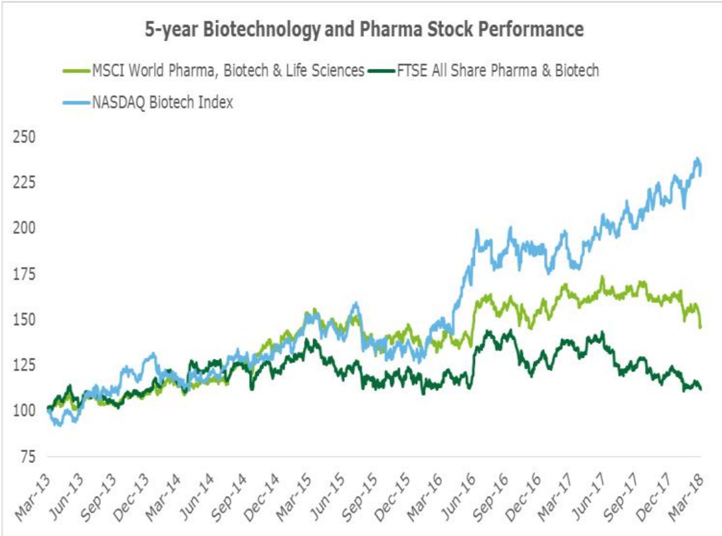
Considerations for UK incorporated Foreign Private Issuers

2017 saw renewed growth in US biotech stocks and an increase in the number of UK and other European biotechs listing on Nasdaq. There are currently 35 European biotech companies listed on Nasdaq, with more listings anticipated in 2018.

The rationale behind this US market interest centres around higher valuations, liquidity, and access to greater follow-on financing as well as greater analyst coverage, relative to the UK market.

Further, compared to their UK peers there is a greater willingness among US investors to invest in biotechs at earlier stages of development. The proportion of US IPOs completed at the early stages of development has increased significantly in recent years. The UK, on the other hand, continues to back more developed companies with existing partnerships with large pharma and/or marketed products.

This is an important observation given that over 70% of the 233 listed biotechs in Europe have a market value of less than $300m.*



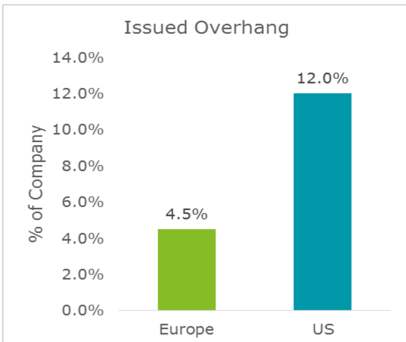
Remuneration, governance and disclosure implications for UK FPIs

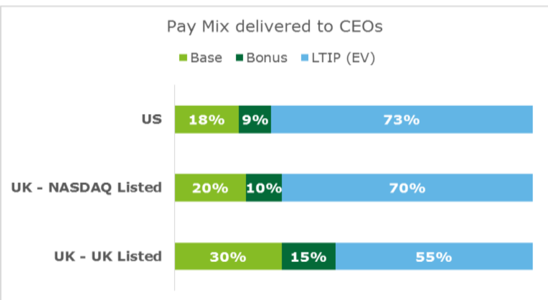
Subject to certain SEC criteria (most notably a requirement for 50% or less of voting securities to be held by US residents or if this is not the case, for certain "business contacts" tests to be met), UK-based biotechs may qualify as foreign private issuers (FPIs). FPIs enjoy certain exemptions from SEC compensation reporting rules. For example, FPIs are exempt from proxy rules, 10Q and 8K filings, as well as requirements to have a majority of independent board members, tabular disclosure for individual directors and a shareholder vote on pay or any material changes to pay.

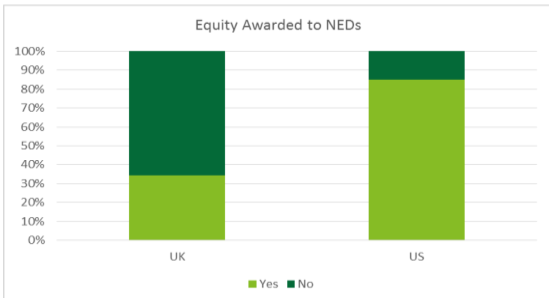
Most UK FPIs in the sector also qualify as Emerging Growth Companies (EGC) under the JOBs Act. This allows EGC companies (companies with total annual gross revenues of less than $1 billion in the last financial year) to enjoy reduced disclosure obligations, although a company cannot have EGS status for more than a maximum of 5 years.

These provisions enable a degree of flexibility for UK companies to structure cash and equity compensation in a manner that is competitive with US practices (not necessarily US quantum). This is a key consideration given the differences in remuneration practices between UK and US biotechs.

The charts to the right and below outline some of these differences. We show here differences in issued overhang (outstanding share/option awards as a percentage of company), pay mix and non-executive director equity award prevalence.**







* Source: Biocom AG 2018

** Source: Deloitte Life Science Data, UK and US biopharma (MV range £40m - £1B)

Challenges for UK Incorporated Biotechs

The problem often confronting UK incorporated FPIs is reconciling their pay practices to the UK governance and disclosure regime. While AIM listed companies have less onerous disclosure requirements than premium listed companies, a UK incorporated company that is listed on Nasdaq (including a secondary listing), is required to disclosure a remuneration report in line with the requirements of the UK Companies Act. This means emerging, research-stage biotechs have broadly the same remuneration disclosure obligations as a FTSE 100 company.

The key issue for UK incorporated FPIs is that remuneration proposals are subject to a shareholder vote, with the proposals assessed by proxy advisers such as ISS against UK governance guidelines. As FPIs generally seek to operate incentive practices that are US orientated and consistent across a trans-Atlantic board and senior management, assessing their remuneration proposals against UK guidelines is more challenging. A frequently cited issue in this respect is the award of equity to non-executive directors. This is common practice in the life science sector yet it is an issue that can trigger a significant vote against the remuneration policy or report, depending on the company’s shareholder base and the extent to which they follow ISS guidance.

In recent years a number of FPIs in the sector have struggled to obtain adequate shareholder support for a sector, rather than UK orientated, approach to executive remuneration practices. A knowledge of the detail of peer practices as well as careful dialogue with investors and proxy advisers can help position a company’s pay approach in the context of biotech sector practice in order to maximise shareholder support.

A first step here is the selection of a robust and defensible peer group of companies as a basis for Remuneration Committee decision making in terms of quantum, executive and non-executive director equity vesting, overhang (dilution) rates as well broader remuneration planning decisions.

Companies that are planning a listing on Nasdaq will benefit from consideration of these issues as a component of their IPO readiness assessment.

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