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What do Venture Capital Investors Look
for in Biotechnology Investment
Opportunities?

Gordon Hamilton, 28 November 2005

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Introduction

- The Limited partners of a Venture Capital firm are looking to make a good economic return
- Biotechnology investing is high risk – but there are a number of focused funds
- Traits of biotechnology companies
 - Investors apply portfolio theory – want a pipeline
 - Risks are very high – want IP protection and validation
 - Long development timelines do not always fit well with a 10 year LP – need clear milestones
 - It is difficult but that is why it is called Venture Capital
- Current debate on whether European VC model is broken
- Investment thesis for the sector remains strong despite recent Pharma difficulties

Timing – Factors VC's consider with regard to Timing

- Pharmaceuticals and Biologics are characterised by long development timelines with hugely varied value inflexion points
- The Public Equity markets for Life Sciences have followed 4-5 year cycles allowing companies to raise money when the “IPO window is open”
- Predicting public equity investor appetite is very difficult
- Predicting acquisition appetite of trade buyers is almost impossible
- Only a few opportunities that can be financed to market

Assets – What do VC's Invest in?

- Anything that has a compelling enough value proposition
- A clear business model
- Are wary of doubling up on normal development risk:
 - Developing drugs against new targets which have no clinical P.O.C
 - Developing new types of therapeutics unfamiliar to the regulators
- Niche indications, unmet medical needs are natural starting points
- Different risked portfolio of development programs is attractive
- Physician-led initiatives are preferable

People – In Who and With Who do they Invest?

- A good management is probably the single most important success factor for a biotech company
 - Reference checking is a must
 - Experience does not equal effectiveness
 - Recognise limitations upfront and plan for succession before investing if necessary
 - Management interaction together is monitored
 - Global network of contacts
- Syndicate partners are chosen with care
 - To add – profile in home market, firepower, expertise and network

The Deal – Due Diligence and Deal Structuring

- Due diligence allows VC's to correctly characterise the risk : reward ratio of the investment
 - It defines what is known and unknown and ensures the known facts have both validity and integrity
 - Of critical importance is the selection of the right external advisors
 - Translate analysis into an overall risk assessment
 - Would you do the deal at any price? If yes, what price?
- Deal structuring – keep it appropriate and keep it simple
 - Always consider management and key founder economic interests
 - Warrants for upside, anti-dilution and liq pref for downside protection
 - Assess voting power in terms of economically aligned shareholders
 - Re-organise overcomplicated capital structures
 - Consider tranching, reserve enough for the follow-on

Managing to an Exit

- VC's monitor through Board representation
- Remuneration committee is powerful
- Defined milestones that management is accountable for
- Act swiftly to change a failing strategy
- Be prepared to shuffle the pack, be it changing management, closing down programs or acquiring new assets
- VC's try to maintain contact with the company at several levels
- VC's are becoming less afraid to let a failing company fail
- Do not be pushed into a premature IPO, it is not an exit

Conclusion

- Successful venture capital investing in Biotechnology is about finding the best management teams with the best commercialisable science.
- Investor must provide them with the financial means to enact a sustainable business plan and advice to foresee and circumvent the many pitfalls that will be encountered on the way
- To make an economic return an investor must weigh up the risk : reward ratio of an opportunity, validate it and price it, all whilst ensuring that the capital need can be realistically met within the constraints of the funding environment

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