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Dx IPOs Plummet, SPAC Market Recedes Among Macroeconomic Difficulties

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NEW YORK – Last year the diagnostics industry saw a spate of companies go public, whether through traditional offerings or via mergers with special purpose acquisition companies (SPACs), but that trend has seen a significant slowdown in 2022.

In the first half of 2021, eight diagnostic companies had already gone public or filed for initial public offerings, and by the end of the year the tally reached 19, with two deals above $1 billion: Ortho Clinical Diagnostics' $1.29 billion IPO and Ginkgo Bioworks' $1.63 billion offering through a SPAC, although Ortho was later acquired by Quidel in a $6 billion deal.

Other major deals in 2021 included SomaLogic's $630 million SPAC-based offering in September, Sema4's $500 million IPO via SPAC last July, and Sophia Genetics' $234 million raise, also in July.

So far this year, however, the IPO market has been virtually silent. Two firms have filed to go public – Cardio Diagnostics via a merger with Mana Capital Acquisition and Seoul-based software firm Lunit on the Korean Exchange – and Prenetics debuted on the Nasdaq in May after filing to go public last September. Hong Kong-based Prenetics was valued at $1.25 billion with a combined equity value of $1.7 billion when it announced its merger with Artisan Acquisition, while Cardio Diagnostics is expected to have a post-transaction equity market capitalization of $175 million. Lunit, meantime, is expecting to raise at least $42 million.

This rate of deals is about on pace with the six diagnostic IPOs seen in 2020 and a little ahead of the four IPOs in 2019, indicating the 2021 diagnostic bubble, which was largely the result of demand for COVID-19 testing driving interest in the space, may have burst.

The diagnostics market in general has taken a step back from dealmaking, partially due to broader economic concerns like high inflation, geopolitical strife across the world, and rising interest rates in the US, but there is also hesitance among investors to go all-in on diagnostic companies when post-IPO performance hasn't always met expectations throughout the pandemic.

Raymond James analyst Andrew Cooper noted that the status of the larger economy right now has been a major deterrent for firms considering going public, since "nobody ever wants to become public in a down market unless you have to." Companies still need capital, but as diagnostic industry valuations have deflated from their record highs, firms that may have gone public are instead looking at private financing and mergers and acquisitions, he said. "I think we're seeing folks that, all else equal, in a better market probably would've been public, either look to remain private and fundraise as best they can" or look for M&A opportunities.

"If you have the cash to stay private right now, you probably aren't going to be rushing to do anything," he said. "You'll operate, you'll execute, [and] you'll hope that you can come out in a position of strength in a market that's a lot more amenable to IPOs."

Harry Glorikian, general partner at venture capital fund Scientia Ventures, said that companies he's talked to have been "hesitant" to start the IPO process, regardless of their financial dynamics, because of the uncertainty surrounding the broader economy. "If by some chance the economy turns in the next six months, that might be a great opportunity" to go public. "But the problem is you can't just wake up and go 'we're going public tomorrow,'" he said. "It's a process."

Firms that have started the IPO process may continue it, but for those that haven't, they're "thinking long and hard [about] whether they want to go down that road at this moment."

Deals can also depend largely on where in the diagnostics industry a company is working, Cooper said. Those in the oncology market may have more options or opportunity to go public, as there's been a lot of investment in the space and many firms are moving closer to commercialization of their products, while infectious disease firms looking to go public on the back of COVID-19 testing might have missed their chance as public investor excitement for COVID-19 testing has waned. "You either did if you were going to … or you're still very early and not necessarily about to come try to make a big splash in the public markets," he said.

Oded Ben-Joseph, managing director of investment firm Outcome Capital, said that most investors have realized the COVID-19 peak has passed and that those revenues are "not sustainable." They are "heavily discounting any COVID-19 revenues," which is depressing valuations, he said.

The performance of some companies that went public last year on the backs of their COVID-19 testing businesses has also been lacking. Talis Biomedical, which went public for $254 million in February 2021, debuted on the Nasdaq at $16 per share. At the close of the market on Monday, the company's stock price was $.86 per share, providing the firm with a paltry market cap of around $23 million.

