MEDICON VALLEY
ACADEMY

medicon valley financing guide

HOW AND WHERE TO GET VENTURE CAPITAL

PROFILES OF 75 NATIONAL AND INTERNATIONAL INVESTORS

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Introduction

BY BENT CHRISTENSEN, MANAGING DIRECTOR & NIELS GERNER LARSEN, PROJECT MANAGER, MEDICON VALLEY ACADEMY

After the optimistic years around 2000, it has now become somewhat more difficult for R&D biotech and meditech companies to find venture capital. Despite this global trend, however, venture capital can still be attracted by unique business cases.

The aim of this publication is to improve the ability of companies in Medicon Valley to identify and approach potential investors, thereby increasing their chances of attracting national and international venture capital. We have focused particularly on international venture capital, the importance of which is becoming clear to an increasing proportion of companies in Medicon Valley.

The guide is divided into two parts. Part one describes the financing process from start to finish. Here, you can learn about such topics as what will make your company attractive to investors, how to contact them, what should be included in a good company presentation, how to get the greatest benefit from your investors, and how to influence your exit possibilities, etc. The overall aim of part one is to increase the level of understanding of the financing process among the entrepreneurs and management teams of biotech and meditech companies.

There is also a great deal of sound advice and experience, contained in five articles written by experts in financing and accounting. In four company cases, you can read about the experiences of CEOs and CFOs in attracting national and international venture capital to Medicon Valley companies.

The target group for part one consists mainly of non-public companies in the first and second rounds of financing, but more experienced executives will also be able to find inspiration here.

Part two is aimed at all non-public companies seeking financing. After a wide-ranging process of research, we can now present 75 national and international investors in the biotech and meditech fields, including significant local and global investors, all of whom will be of interest to companies in Medicon Valley. Each investor is presented with accompanying contact information, a brief profile, and key figures.

Medicon Valley Academy wishes you the best of luck in your search for financing!

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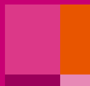


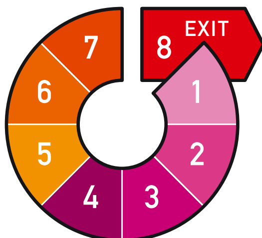
"The biotech industry is a global industry, and it is therefore natural to have an international investor base"
[Thomas Feldthus, CFO, Symphogen A/S, page 40]

"It's important to have both an exciting technology and the potential to make it into a profitable business. Too many biotechnology companies are simply 'science masquerading as business' and it is difficult to see what market need they will satisfy" [Zahed Subhan, CEO, Nuevolution A/S, page 12]

"Personal contacts are crucial in gaining access to the venture capital market; it is very much a market of 'introductions'" [Chapter 4, page 29]

". . . there is a tendency for companies to provide too much information on their technology and too little on how the technology can be commercialised" [Chapter 5, page 32]

". . . very seldom would even a really hot company manage to raise international capital, if the seed investors are less than impressive in the eyes of the international investor" [Florian Schönharting, Partner, Christian Hansen, Partner & Henrik Nilsson, Investment Analyst, Nordic Biotech Advisors, page 24]



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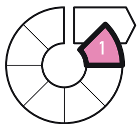


Is your company attractive to investors?

Each year, investors receive hundreds of business plans, of which 95 to 99 percent are rejected.

When you are seeking financing, it is thus essential that your company really is attractive to investors.

The purpose of this chapter is to help you to evaluate whether your particular company will be able to attract venture capital from potential investors.

The criteria for evaluating potential investment opportunities vary from one investor to the next. Nonetheless, through interviews with investors, we have identified some key determinants of the attractiveness of your company.

If you can answer 'yes' to the following questions, your company is likely to stand a chance in its quest for venture capital:

- Does your company have high prospects for *growth*?
- Does your company have a *unique business case*?
- Does your *management team* have a strong track record?

Additionally, if you have been through one or more financing rounds:

- Does your company have a *strong investor base* and a *clear ownership structure*?

Does your company have high prospects for growth?
Investors look for business ideas with high growth prospects because their primary objective is to generate financial returns on their investments. In other words, their aim is to make money.

