

# Biotech IPOs and the Funding Gap

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A noted management consultant comments on whether, in fact, the “nuclear winter” is over for biotech IPOs.

**T**he day is near; the Initial Public Offering (IPO) is approaching rapidly. After all the preparation and hard work by the young company and its eager associates—engaging an underwriter, legal counsel, auditors, and more, it will all come to fruition very soon. The company and its executives will soon be able to access the financial markets for much needed capital to fuel growth. The Venture Capitalists (VC) and private equity investors will finally reap their harvest and get a handsome return on their investment. The public now has the opportunity to own stock in an exciting new company with a promising new technology. Sounds like a win-win-win situation. But wait, the IPO has been pulled! Sound familiar?

If that isn't familiar, how does this sound? The IPO goes as planned but the company raises much less capital than it anticipated and much less than it needs for its planned growth.

### STARK CONTRAST

At the risk of sounding pessimistic, about three fourths of last year's IPO companies are trading significantly below their stock price on the date of their IPO. That is in stark contrast to the solid double digit growth experienced by the major biotech stock indices as compared to the broader stock market indices.

No question about it, we all read the funny pages—I mean the financial pages—the biotech IPO market has been weak these past few years. Near term, there probably will not be a significant improvement.

According to recent data by Burrill & Company, about one out of every five biotech companies that filed for an IPO since 2003 has pulled or withdrawn its offering<sup>1</sup>. Last year, biotech companies that did successfully execute an IPO raised about half as much money as companies did the year before. And 2004 was no darling. No surprise then that alternative sources of capital such as acquisitions, partnering and debt financings are growing.

### WEAK, BUT OPEN WINDOW

Although weak, and arguably growing weaker, the IPO market for biotech is still considered viable or open (an open window of opportunity) according to the experts at Burrill & Company.<sup>2</sup>

An open or viable IPO window is important to VC funds because they need to reap their investment harvest to be able to reinvest in new ventures. As they say in the parlance of venture capital—the VC funds need to reload and they can't reload unless there's an IPO.

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The experts at Burrill predict an open and “reasonably robust” biotech IPO market for 2006, whatever that means. It shouldn’t go unnoticed that Burrill & Company is a merchant bank with significant VC funding activities.

But is an IPO worth it today? It appears that the public no longer has an appetite for relatively high risk companies with relatively long time horizons.

And biotech’s cousin, high tech, hasn’t fared a whole lot better.

### NUCLEAR WINTER

It’s generally recognized that the IPO market peaked in 1999. We all remember the quick hit, seat-of-the pants IPOs of that era. We also remember the “nuclear winter” from 2000 to about mid-2003 when VC and private equity funding was scarce.

So what does the future have in store? I am always leery of predictions, particularly from the experts. I am sure I will be getting a lot of highly opinionated email, particularly from the experts and the VC crowd. But I believe there is a sound foundation for my prediction.

A group of researchers at the University of Chicago Graduate School of Business recently published an interesting paper.<sup>3</sup> The researchers studied about 50 venture capital (VC) financed companies—from initial startup to IPO. Approximately one third of the companies studied were biotech companies. What they found was that it took, on average, about six years for a company to reach the IPO stage.

What does that mean in terms of our current situation? VC capital was scarce during the so-called nuclear winter that spanned the early part of this decade. Not until mid-to-late 2003 did VC funding start to thaw that nuclear winter.

If we do the math, those results suggest that not until about 2009 will we start seeing a “robust” biotech IPO market again.

Although one can argue that there are alternatives to VC financing, an overwhelming majority of companies that go public receive VC financing. Furthermore, I suspect that the six

year average duration may be skewed to the short side and it may take longer for startup biotech companies to reach the IPO stage.

In addition to the public’s lack of appetite for biotech IPOs, the VC funding gap in the early part of this decade may have played a significant role in today’s relatively meager IPO market.

### ALTERNATIVE SOURCES

So if the biotech IPO market does not improve for several years, what does that mean for today’s biotech executive?

Contrary to the experts’ claims of a robust biotech IPO market, it would be prudent to explore alternative sources of capital. That may mean a lot of hard work, creative thinking and partnering including private placements, limited offerings and debt financing.

I know one biotech executive who is seriously considering a reverse acquisition or reverse merger with a public company. His company is putting together a road show presentation to raise funds from institutional investors and money managers.

For what it’s worth, there often is a rainbow at the end of the tortuous path of fund raising. ~

### REFERENCES

~1 “Burrill’s Biotech Outlook For 2006 ...and A Look Back At 2005”, December 23, 2005 ([http://www.burrillandco.com/burrill/pr\\_1136590534](http://www.burrillandco.com/burrill/pr_1136590534)).

~2 “US Biotech Initial Public Offerings”, Burrill & Company, December 15, 2004 ([http://www.burrillandco.com/pdfs/ipo\\_status\\_121505.pdf](http://www.burrillandco.com/pdfs/ipo_status_121505.pdf)).

~3 “What Are Firms? Evolution from Birth to Public Companies”, Steven N. Kaplan, Berk A. Sensoy and Per Strömberg, National Bureau of Economic Research (NBER) Working Paper No. 11581, August 2005 (<http://www.nber.org/papers/w11581>).