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Q3: Post-ASCO Public Slump, But Venture Holds Steady

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Editor

Despite the usual summer slowdown and some less-usual contributing factors, like a stock slump on the heels of the American Society of Clinical Oncology (ASCO) annual meeting in June, biotech fundraising continues to inch back from the brink.

Biotech companies raised about $5.34 billion in the third quarter of 2010 – up a bit from the $4.77 billion raised in the second quarter and the $3.45 billion raised in the first quarter, according to data from *BioWorld Snapshots* and *BioWorld Insight*. Yet the sector hauled in $5.2 billion in the third quarter last year, indicating that while the fundraising situation continues to improve, its recovery is on par with the tortoise rather than the hare.

"I think a little bit of realism is setting back in," said Jack Florio, senior vice president with Brinson Patrick Securities Corp. He added that while the financing environment is "not bad," it hasn't turned around "as dramatically as people had hoped."

Blurring the Follow-On Lines

Follow-on public offering activity took a marked dip in the third quarter, with a handful of deals raising a total of just $638 million, down from $929 million in the second quarter and $1.16 billion in the first quarter. And each quarter this year has been slower than the third quarter of last year, when hefty deals from Human Genome Sciences Inc., Onyx Pharmaceuticals Inc. and Qiagen NV pushed the follow-on offering total toward $2.6 billion.

Michael Brinkman, managing director of healthcare investment banking at Jefferies & Co. Inc., attributed this year's sluggish third quarter to a post-ASCO stock dip. He noted that the Nasdaq Biotech Index (NBI) rose from about 600 points in the spring of last year to about 950 points this year, just before ASCO. That run-up caused investors to start taking profits, and the NBI subsequently dipped under 800 in July. Although stocks have since regained some ground, "many companies have not fully recovered," Brinkman explained.

Yet while July and August were particularly slow, September has brought public offerings from companies like Halozyme Therapeutics Inc. and MAP Pharmaceuticals Inc. Additionally, Brinkman pointed to an increase in what he called "wall-cross follow-ons," in which companies market a deal privately for a few days and then sell the rest publicly – as Vical Inc. and NPS Pharmaceuticals Inc. both did in September.

Brinkman also reported that the follow-ons his team has done this quarter have been oversubscribed, which he said indicates "a very healthy market." He predicted a more "robust" follow-on market for biotechs through the remainder of the year.

Alternatives No Longer Last Resort

If public follow-on activity has waned this year, the use of alternative financing vehicles has more than made up the difference.

Biotechs raised a whopping $3.27 billion in the third quarter through private placements, registered direct offerings, rights offerings, at-the-market deals, loans and other such financing alternatives. That's up from $2.24 billion in the second quarter and $834 million in the first quarter. It's also more than double the $1.6 billion raised through such vehicles in the third quarter last year.

A significant chunk of the third quarter 2010 alternative financing total, however, was driven by a single deal that doesn't represent the norm for smaller biotechs: Gilead Sciences Inc.'s $2.2 billion private placement of convertible senior notes. But there were also plenty of private placements and registered directs, which some investors have said are driven by companies taking money however they can get it, despite the fact that these deals usually involve warrants and other discounts.

Brinson Patrick's Florio said he is also seeing increasing interest in other forms of nontraditional financing, like at-the-market deals.

Florio's theory is that biotechs face clinical risk, implementation risk and financing risk. There's only so much that can be done to mitigate the first two, so the third "may be the only risk they can try to take off the table," he said.

Yet doing a public follow-on offering isn't as easy as it once was.

"In the past, the money was always there" when a company hit its milestone and was ready to do its offering, Florio said – but that's not the case any more. As a result, he said biotechs are "starting to see alternative financings as a positive connotation, not a financing of last resort." Having an at-the-market offering or a committed equity financing facility in your back pocket is becoming part of the financing strategy for many biotechs.

Venture Slowly Rising

Biotech venture fundraising is climbing slowly, steadily out of its hole. Private biotechs raised $1.34 billion in the third quarter, about even with the $1.35 billion raised in the second quarter, but up from the $1.1 billion raised in the first quarter. And each of those is better than the $890 million raised in the third quarter of last year.

Driving the third quarter venture numbers were a handful of hefty mid-stage rounds, like Relypsa Inc.'s $70 million Series B and Immatics Biotechnologies GmbH's $70.6 million Series C.

There were also some sizable later-stage rounds, like Reata Pharmaceuticals Inc.'s $78 million seventh round and Pacific Biosciences Inc.'s $59 million sixth round. Both of those late rounds served to position the companies for big things to come: Reata for a giant partnership with Abbott and PacBio for an initial public offering, if all goes as planned.

But the start-ups didn't fare too poorly. Calithera Biosciences Inc. pulled in a $40 million Series A for anticancer caspase activators, while Euthymics Bioscience Inc. closed a $24 million Series A to pick up DOV Pharmaceutical Inc.'s old pipeline.

For an in-depth analysis of third-quarter biotech venture activity, don't miss Cynthia Robbins-Roth's quarterly venture analysis, coming soon in *BioWorld Today*.

Challenges Remain for IPOs

The third quarter brought just two pricings of biotech initial public offerings: a $50 million deal from a Trius Therapeutics Inc. and a $50 million deal from NuPathe Inc. That's less than the $241 million total raised by global biotech IPOs in the second quarter and the $370 million raised in the first quarter – although it's an improvement over the $93 million raised by biotech IPOs in the first three quarters of last year.

As of this writing, Trius was trading about 20 percent below its $5 offering price and NuPathe was trading about 28 percent below its $10 IPO price. In fact, most of the biotech IPOs to price this year have raised less money than they wanted and are now trading below their offering price. Some, like Anthera Pharmaceuticals Inc., have already returned to the markets to raise more money.

Brinkman admitted that the IPO environment is "challenging," yet he maintained that each company's experience is correlated with its strength. Ironwood Pharmaceuticals Inc., for example, which priced in the first quarter and was widely considered one of the best biotech IPO contenders, raised a healthy $216 million and has fallen less than 10 percent from its $11.25 IPO price.

Brinkman isn't expecting the IPO window to burst open any time soon, although he does believe we'll see a continued "trickle of IPO filings and occasional pricing" through the remainder of the year. To be sure, the cool market reception to the IPO pricers thus far has done little to dampen the enthusiasm of IPO hopefuls – 10 of which jumped into the queue with U.S. and international filings during the third quarter.