Evaluate Vantage

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Biopharma throws grease on the deal wheels

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Company takeovers with promises of more cash down the road ticked up this year, a new Evaluate Vantage analysis finds.

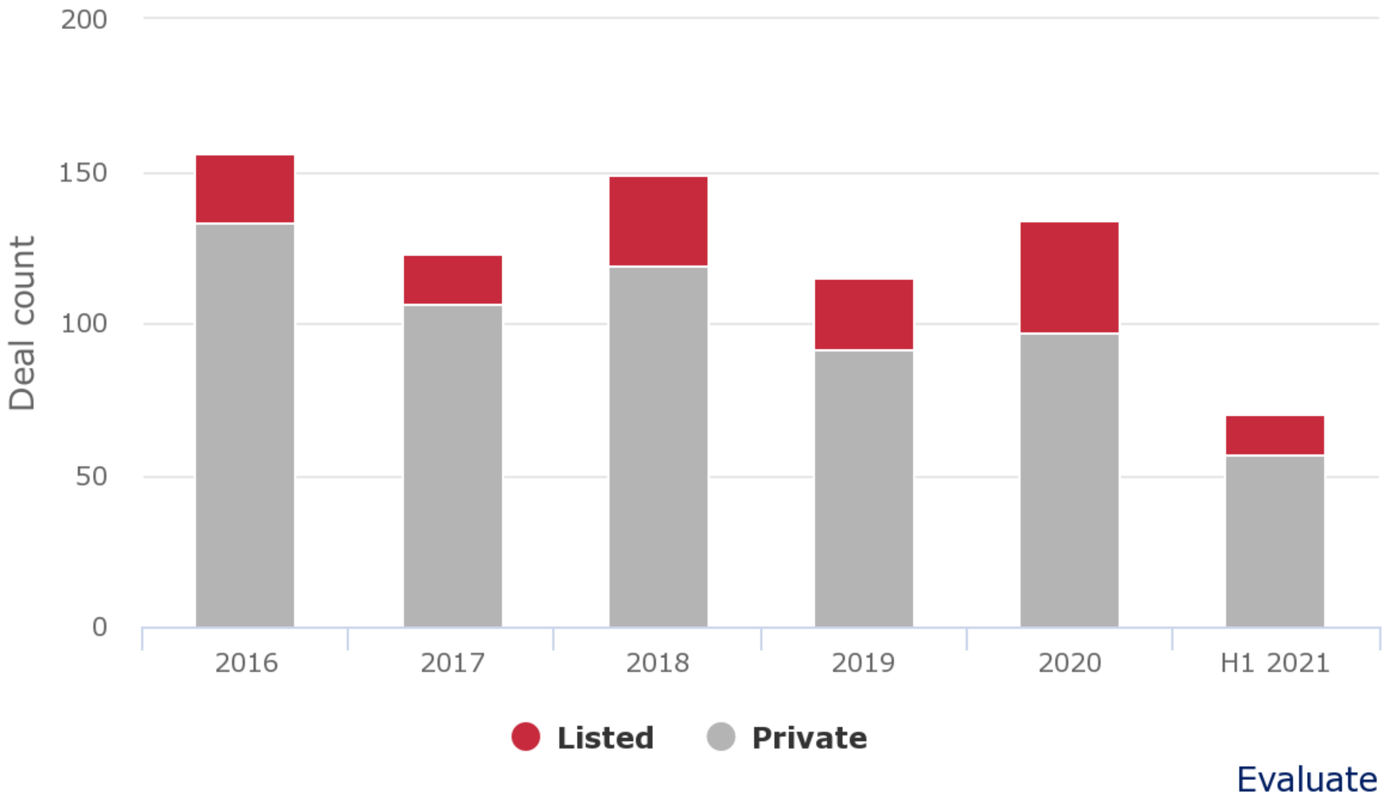
A quiet spell for biopharma M&A has investors anxiously waiting for the next big takeout, but with valuations sky high it seems that bankers are continuing to grease the deal wheels to get transactions done. A quarter of the acquisitions announced in the first half of this year involved disclosed downstream payments, a big uptick on 2020 and one of the highest proportions in the last five years.

These future outlays, contingent on certain clinical or commercial milestones being hit, can be used to bridge disagreements over valuation – and shield the buyer from criticisms of paying too much. Interestingly, the number of deals with this structure has risen more noticeably in acquisitions of listed companies, although this approach is most frequently seen in private buyouts.

A major caveat here is that numbers are small, particularly with the incomplete data for 2021, making reliable trends hard to spot. For example, this *Evaluate Vantage* analysis of *Evaluate Pharma* data finds that three of the 13 takeovers of listed biopharma companies that closed in the first half 2021 used a delayed payment mechanism.

A separate *Evaluate Vantage* article recently noted a quiet few months for M&A activity. If buyers are determined perhaps they should be considering these potential sweeteners to bring sellers to the table.

