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Back To Business: Deal-Making On The Other Side Of COVID-19

by Ben Comer

COVID-19 has introduced new challenges (and more attorneys) into the biopharma deal-making environment, but experts say the fundamentals for deal activity point toward a rebound. Companies that adapt quickly to changes – in communication, due diligence and deal structure – will make successful connections in a time of social distancing.

Things often look rosier in the rear-view mirror, but it's hard not to feel nostalgic about 2019. Biopharmaceutical innovation commanded a premium, to say the least, and company valuations last year helped create an all-time high in total deal value for the sector, at over $350bn globally. In the first three months of 2019, there were $147bn worth of transactions globally, compared to about $22bn during the first three months of 2020, Arda Ural, Americas Industry Markets Leaders for Health Sciences and Wellness at Ernst & Young LLP (EY), told *In Vivo*. That precipitous drop is not entirely due to the onset of the global coronavirus pandemic, but then, it did not help matters.

Biopharmaceutical company valuations looked grim in March 2020, as did the major US stock indexes; both have since regained a remarkable amount of ground. The NASDAQ Biotechnology Index was up 28% from 9 June 2019 to June 9 2020, despite a declared recession in the US and mass unemployment. "It's like the market doesn't believe that the economy is as bad as it is – it's really bad – but the market reaction is really interesting," said Brian Teras, a partner at Arnall Golden Gregory LLP (AGG), in an interview with *In Vivo*. "When you see several fairly large [biopharma] deals getting announced in recent weeks, I think that's a good sign. Even a month or two ago, we weren't seeing those kinds of deals."

One thing COVID-19 has not changed is biopharma's fundamental need to grow its bottom line, either through internal pipeline progress or, lacking that, through acquisitions or partnerships. As an industry critical to the health and wellbeing of people all over the world – an "essential business" if there ever was one – the biopharma sector

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has proven resilient in past recessions. In 2020, biopharma has a unique opportunity to shine amid the current crisis, by way of safe and effective therapies and vaccines to treat COVID-19. Finding ways to effectively communicate internally and externally, to complete deals and other transactions virtually if necessary, and to explore new deal structures and options, have become key competencies for deal-making, in all therapeutic areas. Successful collaboration in support of developing and manufacturing COVID-19 treatments, and distributing them effectively across the globe, will require an acceptance of new risks. The trade-off is an unprecedented opportunity to save lives, build trust and improve the industry's long-suffering reputation.

Communicating In The Zoom Era

Experts disagree about the extent to which video conferencing can replace face-to-face meetings in all situations, but there is consensus around the usefulness of virtual tools. Even so, "some people will want to look a CEO in the eye and discuss a transaction," said Alan Hartman, a partner at Centerview Partners, during a panel at the 2020 BIO Digital conference. "Body language is very difficult to read in a video," added Prakash Raman, senior partner and chief business development officer at Flagship Pioneering. Lonnie Moulder, founding partner at Tellus BioVentures LLC, said that data reviews, conference calls, negotiations, information exchanges and many other things can be done virtually, but agreed with Hartman that "a transaction of size will need a meeting of the principals" in person.

Hartman noted the face-to-face process *Spark Therapeutics Inc.* and *Roche* CEOs used prior to Roche's $4.8Bn acquisition of Spark in 2019, meeting multiple times in Philadelphia. "Big transactions are make or break for the big pharma CEO … for that person to sit across the table and see the decision-maker and know that person is engaged is very important psychically." On the other hand, a face-to-face may not be necessary in every case. Roche's research collaboration deal with *Arrakis Therapeutics Inc.*, announced in April, included a $190m payment upfront. The companies "made a point of saying that all the final negotiations had been done over Zoom, which is something that would have been unimaginable six months ago," said Teras.

Previous relationships between companies or individuals involved in a deal can also help overcome distances, by way of trust, according to EY's Ural. "If you know the person, you have history, maybe you interacted with them on another asset, at the same company or at a different company, that is very important," said Ural.

"The ability to communicate with potential buyers is unique in this industry – it's incredibly powerful to have a sense of who the other players are," said Hartman on the BIO panel. "It helps on the sell side (biotech side) to really understand who those parties are that are showing real insight. Almost all the deals that fail are between companies that haven't shared insights over time. Companies can know one another, before you're in that small focused timeframe of evaluating a deal."

With more time and experience, perhaps video conferencing will begin to enable the kind of chemistry and trust that seems to come easier with face-to-face meetings. "We'll continue to get better at virtual communication," said Moulder. But if a pharma CEO is not ready to get on a plane and meet a biotech CEO, countered Hartman, someone else will. "Then that pharma CEO might decide to go the next time," said Hartman.