Investors in life sciences are attracted by companies with high growth and thus high earnings potential. For the same reason, venture capitalists are also willing to take on a considerable degree of risk. In return, they expect an average annual return on all their portfolio companies of 25% to 40%.

Since a significant number of ventures fail, the actual requirement for each individual company is, however, much higher. In fact, most venture capitalists will not invest in a company with an expected return of 'just' 25% to 40%.

Expected market size
The size of a product's or technology's expected market is naturally a crucial parameter for investors. For drug discovery and development firms, a projected product must either have a large expected market, i.e. cater to a large group of diseases, or be able to obtain a leadership position within a clearly defined niche market. Within therapeutics, investors look for a product or technology that has an expected market value of several hundred million dollars. For companies within diagnostics and medical devices, the expected market potential must be at least one hundred million dollars.

Time-to-market
Another important parameter for investors is the expected time-to-market for your company's product. The longer or more uncertain the time-to-market for your product, the greater the risk involved in investing in your company. Moreover, a company with ten years to the market needs significantly more capital to get there and, given the required annual return, the required exit value becomes very high for long-term investments. Ever since the financial markets came under growing pressure in 2001 and 2002, investors have become increasingly focused on products with a shorter time-to-market, and thus with better exit opportunities for investors. (See the case of LifeCycle Pharma, page 10.)

Does your company have a unique business case?
Essentially, making your company attractive to potential investors requires you to have a clear business case supported by a precise commercial focus. This is the first and most important message that you will need to convey to your company's potential investors: how they can make money by investing in your particular company, why your business case will generate revenue, the market potential and worth of your

technology, how your product can be commercialised, and how your product will reach the market within a foreseeable future.

It is important to identify how your business case sets itself apart from its competitors. This means you must demonstrate not only that the technology of your company is unique, but also that it has a competitive edge.

Do you have a broad technological platform?

Investors generally prefer a technology with a broad range of potential applications – meaning that it can be applied in a large number of therapeutic areas – because this will allow you to spread the risk involved in the technological venture, both for the sake of your company and its investors. However, companies with an R&D profile that is too broad will not attract investors, since this leads to a burn rate that is disproportionately high in relation to output.

You can improve your chances of attracting investors through consolidation and the strengthening of your company's technological platform by entering into strategic alliances or engaging in mergers and acquisitions. Examples of acquisitions and mergers in Medicon Valley include TopoTarget's acquisition of Prolifix and the merger between Pantheco and Cureon to form Santaris Pharma.

Is your technology well-protected?

No patent, no money! To be attractive, your company must own the rights to the intellectual property that underlies its technology and its business idea (or is able to gain access to these through in-licensing). The stronger your intellectual property rights and the longer their time to expiration, the better. It's important to ensure that your freedom-to-operate is not restrained by dependence upon other patent-holders. This might be the case if, for example, part or all of your final product is covered by intellectual property rights owned by other patent-holders, or if your projected manufacturing process is inadequately protected.

If your company is more mature, investors will look at its ability to conquer territory through aggressive and strategic patent filing. Are there significant areas that are not covered? Can the results from one project be extrapolated to other products and/or markets? A thorough analysis of these points is a strong contributor to the overall attractiveness of your company to potential competitors.

See also Medicon Valley Patent Guide: *www.mva.org/patentguide*.

Does your management team have a strong track record?

The most groundbreaking business idea is worthless unless your management team has the necessary expertise to effectuate it. That's why many investors say that they invest in "people, people and people" rather than just companies. A company's life is full of surprises and challenges. Consequently, investors regard an experienced management team – with relevant industry experience and a strong track record in doing business and in bringing products to the market – as a form of 'insurance'.

The greater the experience of your Chief Executive Officer (CEO), Chief Financial Officer (CFO) and Chief Scientific Officer (CSO) in various aspects of business development, the better.

Moreover, investors value a management team that has international experience and established ties to the UK and the USA – both of which are home to vast biotech markets, and therefore interesting to investors – since such ties can help to increase your company's chances of obtaining further financing, and improve its future exit opportunities. (See the case of Nuevolution, page 12.)

