Reuters Legal News

Life sciences investors gear up for IPO readiness

By Christopher Miller, Esq., Troutman Pepper Hamilton Sanders LLP

JUNE 5, 2023

For life sciences investors, the question on everyone's mind is when the IPO market will reopen. After last year's IPO slump, company valuations are down and there's stiff competition for private funding. These financial conditions have created a buyers' market, and now private equity and venture capital funds are assessing their existing portfolio companies so they can successfully pivot in this long-beleaguered market.

So far, the IPO bust of last year has bled into 2023. In biotech, there were only five IPOs in Q1, compared to 17 in Q1 of 2022. For investors, the question remains: Will things get worse before they get better, or will the IPO window open in the second half of 2023?

Here's current investment activity we're seeing in the life sciences industry in 2023, and what it means for IPO readiness. This article also discusses strategic measures companies may consider in terms of financing and raising capital as they wait to see which way the market is headed.

The market upswing may soon be here

For the past year, "down 10%" has been the new "up" for valuations of life sciences companies. But some companies with positive data have been able to achieve an actual "up" round. With private financing valuations on the rise, there's optimism that the IPO market may soon be back on track for companies with positive clinical data.

In biotech, there were only five IPOs in Q1, compared to 17 in Q1 of 2022. For investors, the question remains: Will things get worse before they get better, or will the IPO window open in the second half of 2023?

While biotech companies with good data read outs are in prime position for a successful IPO if the market begins to improve in Q3, there's no guarantee on this timing. In the meantime, biotech companies must also conserve cash — at least enough of it — so they can survive if the IPO market doesn't jumpstart in the coming months.

Timing is everything, and investors in the life sciences industry must be prepared for all possibilities — whether the IPO market heats up in the second half of 2023 or the hiatus continues for the rest of the year.

It's a balancing act for biotech companies

In this difficult market, companies between data read outs are struggling to obtain funding. However, it's still possible for companies to secure financing to make it through the current stage of clinical trials. Even so, it's a balancing act for biotech companies to remain operationally agile, while maintaining enough cash to keep the lights on long-term.

With the possibility of the IPO market heating up as soon as Q3 this year, bridge loans are becoming the go to for investors looking to keep their portfolio companies afloat.

Since cutting down on operations creates the risk the company will not be IPO ready when the time comes, creativity is key. In addition to raising capital where they can, biotech companies can take other strategic measures to conserve cash, such as seeking non-dilutive financing, negotiating with existing vendors to extend payment windows, or putting some development opportunities on hold.

Raising capital at a discount is better than no capital at all

While development stage companies need cash on hand to complete clinical trials, growth stage companies with products on the market are striving to get to cash flow positive. But some companies may be hesitant to obtain financing at a lower valuation.

However, life sciences companies unwilling to raise additional capital at a discount risk running out of cash if an IPO is not possible in the short-term. As a result, some companies are willing to take the financial hit upfront, so they are not forced to sell in a weak M&A market at a later date because they've exhausted their cash runway.

Bridge loans bridge the IPO gap

With the possibility of the IPO market heating up as soon as Q3 this year, bridge loans are becoming the go to for investors looking

Thomson Reuters is a commercial publisher of content that is general and educational in nature, may not reflect all recent legal developments and may not apply to the specific facts and circumstances of individual transactions and cases. Users should consult with qualified legal counsel before acting on any information published by Thomson Reuters online or in print. Thomson Reuters, its affiliates and their editorial staff are not a law firm, do not represent or advise clients in any matter and are not bound by the professional responsibilities and duties of a legal practitioner. Nothing in this publication should be construed as legal advice or creating an attorney-client relationship. The views expressed in this publication by any contributor are not necessarily those of the publisher.

THOMSON REUTERS®

to keep their portfolio companies afloat. While it's fairly common for bridge loans to convert to equity at a discount, investors may be willing to be flexible, provided the valuation is within investor expectations.

But current market conditions could leave the door open for some investors to take a predatory approach with their own portfolios. This is especially true where investors will only agree to a bridge loan with a steep conversion discount, in addition to an expected financing at a reduced valuation. Additionally, conversation caps within the bridge loan can grant even greater benefit to investors.

Venture debt is a risk that investors may not be willing to take

Investors are keen to hedge their risk, particularly when a company's IPO readiness hinges on clinical trial results. While venture debt can provide a fast, non-dilutive cash infusion, it puts investors at greater risk in an uncertain market. It can also be a dealbreaker for future investors if the company takes on additional debt before it has a steady revenue stream, as new investors may not want their dollars used to pay down existing debt.

In this tough equity financing market, lenders are hesitant to issue venture debt when the company is struggling to raise equity. But if venture debt is on the table, there will be strings attached. Expect to see contingent loan structures, subject to milestones. Lenders will also be more likely to extend financing when there is a strong investor base that is ready to provide a cash infusion if necessary.

Christopher Miller is a regular contributing columnist on transactions and financing in the life sciences industry for Reuters Legal News and Westlaw Today.

About the author

Christopher Miller is a partner in the life sciences group at **Troutman Pepper Hamilton Sanders LLP** and concentrates his practice in the areas of mergers and acquisitions, private equity, venture capital, securities, technology law, and general corporate matters. He represents U.S. and foreign public and private companies and private equity funds in merger and acquisition transactions and private equity funds and emerging companies in venture capital, growth equity and debt financing transactions. He regularly counsels companies in the information technology and life science industries on general corporate matters and in connection with licensing and commercialization agreements. He is located in Berwyn, Pa., and can be reached at christopher.miller@troutman.com.

This article was first published on Reuters Legal News and Westlaw Today on June 5, 2023.

© 2023 Thomson Reuters. This publication was created to provide you with accurate and authoritative information concerning the subject matter covered, however it may not necessarily have been prepared by persons licensed to practice law in a particular jurisdiction. The publisher is not engaged in rendering legal or other professional advice, and this publication is not a substitute for the advice of an attorney. If you require legal or other expert advice, you should seek the services of a competent attorney or other professional. For subscription information, please visit legalsolutions.thomsonreuters.com.