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Why That Hot Biotech IPO Could Be a Winner

Biotechnology IPOs tend to do well over the long term just as financing markets begin to thaw, an analysis shows

By David Wainer Follow

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Stocks of biotech companies started to bounce back during the second half of last year. PHOTO: ROGER KISBY FOR THE WALL STREET JOURNAL

The best time to make money in biotech is usually during periods of cautious optimism. There are strong signs that right now might be one of those moments.

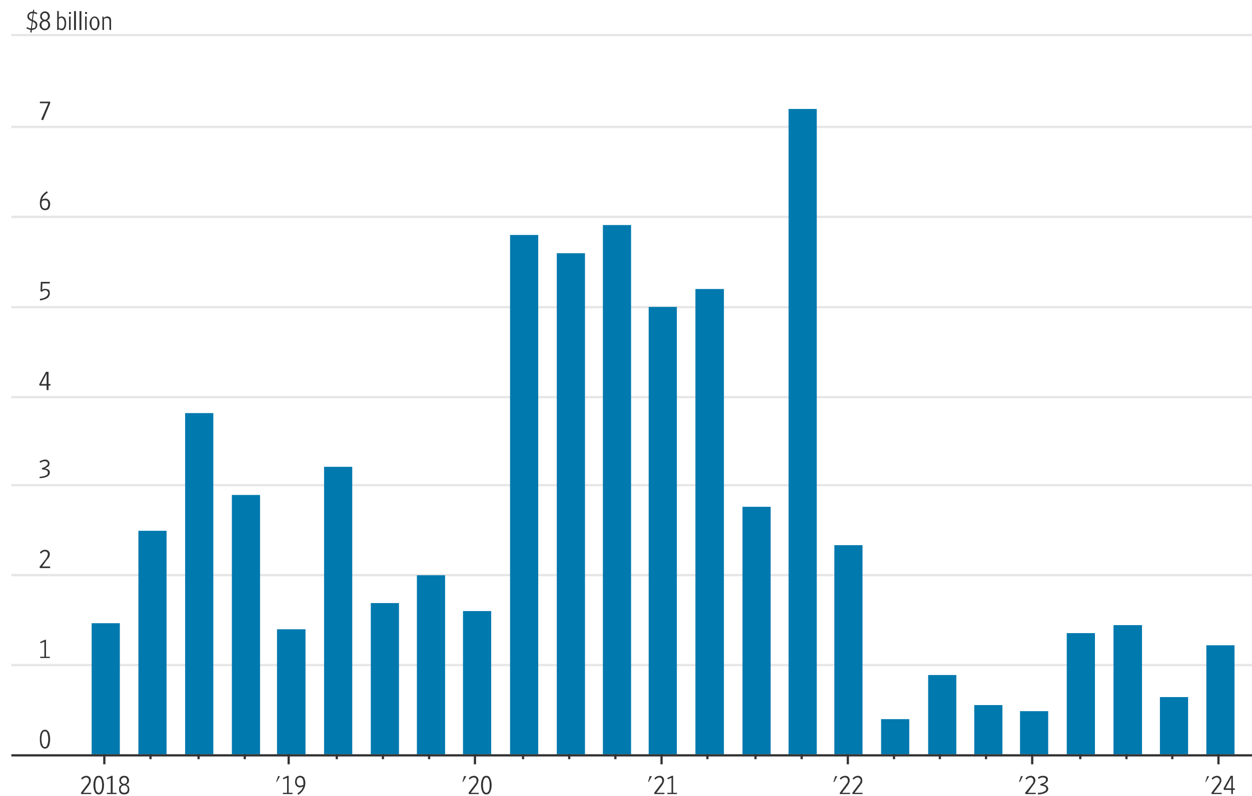
The always-volatile industry has just gone through a major roller-coaster ride, even by its standards, in recent years. The stocks surged in 2021 amid a vaccine-fueled bubble and then crashed hard for the next two years, forcing companies to undertake huge layoffs while putting many clinical trials on hold.

We are now past the downturn but not yet in bubble territory. Biotech stocks started to bounce back during the second half of last year as the Federal Reserve signaled it was done raising interest rates, with cuts penciled in for 2024. A leading biotech exchange-traded fund jumped by nearly 40% in just the last two

months of 2023. The growing appetite for risk has, in turn, opened the window for new rounds of biotech financing this year.

Biotech IPO total raised, quarterly

IPO volume still isn't where it was before the crash.



Note: Data for the 2024 quarter is through the end of February.
Source: Jefferies

Biotech companies raised $15.5 billion through the first two months of this year, making the first quarter, which isn't yet done, the best haul in six quarters so far, according to Jefferies. Initial public offerings, however, are still far from where they used to be, with IPO funding of more than $1.2 billion so far this quarter still far below precrash levels, Jefferies data show.

