



Life Sciences

KnowledgeLine

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Life Sciences Equity Markets: No, It's Not All Gloom and Doom

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Most of us are painfully aware that the current economic climate is ugly. With the Nasdaq down 30 percent from its high in 2000 and the demise of the Neuer Market, critical public capital avenues for small cap technology companies have been virtually eliminated. Private venture capital investments in the U.S. and Europe have regressed to pre-bubble levels.

The big news is that while life sciences companies are not immune to today's capital ills, they are gaining more than their share in the down market. The life sciences sector received nearly one out of every four dollars of venture capital investment last year, topping all other industry segments. And it's still possible – albeit difficult – for biotech companies to access public markets.

In this *KnowledgeLine*, we will take a broad look at the private and public equity market trends for life sciences companies in both the U.S. and Europe and drill down to specifics on what is going on in the markets. Finally, we will discuss what these trends mean for the future of the industry on both sides of the Atlantic.

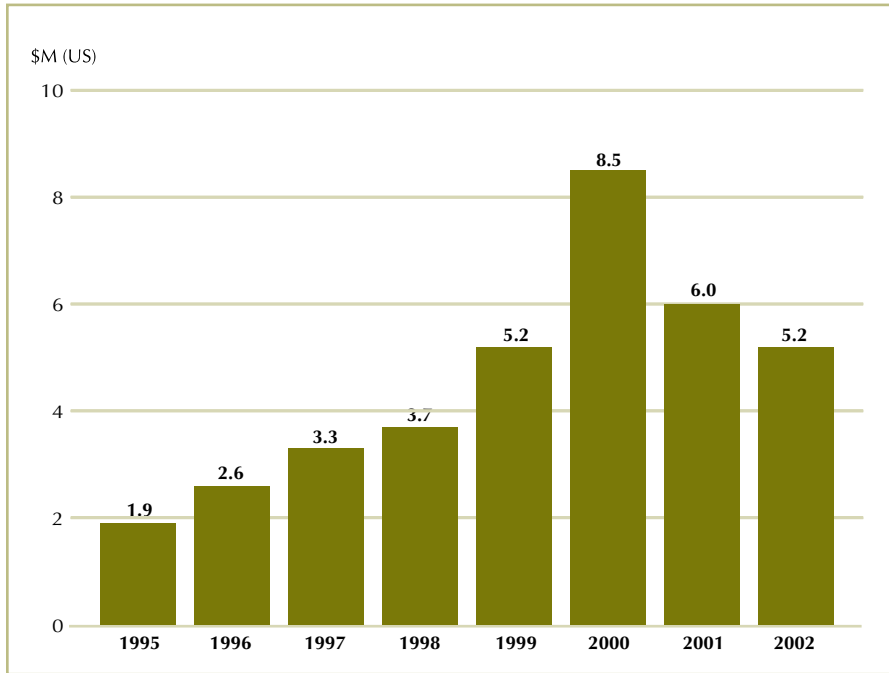
One Step Back, Two Steps Forward

Private venture capital is down considerably from its heydays of 2000 and 2001. In the U.S., venture capital financings only reached \$20 billion in 2002, down from more than \$107 billion in 2000. European venture capital investments, meanwhile, topped approximately €9 billion in 2002, down from, €12 billion in 2001 and nearly €20 billion in 2000.

Life sciences, however, is not faring all that badly in light of the downturn in private funding. While the \$5 billion in VC money raised by life sciences companies in 2002 is significantly off the \$7.5 billion raised in 2000, the industry remains well above the “pre-bubble” norms of 1998 and previous years.



US LIFE SCIENCES VENTURE CAPITAL INVESTMENT 1995-2002



Source: PricewaterhouseCoopers/Venture Economics/National Venture Capital Association MoneyTree™ Survey

And venture investment in life sciences is gaining a greater share of total VC investments than it has in recent years. In 2002, a record year for life sciences investments, U.S. biotechs garnered \$2.8 billion in venture capital. The private investments in biotech boosted the industry to its highest spot among VC leaders as it ranked third most popular in terms of dollars raised behind perennial VC winners, software and telecommunications. When medical devices investments are taken into account, the life sciences sector netted \$5 billion and ranked number one in dollars raised, capturing a quarter of all the VC investments made last year. Compare that to 2000, when the sector was hot amid the genomics hype. In 2000, life sciences raised \$8.5 billion, but that figure was a mere eight percent of the total VC investment, which topped \$107 billion that year.

