bioentrepreneur

Brought to you by nature biotechnology

Finance/Funding

Published online: 24 July 2003, doi:10.1038/bioent757

Private biotech companies face new funding challenges

Aaron Bouchie[1]

Aaron Bouchie is a news editor at *Nature Biotechnology*

Venture capital funds are spending more on fewer companies.

Many partners at top-tier venture capital firms say they are investing the same amount of money into startups, but the deals are fewer and larger. Because of this trend, venture capitalists (VCs) need to exit their old investments before they will loosen their purse strings for many new private companies. But several changes in the investment banking community suggest that a rash of initial public offerings (IPOs) is unlikely anytime soon.

Large VCs invested very large amounts of cash into a handful of companies in the second quarter of 2003 (2Q03) (see Table 1). However, smaller investor firms are continuing to invest lesser amounts in other private biotech firms. That is how Ken Andersen, editor of VentureWire (New York, NY, USA), explains the steady number of investments in the private biotech sector this past quarter (see Table 2 and Table 3). Andersen says the biotech sector stayed strong in 2Q03, raising the most money of any sector of the economy; the enterprise software sector completed more financings (64) but raised only $427 million.

Table 1: Top five financings into US private biotechnology firms in 2Q03

Firm	Amount raised ($ million)
RibX Pharmaceuticals (New Haven, CT, USA)	63.5
Acorda Therapeutics (Hawthorne, NY, USA)	55.3
CellGate (Sunnyvale, CA, USA)	46.2
BioMedicine (Emeryville, CA, USA)	43
Galileo (Santa Clara, CA, USA)	32
Source: VentureWire	

Table 2: US private biotechnology fundraising total rounds

Quarter	Financings closed	Amount raised ($ million)
2Q03	62	649
1Q03	33	499
2Q02	62	950
Source: VentureWire		

He also notes that the US private biotech sector is in a healthy cycle of fewer financings in the first and third quarters of each year, followed by stronger second and fourth quarters. "This investment pattern is better than a 'boom and bust' cycle in which investors overinvest and create a bubble that bursts," says Andersen.

Nevertheless, VCs anxiously await the opening of the next IPO window to exit many of their current investments[1]. Steven Burrill, CEO of life sciences merchant bank Burrill & Co. (San Francisco, CA, USA), expects that around a dozen biotech firms will go public before the end of the year. However, he says, these firms must be based on "real earnings, no more IPOs based on promise, hype and hope." Jesse Schulman, managing partner at healthcare transactions advisory firm Capel Thompson & Homer LLP (Twickenham, UK), agrees: "I will be astonished if we see any but the most gold-plated of offerings getting out in 2003."

Burrill also predicts that when the window does open, it will be of a lesser duration and appetite than the last window. In other words, biotech firms should not expect to complete multiple financings like Maxygen's (Redwood City, CA, USA) raising of $250 million in two financings only three months apart in December 1999 and March 2000.

New trends within the investment banking community may also inhibit private biotech firms from going public. There are not as many small boutique banks around to complete IPOs anymore, and the large banks just aren't interested in small biotech companies. "There is a shallow pool of bankers and analysts that are familiar with biotech right now because the old biotech guys have left the sector," says Burrill. However, he expects that once the markets open up, the banks will "jump back in."

There is also the need for VCs to know what banks' analysts are going to say about them before they go public, and this is more difficult to discern because of new rules instituted by the US Securities and Exchange Commission (Washington, DC, USA)[2]. Biotech firms do not want to enter the public markets if research analysts are going to immediately downgrade their stocks, says Burrill.

Because of these barriers to listing on the public markets, mergers and acquisitions (M&A) are increasingly becoming a more likely exit strategy for VCs. Indeed, Michael Lytton, partner at the venture capital firm Oxford Bioscence (Boston, MA, USA), says that because of this trend, liquidation terms on term sheets are changing to ensure VCs maintain current levels of returns in the case of M&A exits, which give increasingly lesser returns to investors in the current economic climate. Lytton's advice when striking an investment deal is to set up an employee preferred incentive plan that puts aside cash for key managers in the case of M&A liquidation, which sometimes leaves nothing for common stock holders, in order to incentivize management to stay on board when a decision has been made to sell their company.

Additional reporting done by Peter Mitchell, London, UK.

Table 3: US private biotechnology fundraising seed and series A rounds

Quarter	Financings closed	Amount raised ($ million)
2Q03	26	128
1Q03	9	57
2Q02	26	212
Source: VentureWire		

References

1. Mitchell, P. Public markets show signs of life. *Nat. Biotechnol.* **21**, 833–834 (2003).
2. Bouchie, A. New SEC regulations could hinder biotech investment. *Nat. Biotechnol.* **20**, 639–640 (2000).