A&M INSIGHTS

Health Care and Life Science IPOs are Soaring. Should Your Company Climb Aboard?

The recent proliferation of initial public offerings (IPOs) by health care and biotechnology companies is sparking interest among leadership in similar organisations and causing them to wonder whether offering stock to the public to fuel future growth.

This path to expansion and business opportunities has been quite popular lately.

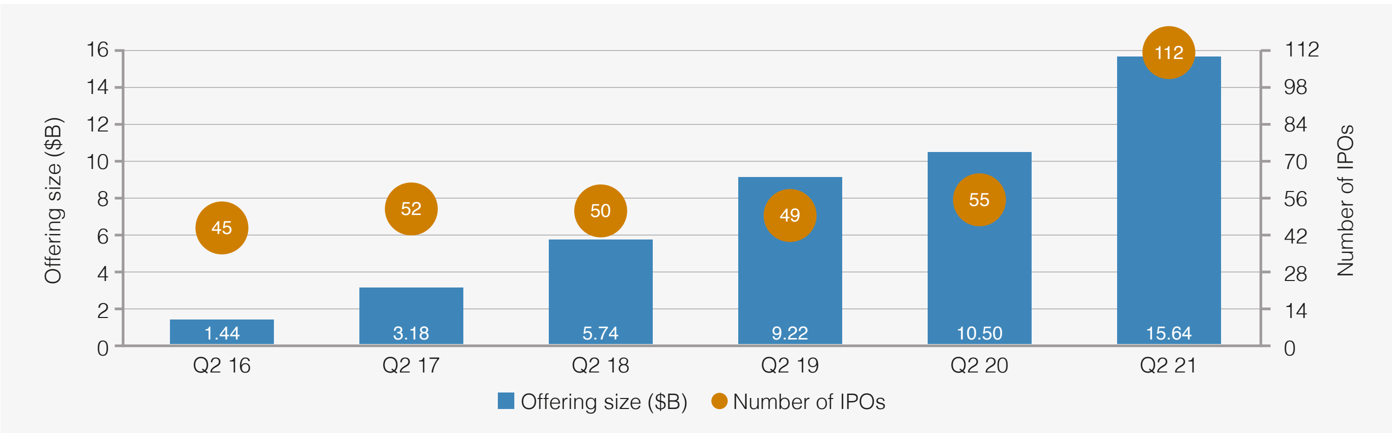
According to data compiled by S&P Global Market Intelligence, 112 global health care and life science (HLS) companies went public globally in the second quarter, more than doubling the number of IPOs in the same quarter in the previous year. The total valuation of these offerings was $28.8 billion — more than half of the combined offering sizes of IPOs in the entirety of 2020 — with the lion's share of the group consisting of IPOs of health care services and biotechnology companies[1]. Furthermore, the average offering value per IPO increased significantly over the past six years, from $1.44 billion in the second quarter of 2016 to $15.64 billion in the second quarter of 2021.

One trend stands out in the sector. Of the 25 large-scale, global HLS IPOs in the first quarter of 2021, almost one-fourth were biotechnology companies[2]. Investor appetite for biotech companies is quite understandable when you consider investors' primary criteria are finding companies with a compelling equity story and significant growth potential, two typical characteristics of biotech companies. Investors also see significant advantages in these companies since they often provide a convincing narrative about their potential future prospects.

But why should HLS companies consider an IPO to begin with?

There are compelling benefits to conducting an IPO, but some companies will need to weigh the substantial costs before undertaking a public offering. The right choice depends upon an organisation's business strategy, its position along the company's business lifecycle, and particular criteria for going public.

Global healthcare IPOs in Q2 since 2016



Note: August 2021 YTD
Source: Co-Star

[1] Source: S&P Global Merger Intelligence
[2] Source: S&P Global Merger Intelligence, data compiled April 2021

Advantages of an IPO

For companies with a strong and sustainable growth path, an IPO offers several advantages, including:

Fundraising: In general, a company can raise significant proceeds with an IPO — in many cases more than $100 million. Those proceeds can be used to speed up the company's growth significantly, allowing it to acquire a competitor or a specific technology, for example. Nevertheless, each company should bear in mind that they will be continuously asked about the use of these proceeds. Analysts and investors tend to back off quickly if these questions cannot be answered satisfactory.

