Evaluate Vantage

March 17, 2010

Short term pain for long term gain from Lexicon's ambitious financing

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Lexicon Pharmaceuticals launched an audacious bid yesterday to raise $165m through the sale of 147 million shares at $1.15 each, easily the biggest public offering in the pharma and biotech sector so far this year, which the company hopes will propel it through the "proof-of-concept zone" it has just entered, according to Arthur Sands, chief executive.

The stock offering will cause massive shareholder dilution, almost doubling the shares in issue to 323 million, while the offer price announced yesterday is a 36% discount to when the offering was first revealed last week. Lexicon shares declined 10% yesterday to $1.28, a six-month low, and a 28% fall overall since the offer was made public. Investors will therefore be hoping any short-term erosion in value will be replaced with long-term gains when more lucrative partnerships are secured for Lexicon's phase II candidates, given Mr Sands' confidence the extra cash will strengthen the company's negotiating position.

Dilution effect

Lexicon is offering 87.7 million shares to the public at $1.15 per share, at the same time selling 59.3 million shares to its biggest shareholder, Invus, in a private placement at the same strike price. In addition, a further 15 million shares could be made available under over-allotment options to the underwriters and Invus.

As such, the total shares in issue could reach 337 million, almost double the 176 million currently outstanding. Invus currently holds 38% of Lexicon stock so the private placement to them enables Invus to maintain its overall share of the company.

Having sold 38 million shares to the public in October to raise $55m, Lexicon ended 2009 with around $125m in cash. With a cash burn rate this year of $90m-$95m, the Texas based company is not in urgent need of fresh funds. Meanwhile, potential pipeline catalysts over the next 12 months could drive shares significantly higher, enabling a financing round to be executed on much more lucrative terms without the need for such massive shareholder dilution the current financing will cause.

While Mr Sands accepts this wait-and-see approach to financing could have been an option, he believes the time is right to raise this cash to enhance the company's options and flexibility when it comes to licensing and internal development decisions.

Given the current theme that bigger pharma partners are able to leverage a small biotech's perceived position of financial weakness to strike cheaper and more option-based deals, Mr Sands is keen to swing the balance of power in its favour for ongoing and future partnerships talks: "Remember that a poor partnership on unfavourable terms can also be highly dilutive", he says.

Ongoing discussions

Lexicon currently has four phase II candidates: LX1031 for irritable bowel syndrome, LX1032 for carcinoid syndrome, LX2931 for rheumatoid arthritis and LX4211 for type II diabetes.

LX4211, an SGLT2 inhibitor offering potential as a new approach in diabetes, reported encouraging phase IIa data in January which raised the drug's profile in terms of potential partnerships. As previously highlighted by *EP Vantage*, Lexicon's candidate is one of the few unpartnered SGLT assets out there not already in the hands of big pharma (*Therapeutic Focus – Growing interest in SGLTs as novel diabetic agents, June 15, 2009*).

Mr Sands confirmed that the company is already engaged in partnering discussions over LX4211, although he would not be drawn on a likely time frame for completing a deal. "It takes a lot of time to complete these deals so the financing will enable us to strike the most lucrative deal possible", he says.

The extra cash therefore means the company has the option to develop its candidates further if a suitable licensing deal cannot be struck. Mr Sands also ruled out the possibility that some of the cash could be used to buy out Symphony Icon, a company established with Symphony Capital Partners to develop LX1031 and LX1032 until phase IIb and phase IIa, respectively.

Lexicon has the right to buy out Symphony Icon by June 15, 2010 for $81m, which rises to $90m thereafter until June 15, 2011, the final exercise point. Mr Sands currently expects this purchase decision to hold until next year and that any acquisition would depend on partnership prospects for both drugs.

As such, investors will be hoping their current pain is soothed with long term gain.