

BIOTECHNOLOGY AND BIG PHARMA'S IMPERATIVE FOR M&A



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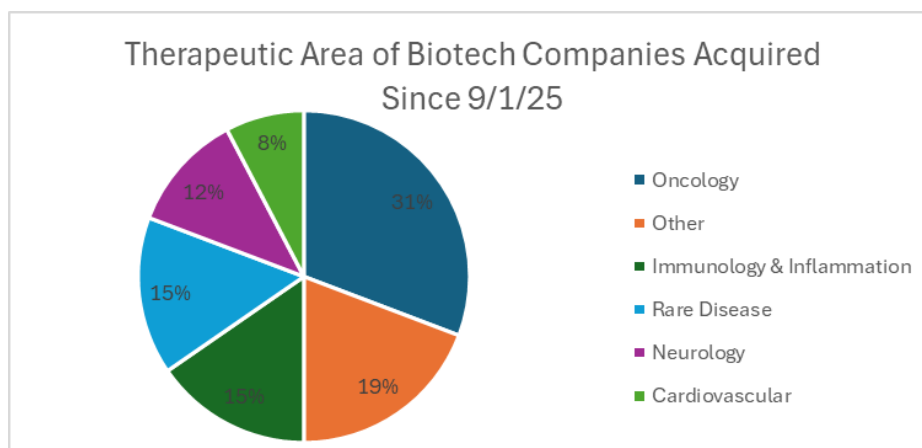


The healthcare sector entered 2026 with robust mergers and acquisitions (M&A) momentum, continuing a trend that accelerated in late 2025. For investors and stakeholders, the current landscape is defined by Big Pharma companies – those with \$50B+ market caps – and their urgent need to fill significant revenue gaps created by looming "Loss of Exclusivity" (LOE) cliffs. Almost half of 2025 pharma sales will be subject to generic competition by 2031. Biotechnology companies in the \$2 billion to \$10 billion market cap range are particularly well-positioned as "bolt-on" acquisition targets, offering assets with attractive risk profiles that can provide immediate line-of-sight to the more than \$1 billion in peak sales required by major manufacturers. Larger mega-mergers have not been well received in the past and are unlikely in 2026 due to regulatory and integration issues, leaving most of the acquisition opportunity within smaller cap companies.

The Impending Revenue Gap: The \$318 Billion LOE Cliff

The primary driver of the current M&A surge is the unprecedented level of revenue at risk due to patent expirations. According to FactSet data and Needham & Company reports, an average of 46% of 2025 pharmaceutical revenues are expected to be at risk by 2031, totaling approximately \$318.6 billion. The cycle began in earnest in late 2025 when there were twelve biotechnology companies acquired for more than \$1 billion each, and the trend has continued with another twelve such acquisitions through the time of this publication in April 2026. The therapeutic areas most impacted by these expirations are oncology (\$113.2 billion at risk) and Immunology & Inflammation (I&I) (\$71.1 billion at risk).

To mitigate these losses, Big Pharma is aggressively buying clinical-stage drugs with the potential to provide revenue to offset this cliff.



Source: TD Cowen M&A Database

The Firepower Is There: \$1.2 Trillion in Deployable Capital

The magnitude of acquisition capacity from big pharma is immense. Stifel estimates that the top 18 pharmaceutical companies have a total of \$1.2 trillion in firepower if they were willing to stretch their leverage to 5.0x net debt/EBITDA and \$500 billion of more comfortable firepower at 3.0x net debt/EBITDA between them.

Viewed through the lens of the patent cliff, the \$318 billion in revenue at risk could theoretically be "solved" for between \$600 billion and \$900 billion in acquisitions at current 2x–3x peak sales multiples (*see chart below*) – well within the aggregate firepower already on hand. The capital constraint is not binding.

