BIOPHARMACEUTICALS '89

LATER-STAGE FINANCING IN THE DOLDRUMS

SAN DIEGO, Calif.—The dearth of later-stage, pre-initial public offering financing clearly has biotech venture investors worried. Leading off the financing trends panel at September's Biopharmaceuticals '89 conference, co-sponsored by PaineWebber (New York, NY) and *Bio/Technology*, Stephen Evans-Freke, president of PaineWebber Development Corp., painted a picture of today's market that left little doubt of the uncertainty and skepticism clouding the current climate.

Evans-Freke notes that, since the '87 market crash, biotech stocks have underperformed the market. These stocks have even underperformed the high-technology sector, as represented by an index of computer-company stocks. Short-term (quarter-to-quarter) market considerations dominate, and investors are risk-averse—especially retail investors, who are wary of committing funds on any scale. "The whole concept of long-term value investing appears to have been lost," Evans-Freke laments. This reflects back into pre-public market evaluations: There's "a heavy concen-

tration on risk management, and a heavy focus on exit windows," he believes. "If you can't convince buyers that, as a private company, you have a credible exit window into the public market, you're going to have a tough time accessing the private market." Thus, the attention is on top-tier companies. Venture capitalists now are occupied with follow-up funding—protecting their existing portfolios. And for the broader population of biotech companies, there's no access to venture capital.

Brook Byers (Kleiner Perkins Caufield & Byers, San Francisco, CA) agrees that there may be trouble on the horizon for smaller companies. He notes that, according to fellow panelist Steve Burrill of Ernst & Young (San Francisco, CA) in his recent industry survey (*Bio/Technology* 7:1023, Oct. '89), the larger biotech companies are planning on raising a lot more money than the smaller companies between now and the year 2000. "But that is actually illogical...because the large companies today are the ones that are going to move to break-even, and presumably better

cash-flow positive positions. The smaller companies wholly underestimate how much capital they are going to need." He advises companies that "If you're not unique, and if you don't believe you can move into the second tier of biotech companies on your own, you should combine with another company that also does what you do."

Yet while there is no longer a wide-open capital market for biotech financing, Bill Gedale, senior vice president of General American Investors (New York, NY), sees a silver lining inside the gathering clouds—at least for the more-established companies. "I think what's going on now in the public markets—people finding them nonreceptive—is favorable and very constructive in the long term for biotech companies." He points out that "the top tier of companies, in particular, are beginning to put together a pipeline. In very classical pharmaceutical terms, one can begin to analyze that pipeline and assign some values to it coming out the other side." He sees the corporate opportunity "becoming more definable...As this evolution toward Phase III continues, the institutional investor begins to look very hard" at the biotech companies' potential for generating high profit margins.

Investors will see more special transactions, says Burrill. He has repeatedly asserted that "people wrote the obituary for the R&D Limited Partnership (RDLP) way too early," as a result of tax-law changes. With new RDLP-like transactions like Centocor's (Malvern, PA) Tocor deal and the recent Immunex (Seattle, WA) Receptech offering (*Bio/Technology* 7:1115, Oct. '89), that prediction is being borne out. "When you can get \$50–100-million of R&D done and not have to traffic it through your P&L as an expense, that represents something fairly interesting," he notes. "And we will continue to see some interesting convertible securities coming out as institutional investors look for a way to get some return while they wait."

Evans-Freke summed up the consensus opinion of the panel: Raise money when and where you can. "You have no assurance...however much you may dislike the valuation today, that it won't be worse six months from now. And at the end of the day, a 20-percent difference in valuation in any one financing won't make the difference in the longer term."

—Mark Ratner

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