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Loxo’s Bayer deal falls short of bullish expectations

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Loxo Oncology pulled off a rare feat in the world of cancer drug development: it signed a licensing deal with a bio-dollar total in excess of $1bn and saw its valuation shrink.

The deal appeared to disappoint investors who had expected Loxo to convert its lead in the Trk inhibition space into a commercial advantage over rivals like Ignyta and Mirati. Possibly making things worse is the fact that Loxo’s senior partner is Bayer, which does not make the top 10 of oncology companies globally and thus might not have the muscle of a Roche or Novartis.

About face

Loxo shares fell 11% today as shareholders absorbed the news, on a day in which the Nasdaq biotechnology index fell more than 1%. In another time the deal might have had a better reception – after all, the transaction will see Loxo receive $400m up front, and executives said this morning that between that signing fee and some near-term milestones they expected payments from Bayer to total $975m by the end of 2018.

But Loxo as recently as two weeks ago had been guiding investors to expect a solo commercial launch, allowing the group to retain all the economic value of larotrectinib and LOXO-195, which combined are worth more than $2bn in net present value, according to *EvaluatePharma*’s consensus of sellside analysts.

That Loxo executives agreed to a partnership that fell short of this – the total value of the up-front fee plus milestones is $1.1bn – could be taken as a tacit admission that Bayer and Loxo alike believe the assets to be worth less than the sellside reckons, although revenue from the 50% US co-promotion could push their value closer to that $2bn figure (*The sector’s most valuable unpartnered assets – up for grabs or on the shelf?, August 22, 2017*).

Selling themselves short?

Alternatively, the investor reaction could be a vote of no confidence in a management team that they believe miscalculated in settling for a low-ball offer from a second-tier oncology player – and, importantly, the conclusion was a licensing and co-promotion deal rather than a trade sale.

On the other hand, long-term investors might have simply seen this as a timely exit point, as few catalysts for larotrectinib remain before regulatory decisions – anybody who bought Loxo shares ahead of Asco 2017 and sold today will have received a 73% return.

In terms of a commercial proposition, there is some sense in a Bayer tie-up. Loxo executives pointed out that because of its existing oncology line Bayer sales reps were calling on the same specialists that would be prescribing larotrectinib – those working in thyroid and gastrointestinal tumours where Trk mutations are common.

Loxo, meanwhile, will work with the laboratory and diagnostic side to raise awareness of the test for the Trk mutation, which will be essential for identifying patients who may respond.

Despite the apparent investor disappointment, this deal should by no means be viewed as the end of the world. Taking Bayer's approach with its former oncology partner Algeta as an example, an eventual acquisition could be the endgame. It just might not happen in a way that satisfies today's investors.

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