Finally, many investors feel that a company's board members and its scientific advisory board are often overlooked. It is thus important to ensure that the board consists of members with complementary areas of expertise, who will be able to assist the management team in the development of strategic guidelines, networking and other important activities. If your board members have solid international industry knowledge and established track records, it will create value for your company, reinforcing its credibility and its attractiveness as a potential investment.

Does your company have a strong investment base and a clear ownership structure?

A very important part of developing a company is building the investor base. The more competent and experienced your investors, the better. Strong investors add significant value to a company by providing sparring on questions of strategy and other important manage-

ment issues, and by supplying access to networks (e.g. international contacts with industry investors), and 'deep pockets' (i.e. the financial capability to support the company in the long run).

In Chapter 7, we will discuss the possible roles of investors in greater depth. If you have already completed one or more rounds of financing, your company will be attractive to new investors if your company's investor base consists of experienced and competent local and international investors with impressive track records. These types of investors provide intelligent capital and make your company far more attractive to potential investors than a company with, say, a local lead investor who has no specific industrial expertise in life sciences. In Chapter 3, we will discuss how to identify the right investors for your company.

On a related note, most investors consider a large number of owners to be a disadvantage for a venture company, because it is difficult to make fast, dynamic decisions in companies run by a lot of owners. A clear ownership structure with a few, competent investors is attractive to most investors.

MEDICON VALLEY PATENT GUIDE 2002
WWW.MVA.ORG / **PATENTGUIDE**

A start-up company with short time-to-market

AN INTERVIEW WITH MICHAEL WOLFF JENSEN, CFO

LifeCycle Pharma A/S

ESTABLISHED **2002**
HEADQUARTER **COPENHAGEN, DENMARK**
STAFF **8**
FINANCING ROUNDS **1**
RAISED CAPITAL **DKK 22 MILLION**
WEBSITE **WWW.LCPHARMA.COM**

LifeCycle Pharma is a spin-off of H. Lundbeck A/S. LifeCycle Pharma is developing its own product pipeline of six to eight product opportunities that are based on better formulations of existing, high-value drugs. We met the CFO, Michael Wolff Jensen, and had a general discussion on the financing process in a biotech company. Michael Wolff Jensen possesses experience from the Medicon Valley biotech company, Genmab, where he was part of the senior management team that integrated a successful business strategy resulting in the to-date largest initial public offering for a European biotech company by raising more than $ 183 million. Michael Wolff Jensen has cross-Atlantic management experience in mergers, acquisitions, private placements, and public offerings.

LifeCycle Pharma was able to attract investors – in your opinion, what made you particularly attractive to investors?
It was the combination of a number of factors. Most importantly, we were able to go out and present a business case, where the time-to-market was relatively short in comparison to other biotech companies – particularly start-up biotech companies. We work with second-generation medicine, meaning that we develop an improved version of an existing product on the market. We will thus be cash positive in approximately 3½ years, i.e. in 2006-2007. It was an advantage that our technology is clinically validated on products in clinical Phase I and II together with the fact that it is very easy to understand from a technical point of view. It is based on some well-known principles and has a broad application platform. In fact, our technology can be used in all therapeutic areas: a business case, which is easy to understand – that is definitely an advantage when you seek capital.

What are important messages to communicate to investors at a presentation?
One very basic thing which you must do is explain to investors why and how they can make money investing in your company. Why is this company going to make money? Why is the technology not just a 'sexy' technology for the sake of technology? How can it be commercialised? Why is the company's product better and different from other products on the market and in clinical development, and how will it reach the market within a foreseeable future?

Do you use your investors actively?
Yes, good advice is never a bad thing

to get! I strongly recommend that you establish a dialogue with your investors. It can give them a better understanding of why your company needs to raise further capital in the future. If you got some good advice from your investors and you followed it, well, then you have also aligned your business with some of their wishes. And that makes them more interested in investing in your company another time. Moreover, your investors can also help you develop relationships to new networks and collaborative partners. One of our investors has just been in the US, where one of his tasks was to establish contact to a number of American companies, which has opened some doors for us to potential collaborative partners.

