

Discovering the Investment Opportunity in Pre-Clinical CROs

The process to bring a drug to market is likely to be extensive and costly, from the starting points of research and development (R&D) across all phases of clinical trials to a multi-faceted marketing launch. This complexity and outsourcing dynamic continues to be a significant draw for private equity (PE) investment at the earliest stages of the drug lifecycle: the drug discovery services market.

THE PHARMA INDUSTRY HOLDS GROWING RELIANCE ON OUTSOURCED DRUG DISCOVERY PARTNERS

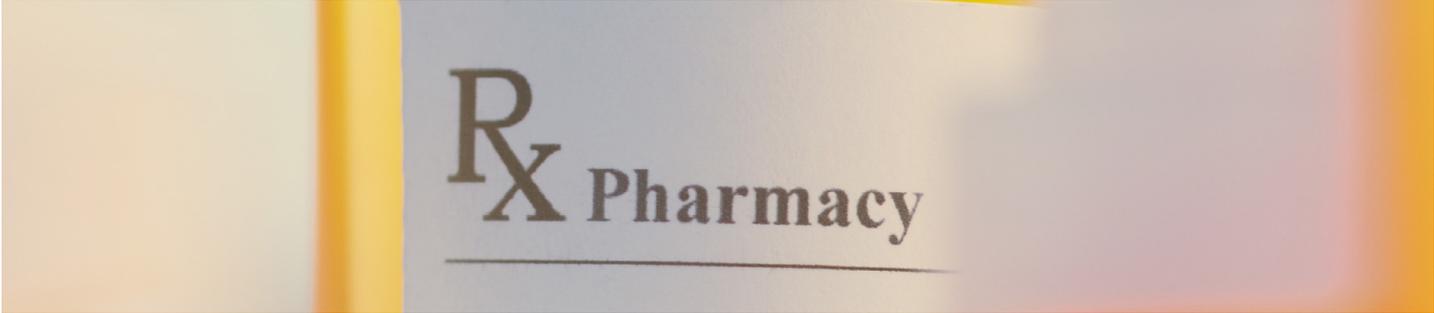
The drug discovery space encompasses a wide range of chemistry, biology and other services that determine which drugs are viable to progress into the earliest stages of toxicity testing, before moving across pre-clinical and clinical trial stages. The ability to identify winners and losers at this early stage is critical as well as the capability to validate those winners through a demanding set of testing and validation studies.

Historically, these discovery services have been kept in-house, close to the IP heart of pharmaceuticals and biotechnology. In an increasingly competitive market, pharma and biotech have moved to a partnering model with contract research organizations (CROs) or drug discovery specialists to accelerate the successful number of drug candidates to progress and more effectively test across the pre-clinical phase. There is a growing trend toward outsourcing drug discovery and other pre-clinical services.

Outsourcing drug discovery services offers a number of benefits, including allowing companies to combat the rising costs associated with research and development, keep pace with a fast-evolving and increasingly complex and personalized therapeutic landscape and grow the number of potential drug candidates for the next stage of development more quickly. CROs with specialized technology can make the discovery process more efficient, while also boosting positive results.

As pharma outsourcing increases, total outsourced pre-clinical development is expected to grow at a CAGR of 8% from 2021 onwards. This growth rate makes discovery services one of the fastest growing areas of outsourcing. During 2021, outsourced pre-clinical drug development spend totaled \$6.1 billion.

(continued on next page)



Rx Pharmacy

DRUG DISCOVERY ORGANIZATIONS PIVOT IN THE FACE OF HEADWINDS

While the industry has seen growing reliance on outsourced partners in recent years, CROs are facing their own challenges in today's market.

Biotech funding was robust during the last three years, with biotech companies raising more than \$34 billion in 2021—double the total seen in 2020. However, that funding has dried up significantly in 2022, including funding which would ultimately fuel the supporting CROs and service providers. Amid these market conditions, CROs have turned to developing future-looking capabilities, including building out technology offerings to attract and retain clients less dependent on biotech funding cycles.

At the same time, staffing shortages impacting businesses across sectors have also hit this market. Competition for talent remains a top priority, especially for mid-tier scientists with many companies in the market feeling a shortage in talent. This is an increasing area of focus across mergers and acquisitions (M&A) transactions.

LINCOLN PERSPECTIVE

The drug discovery market remains fragmented with opportunity for consolidation across a number of services for investors looking to enter the space. This PE opportunity spans lab services alongside software products in the sector.

Several strategies can set drug discovery specialists apart:

Artificial Intelligence (AI) Tools Increase Discovery Efficiency:

Technology is fast becoming a key offering among CROs, but AI capabilities are transforming the speed and productivity of the drug discovery process and are viewed as a premium offering. AI can increase the efficiency of testing alongside the ability to identify a wider range of targets.

Buyers See Value in Specialization:

Companies that can specialize in drug development for high growth therapy areas like rare diseases, autoimmune diseases or oncology are especially attractive. As PE players build out their platforms, they look to acquire specialty capabilities not yet captured in their portfolios. To add to their suite of capabilities, buyers will look for companies on the cutting edge of new technology and drug treatments, even for diseases that were recently unresearched.

Global Offering Attracts Sophisticated Acquirers:

Companies with a global footprint and strategy for selling across borders can unlock an additional universe of acquirers. As the pharma market becomes more and more global, there's an indisputable benefit to selling drug discovery services across geographic markets. During the sale process, CROs can expect PE investors to inquire about plans to expand presence in new regions with lab locations and management strategy.

For other perspectives, visit us at www.lincolninternational.com/perspectives

Interested in learning more?

Get to know Lincoln's Healthcare Group at www.lincolninternational.com/healthcare.