

Industry Commentary

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European Biotech: What U.S. Equity Market Trends Mean for the Capital-Raising and Deal-Making Landscape

At the BIO-Europe 2015 conference in Munich in November, the outlook for IPO and M&A activity generated a tremendous amount of discussion among business owners and investors across Europe's biotech community. We examine the most important trends shaping capital-raising and deal-making opportunities for European biotech companies.

The last three years have seen unprecedented levels of capital markets activity involving biotech companies. Robust valuations and growing pools of capital focused on the sector in U.S. markets have prompted many of Europe's most promising biotech firms to go public on the Nasdaq or other U.S. exchanges. Equity market volatility in the summer of 2015, however, has raised important questions about IPO and M&A opportunities for European companies in 2016.

In this report, we examine the reasons for European biotech companies' preference for U.S. markets and identify the characteristics that U.S. investors are seeking in IPO candidates. We also look at how the recent IPO boom has shaped M&A activity in the biotech industry.

The Appeal of U.S. Listing

European biotech companies have shown a strong preference for going public on U.S. markets as opposed

to domestic markets, and there are several reasons for this phenomenon. Most importantly, U.S. markets provide greater access to capital. The vast majority of dedicated biotech funds and other investors focused on the sector prefer to deploy capital on U.S. exchanges. Despite this preference for investing via U.S. markets, geography is not one of the primary factors that biotech investors consider when evaluating the fundamentals of a company's technology or clinical assets. Investors use the same criteria to assess a company regardless of whether the company is based in the United States or Europe.

U.S. markets also tend to be more supportive of earlier-stage companies. Conversely, European investors tend to be more focused on later-stage companies and revenue generation. A company that is looking to raise, for example, €50 million to fund the development of a product likely will face more challenges in getting funding on European markets than on

U.S. markets. U.S. markets often will be very supportive of such an offering if the company has an attractive product and several of the characteristics of high-quality IPO candidates that we identify below.

The higher trading volume of U.S. exchanges is advantageous for biotech companies because it reduces risk for investors. By eliminating the “illiquidity discount,” higher trading volume leads to higher valuations for issuers. In addition, having more consistent access to capital through U.S. markets reduces balance sheet risk, which is very important for cash-burning businesses such as biotech companies.

IPO Activity Begins to Level Off

The last three years have seen an unprecedented surge in biotech IPO activity. From 2013 through November 30, 2015, there have been 193 biotech IPOs, which cumulatively have raised \$18.6 billion. From 2009 through 2012, by contrast, there were only 37 biotech IPOs, collectively raising \$3.5 billion.

The sector’s strong momentum of the last three years has been somewhat interrupted by the renewed volatility that rattled equity markets in August amid fears of China’s slowing growth, uncertainty about U.S. interest rates, and depressed oil prices. In addition to this macro volatility, biotech valuations dipped again in late third quarter and fourth quarter as politicians in the U.S. Congress and on the presidential campaign trail vowed to address the industry’s pricing practices.

Even without these headwinds, the surge in biotech IPO activity was unlikely to continue at its recent pace for much longer. While we expect markets to remain quite favorable for high-quality biotech companies, we anticipate that IPO activity will gradually return to a more sustainable pace in 2016.

Characteristics of High-Quality IPO Candidates

Given the amount of capital focused on the biotech sector, high-quality European companies will continue to have ample opportunities to

