The final countdown

Why biotech companies are the hot targets in big pharma's buying spree.

Update
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The long reign of the US tech giants has delivered stellar returns, but with momentum cooling, a shift in leadership is paving the way for a new wave of opportunity. As hedge fund boss Seth Klarman observed, "The best investments are often made during times of uncertainty."

With technology valuations looking distinctly stretched, investors are beginning to look further afield for the next big growth story. One such contender is biotech which offers exposure to the long-term structural themes of ageing populations and cutting-edge innovation, combined with valuations that leave plenty of upside potential.

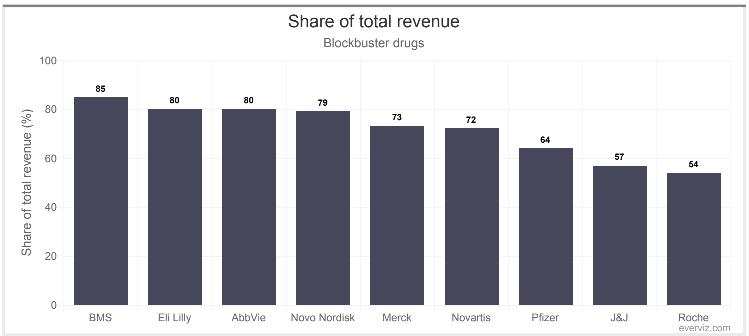
It's undoubtedly been a tough few years for the sector, which has endured a prolonged bear market, including another setback in April amid tariff tensions and overhaul at the FDA.

Yet, beneath the headline numbers, biotech has remained a fertile hunting ground for alpha as big pharma turns to M&A to plug looming patent cliffs. Investors are starting to take notice too, with early-birds enjoying a 20%-plus rise in the Nasdaq Biotech Index since early April.

The long shadow of patent expiries

Blockbuster drugs (defined as those generating over $1 billion in annual revenue) are the lifeblood of big pharma, with BMS, Eli Lilly and AbbVie deriving 80% or more of their revenue from blockbusters.

Fig.1: Big Pharma Are Highly Exposed To Patent Expiries



Source: Latest annual reports

This concentration creates a major patent expiry risk as patents typically last for only 10-15 years post-launch and, once expired, generic rivals can wipe out up to 80% of revenue in the first year.

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Merck's oncology therapy Keytruda is a striking example. As the best-selling global drug, it generates $30 billion in annual revenue (nearly half of Merck's total revenue) but its US patent expires in 2028. Similarly, Novo Nordisk's weight-loss drug Ozempic contributes 40% of revenue and also faces a US 'patent cliff' in 2032.

Deloitte estimates that 190 drugs (including 69 blockbusters) will lose exclusivity by 2030, threatening nearly half of revenue for the top-10 pharma companies and creating a $240 billion annual patent hole to fill.

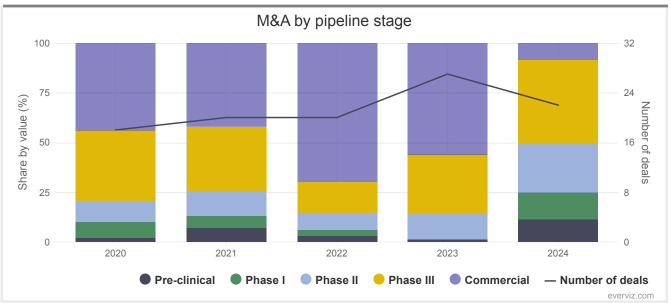
Why big pharma is gobbling up biotech

A decade ago, in-house R&D drove the pharma engine but today, biotech firms lead the way in cutting-edge innovation. Their share of global drug approvals has trebled to 70% over the last decade, offering a faster and more cost-effective process than their larger peers.

EY reports that acquired products now generate the majority of revenue for the top 25 pharma companies, growing at more than twice the pace of their organic portfolios. As a result, big pharma has amassed significant war chests for M&A, with $1.3 trillion in firepower reserves heading into 2025.