Will LifeCycle Pharma seek international capital in their second round of financing?
We would very much like to do that. Definitely.

How will you approach international investors?
I will make use both of my own network as well as the current investors' networks. You need to have a very clear strategy on how to go out and do these things. So we make a plan together with our investors. We make a list of potential investors that we wish to contact. Our board then gives the Senior Management authorisation, so we know which figures we have to negotiate with, when we meet with the investors.

You have worked as the CFO for Genmab, which is a very international company. Do you have any suggestions as to how biotech executives in Medicon Valley can strengthen their management competencies?
No matter whether you are working with cancer, diabetes, HIV or something entirely different like trying to out-license a technology platform, then you have to compete on a global market. You must therefore broaden your horizon and look to where you can find the best experience. Within biotech, you therefore naturally look to the US and the UK. There you can find useful knowledge, which biotech executives can benefit from. You can access some of this knowledge by for example attracting investors, by developing collaborative partners, or by attracting employees from the countries in question. This can provide you with good insight into how they work on projects.

What typical conflicts come up at a negotiation?
The usual conflict is on valuation issues. Investors want the company's valuation to be as low as possible, and we, as the company, naturally want it to be as high as possible. And then there is the golden rule no. 1: don't think that the negotiations are over before the contract has been signed. Every time you think that you have agreed on all documents – that everything is in order – then someone bring up something new, which opens up for discussion again!

What determines valuation?
You can make a lot of nice things on the drawing board, but at the end of the day, this is highly contingent on what's in fashion at the time. Investors are after all generalists, and therefore do not know everything about specific technologies. This means that they – to a certain extent – follow trends. In 1999-2000, genomics was 'the thing', and could really draw money out of the investors – even the most conservative ones. So the things, which are popular at a given moment, get high valuations. Things, which are less popular, get lower valuations.

Today the investor trend has clearly moved towards a 'product development' and 'time from concept to market' focus. So for companies having products in clinical development – either internally or together with a partner – and where the time to commercialisation is relatively short, the valuation question is completely different than for companies with focus on target identification or products in the very early stages of pre-clinical development.

What is the most important lesson that you have learned?
That you need to have an international focus! It is not enough for the researchers to go to international conferences. The whole company needs to have an international focus.

"...good advice is never a bad thing to get! I strongly recommend that you establish a dialogue with your investors"

International CEO in a local company

AN INTERVIEW WITH ZAHED SUBHAN, CEO

Nuevolution A/S

ESTABLISHED **2001**
HEADQUARTER **COPENHAGEN, DENMARK**
STAFF **32 (INCLUDING 18 PHD STUDENTS)**
FINANCING ROUNDS **2**
RAISED CAPITAL 1ST ROUND **$ 9.8 MILLION**
RAISED CAPITAL 2ND ROUND **$ 15 MILLION**
WEBSITE **WWW.NUEVOLUTION.COM**

Nuevolution is a privately-held drug discovery company striving to revolutionise the drug discovery and development process by utilising its proprietary technology – Chemetics™.

The appointment of Zahed Subhan, PhD, MBA, LLB, as the new CEO of Nuevolution was publicly announced on May 6, 2003. The headhunting of Zahed Subhan from his previous position as Vice President of Business Development for the US-based biotech company Locus Pharmaceuticals, Inc. is a step towards attaining the commercial potential of the technology by helping Nuevolution succeed in attracting international capital as well as enter into serious, international partnerships, two key ingredients necessary to guide the company towards an exit. We had the opportunity to meet with Zahed Subhan and ask what convinced him to take a job in Medicon Valley, and what he believes his experience from twenty years in the international pharmaceutical and biotech business can offer Nuevolution.

What convinced you to accept the job as CEO for Nuevolution?
I was attracted to Nuevolution, because I saw their technology as being truly unique with a solid commercial application. I was therefore reasonably certain that the company would be able to raise new money as long as it was positioned appropriately. I looked at a number of CEO positions with very interesting technologies, however, at the end of the day, I doubted their potential to succeed commercially. It's important to have both an exciting technology and the potential to make it into a profitable business. Too many biotechnology companies are simply 'science masquerading as business' and it is difficult to see what market need they will satisfy.