That might be a sign that conditions are ideal for investing in new biotech offerings. Historically, long-term returns are better when the industry is recovering but not yet sizzling, according to an analysis by University of Florida finance professor Jay Ritter going back to 1983. While there are exceptions, and single-stock performances can skew numbers heavily in any given year, the first-day move, which serves to highlight enthusiasm in the sector, seems to be predictive of long-term performance. When initial demand for IPOs is sky-high

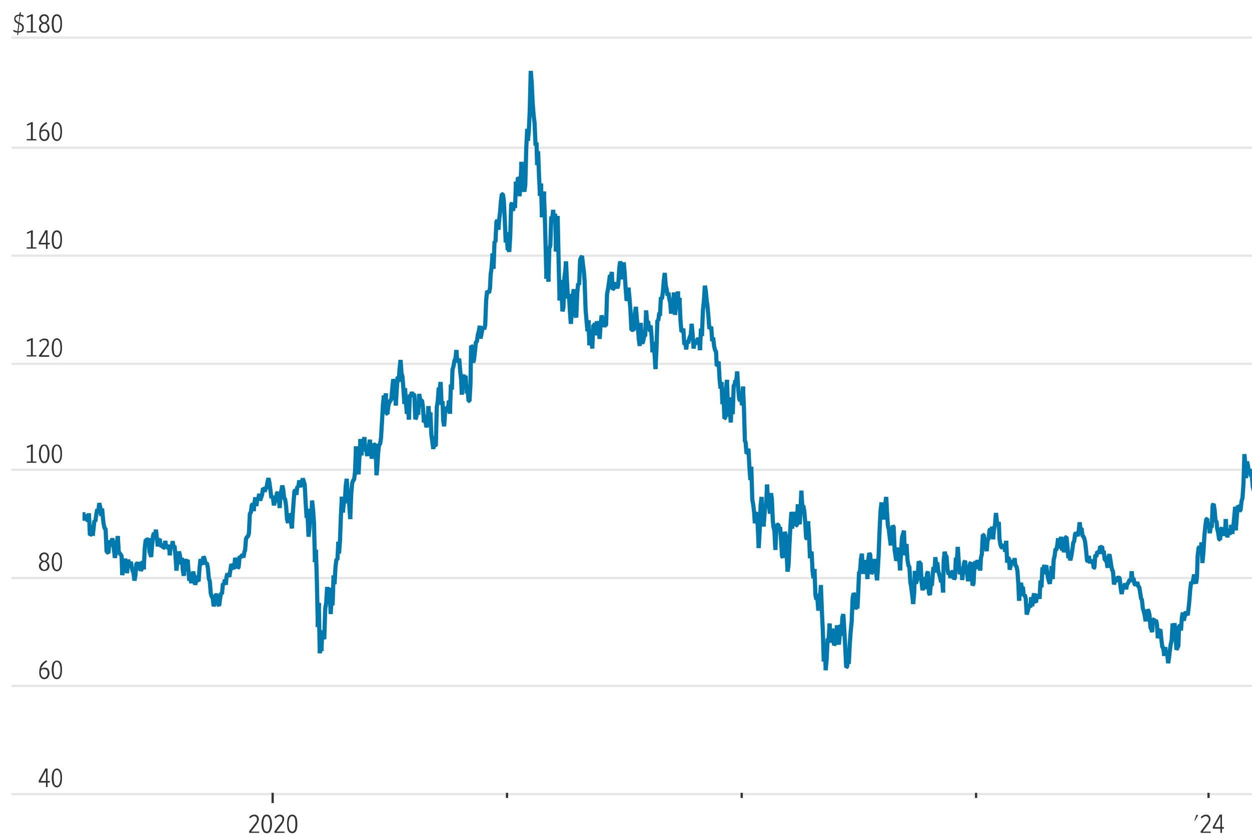
and stocks surge on the first day of trading, they tend to perform poorly in subsequent years. When demand is more muted, IPOs tend to do better.

At the height of the dot-com bubble, in 2000, 50 life-science companies went public and rose an average of 32% in their first day of trading. Those stocks went on to deliver negative three-year returns, as measured from the first close, according to Ritter's analysis. Contrast that with 2004, when 30 biotech companies went public. Their initial first-day gain was lower, rising an average of 7.8%. But within three years, investors saw a 48% return from the first close. A similar thing happened after the 2008 crash. In 2010, when financing started to come back, 11 biotech companies went public, rising an average of only 0.9% on their first day. From the first close, though, their three-year return was 51%.

"There does seem to be a pattern," Ritter says. "When public-market investors are enthusiastic, as reflected in big first-day jumps, the long-run results have been very poor."

Biotech stocks started bouncing back last fall

SPDR S&P Biotech ETF



Source: FactSet

How might investors extrapolate this data for companies going public now? In 2024, there have been eight life-science IPOs so far. While there have been some impressive performances, with Kyverna Therapeutics KYTX -1.20% ▼, a company focused on autoimmune diseases, surging on its first day, the average first-day return stood at 9.8%, says Ritter. That isn't as high as the 24% first-day bump they got in 2021, when 89 companies went public, according to Ritter's list. Those companies went on to deliver a 60% decline through 2023 as the market crashed. In 2022 and 2023 combined, the IPO market was much slower, with just 29 companies going public.

"We are definitely on pace to eclipse the volume of the last two years, but with no sign of excessive investor enthusiasm," says Ritter.

So why might new listings during a thaw, when excitement isn't as high, outperform? One obvious reason is that valuations tend to be cheaper right after a crash, when the market isn't yet euphoric. Another reason might be that the bar for IPOs tends to be higher during those times, so the companies that sell shares to the public have, on average, better prospects than the ones listing at the height of a bubble.

Biotech stocks are especially binary, as clinical-trial results tend to make or break drug developers (see Amylyx's recent wipeout). But from a broader perspective, timing is important as well. And history suggests that investing at this moment, as markets begin to thaw, tends to be best.

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