Given that the aggregate market cap of all the small cap biotechnology companies in the Russell 2000 Growth Index as of April 2026 is only ~\$400 billion, Big Pharma's existing firepower could theoretically acquire the *entire* investable small cap biotechnology universe at a 100% premium. To be clear, there are both private and foreign biotechnology companies, but most of the sizable targets are in the public universe. *Said differently, the demand for assets vastly exceeds the supply of quality targets, creating a compelling opportunity for small cap investors with expertise in biotechnology.*

The "Sweet Spot": Why the \$2 billion to \$10 billion Range Dominates

While the industry occasionally sees "mega-mergers," the 1Q26 market has been dominated by "bolt-on" deals – acquisitions typically valued under \$10 billion. Several factors make companies in the \$2 billion to \$10 billion market cap range the ideal targets this year:

1. Preference for De-risked Assets: Buyers are increasingly favoring companies with Phase 2 proof-of-concept data or later. According to Needham's Biotech M&A Landscape report, approximately 71% of public company acquisitions since 2018 have involved targets in Phase 3 development or later.
2. Scale of Impact: To move the needle for a global pharmaceutical giant, an acquired asset must have a clear line-of-sight to at least \$1 billion in peak annual revenue. Companies in the \$2 billion to \$10 billion range often possess one or two such high-value assets.

Why This Cycle Is Uniquely Favorable for Small and Mid Cap Managers Like Emerald

Headlines in prior years were often dominated by the occasional \$50 billion to \$100 billion mega-transaction – a single deal that inflated total dollar volume but benefited only one stock. The current cycle is structurally different, and materially better for Small and Mid Cap managers, for a few reasons:

First, a cycle defined by dozens of bolt-on deals in the \$1 billion to \$10 billion range means more stocks participate in acquisition premiums. When a \$50 billion mega-deal dominates headlines, it crowds out smaller deal flow and concentrates returns in a single name. The current environment spreads those premiums across a larger portion of the investable Small and Mid Cap universe.

Second, premium magnitude is inversely related to deal size. A company acquired for \$3 billion will receive a higher percentage premium than one acquired for \$50 billion, simply because large deals face greater dilution risk and integration complexity for the acquirer. Premiums in recent Small and Mid Cap transactions have ranged from 38% to 140%; mean 1-day premium has been 54% for biotechnology companies acquired for more than \$1 billion since September 1, 2025, according to the TD Cowen M&A Database.

Third, recycling of capital keeps the industry self-reinforcing. When a Small or Mid Cap biotechnology company is acquired, the proceeds flowing back to specialist shareholders are often redeployed into the remaining opportunity set rather than rotated out of the biotechnology industry entirely. This recycling dynamic further supports valuations across the broader Small and Mid Cap biotechnology universe. The robustness of the venture market provides further confidence that acquired assets will be replaced by the next generation of innovation. In the period 2020-2025, Biotechnology Venture funding has averaged \$47 million per year, up from an average of only \$18 million per year for the period 2014-2019. As biopharma venture markets continue to grow, we expect that new companies and innovative therapies will continuously replenish the biotechnology opportunity set.

Fourth, these deal sizes open opportunities for non-Big Pharma companies to assume acquirer roles, a new trend that we expect to accelerate. In Q1 2026, two mid cap companies have acquired assets in this \$1 billion to \$10 billion range, creating more competition and driving up value in the small cap space. In the past, upon approval of their first drug, biotechnology companies had to determine if they wanted to sell the company or try to launch the drug themselves. Small companies had historically struggled with drug launches, so they were negotiating from a position of weakness. Recently, small companies have been able to successfully launch drugs by themselves and often reach profitability very quickly. Higher drug pricing at launch and companies preparing for the

launch years in advance has resulted in a new crop of companies who are now profitable and they themselves are becoming acquirers of smaller companies. This increases the pool of potential buyers for small cap biotechnology companies.

The result is an M&A environment that may not grab headlines the way a single transformative mega-merger does, but which is, in practice, far more rewarding for active Small and Mid Cap investors.

Current Therapeutic Trends and Market Dynamics

The M&A activity in 1Q-26 has been highly concentrated in three key areas: Oncology, Immunology and Inflammation, and Cardiometabolic/Obesity.

- **Oncology and Immunology and Inflammation:** These sub-industries accounted for the majority of deal activity in early 2026, directly reflecting the areas of highest LOE risk.
- **Cardiometabolic/obesity:** There is significant trend-following in the obesity and cardiometabolic space following the success of GLP-1 therapies, as companies look to diversify their portfolios.
- **Regulatory Windows:** Analysts suggest some M&A may be "pulled forward" as the current FTC environment is viewed as favorable.

Small and Mid Cap Biotechnology as the Innovation Engine: What the Data Shows

A critical but underappreciated dynamic underpins the long-term case for Small and Mid Cap biotechnology investing as small and emerging biopharma companies are not merely acquisition targets – they are the primary source of pharmaceutical innovation.