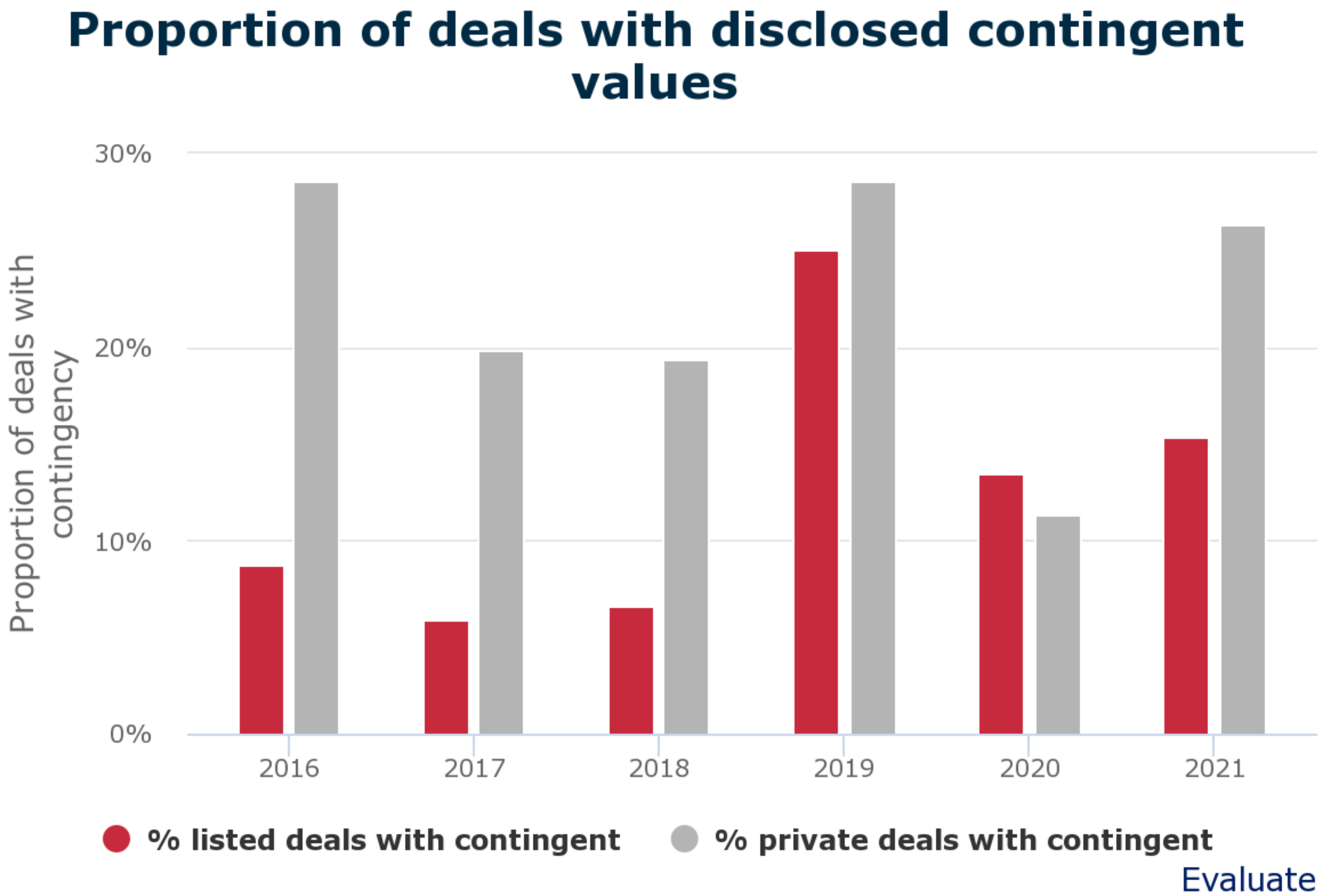
Biopharma M&A: private and listed company takeout counts



The volume of takeouts of private companies has slowed in recent years, the chart above shows; the vast majority of these targets will have been backed by venture investors, which rely on buyouts for a big pay day. This retrenchment is presumably down to the private financing boom, which has driven valuations higher and made start-ups less inclined to seek a buyer.

The next chart shows the proportion of M&A deals that included a contingent payment. The overall rise in the listed cohort over the past few years suggests that lofty stock market valuations are having an impact on deal negotiations.

Recent examples include Lilly's $880m takeout of the gene therapy player Prevail, which included a contingent value right worth $160m payable on first regulatory approval. And when Alexion bought Achillion in 2019 for $930m, or $6.30 a share, it offered a further $2 per share if certain milestones were hit.



The extent to which these delayed sums actually get paid out is hard to know. In all likelihood a very small proportion of what is offered ends up leaving the buyer's bank account. But these promises do inflate estimations of the value of transactions in any year, unless data are adjusted to include only initial payments.

In much the same way that licensing deal announcements highlight the “bio-dollar” amount – the total value of a transaction should all milestones pay out – takeover deals with downstream payments also tend to focus on the bigger sum. Using the period from 2016 as an example, the combined contingent value across all deals (public or private) has ranged from 4% to 15% of biopharma’s “total” M&A spend.

A further finding is that the up-front portion of an M&A deal, on average, represents 42% of the total transaction value, at least across the period of this analysis. A wide range sits behind this number, however, and up fronts associated with takeouts of listed companies tend to be higher than those seen in private buyouts – 64% versus 39% respectively.

The use of contingent payments will always been seen more widely when valuations are high, of course. The M&A requirements of larger developers do not wax and wane with economic cycle, however, so while young developers remain well funded, expect to see contingent payments used more widely.

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