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PE DEALS

NovaQuest provides structured finance for Phase III pharma partners

The influx of PE investment in drug development is 'great evidence of the need for capital solutions for the life sciences,' said NovaQuest's Patrick Jordan.

NovaQuest Capital Management pioneered a product finance solution, providing at-risk, nondilutive funding that enables partner companies to advance pivotal clinical trials, launch new brands, license products and acquire accretive products or companies.

As part of our ongoing series profiling private equity firms investing in healthcare, PE Hub discussed the firms' strategy with Jonathan Tunnicliffe, managing partner and chief investment officer, and Patrick Jordan, managing partner and chief operating officer.

Tailored capital solution

"We developed a structured finance model targeted at the biopharmaceutical industry, called product finance," Tunnicliffe told PE Hub. "It's a tailored capital solution that ... funds innovation in the last R&D stage, Phase III, or in the launch phase of commercialization. We invest alongside a pharmaceutical company in that final stage of R&D, on their most strategically important products, and the returns for us come from lump-sum cash payments on approval by the FDA or the regulatory bodies, and/or from royalties, and everything comes once the product is approved."

The firm was spun out of Quintiles, now IQVIA, one of the world's largest providers of services for pharmaceutical R&D and commercialization, 12 years ago. As a separate entity, the firm has



Jonathan Tunnicliffe, NovaQuest

raised about \$2.3 billion of invested capital deployed across three investment funds.

"It gives a differentiated focus for investors within the spectrum of different healthcare investment alternatives," Tunnicliffe said. "And when we get into why biotech companies and pharma companies need this, it becomes a tailored solution, a bespoke structured solution that fits within the smorgasbord or toolkit of their financing options. But you need that experience and that field expertise, not just to underwrite risk, but also to structure the deal. It's not bidding on a piece of paper; it's tailoring a capital solution for these companies."

Because the return mechanism is predefined, it doesn't have the exit risks

with equity holds "as the returns are already baked in; it's self-liquidating," he said.

"The hold period isn't dictated by the term of the royalty, because you have a royalty component as part of the structure," he continued. "Where the deal is just an approval milestone, then that's more like a two- to four-year hold. Then when you add a royalty strip on the back end, it could add a few years to that return."

He noted that executives see the investment as a non-dilutive alternative to them.

"For investors, that means it's non-correlated, of course," said Tunnicliffe. "And the reason that pharma and biotech executives like this model is it allows them to keep control of the product, and to execute on their product. With some of the alternatives like partnering with a large pharma company, even on a regional basis, they could see a loss of upside value and loss of control."

Standing out, not fitting in

"We've developed a real sense of understanding about not only how the drug development endeavor works, but also how a biopharmaceutical executive manages that effort," said Jordan. "We're not tourists to the drug development or commercialization space; we all have decades of experience in it ourselves. Our industry experience and a sharp

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financial focus put us in a unique position to understand what the pharma company is trying to achieve and the barriers that they need to overcome. We think that the other funds that are coming into the life sciences space is good news, because it further validates an important part of the life sciences financing world, and it provides great credence to the model that we established.”

According to Jordan, one thing in particular that makes NovaQuest “unique” is that the firm takes a broad look at development opportunities.

“We want to see a very clear pathway to Phase III with great Phase II data, a strong regulatory environment, statistical plan, non-clinical plan, and the like, all of that up to grade and evidenced by a positive end of Phase II meeting with the FDA,” said Jordan. “What you didn’t hear me say is that we hunt for specific therapeutic areas, or we want to double down on the latest platform technology. That could create too much portfolio concentration and even class-effect risk. Instead, we look toward those promising assets with well-defined endpoints, development track record, readiness for Phase III study, and have a good plan of action for commercialization. That methodology applies to our asset selection, whether in autoimmune, pain management, or women’s health, or any other therapeutic area.”

Life sciences boom

There have been more and more private equity firms investing in life sciences, evident by the recent surge in PE firms teaming up with VC firms to tap biotech growth market.

“I would start by saying it’s great evidence of the need for capital solutions for the life sciences,” said Jordan. “And we’re glad to see that part of the market mature. Having been in the early pioneering days ourselves in the early 2000s, we’re glad to see this model being validated.”