The pursuit of high-returning assets has also prompted a shift to earlier-stage acquisitions over market-ready assets, with pre-Phase III companies accounting for half of deals in 2024.

Fig.2: Share Of Early-Stage M&A Deals Has Risen



Source: IQVIA, based on $1 billion plus acquisitions of majority stake

While the IPO market remains challenging, high-quality biotech companies continue to successfully raise money on positive clinical data.

Harnessing the M&A tailwinds

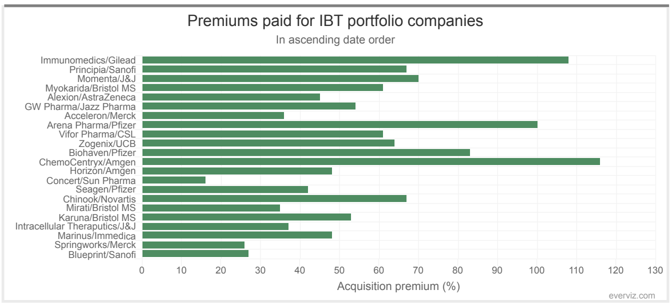
M&A can be a significant driver of returns but identifying likely targets requires deep scientific expertise in order to understand the complex medical technologies and clinical trial data.

And this is where active management shines: **International Biotechnology Trust (IBT)** managers Ailsa Craig and Marek Poszepczynski bring over 30 years of combined experience across the biotech ecosystem. Marek's background in business development also provides a significant advantage, offering a first-hand insight into the attributes that acquirers are looking for and how they value assets.

The wide dispersion in quality across the biotech universe makes risk management a core pillar of IBT's strategy. Ailsa and Marek focus on companies addressing high unmet medical needs, backed by strong patent protection and pricing power, while avoiding lower quality, speculative names.

Although IBT doesn't invest solely on the basis of M&A potential, the managers have an impressive hit rate on that front, with 28 acquisitions of quoted and unquoted portfolio holdings since 2020.

Fig.3: IBT's Portfolio Companies Have Commanded Substantial Premiums



Source: Offer documents, premium based on share price immediately prior to announcement or, in the case of offer speculation, the 'unaffected' share price

For example, Johnson & Johnson paid $15 billion earlier this year to acquire Intra-Cellular Therapies and strengthen its neuroscience portfolio. Intra-Cellular's flagship drug Caplyta (FDA-approved for schizophrenia and bipolar depression) is forecast to deliver up to $5 billion in peak annual sales to replenish the blockbuster pipeline.

Remarkably, this was the third time that IBT's largest holding has been acquired, with the near-40% premium providing a significant boost to returns. It also marked the largest deal since early 2023, signalling the end of a quiet patch for big-ticket M&A (although recent deal premiums have been somewhat compressed in a buyers' market).

The trust has also enjoyed 100%-plus premiums on the acquisitions of Immunomedics and ChemoCentryx. Gilead paid $21 billion to add FDA-approved breast cancer drug Trodelvy to its oncology stable in the former, while Amgen snapped up smaller-cap ChemoCentryx, thanks to its first-in-class rare disease treatment in Tavneos.

Positioning for the upturn

Biotech valuations remain compelling, with an increasing proportion of biotech businesses trading below the value of their cash positions. Falling interest rates should also be supportive given the sector's historical inverse correlation with yields.

Against this more favourable backdrop, Ailsa and Marek have gradually shifted the portfolio further down the market cap spectrum, with more than 75% of the portfolio invested in small and mid-caps. These offer higher-growth pipelines, often at cheaper multiples, and many of them are clinically de-risked with 60% having already secured product approvals.

Looking ahead, the secular forces of "older, richer, sicker" continue to drive long-term demand for healthcare. The pressing need for M&A to bridge big pharma's patent cliffs creates a powerful tailwind and a compelling opportunity for managers with the specialist expertise to identify biotech's most valuable assets.

All data as at 30/07/2025 unless otherwise specified.

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