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January 13, 2015

Roche deal will shelter Foundation from market pressures

Amy Brown

Foundation Medicine was facing a long slog to prove that it could forge a commercially successful entity from its genomic sequencing platforms, so the offer from Roche to take a majority stake represents an attractive opportunity for the company and its long-term backers.

Sales of Foundation’s tumour diagnostic tests have been climbing, but reimbursement remains a problem and the markets would have been quick to punish any stumble or stagnation. This deal will help shelter the company from many of the pressures of a public listing. And at a 178% premium to its 2013 IPO, shareholders are unlikely to turn it down.

The deal announced yesterday will allow the likes of Google Ventures and Third Rock, as well as private investors including Bill Gates, to sell to Roche at $50 a share. This is more than double the stock price last week and represents a healthy premium to Foundation’s $18 float, and the average pre-IPO share price of $4.70.

Third Rock, Perkins Caufield & Byers and Google Ventures, which together control almost a third of the stock, have each committed to tender “at least” a majority of their holdings, so it would be very surprising for Roche to fail to get the 52.4% stake needed to seal the deal. The Swiss giant is seeking a maximum 56.3% stake, including 5 million new shares issued by Foundation for $250m; Roche would pay just over $1bn if the full investment is made.

The deal also includes $150m of research funding over five years. This will initially focus on developing genomic profile tests for cancer immunotherapies and for continuous blood-based monitoring, although it will also involve work on the standardisation of molecular testing in clinical trials.

The value of Foundation’s technology to clinical research was always apparent; how to make serious money out of it was less clear. With Roche on board, and largely taking on this risk, it becomes less of a concern to investors.

Real motivations

Shareholders have been more focused on the other aspect of Foundation’s business – the commercial sale of tests to oncologists – which provides a more obvious revenue stream.

The company currently sells two products: FoundationOne, which provides an in-depth genomic read-out on solid tumours, and FoundationOne Heme, which does the same for blood cancers. These are intended to help physicians guide treatment decisions, but insurance companies have struggled to justify the expense. The lack of drugs available to target any specific molecular driver identified is a major factor here.

Use of the tests has been steadily rising nevertheless, and this situation should only be aided by Roche’s presence. The deal hands Roche ex-US rights to Foundation’s products and any others they co-develop in the future; even in the US, where the smaller partner remains in the driving seat, the backing of the world’s biggest seller of cancer drugs should only prove a benefit.

However it seems unlikely that this aspect of the business is what really attracted Roche. Analysts at Bernstein write this morning that the deal appears to be driven more by R&D aspects, noting that Roche will be able to incorporate the technologies that Foundation offers throughout its research efforts, including at the very early stage.

“Competitor companies, by contrast, typically have to 'rent' this technology, and because of that [they] do not always incorporate it as early as they should in the drug development process,” they say.

If this really is Roche's motivation then it was perhaps inevitable that Foundation’s future lay in research – a space in which it is still much harder for small, standalone companies to generate returns and justify a healthy valuation, despite clear evidence that molecular profiling is the direction in which oncology is moving.

Roche's bid should be welcomed by investors – particularly the venture firms that can now boast a successful exit.

To contact the writer of this story email Amy Brown in London at AmyB@epvantage.com or follow @AmyEPVantage on Twitter