“The message clearly is that public financing of life sciences may be down, but it’s not out.”

Why are life sciences companies getting a bigger piece of the VC pie? For one thing, despite setting record dollars raised in 1999, 2000, and 2001, the percentage allocated to life sciences was relatively low simply because so much money was going into IT and Internet-related investments at the time. As venture investments began to cool off in 2001, VCs began to diversify their portfolios away from tech-heavy investments and increase funding to life sciences concerns. The trend also reflects the traditional behavior of investors looking to healthcare as a recession-proof haven in a down market.

Nowhere To Go But Up

On the other side of the Atlantic, VC investment also has decreased for the past several years, but the decline has not been as dramatic as it has in the U.S. Private equity activity even increased steadily quarter to quarter throughout 2002, retreating only slightly in the fourth quarter, which is a historically slow period in European capital markets.

While the VC market has sustained some of its momentum, however, life sciences companies in Europe are struggling to access private funds. According to the European Private Equity & Venture Capital Association, one billion of the total €9 billion of venture capital were invested in biotechnology last year. The difficulty for many investors and companies in this sector is that current VC biotech funding is well below the levels of investment seen in 1999 and 2000. What’s more, the quality of potential private deals in Europe continues to lag behind that of the U.S. Two explanations can be drawn. First, there are fewer venture funds in Europe that do mezzanine and middle

rounds of financing. In general, many of the funds which took part in the first rounds of biotech financing never anticipated having to throw more money into these companies in later rounds. Second, too many companies that got financed during the funding frenzy of 2000 were “me too”- type plays, leaving investors today to question just how many of these companies can and will survive.

The good news is that better times may be ahead. Biotech funds including Schroder Ventures Life Sciences, Abingworth Management, Merlin Biosciences, and MPM Capital have all raised substantial funds. Research firm AltaAssets reports that 250 private equity firms worldwide plan to commit at least 25 percent of their capital to life sciences, which is consistent with the U.S. VC investment allocations for 2002. Another selling point is that the European biotech sector is maturing and accumulating a growing pool of experienced management and investors.

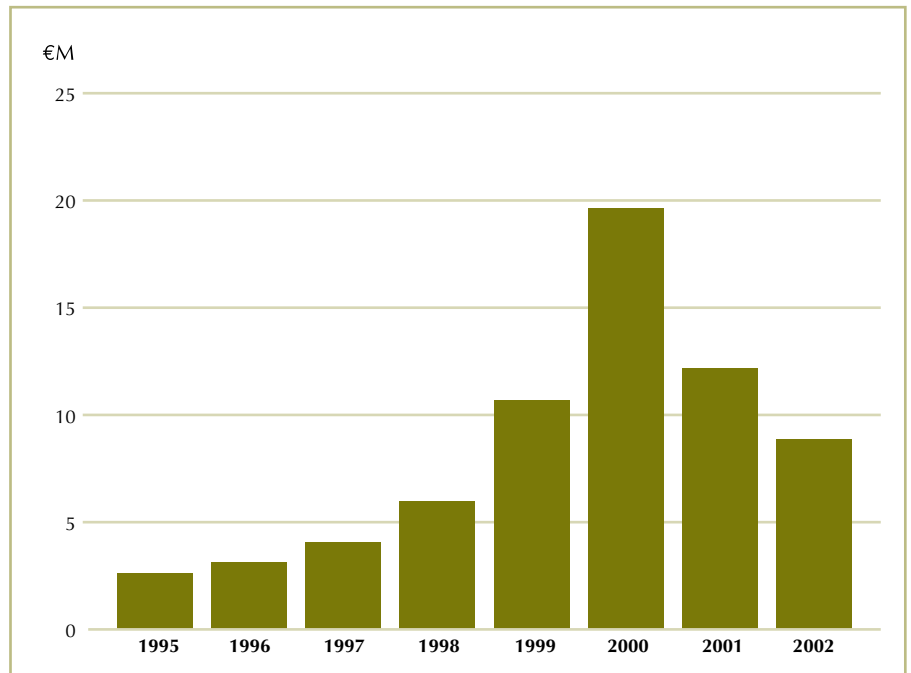
Down, But Not (Quite) Out

Public biotech funds have also shrunk and many biotech companies on both sides of the Atlantic are running low on cash to fund their costly drug development programs. Consider this sobering data from Merrill Lynch recently published in the *New York Times*:

- Sixteen percent of public biotech companies trade at a market valuation that is less than their cash on hand;
- Thirty-five percent of public biotechs have less than a year’s cash left at current burn rates; and
- Forty-five public biotechs have announced restructuring and staff reductions since June 2002.