“The recent trend speaks to the breadth



Patrick Jordan, Novaquest

of that landscape, where you’re seeing private equity evolve at a rapid pace,” he said. “You’re seeing large pharma also being targeted for investments by some of the bigger private equity groups. We think this is a great development to put this type of financing solution on the table as an alternative. If you look back, the past options for a biopharma exec were relatively slim. You could license your technology, and in doing so lose a lot of that strategic control. You can issue equity, which in today’s market is a tough road, given the depressed valuations. Or you can deprioritize the molecule and change your pipeline, which can have negative downstream effects. We think this solution, which is embraced by more and more, both private equity groups and the industry, is a positive development.”

Jordan noted that the financial space NovaQuest occupies between venture and royalty is “enormous and growing.”

“Last year, there were more than 1,100 phase III candidates in development,” he said. “And trial starts, which are a good indicator for the robustness of the phase III stage of development, were up 14 percent. Investment capital going into drug development is enormous and growing, with \$212 billion deployed in 2021. These dynamics create opportunities for us to

develop economic solutions that align our success to the success of the molecule.”

Challenges

“Around our core target market, emerging or growth biopharma represents about two-thirds or so of the overall phase III pipeline,” said Jordan. “This market segment is quite productive, and last year, the FDA approved 50 novel medicines. You might think that the majority of them were by top 20 pharma; but in fact, 66 percent of them were from companies that were outside of the top 20 pharma. That segment of pharma is most exposed to some of the current challenges – inflation, supply chain disruptions, and access to capital. Yet, they’re the ones that have been the most productive, and therefore, the ones most in need of a solution like ours.”

Firm facts

Founded in 2010, NovaQuest Capital Management is a Raleigh-based private equity firm targeting investments in life sciences and healthcare companies. The firm invests in companies with revenues between \$20 million and \$100 million. Currently managing more than \$2.2 billion in capital, NovaQuest is actively investing from the \$1.2 billion Pharma Opportunities Fund V.

Recent exits

In 2018, NovaQuest provided \$100 million in financing to support Dermavant in the acquisition and development of tapinarof, a Phase-III-ready topical, dermatological drug targeting psoriasis and atopic dermatitis. In return for its investment, NovaQuest would receive lump sum payments conditioned on the product achieving milestones, such as regulatory approval, in the development and commercialization of tapinarof. Accordingly, in May 2022 the FDA approved VTAMA, a treatment for plaque psoriasis in adults, thereby triggering a significant milestone payment to NovaQuest. This approval also brings the

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first topical novel chemical entity for US psoriasis patients in 25 years.

Recent investments

NovaQuest invested in Grünenthal, Phathom Pharmaceuticals and Targan in 2022 and invested in Aceragen, Argenta Limited, Cerevel Therapeutics, Covenant Animal Health Partners and Dermavant Sciences in 2021. (See below for more information)

NovaQuest's healthcare portfolio highlights

(Dates refer to initial investments)

Aceragen: Is a biopharmaceutical company focused on the development of innovative therapeutics for rare and ultra-rare diseases. (May 2021)

Argenta Limited: Is a veterinary global contract research organization (CRO) and contract manufacturing organization (CMO). (May 2021)

Arvelle Therapeutics: Is a biopharmaceutical company with the

mission of bringing innovative solutions to patients suffering from CNS disorders. (February 2019)

Cerevel Therapeutics: Is a clinical-stage biopharmaceutical company that engages in the development of various therapies for neuroscience diseases. (April 2021)

Covenant Animal Health Partners: Is dedicated to the development and registration of "revenue-ready" animal health products. (November 2021)

Dermavant Sciences: Is a subsidiary of Roivant Sciences and is a clinical-stage biopharmaceutical company dedicated to developing and commercializing innovative therapeutics in immuno-dermatology. (June 2021)

Grünenthal: Is a pharmaceutical company providing treatments in pain management and related diseases. (March 2022)

Mileutis Limited: Is a company that focuses on discovery, development and commercialization of novel and biologically sourced, safe and residue-free therapies for

animal health. (October 2020)

Mycovia Pharmaceuticals: Is an emerging biopharmaceutical company dedicated to recognizing and empowering those living with unmet medical needs by developing novel therapies. The company developed the first and only FDA-approved medication for recurrent vulvovaginal candidiasis (chronic yeast infection). (December 2017)

Nevakar Inc: Is a fully integrated specialty pharmaceutical company with an extensive portfolio of products in the ophthalmic and injectable areas. (June 2019)

Phathom Pharmaceuticals: Is a biopharmaceutical company committed to transforming the treatment landscape and improving the lives of patients suffering from acid-related gastrointestinal (GI) disorders. (May 2022)

Targan: Is a biotechnology systems company poised to transform animal protein production industries worldwide by bringing affordable, individualized care technologies to the market. (May 2022) ■