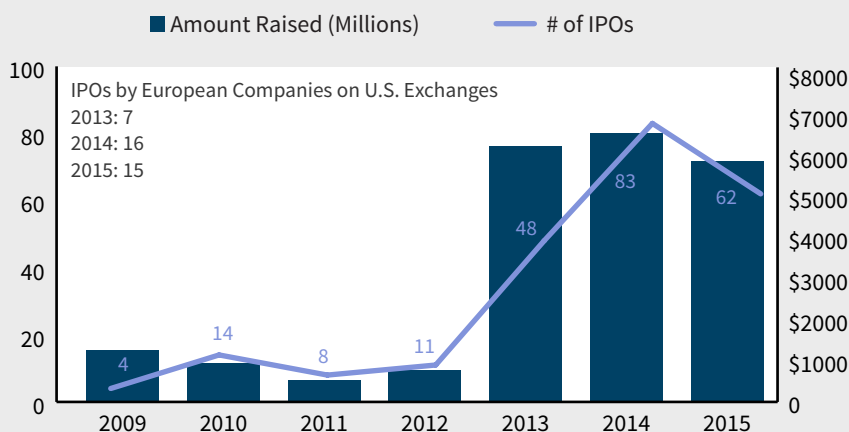
BioNovion Acquired by Aduro

William Blair advised BioNovion on its acquisition by Aduro Biotech. A Netherlands-based biotech company that specializes in immune-oncology antibody discovery, BioNovion has developed a proprietary technology to rapidly produce a broad library of therapeutic antibodies against validated targets. William Blair conducted a highly competitive process and showcased how BioNovion’s technology platform and European headquarters would be an ideal strategic fit for Aduro.

William Blair’s healthcare investment banking franchise has delivered outstanding results for biotech companies across Europe and the United States. Since 2014, William Blair has completed more than 50 biotech transactions.

Biotech IPO Activity on U.S. Exchanges

There has been an unprecedented surge in biotech IPO activity since 2013, and during that time 38 companies based in Europe and Israel have gone public on U.S. exchanges.



Source: Dealogic, as of November 30, 2015

go public on U.S. markets. Regardless of where a company is based, U.S. investors typically look for the following characteristics when evaluating IPO candidates:

- **Composition of existing shareholder base:** Having top-tier venture capital firms, large corporate investors, and/or crossover funds in the existing shareholder base makes a company a more attractive IPO candidate. Backing from venture funds that have a track record of success in the sector or from global life sciences and pharmaceutical corporations can serve as a de facto stamp of approval in the eyes of public investors.

Crossover funds, which are funds that invest primarily in publicly traded companies but also invest selectively in private companies, are particularly valuable to have as investors because they represent a built-in base of institutional shareholders for when the company goes public. A crossover

fund that has already made a private investment in the company will likely be one of the largest orders in an IPO.

- **Disease indication's competitive dynamics and market opportunity:** Investors will pay close attention to the therapeutic area that the technology addresses. In addition to looking at the size of the end-market, investors will also look at the degree of competition in that market. Technologies that are among the first to target a relatively small patient population can be more attractive investments than technologies that target therapeutic areas that are already being addressed by several competitors.
- **Proof-of-concept data with human subjects:** How far along a company is in development plays a large role in the company's appeal to public investors. For a company to be a viable IPO candidate, investors typically prefer to see proof-of-concept data involving

human subjects. While this rule generally applies, investors have shown a willingness to fund early-stage companies in certain disease indications or technologies. Over the past two years, a handful of preclinical companies have had successful offerings.

- **Strength of pipeline:** Investors will evaluate the quality and quantity of a company's development pipeline. Companies with an interesting technology platform that involves multiple products and a research team with a track record of product development will be more attractive to investors than a company with a single product.
- **Strategic partnerships:** A partnership with a large pharmaceutical company can serve as an important form of validation and funding for a biotech company. These partnerships can help a biotech company advance through an investor's screening process. It is important to note, however, that investors will closely evaluate the structure of the partnership to determine whether it has limited the investment's upside potential.

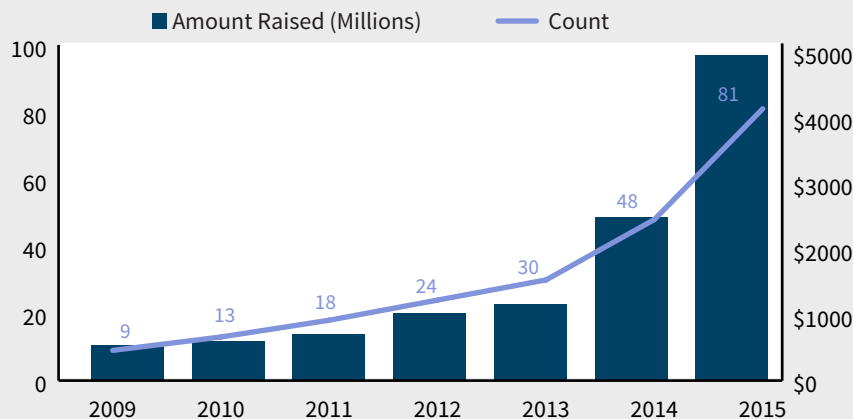
A company does not need to check all of these boxes to go public, but companies that can display most or at least several of the characteristics will be very attractive to investors.