As such, the market for public offerings remains virtually closed. Five biotech companies managed to squeeze through the IPO window in the U.S. and three in Europe in 2002. U.S. companies raised \$466 million, down considerably from \$6.2 billion in 2002. In Europe, it is worse yet. Biotech IPOs brought home \$34.7 million last year – a far cry from the \$2.2 billion in 2002 and a tenth of historic pre-bubble levels.

EUROPEAN VENTURE CAPITAL INVESTMENT 1995-2002



Source: EVCA Survey of Pan-European Private Equity and Venture Capital Activity 2002. Conducted by PricewaterhouseCoopers

Europe suffers more because it has fewer large biotech companies and in this climate it is only relatively mature companies – those with promising Phase II results or those in Phase III – that have a chance in the public market. Germany, in particular, also has an excess of tool and platform companies which investors today perceive as much less likely to pay off than those companies with therapeutic products.

While the number of biotech IPOs and money raised in 2002 may seem paltry compared to figures in the past, please note that several technology sectors have not seen any IPOs for two years. Five biotech IPOs came as only 70 companies went public in all of North America. The message clearly is that public financing of life sciences may be down, but it’s not out.

Finding A Floor

Biotech did not get its usual January rally. In fact, it underperformed most equity markets in the first quarter of 2003. And with market caps under as much pressure as they are – 227 North American-listed biotechs were valued under \$100 million at quarter end, according to BioCentury – the industry may be closing in on a floor. But don’t expect any quick life sciences



NORTH AMERICAN BIOTECH IPOs

YEAR	# COMPANIES	TOTAL RAISED \$M (US)
2002	5	\$466
2001	7	\$276
2000	75	\$6,205
1999	12	\$714
1998	14	\$498
1997	41	\$1,226
1996	81	\$1,634

Source: BioCentury

EUROPEAN BIOTECH IPOs

YEAR	# COMPANIES	TOTAL RAISED \$M (US)
2002	3	\$34.7
2001	5	\$81.8
2000	28	\$2,155.1
1999	8	\$300.1
1998	10	\$304.1
1997	6	\$317.3
1996	13	\$556.8

Source: BioWorld

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turnaround. We are anticipating a broad economic upswing in the U.S. by the end of the year, with Europe following somewhat behind. Yet, a biotech rebound will require general investors to return to the sector. That won't happen until generalists are better educated about the risks and time horizons involved in the industry and become more comfortable putting money into biotech. And it will require biotech companies to show they can deliver by moving more products through the clinic and onto the market and by consolidating to create stronger, more profitable companies. Finally, the most likely driver for the industry in Europe would be a resurgence of U.S. biotechnology. We're not there yet.

In the short-term, the key for both public and private life sciences companies is to preserve capital. That will mean more restructuring and lay-offs, which are typically harder to do in many parts of Europe than in the U.S. It will also mean postponing trials or other cash-intensive activities and boosting efforts to find equity or M&A partners to ease the financial crunch. Indeed, consolidation may play a stronger role in Europe than it will in the U.S. as the excess capacity of "me too" companies that were funded during the frenzy of 2002 are rationalized.

While investors wait for the capital markets to re-open before making a big return to life sciences, we have reason to feel confident in the long-term. For starters, diseases are not about to disappear, populations in developed markets are aging at an unprecedented rate, and a pipeline of strong IPO candidates is being created as more products move from Phase II to Phase III trials. What's more, exits do still exist. The IPO market, though slow, is not entirely closed and large pharmaceutical companies continue to be plagued by weak pipelines in need of biotech products to fill large gaps. Thus, life sciences companies that can stem the current economic tide may well find a brighter future ahead.

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