Exit Opportunity: Founders and investors of previous financing rounds often use an IPO as a significant exit opportunity. However, it is important to note, that shareholders do not immediately receive liquidity from an IPO. Instead, they must sell their shares via a secondary exchange, and mostly, they have to agree to certain lock-up agreements, forcing them to keep their shares for 6 to 12 months, or even longer, after the IPO.

Publicity and Credibility: An IPO significantly enhances the degree of recognition and credibility of the organisation; the latter because the company needs to go through intense scrutiny to ensure the correctness of its reporting. For some companies, and in particular HLS businesses, this heightened exposure imposes the risk that confidential research and development (R&D) projects may be leaked to the public too early, potentially hampering any competitive advantage the technology may have offered initially.

Stock as an alternative means of payment: Public stock is a form of currency that can be used in acquiring other companies or designed to retain key talent through stock option programs.

Disadvantages of an IPO

There are no “free lunches” with IPOs, which entail significant costs along with great opportunities. Along with the advantages of going public, companies should consider the disadvantages of an IPO in the decision-making process.

Strict regulatory requirements and disclosures: Publicly listed companies are obliged to comply with and adhere to the standards of their stock exchange. This includes — but is not limited to — the obligation to publish ad-hoc announcements, requirements to follow strict disclosure rules in its financial statements, the implementation of stringent financial controls and adherence to risk and compliance standards. Meeting these conditions can entail immense effort and cost.

Loss or at least limitation of control: Founders may lose control of their company, though there are ways to ensure that founders retain the majority of the decision-making power once the company is public. For example, companies can issue non-voting shares or limit the number of shares offered publicly. Nevertheless, public shareholders can put a lot of pressure on the decision-makers, either through shareholder votes or public criticism.

Specific market pressure: Stock markets reward the fulfilment of short-term objectives, as investors and analysts focus on meeting quarterly earnings targets. Being constrained to short-term public goals can of course be detrimental to a company’s long-term growth objectives and sustainability. This is something that HLS companies should consider thoroughly, particularly pharmaceutical companies, which often have long R&D cycles.

In addition, publicly listed companies face a higher risk of potential activist investor stock purchases. These investors’ primary objective is to influence the company’s strategy and operations, which can significantly hamper the company’s capacity to make decisions.

Furthermore, publicly listed companies are at greater risk of a hostile takeover by a larger competitor, especially if they are undervalued (temporarily or long-term).

High Transaction Costs: An IPO is a very expensive capital markets instrument. The recurring expenses of public company regulatory compliance, such as auditors and investor relations, are high, and the IPO transaction process itself is extremely costly. The typical underwriters can charge between 5 and 7%, and that’s on top of incurred legal fees, auditor fees, and registration and printing fees. If the company decides to hire a speciality advisor (which is highly recommended given the tremendous importance of this step), the transaction costs will be even higher. Should an IPO prove unsuccessful, all external advisory fees will have to be borne by the organisation even though no IPO proceeds were generated.

Conclusion

Whether an IPO is the instrument of choice for your company depends on a multitude of factors and criteria and should be diligently evaluated. The various advantages and disadvantages are closely correlated to both corporate strategy and the current level of IPO readiness, so the decision is not trivial.

Founders, investors, and the Board of Managers should keep in mind that there are numerous alternatives to an IPO that might provide a more desirable risk-return-profile or other factors in certain situations. Alternatives to consider are private placements, reverse mergers, direct listing, as well as joint ventures or partnerships, employee participation programs, and mezzanine financing, among other options.

Solution

When considering an IPO, emotions can run high among company leadership as they consider the high cost, extreme complexity of an offering, and the intersection of high-stake interests. Introducing a neutral, external advisor can help moderate, structure, and guide this process and increase the likelihood that decision-making will be substantially improved and objective. Companies can also gain a higher level of trust in confidence by engaging with an independent trusted advisor and sparring-partner to the Management Board and/or the founders.

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A&M has worked with some of the largest European and global organisations to transform operations and accelerate growth through decisive action. A&M's Healthcare and Life Sciences team brings decades of experience and fact-based, action-oriented leadership to create value and drive rapid results for health care businesses.

We have a strong track record in IPOs and other capital markets instruments and would be more than willing to support you and your company by running an initial "IPO Readiness Workshop" as a starting point. To learn more, reach out to our key contacts.

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