Several speakers on the BIO panel noted the importance of internal communication with members of the corporate board of directors, particularly in the run-up to a deal or transaction. "I can't overemphasize the importance of ongoing communication with your boards," said Raman. "Here's what we're trying to do, here are potential partners, and then nurturing relationships at potential partnering companies … communication is key," he said. "It helps seal the deal."

Due Diligence And Contracting Challenges

As a key element of M&A go and no-go decisions, manufacturing capabilities represent a unique challenge. Buyers need a level of comfort and need to know where the manufacturing sites are located, if they are up to standards, and whether they can be transitioned internally, said Raman. "Seeing the physical space is really important." That can sometimes be accomplished through video live-streaming, but conversations with site staff and the inclusion of manufacturing staff in diligence conversations is important. "Companies may also be able to use local representatives – not a key person from headquarters – but there may be someone nearby that could potentially visit in person … that can be helpful," said Raman. Hartman noted that manufacturing inspections, and the ability to do them virtually, would differ depending on a product's mechanism of action, whether it was a small versus large molecule or gene therapy.

Ural described handheld cameras and manufacturing site walk-throughs as a remedy for travel restrictions, but noted that data and trust become more critical as a result, and communications become more challenging. "Sometimes it's a hurdle or a nuisance, but in deal-making, if the fundamentals are there, we will continue, because the need for innovation continues."

Innovation in contracting and deal structure are other tools dealmakers are using to de-risk transactions. *Alexion Pharmaceuticals Inc.*'s deal to acquire *Portola Pharmaceuticals Inc.*, announced in May this year, demonstrates "the impact of what's going on with references in the documents, lawyers getting a hold of them, and adding references to pandemics and exceptions for pandemics," said AGG's Teras. "In the Alexion agreement there's specific carve-out language in the typical covenant between signing and closing, about conducting your business in the ordinary course, for things related to COVID-19. That allows the target seller to take certain actions if they deem it necessary to respond to the health and safety of their employees, which I thought was very interesting, because in other industries, for deals that were signed before the pandemic, that has been one way buyers are trying to get out of these deals by saying you weren't acting in the ordinary course because you took certain actions."

In addition to protecting employee health, other events could potentially cause material adverse changes, such as a delayed clinical trial, a postponed FDA PDUFA date due to the agency's focus on COVID-19, or a newly launched product commercialized with limited sales support, for example, could have serious implications for deal-making. "If you weren't paying attention to the legal language in the contracts, now is a great time to read those," said Ural. "Your contract covenants, basically the footnotes in those contracts, all of a sudden become very important." Ural added that the onus is on the legal professionals to consider all angles. "You need to frame the uncertainty to better control it," said Ural. (Also see "*How To Obtain Effective Relief When A Global Pandemic Disrupts Your Supply Chain*" - In Vivo, 27 May, 2020.)

COVID-19 may also lead to more research and collaboration agreements that give buyers a look at the technology before deciding how far in they want to go. In an option structure, for example, a buyer typically pays an upfront payment as consideration for the option, with the ability to decide down the road if they want to go through and purchase the entire company. "In this uncertain time, those kinds of deal structures are certainly going to be explored. Flexibility is really the important point," said Teras. Companies may also get more creative with contingencies, in terms of structuring earn-out payments based on financial targets or milestone targets, to help bridge the uncertainty gap. That process could also help smooth over disagreements about valuation, said Teras, by creating a "prove it" scenario. "There's every reason to think that will continue."

Silver Lining Opportunities

Many uncertainties remain, including potentially disruptive supply chain actions, such as mandatory "onshoring" of certain products or ingredients, not to mention the development of an effective COVID-19 vaccine, manufactured at risk and distributed in unprecedented amounts. In the next six to 12 months, says Ural, there will continue to be transitory impacts to deal-making.

With respect to deal making in the third and fourth quarters of 2020, many industry stakeholders are voicing positive predictions. "I'm fairly optimistic about the third and fourth quarters, I think we'll see deals start to come back more, especially in life sciences," said Teras. "And then by 2021, we may be back to normal."

The current moment, as an opportunity for the

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industry, is historical; the tragic loss of life due to the COVID-19 crisis, which continues to infect new patients, is the leading unmet need, and one that biopharma companies can address directly. "I think the industry has an opportunity right now to change and shape its perception as the driver of innovation in the US and in the world," said Ural. "So far, I think the industry has been behaving very responsibly in pre-competitive and non-competitive spaces … when you read CEO interviews or listen to them, you see that tone. And when I talk with [biopharma] presidents and CEOs, they also indicate that this is not about just changing the way we make profits, but there's also a focus on showing the world how we are finding cures and managing this crisis."