Cash is king in biotech M&A, but will clinical data be a saving grace?

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Biotech companies are hemorrhaging cash, and Big Pharma can smell blood in the water. Last year's IPO slump left most biotech companies unable to raise capital from public offerings. With many biotech companies at the end of their cash runways and the public markets essentially closed to them, there's fierce competition for funding in the private market and only so much cash to go around. As a result, M&A with Big Pharma may be the only way for some companies to get their products to the research and development (R&D) finish line.

And Big Pharma is ready to pounce. Over the next decade, pharma firms will be taking a major revenue hit due to loss of exclusivity for their most lucrative products. Competing generics and biosimilars will be taking over the market share, and there's not enough coming down Big Pharma's R&D pipelines to soften the financial blow. To boost their bottom lines, pharma firms are on the hunt to acquire biotech innovation.

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Big Pharma has the negotiation leverage with cash in hand and plenty of biotech companies on their last legs. But some companies might not be ready to give up without a fight, and those with the right clinical data readouts may just make it out alive.

Data readouts may be a matter of survival

For biotech companies running out of cash but not ready to sell, their best bet may be to limp to their next clinical data readout.

Biotech startups are struggling to find fresh financial backing. A company's existing investors could be holding the cash reserves the company desperately needs but will want to know their risk exposure before providing more funding. These existing investors will hinge their decision on the outcome of the current trial phase and whether data readouts show promise for continued product development.

For biotech companies with cash falling short of their next clinical trial stage, cobbling together enough funding to make it to the next data readout could make all the difference. Companies with multiple product candidates in the pipeline may have to prioritize them and conserve cash by slowing down the development of certain products.

However, cash-strapped biotech companies that fall short of the next trial phase or have a poor data readout may find themselves with no other choice but to sell.

Due diligence could cause slowdowns

For biotech companies running low on cash and unable to bridge the financial gap, a speedy M&A transaction will be essential to getting the most favorable deal terms. This makes the due diligence process a potential pinch point acquirers can use to their advantage. Buyers will be incentivized to drag out the diligence timeline, knowing the biotech target's negotiation power will wane as time lapses and money starts running out.

A biotech company expecting an M&A transaction should endeavor to get out ahead of it. This means proactively reviewing and consolidating due diligence documentation, as well as resolving any identified concerns, well before a potential buyer gets involved.

During the initial phases of a potential transaction, biotech companies should also carefully negotiate the letter of intent to establish timing and expectations, so there are no misunderstandings of the essential elements of the deal. This will reduce the possibility of losing leverage from a drawn-out diligence process.

Contingent payment structures allocate (and create) risk

Competition for late-stage assets has been high, but purchasers have to pay a premium for products that are ready to go to market. Now that more early-stage biotech assets are up for grabs, buyers will be looking to allocate risk should an acquired product fail to make its way through the R&D process.

Contingent payment structures, such as milestone payments and royalty-based fee arrangements, are becoming more common in M&A transactions. Particularly if the target asset is in earlier stages of development.

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But biotech companies should beware of the risks as well. If the buyer isn't dedicating the necessary resources to the product's development post-acquisition, the seller might not hit the milestone targets needed to receive the full purchase price.

Disputes over commercially reasonable efforts

With many biotech companies selling at lower valuations, acquirers don't need to be as selective with their purchases. Some may be snatching up more assets than they need, only to let their less promising products go cold on the R&D pipeline.

Acquirers and targets subject to contingent payment structures should be focused on deal terms related to the acquirer's obligations to bring the product to market. If standards for a buyer subject to a contingent payment obligation are ambiguous, it may create headaches for the selling biotech company down the road.

During negotiations, biotech companies need to set specific benchmark requirements for the acquirer. If the parties rely on general contracting terms, such as merely requiring the buyer use "commercially reasonable efforts" to bring the product to market, the selling biotech company may be setting itself up for an uphill litigation battle if the buyer is later in breach of its obligations.

Collaborations and partnerships

With Big Pharma aiming to mitigate risk exposure and biotech companies looking for a cash infusion, collaborations and partnerships are also on the table. Pharma firms can keep their options open and allocate risk by entering these arrangements, since it requires less cash up-front and can provide an option to acquire the asset after development is complete.

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.

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