Evaluate Vantage

July 21, 2022

Private equity gets serious about drug development

Amy Brown

Venture capital has the brains, private equity has the books – can they make lots of money?

Private equity is going shopping, and biotech venture funds are on the list. Three deals in the past few months suggest this to be true: EQT's acquisition of LSP, Carlyle's Abingworth buyout and, most recently, Sofinnova's sale of a minority stake to Apollo.

For the buyers, these moves were not about adding scale; Carlyle could raise the $2bn that Abingworth had under management with a shrug of the shoulders. They were about adding expertise in a complex area, and being able to offer investment opportunities in a sector that Covid proved to be critical.

"Some aspects of business you can apply broadly in many industries, but healthcare is very different," says Thilo Schroeder, managing partner at Nextech Invest, a European oncology-focused venture fund. "Building expertise internally takes time – or you buy a fund and bring it in overnight."

Similar deals are expected to follow. Large private equity groups and asset managers have broad but fundamentally identical business models, and a life science specialism is, for now, a unique selling point, says Otello Stampacchia, founder of the biotech venture firm Omega Funds.

"Life sciences has become another arrow to add to the quiver for these firms," he says. Omega has been approached by suitors, but "we're not entertaining offers right now".

Private equity's interest in the venture world is not new, of course. Blackstone's acquisition of the US life sciences fund Clarus in 2018 was probably the first overt statement of intent. Other houses, like General Atlantic, KKR and TPG have been building teams organically for a few years now.

But these recent deals represent an acceleration of this strategy. It is surely no coincidence that this happened in the wake of the pandemic, which prompted global investors to flood towards the drug development sector.

What has changed?

The biotech venture capital model, which sees firms placing numerous small bets on high-risk start-ups, is not typically private equity's investment style, which leans towards much larger deployments of capital. These PE firms must have seen opportunities beyond the fundamental importance of healthcare.

One explanation is that private equity has been persuaded that it can play a role in filling a funding need that developers face in the later stages of clinical development. This is when demands on cash grow substantially, beyond the means of many venture backers.

This is particularly true in Europe, where small developers and their backers often have no choice but to sell or license promising assets. For a while they could tap the US markets, although for now that window is closed.

Many European venture funds, including Abingworth, LSP and Sofinnova, have been offering so-called growth capital for some years, in an attempt to address this funding gap. But demand is greater than supply, and the arrival of private equity could signal an expansion of these strategies.

Nextech's Mr Schroeder reckons that deep pockets will be welcomed as the sector braces for a tough couple of years on the fundraising front, but also for the longer term as well.

"It will be great for the industry if we can create alternative funding mechanisms, rather than going public. In the tech industry it's already common. So why not in healthcare? I can see a need and a rationale for that," he says.

He also believes that big pharma cannot be considered the solution they used to be, in terms of taking over clinical development of promising assets via licensing or M&A. Partly this is because of balance sheet pressures, but capacity is also an issue. The number of large biopharma groups has stayed largely static over the past 10 years, he points out, while the number of smaller companies and assets has ballooned.

All about growth

The closing of the equity markets for biotech makes the logic behind these collaborations even sounder, the venture firms that have struck these deals with private equity argue. Access to deep pools of capital will allow them to support their existing portfolio companies for longer, where necessary, and make new investments while valuations are low.

For the venture firms, these deals were all about growth. As Antoine Papiernik of Sofinnova tells *Evaluate Vantage*, any company with growth ambitions needs more money. More from Mr Papiernik and Tim Haines of Abingworth regarding the individual circumstances of their transactions later.

But what might private equity's incursions mean for biopharma more widely? Large drug makers remain perfectly happy to pay a premium for de-risked assets, and will surely welcome new entities willing to take on the risk and expense of late-stage development.

More collaborations like that between Abbvie and Calico Life Sciences will perhaps emerge. This has seen the pharma group plough billions into the Alphabet-founded firm in exchange for early-stage R&D and options over any promising assets. Astrazeneca, meanwhile, recently expanded its partnership with Avillion, the clinical co-development group owned by Abingworth and Blackstone, demonstrating appetite for these sorts of arrangements.

Still, an abundance of capital does not necessarily mean better decisions. Many believe that the recent venture capital boom, which turned into an IPO boom, damaged the early-stage biotech sector by allowing too many weak companies to progress. Ultimately this turned investors away from the sector.

European investors would no doubt argue that they are a long way from an abundance of capital. But the pressure is on for these newly minted venture firms to prove to their new backers that they can pluck needles from haystacks.

Drug development will always be expensive, and the failure rate will always be high. Private equity is known for ruthless efficiency for good reason. The question is, how much failure can they take?

Abingworth and Carlyle: evolution of a deal

Abingworth had been working closely with private equity for years, although not with the firm that bought it. The genesis of the Carlyle transaction was via a relationship with another party, Tim Haines, the UK venture firm's managing partner, tells *Evaluate Vantage*.

That party was PPD, a contract research organisation that was bought by Thermo Fisher last year, leaving the CRO's top team looking for new avenues. "We knew the PPD team very well; they had been an investor in our funds, and they approached us and Carlyle with an idea for a biotech, similar to Avillion and SFJ," he says.

