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# REAL DEALS

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## A DESIGN FOR LIFE SCIENCES

With three major exits in the past 18 months, Abingworth has taken the European venture market by storm. Managing partner Stephen Bunting explains how.



**SECONDARIES ROUNDTABLE:** MARKET PRAYS BIG MOMENT WILL ARRIVE IN 2010



# Q&A STEPHEN BUNTING

The managing partner of Abingworth speaks to Real Deals about trying to raise money in the middle of a financial crisis, the pros and cons of the life sciences investment model, and how government can help to reinvigorate the European venture scene.

INTERVIEW **JAMES HARRIS** PHOTOGRAPHY **GREG FUNNELL**

**Abingworth is a specialist life sciences and healthcare venture capital firm, but your latest fund was a growth capital vehicle. What is the firm's official focus?**

As a firm we invest in venture capital, including seed-, early- and late-stage investment. We also invest in growth equity, public equities and VIPES, a term we coined some years ago. VIPES are investments in public equities, but where we take an active role as if it were a venture investment and have a high level of ownership.

We can, in theory, invest in any area of life sciences and healthcare, in any country, at all stages, including growth equity and public companies. We do some medtech, and have a partner who specialises in this area. We are very much a venture firm, but our latest fund was growth equity. Being close to an exit is an important consideration for us, and growth equity is a more mature investment.

**How does your VIPE model work in practice?**

It fits our criteria of being close to exit. A VIPE is a quoted investment, but it imposes a venture capital corporate governance structure onto a public company. We take it as meaning a significant share of a company and a board seat.

It's a venture investment where you exercise

a significant level of control in a company, and where the alignment of interest between investor, shareholder and management are the same as a venture-backed company.

We prefer a remuneration package that is very much stock-based, because it aligns interests between managers and shareholders. Many of the small cap public companies prefer to pay higher salaries, and they tend to use a smaller stock component because it is difficult to get shares through to people in a tax-efficient way in a small cap public company.

**Your growth equity fund was raised in 2008, shortly after the collapse of global financial markets. Was that a difficult time to be raising?**

It did not go with the speed of the previous vehicle. We were targeting just £100m (€115m), because it was a top-up investment fund, and we took about a year to raise it. In the end we were undersubscribed by about £16m. We were disappointed, but people at the time told us that we were lucky to get anything given the poor market conditions.

The previous fund closed in early 2007 within two months of launching, which is a record for us. On that one we were significantly oversubscribed, targeting £250m and closing on £308m.



**Do you have any more plans for fundraising at the present time?**

We still have quite a significant amount of capital left, so we're not fundraising right now. We are barely halfway through the growth equity top-up fund, and we still have significant money in the 2007 fund. We may do something next year.

**European venture continues to suffer a reputational imbalance compared with the US. To what extent has fundraising for European life sciences struggled?**

You can argue that in America, there was an oversupply of venture capital for a period. I think there were a lot of funds chasing few opportunities, which impacted pricing. In Europe, historically we have been well supplied with venture funding, but that's changed in the past three or four years. Fund sizes are shrinking, and several firms have pulled out of the industry completely. We have seen Apax pull out, and 3i has also withdrawn from life sciences venture capital. But right now, a lot of LPs that used to put money into venture funds are putting money into China or India.

**Does this confluence of factors mean, in your mind, that it is difficult for European venture to stack up for investors?**

There's a tendency for Europeans to perceive themselves as not having attained the same level of achievement as the US, but if people looked at the examples, they would realise that is not quite correct.

One of the more exciting deals we worked on was the DNA sequencing company Solexa, which was sold to Illumina for \$600m (€470m) in 2007, after a ten-year holding period. It was a challenging project – at one point, the company almost ran out of money. Today the technology dominates the DNA sequencing market.

The UK is not meant to be good at this sort of thing – you would normally locate a company in biotech instrumentation in the Bay area around San Francisco. We had to merge Solexa with a US business to access further capital, as well as operational and managerial talent, but the technology originated from a UK company based on developments from the University of Cambridge.

**But as you say, the business required a US angle to succeed. And as venture firms are pulling out of Europe, is there a threat to the industry's viability?**

We still lack major life sciences companies in Europe like Genentech and Amgen. We don't have the really big successes. That's down to the fact that at the time the biotech industry started, America had very sophisticated venture capitalists, whereas the UK and Europe didn't have a venture capital industry, and when they did start, they were relatively inexperienced compared with their American counterparts.

One of the trends now happening is that corporate investors have stepped in to support



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the industry with venture funding. You will now see big pharma companies setting up their own venture houses, and taking the sorts of risks that used to be taken by venture capitalists.

The relationship between venture and pharmaceutical companies is becoming increasingly close. That's helped to keep the industry going. They bring a different type of knowledge from venture firms and have provided significant amounts of money and expertise. It has been a big change compared with ten years ago – one that we would not have predicted.