Lucira Health, another COVID-19-focused company that went public in February 2021, priced its IPO at $17 per share. Its stock closed on Monday at $2.43 per share, and the firm's market cap rests just under $100 million. And Cue Health, a major player in the point-of-care COVID-19 testing space, has seen its share price drop from $16 per share when it went public in September to $3.28 at the close of the market on Monday.

SPAC 'craze' wanes

A big component of the booming IPO market last year was the opportunity to go public via merging with a SPAC – a route with significantly fewer restrictions than a traditional IPO that also provided access to capital. SPACs are shell corporations created for the express purpose of acquiring existing companies and taking them public, and they have some key benefits over regular IPOs. According to Ben-Joseph, there's less risk for sponsors to invest in a company via SPAC because they're less subjected to market volatility, and for the companies themselves the process is shorter, cheaper, and has a guaranteed financial outcome compared to a regular IPO, he said.

Paul Mieyal, another managing director at Outcome, said that the major impetus for SPAC transactions in 2020 and 2021 is that traditional IPOs "weren't really an option" with most of the world and economy shut down due to the pandemic. Companies were still trying to go public and raise money, and investors were still looking to spend their money, so SPACs were "satisfying a need to put private companies together with public money," he said. Early SPAC deals were more attractive than they have been because they were "effectively replacing the IPO market," Mieyal added.

Although SPACs "come in and out of vogue over the years," the most recent trend is a bit of a "new phenomenon" – Mieyal said that SPACs haven't traditionally been interested in pre-revenue-stage companies like many of those in the diagnostics industry.

And while SPACs used to be the province of shady sellers, once "household names" and "credible investment funds" in the healthcare space got into the market, investors jumped on board and the opportunity for "effectively pre-funded IPOs" was wide open, Mieyal said.

However, the pendulum swung and SPACs are "not nearly the sort of craze" they were in 2021, Raymond James' Cooper said. Part of the issue has been oversaturation, with too many SPACs and not enough companies ready to go public, but there has also been regulatory attention directed toward SPACs that could have played a role in cooling off the market.

In March, the US Securities and Exchange Commission proposed rules to improve disclosure and investor protection by applying traditional IPO standards to SPAC deals. The rules would require additional disclosures about SPAC sponsors, conflicts of interest, and sources of dilution, as well as disclosures about business combination transactions between SPACs and private operating companies.

Ben-Joseph and Mieyal also noted the oversaturation, with Ben-Joseph saying there's "such a proliferation of SPACs, and they're all fighting for the same assets, so it became a very crowded space." SPACs also have a set time limit for when they must make an acquisition, so there's a level of desperation – if there's no deal made in that window, the money must be returned to investors.

"The lowest hanging fruit was scooped up fairly quickly," Mieyal said, and now a lot of SPACs are "still hanging around" because there are fewer attractive companies to acquire. He noted that there are likely still a lot of negotiations in the works that haven't been made public yet, because SPACs "still have to do all of the same type of due diligence" as with a traditional IPO – the only difference is that everyone knows how much money will be available at the end.

Although Mieyal declined to mention any companies that could be targets for a SPAC merger, "I guarantee the guys with the check in hand are looking" for targets, he said.

While there are currently "too many SPACs chasing too few companies," a biotechnology company that fits the industry's SPAC profile has "got quite a bit of leverage," because multiple SPACs may be making offers and open to negotiations for better deal terms, he said.

As the world has started to open back up after the pandemic, there will likely be a "reversion" to traditional IPOs, albeit not in the short-term due to economic pressures putting a damper on deals of all kinds, he said. With the broader economy in its current state, the IPO slowdown this year isn't unexpected, he added. Even taking out the COVID-19 pandemic overhang and the recent SPAC phenomenon, "any time the markets are in turmoil, and interest rates are shooting up, and there's a lot of volatility in the market, it's really tough to do an IPO."

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