Why do you think Nuevolution decided to hire a CEO with an international background?
I understand that the investors in Nuevolution wished for a CEO with international experience in both the pharmaceutical and biotechnology sectors. This is my third biotech company – following a 14 year career in the pharmaceutical industry – one of which has gone public on NASDAQ. I have also been involved in a trade sale once before with a previous company, Gemini Genomics – sold to Sequenom Inc for $260 million. In all of these positions, I have also been successful in concluding international

partnerships and collaborations which is an activity that biotech companies must be proficient at.

How can you contribute to attract international capital?
I have many contacts in the US Venture Capital community and I am actively discussing with potential investors how we might go about setting up a small US office. This tends to be a pre-requisite of attracting funding from US sources. Remember, the biotech sector is an order of magnitude larger than Europe and there are many good companies to choose from.

Will you consider using an investment bank in your search for international venture capital?
Yes, we are actually already working with the Dutch investment bank Fortis who acted as our advisor in our recent $ 15 million first close of a Series B financing. Fortis will act as our sole private placement agent in the forthcoming second close of this round, in which they will help us raise up to an additional $12 million dollars. Their job is to help us prepare a private placement memorandum and also to actively market the Nuevolution opportunity to venture capital firms around the world. It can be viewed of as a stamp of approval if a world class investment bank agrees to work with your company in a private fundraising.

The advantage of cooperating with an investment bank, even though they may receive a sizable commission is that they work with the company to help define the focus of the business and formulate a clear business proposition. Thus, our business plan has been much improved following Fortis input.

We know that you were hired, among other things, to help Nuevolution succeed in raising their third round of capital – could you tell us a little bit about this?
One reason that investors were reluctant to invest was that the company lacked a market perspective. The great science was very evident but it was not clear how the technology would translate into an attractive business proposition. I understand that some potential investors, looked closely at the company and finally decided not to invest, because the commercial focus was not sufficiently clear.

What finally convinced your new investors to go with Nuevolution?
One of the presentations that convinced new investors directly addressed the market potential of a 'lead generation technology' by focussing on licensing deals, and the value of these, achieved by competitor companies. Putting it into numbers helped them see the obvious commercial potential of our technology. This was actually already on my third day of work at Nuevolution. The management team worked through the night to update the existing presentation to ensure that these points could be made.

What do you think is the most common mistake when presenting a company to investors?
In most cases, scientists believe their science will do the job for them i.e. that science in itself will convince venture capitalists. But most of the time, venture capitalists do not have the time to familiarise themselves with the technology and its potential. A clear business case must be presented – this is especially important with a technology platform as opposed to a product based company.

How would you recommend Scandinavian CEOs to get more international experience?
One way would be to accumulate experience through structuring international collaborations. Another option is getting international investors on board, and drawing on their experience. The world has changed and will continue to change – the USA, in particular achieves a more and more dominant economic position relative to other trading blocks and international experience assumes a greater importance in commerce generally.

What would you recommend Scandinavian CEOs to think of when raising international capital?
Well, there are some very basic points to take on board: I believe that it is necessary to be able to communicate fluently in English. It does not create a good impression on US venture capital groups if the senior management of the company cannot do this. The language does make a difference, and international investors have to know that the CEO representing the company will be able to make himself totally comprehensible in English. US venture capital firms also appreciate if you have international business experience. Of course, this depends on where you wish to do business. If you only want to focus on Europe, experience from Scandinavia will do fine, but for the USA, they would

like you to have had some business exposure in the USA.

What will you do to improve your exit opportunities?

Like all companies, we will have to extend our collaborative partnerships both with other biotech companies and pharmaceutical companies. Given the state of the public markets today, it is a little difficult to envision an IPO exit in the next 2 years or so, although there are signs that the this situation is improving in the USA for biotech companies waiting to go public. So in order to raise attention from potential buyers – who for most Danish biotech companies are likely to be located in the USA – we have to extend our collaborations with US partners and do our best to become visible to possible acquirers in the USA. To succeed with this strategy, it will definitely help us to have international investors on board.

