CHASING THE NEXT BIOTECH UNICORN

HOW THE BIOTECH SECTOR SETS TO THRIVE AMID REGULATORY AND LISTING CHANGES IN CHINA AND HONG KONG
EXECUTIVE SUMMARY

New listing rules in Hong Kong for biotech and the healthcare reform in China are propelling capital raising activities in the region. Rocketed valuation in the biotech sector drives interest from private equity investments, who demand swift investment cycle with clear profit-making path for going public. The importance of rigorous and timely pre-investment screening and due diligence process is at all-time high.

The swift landing of the “emerging and innovative” sector listing regime seems to be more apropos than any other time this year after The Stock Exchange of Hong Kong’s (HKEX) about-turn in listing rules reform last December in response to the never-been-hotter investment boom in biotech and tech unicorns. The introduction of China Food and Drug Administration (CFDA) regulatory reform that appeals to foreign biopharma companies investing in China will create another catalyst for the bourse to become the most desirable exit platform for biotech investments.

According to the consultation paper by HKEX, the new listing regime is set to open a new chapter for biotech companies which are at pre-profit or pre-revenue stage. With at least HK$1.5 billion expected market cap, each of these up-and-coming biotech startups is likely to draw high level of pre-IPO investment. The easing of HKEX’s listing regulation for biotech companies will undoubtedly intensify the already keen competition of private equity (PE) investments in the biotech sector in Asia. Keen interest in IPO exit by later-stage biotech start-ups is also observed across the region. Recently, Taiwan Liposome (TLC) and China SXT Pharmaceuticals (SXTC) became the first two Chinese biotech companies filing for listing in the United States. The new biotech chapter in HKEX will further inject momentum for these aspiring biotech companies with attractive valuation in the capital market.

PE’S APPETITE FOR BIOTECH

According to AVCJ, PE investments in China’s healthcare have already amounted to US$439 million so far this year, compared to US$2 billion and US$686 million in FY 2017 and FY 2016 respectively. 67 transactions by PE were recorded in 2017, representing an increase of nearly 45% over prior year, with total value reaching US$2.85 billion. PE remains as the major driving force in the biotech investment space, and it is expected the trend will sustain in the medium term. According to a KPMG report, global venture capital investment hit a decade high at US$155 billion in 2017, and is expected to remain strong in 2018, with healthcare, biotech and autotech sectors continue to be the shining stars.
Although headwinds are observed that may hinder global biotech M&A activities, the rocketed valuation has driven pool of funds to the sector. Biotech start-ups with shorter investment cycle, more mature clinical trial record, and clearer profit-making path have become the most sought-after. More and more investors from PE funds to large pharmaceutical companies, sovereign funds and even family offices are cantering into the arena. Whatever exit strategy that the private equity is aiming for, a rigorous, time-sensitive and duly-exercised asset screening and due diligence process is critical for investors to win in the neck and neck investment race.

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According to Silicon Valley Bank, biotech companies, in particular biopharmaceuticals, saw a wave of IPOs in 2017, beating 2016’s total. Oncology deals led M&A activities and dominated IPOs, and accounted for 36% of all exits in 2017. M&As continued focusing on early-stage companies while IPOs shifted to later-stage companies. Demand for IPO exit from later-stage companies has reached all-time high, and that the new biotech chapter in HKEX will further inject momentum in these aspiring biotech companies with attractive valuation in the capital market.

OPPORTUNITIES LOOMING AS CFDA REFORMS CHINA HEALTHCARE

CFDA, the Chinese regulator for food and drug safety, is also reforming its healthcare sector with the aim to sharpen its competitiveness as a global player, both in terms of innovation and competency. Off-patent generic drug production has been the key investment arena for PE investors.

China is the second largest pharmaceutical market in the world, yet healthcare expenditure only accounted for 6.2% of its GDP in 2016, far below the benchmarks of many high per-capita economies according to World Bank Open Data (US 17.1% (2016); Canada 10.4% (2016); Japan 10.2% (2014); Korea 7.4% (2014)). The regulatory reform launched by CFDA offers foreign investors the opportunity to access the high-potential Chinese biopharma market. The reform will also facilitate the review and approval process for imported drugs, particularly those innovative imported drugs. Across the other side of the border, HKEX will serve to bridge investors, capital flows, technologies and talents by leveraging its international and renowned status as the region’s financial hub as well as an R&D center of pharmaceutical and life sciences, thus helping global biotech giants to evolve their business strategy in China.

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Baker McKenzie Hong Kong further estimates that approximately 250-300 biotech companies are operating in the city, of which 70 are income-generating and already listed in HKEX. As China propels through its wave of biotech reforms and fundraising, and with HKEX’s new rules in place as the backdrop, Hong Kong will be able to compete for new biotech listings. HKEx hosted its first ever Biotech summit in 22 March 2018 sending a strong signal on the big trends and underscoring significant interest among the biotech industry and the financial community. With final pieces of the transformation plan for Hong Kong’s listing regime being put together shortly, it is believed Hong Kong is perfectly positioned to become the major financial hub for the biotech sector.

WINNING THE RACE

In order to ensure manageable exits and maximise opportunities in the capital market, investors are competing at a much earlier stage of the investment cycle, and timing seems no less crucial than monies. Due diligence is indispensable for every deal, and definitely more so for biotech opportunities which are usually at the embryonic stage of their business journeys. In many cases, track records are just what they lack in face of regulatory review and compliance.

Managing such capital transactions requires the agility to quickly consider opportunities, assemble documentation and share information with external stakeholders. This highlights the importance of a sophisticated yet efficient document collaboration platform that provides the speed, security, support and expertise needed to build a world-class repository of investor and company information.
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