**Looking at the industry as a whole, which sectors of life sciences are attracting your attention at present?**

There has been a resurgence in the conventional science-based start-up. In this kind of investment, a company is formed around a new development in science. There does seem to be a bit more excitement in doing those deals, and this has been our bread and butter for years.

**Abingworth was awarded the Venture House of the Year at the Real Deals Private Equity Awards 2010. Is this partially because the life sciences sector has fared comparatively well?**

I think life sciences has done well compared to other areas of venture capital. We had three major exits from portfolio companies last year, including the \$350m sale of Novoxel to AstraZeneca, and Sanofi-Aventis's €370m acquisition of Fovea Pharmaceuticals. Since the beginning of 2009, ten of Abingworth's portfolio companies successfully refinanced, raising a total of close to \$450m, and eight formed significant corporate partnerships potentially worth more than \$4bn if you include milestones but exclude royalties. In addition, Abingworth made five new investments. I think the sector is looking a bit better than it should considering the difficulties in the past year or so.

**Why did life sciences fare better?**

Ultimately it's about intellectual property. The whole issue of patent protection puts life

sciences in a somewhat different space. Large pharmaceutical companies are facing a huge loss of revenue as drugs come off-patent. This hole has to be plugged somehow, and the industry is therefore taking big bets on products and technologies developed by the venture-backed life science industry.

**Is the development of new portfolios not something that can be achieved in-house?**

There has been a lack of productivity in R&D. Costs have escalated, more money is spent on R&D, but this is not matched with new product approvals.

The loss of patent life combined with the lack of R&D productivity is creating an incentive for pharmaceutical companies to pay a lot of money for early-stage programmes. People have been saying this for as long as I've been in this business, but now it is starting to happen. It also means that pharma is looking to create partnerships externally to reduce R&D expenditure.

Historically, venture-backed companies have been very strong at research and going from bench to clinic. This may be because of the way people operate and interact. In a small company, when you know your success is going to be linked to the future of your business, there is an urgency that is less evident in a large company.

Small companies also have an easier decision-making process. The large pharma companies have been better at development and have significant cash, management resources and experience to deal with the process of clinical development and regulatory issues.

**What is causing the costs of R&D, but not its productivity, to rise?**

To some degree, the easy targets have been picked and there are many good drugs that have been developed already. We have a huge pharmacopoeia of drugs, a lot of them work pretty well and they're cheap because they're off-patent. Drug companies, venture capitalists and entrepreneurs have to think harder about which products need to be invented, and which areas should be targeted.

Identifying drugs against novel targets can be high-risk. Last year there were 26 new compounds approved by the FDA. But in any one year, you may find only one new target that becomes fully validated clinically. Developing a new target can be high-risk, but the rewards can be dramatic.

**How have your investment criteria changed owing to the global economic crisis?**

Probably the single biggest change that has happened in the past few years is that we are now much more interested in financing risk and capital requirements. If capital requirements are significant in a company, it is of less interest to us.

In the old days, we would look much more at which area of science they were in, whereas today, our first interest is how much money they need. If it's too great we're not interested. Financing risk has become critical, but as a

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result, the industry is now more capital-efficient.

We've had to be more ruthless about the cash requirements in projects. In some cases, we've had to turn down good companies with a strong team because we felt they wouldn't be able to access the capital required. You can compare it to taking a plane to New York on half a tank of fuel – it is not something we like to do.

**Do you think the UK is doing enough to support venture-backed businesses?**

More can always be done. At the moment we have an R&D tax credit system, which is popular, but it's indiscriminate.

On the other hand, the UK Innovation Investment Fund (UK IIF) could certainly make a difference. Government investment programmes in Belgium have been very successful in supporting local businesses.

**What would you like to see from a new UK government?**

Perhaps allowing boards to give executives shares or options under an approved scheme at below market value – without inheriting an immediate tax bill – would be helpful to us. The full tax would still be paid when the shares are sold, but it would give us flexibility – particularly in public companies, where we could avoid the high salary structures that evolve because we cannot pay sufficiently with shares or options. This could also make us more competitive than the US, where they have been making life more difficult for venture-backed companies. This structure has recently been introduced into Holland.

**Finally, what is your view on the debate over the lifespan of life sciences, where investments tend to take longer to reach an exit than other venture investments? Does the model work?**

We've had this debate for many years. The ten-year phenomenon has been linked to the history of venture capital, which has been largely based around IT. In IT, the ten-year life cycle is enough for a business to grow and develop, whereas there is an argument that life sciences is better suited to a 15-year cycle.

We have analysed this further and looked at what would have happened if we had not sold our shares in former portfolio companies. We found that if we had held on to the strongest public companies we would have received dramatically higher returns. In some cases, they would have resulted in returns of more than 100 times their cost base. The real value comes at the later part of the game – when you get products on the market.

Some companies, such as Gilead, went on to be worth more than \$50bn, which we didn't predict at the time we distributed but were under pressure to distribute by the length of the fund life. We feel there are strong arguments for a longer holding period for some of our portfolio companies. ●

**STEPHEN BUNTING was talking to JAMES HARRIS, a reporter for Real Deals.**