"Too many biotechnology companies are simply 'science masquerading as business' and it is difficult to see what market need they will satisfy"

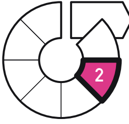
"It can be viewed of as a stamp of approval if a world class investment bank agrees to work with your company in a private fundraising"

mva / business academy

MVA Business Academy offers 2 x 45 minutes biotech management lectures hosted by Medicon Valley Academy, starting at four o'clock in the afternoon.

The mission is to strengthen biotech management competencies in Medicon Valley by providing knowledge and discussions on relevant management topics.

WWW.MVA.ORG / BUSINESSACADEMY



Providers of venture capital

R&D companies with a new business idea or technology often have no other financing option than to seek venture capital, since banks will usually only finance a new business if it possesses hard assets against which to secure debt. Since most life science companies in Medicon Valley are R&D companies, this chapter will focus on venture capital: who are the providers of venture capital, where does venture capital initially come from, and how are the individual investment stages defined?

Before identifying and approaching potential investors, we recommend that you familiarise yourself with the basic knowledge of venture capital. If you wish to read about debt capital, you will find more information at *www.mva.org/financingguide,* where you can also learn more about the difference between venture capital and debt capital.

Private equity as a source of financing

During your quest to raise capital for your company, you will encounter a lot of financial terms, some of which may be a little confusing. One of the most common sources of confusion is to be found in the concept of private equity and its relationship to venture capital.

The term 'private equity' is often used to label the growing area of equity financing for non-public companies. The European Venture Capital Association defines private equity as the universe of all venture investing, i.e. covering all stages in the lifecycle of a company, and ranging from seed capital to buyout investing and mezzanine investing. The three main sources of venture capital described in this chapter – venture capital firms, corporate venturing units and business angels – are all providers of capital to the private equity market through their investments in companies.

Venture capital firms

Venture capital is a subset of private equity. It is primarily used to finance high-tech, privately-held companies that can be characterised as high-risk investments with high growth potential, where investors demand a high rate of return in compensation for the risk they take on by investing in such companies. The investment manager working for the venture capital firm, the venture capitalist, acquires an agreed portion of the share capital (i.e. equity) of the company, in return for providing the requisite funding.

The venture capitalist's time horizon for investing in a company typically runs from three to seven years. The venture capital firm does not receive a return on an investment until it has made an exit from the investment. Exit strategies include selling investors' shares to management or to a third party, exiting by means of a trade sale, or exiting by listing the company on the stock exchange in an initial public offering (IPO). You can read more about 'How to Exit?' in Chapter 8.

Venture capital firms often specialize in providing funding for companies at different stages of development. Some specialise in very early (seed) financing, providing money to build prototypes or to fund further research. An increasing number of venture capital firms around the world focus on later-stage financing, targeted at companies in their initial growth and expansion phases, where research efforts have culminated in a commercial product that still needs to prove its competitive potential.

On page 18, we provide a more detailed description of the various investment stages.

In addition to providing financing, venture capitalists may actively participate in running the firm, offering their experience with previous start-ups and their general management expertise for the benefit of the company. For more details on how a venture capitalist can contribute to your growing business, please see Chapter 7.

Venture capitalists recognize that only about one or two out of every ten ventures will be successful in the long run. To reduce the risk associated with investing in such companies, venture capitalists use a technique called staging, which involves providing financing to their portfolio companies in stages.

At any given time, enough money is invested to enable the company to reach its next investment phase. In order to achieve this, one or more milestones are planned. There can be many such stages, each representing a key step in the process of developing the company.

Venture capital firms also spread risk by co-investing with other venture capital firms. It is the exception rather than the rule for a venture capitalist to finance a company single-handedly. Typically, a company's first round of financing will involve one lead investor and one or two co-investors. In subsequent financing rounds, the investor base will typically be extended by a couple of follow-on investors and one or two new co-investors.

Corporate venturing units

Corporate venturing is a type of venture capital provided by large corporations, such as the big pharma companies. In Medicon Valley, Novo Nordisk, Radiometer, Leo Pharma and Danisco, amongst others, possess corporate venturing units. (See the investor profiles at the end of this guide.)