M&A Becoming a More Attractive Path

Over the last six months, we have seen an increased willingness by high-quality private biotech companies to explore sale opportunities. During much of 2014 and the first half of 2015, many private biotech companies were focused exclusively on going public given the lofty valuations and highly accommodative public equity

Biotech Pre-IPO Rounds Involving Crossover Funds

When evaluating IPO candidates, investors will closely analyze a company's existing shareholder base. Investments by crossover funds add to the attractiveness of an IPO candidate because these funds represent a built-in base of institutional investors and validation of the company's technology



Source: BioCentury; as of November 30, 2015, includes only pre-IPO rounds greater than \$20 million.

markets. Much of the M&A activity in biotech over the last several years involved the sale of companies that were already public. But as the IPO market has become more challenging, M&A activity has become a more viable option for promising private companies.

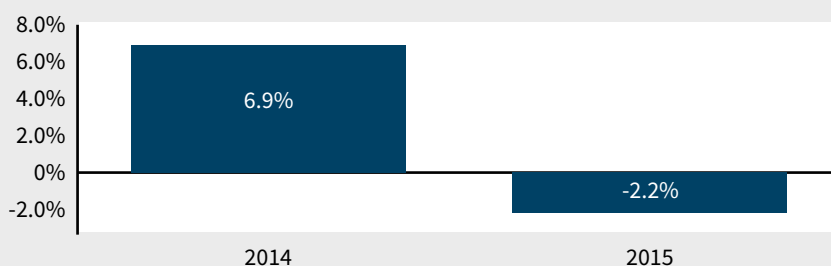
On the demand side of the equation, strategic acquirers' interest in biotech has remained fairly consistent over the past four years. Unlike specialty pharma, which has seen a spike in

M&A activity driven by cheap debt and public investors who have been rewarding acquisitions regardless of strategic alignment, biotech acquirers have remained focused on strategic fit. When evaluating an acquisition target, biotech acquirers place a high value on intellectual property and exclusivity. From a stage-of-development perspective, acquirers look for proof-of-concept data and generally like to see that the target company has completed Phase II clinical trials.

We will continue to closely monitor these and other trends that are shaping the capital-raising and deal-making landscape for European biotech companies. To learn more about what these trends mean for M&A and IPO opportunities in European biotech, please do not hesitate to contact us.

Performance of Biotech IPOs

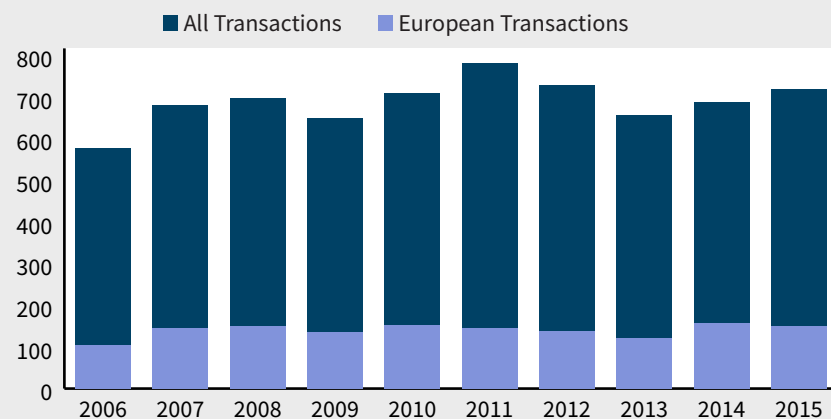
Equity market volatility and increased scrutiny of drug pricing practices from U.S. legislators and presidential candidates have resulted in weaker aftermarket price performance for biotech IPOs in 2015.



Source: Dealogic; 2014 data reflects median performance through 12/13/14, and 2015 data reflects median performance through 11/30/15.

Biotech Pre-IPO Rounds Involving Crossover Funds

Much of the M&A activity in biopharma over the last several years has involved publicly traded targets looking to cash in on robust valuations. But as the IPO market has become more challenging over the last six months, M&A activity has become a more viable option for promising private companies.



Source: Dealogic; as of November 30, 2015.

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