Avillion and SFJ are the two clinical co-development groups that Abingworth backs with Blackstone. That private equity firm inherited the set up when it bought Clarus in 2018.

"The PPD guys wanted to evolve that [clinical co-development] model… to look at opportunities to in-license assets and see them through to approval and either auction them or even launch them," Mr Haines says.

The idea can also be seen as an evolution of the asset-centric company formations that several venture funds have embraced in recent years, but involving later-stage projects and larger deployments of capital – hence the rationale behind bringing in private equity.

Thus Launch Tx was born, a company unveiled at the same time as the Abingworth-Carlyle deal. Launch will be run by PPD's former chief commercial officer Anshul Thakral and backed by Carlyle. Avillion and SFJ will also continue, albeit with one significantly larger parent, "working in slightly different geographies and doing slightly different things" to Launch.

"There is more than enough room" for these three companies, Mr Haines says, adding that the need for alternative funding options is only going to grow. "Public biotechs are going to struggle to raise capital for a while, at a level that won't be massively dilutive."

Talks about founding Launch triggered discussions about Abingworth becoming the life sciences arm of Carlyle, he says.

"I don't believe Carlyle were shopping. We didn't approach them. We didn't approach others. We established a relationship and it felt like a good fit," Mr Haines says.

Abingworth will operate independently, he adds, pursing the same strategies as previously while benefiting from having "a very large parent".

Those benefits include being able to access the fundraising machinery that a large PE house runs, as well as the broader geographic footprint. Carlyle has a significant team in China, which Mr Haines sees as holding potential for both early-stage investments and opportunities for Launch, given the FDA's wariness about China-only data.

He is clear, however, that Abingworth will continue to back early-stage science. One concern that has emerged in the wake of these buyouts is that seed capital for company formation will dry up as three big players move towards late-stage opportunities.

Mr Haines maintains, however, that operating early is essential to be able rigorously to evaluate the late-stage opportunities that Launch Tx, and Carlyle, will be interested in pursuing.

"We will be betting the ranch that we can get likelihood of [clinical] success well above 70% … by our insights, by re-doing studies, negotiating with regulators etc. So you need to know the CEOs and the biotech companies. But even more critically you had better understand the science pretty profoundly," he says.

Sofinnova and Apollo: active engagement

Antoine Papiernik, Sofinnova's managing partner, maintains that his firm's deal "is totally different" from the other transactions in this space. In many ways he is correct. For a start, Apollo is an asset manager rather than a private equity firm, but more importantly the finance group will not completely swallow the European venture firm.

Apollo is taking a minority interest in Sofinnova and committing up to €1bn of managed capital to the venture firm's investment funds, an arrangement that Mr Papiernik describes as "having our cake and eating it".

"We're not relinquishing any of our independence, and being connected to people who will be very helpful," he says.

The deal was all about helping Sofinnova grow. A process to find a partner was started around 18 months ago, and attracted interest from some pure financial firms as well as strategic investors like Apollo.

"Some strategics wanted to buy and we were very clear we did not want to sell. We also said independence was key," Mr Papiernik says. "Apollo shared the same view from a different perspective. In fields [in which] they are not present they would rather be a partner than an acquirer. They want knowledge not control."

Sofinnova also considered it important for the investor to "put their money where their mouth is" and commit cash to the venture firm's funds. Gaining access to Apollo's investors, via its huge limited partner base, will also be a big draw.

"We spend a huge amount of time fundraising. But we have one person that deals with IR – they have hundreds. We have up to one hundred LPs, they have 1,500 LPs," he says.

"Often the sovereign funds, big pension funds, we don't move the needle for them, we're too small, so we can't access them. But through [Apollo], through the relationship and hopefully because they can say 'these guys are really good and we're putting investment in the fund', that will help to sell what we do."

Apollo, meanwhile, will gain knowledge and connections within the early-stage life science world that will inform its decisions when it does later-stage deals, Mr Papiernik says. Healthcare is not a completely new sector for the group, which has already invested around $5bn in the area, although previous activity has been around mature companies.

The final aspect of the transaction is about cash for new funds, to take Sofinnova in new directions. Mr Papiernik declines to say what they might entail.

“We’re not excluding anything, but it needs to be coherent with what we do today. It’s under discussion,” he says.

It seems likely that any new funds will focus on later-stage opportunities, where bigger sums are required. Sofinnova already has funds targeting this space, but a ballooning biotech sector and, more recently, the downturn on the markets, means demand is only going in one direction.

“In Europe in particular we are pushing our companies to exit at too low prices or on to markets with low liquidity. We need funds that can take products from phase 2 to the market,” Mr Papiernik says.

He believes that the current downturn will be “particularly tricky”, but that this makes having plenty of cash on hand, via the Apollo deal, even more important.

People who had cash after previous financial crises made “momentous returns”, he says.

“If you don’t have cash right now you’re in deep trouble. If you do have cash, there are great opportunities. Apollo also recognises this.”

There is also the small fact of existing portfolio companies, which are going to need supporting for longer. “Anyone who doesn’t think this is delusional,” he says.