If a corporation cannot achieve its growth goals through further development of existing business segments, it may turn to acquisitions or to corporate venturing as a means of acquiring a stake in high-growth businesses, products or technologies.

The main difference between venture capital firms and corporate venturing units thus lies in the fact that corporate venturing is motivated not just by the desire for financial returns, like private venture capitalism, but also by strategic objectives, such as the desire to strengthen the innovative image of the parent company or to invest in technologies that complement existing business areas. For the same reason, corporate venturing usually focuses on projects and companies that fall within or close to the corporate parent's business areas, which are thus used as a 'strategic filter' for the identification of new portfolio companies. The strategic fit required in corporate venturing makes it possible to benefit from a venture even if it fails, since the output of the venture can be used to extend the strategic activities of the corporate parent.

Generally, the time horizon for corporate venturing investments is slightly shorter than for venture capital firms, since corporate venturing often enters during the later stages of financing. Like some venture capital firms, corporate venture capitalists provide guidance and support to their portfolio companies on the basis of their knowledge of the industry and business experience. Many corporate investors, for example, seek the same type of board representation as venture capital firms.

Business angels

A business angel is a private individual who has accumulated substantial amounts of capital, and who possesses business expertise and risk capital that he makes available to research projects and companies in the early stages of development, often during the seed stage.

Business angels usually have a background as successful entrepreneurs and businessmen. So in addition to providing capital, they may also provide companies with important management and industry insight. Their knowledge can be helpful in solving complex strategic problems. In capital-intensive industries, such as life sciences, business angels will not generally provide large amounts of capital, but will instead figure as highly dedicated board members, supporting the management team in its strategic planning or networking.

For more information, please see *www.nutek.se/sb/d/204/a/1157* and *www.dban.dk*

☐ Types of investors

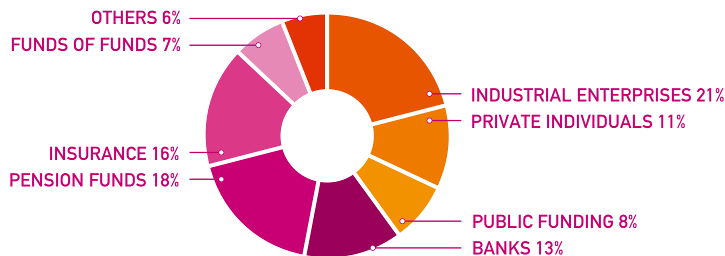
LEAD INVESTOR The investor who leads a group of co-investors in a joint investment, and who is chiefly responsible for contacting, advising and monitoring the investee company. The lead investor is often the investor who owns the largest share in the investee company, although this is not always the case. The lead investor may possess specific expertise which is particularly relevant for the investee company.

CO-INVESTOR One of two or more venture capital organisations that agree to jointly invest in a company. This provides more capital for the investee company, and reduces the risk associated with the investment for each individual investor. Each co-investor receives a share of ownership in the investee company proportional to the amount it has invested.

FOLLOW-ON INVESTOR An investor who invests funds in a company which has previously received capital.

Where does the money come from?
Private equity firms, including venture capitalists, raise funds from a number of different sources, which they then invest in your company. Most Danish and Swedish private equity firms raise capital from external sources, mainly from institutional investors such as pension funds, banks and insurance companies (see figure below). To manage their funds, private equity firms must demonstrate a good track record, for example in the form of successful exits which have produced returns greater than those that could have been achieved with a fixed interest rate, or quoted equity investments from previous investments.

The reason why venture capital firms typically maintain a time horizon of three to seven years on their investments is that many venture capital firms raise their funds through limited partnerships with their investors. Such investment vehicles generally have a fixed lifespan of ten years; by the end of the tenth year, the venture capital firms must return their investors' original funds, plus any additional returns made in the form of quoted shares or through the sale of the portfolio companies invested in by the venture capital firm.