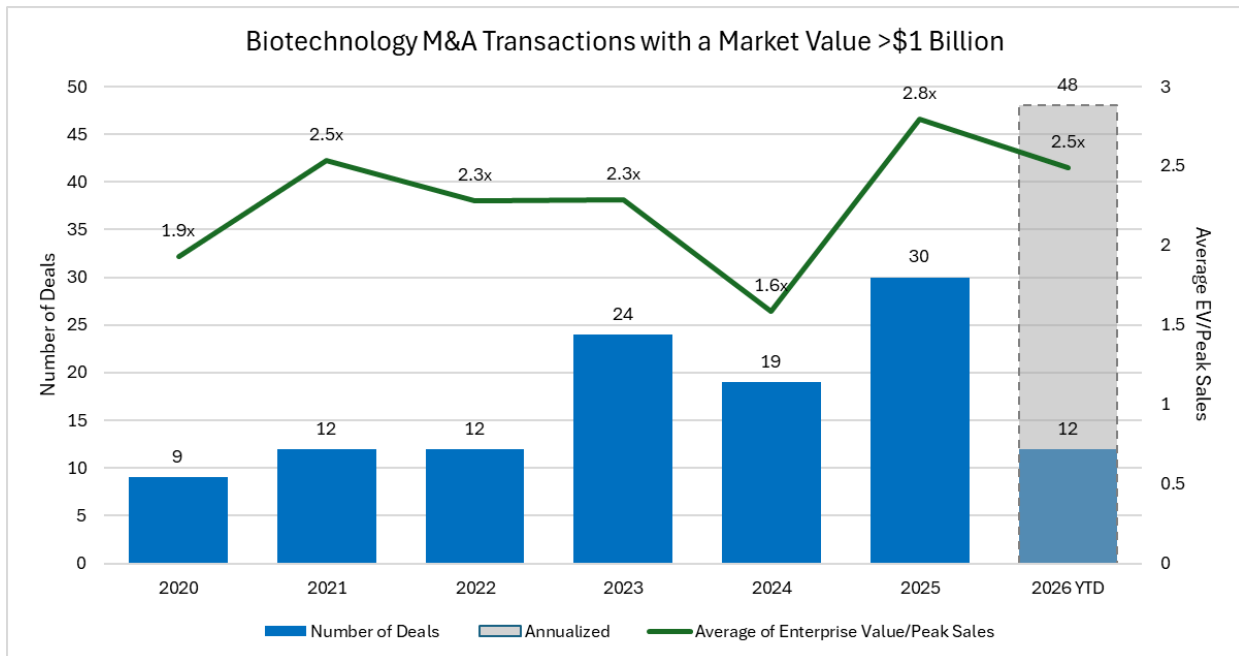
According to IQVIA's Global Trends in Research & Development (R&D) data, biotechnology company sponsors account for approximately two-thirds of trial starts in Phase I and 60% in Phase II. Large pharma companies have seen a relative decline in early-stage activity, reaffirming that the biotechnology community is pushing the boundaries of clinical development and scientific discovery. In 2023 alone, emerging biotechnology companies were responsible for 56% of all novel active substance approvals. IQVIA defined an emerging biopharma company as one that has either: 1) less than \$500 million in global revenue or 2) had less than \$200 million in annual R&D expense.

More than 70% of the 2,800 candidates in late-stage clinical testing were held by emerging biopharma companies – a share that has increased steadily over the past 15 years even as the total industry pipeline has grown.

The implication is straightforward: Big Pharma's internal R&D engine, despite its scale, has ceded the early stages of drug discovery to the Small and Mid Cap companies. Acquiring innovative small companies is not merely a financial optimization for large pharma – it is an operational necessity. Small and Mid Cap biotechnology companies are where new medicines are born.

Conclusion: Constructive Outlook for Small and Mid Cap Targets

The healthcare equity window remains open and selective, but the underlying fundamentals for M&A are stronger than they have been in years. As Big Pharma companies race to replace hundreds of billions in expiring revenue – armed with over \$1 trillion in deployable capital and facing a patent cliff that is solvable at current acquisition multiples – small cap biotechnology companies with strong scientific differentiation and clear commercial paths forward will continue to be the prime beneficiaries of this consolidation cycle. For active Small and Mid Cap equity investors like Emerald, this creates a particularly favorable setup: more deals, larger premiums, recycled capital, and an industry that is irreplaceable as the engine of pharmaceutical innovation.



Source: TD Cowen M&A Database

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