it easier to move with the tide and pursue acquisitions when others are buying, even if at the risk of overpaying. A few are more brave and see a choppy environment as the time to make bold moves.

Yogi Berra said it's tough to make predictions, especially about the future. I might add, especially about the future of biopharma dealmaking. But at least we know many of the factors that will shape it. **L**



**BENET O'REILLY** is a partner with Cleary Gottlieb Steen & Hamilton based in its Palo Alto and New York offices. His practice focuses on public and private mergers and acquisitions, private equity investments, and restructuring transactions.