WHERE DOES VENTURE CAPITAL IN SWEDEN INITALLY COME FROM?
Source: Swedish Private Equity & Venture Capital Association, 2002

Investment stages
When seeking capital for your company, you will encounter terms that refer to various investment stages. Below, we have briefly described the main characteristics of the various stages. Please note, however, that the definitions of these stages can often vary from investor to investor. Different definitions will also be used in different forms of life sciences. The definitions below apply best to diagnostics and tools companies; therapeutics is a little different, due to the long time-to-market for its products.

Stage no. 1: Seed
This stage concerns the research and development of a business idea before it is actually launched. Seed capital is used to allow a business concept to be developed. This includes the development of a business plan, prototypes and additional market research. During this investment stage, the technological and commercial value of the project will be assessed.

Stage no. 2: Start-up
The start-up phase requires financing for product development and initial marketing efforts. Companies are often in the process of being set up, and staff is recruited. As in the case of seed investments, neither the product nor the company can be assumed to have proven themselves commercially, and will not, therefore, be generating profit.

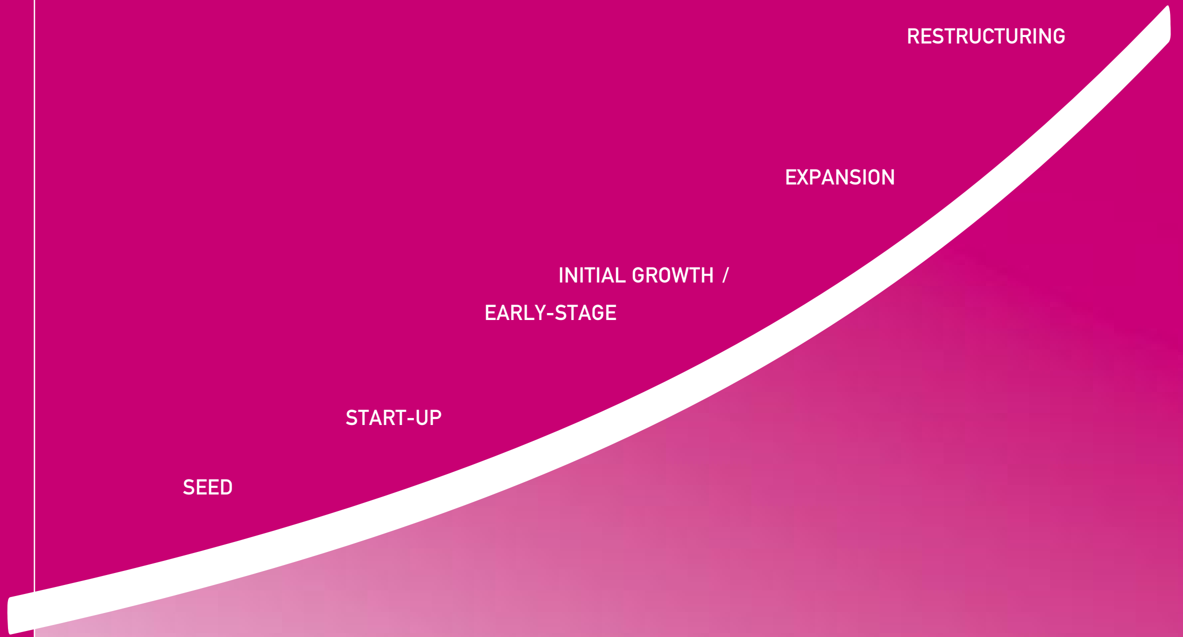
Stage no. 3: Initial growth / early-stage
Initial growth capital is used to build up the infrastructure required to develop the business, including its manufacturing, marketing and sales. Although the product or service may already have been launched, it is usually not yet generating profit.

Stage no. 4: Expansion
Expansion capital is used to further develop and expand the established company. The company is at least breaking even in financial terms, and may even be profitable. Venture capital funding is used to expand production capacity, recruit additional staff, extend marketing or product development programmes, or acquire additional working capital. Expansion capital is also known as 'development' or 'growth' capital.

Stage no. 5: Restructuring
The company is now established in the market, and the capital raised during this stage can be used to diversify into new markets or develop new products. Associated structural changes can have an effect on the company's ownership structure, including preparation for a company's flotation on the stock market.

Investment stages – common types of investors

COMPANY VALUE



TYPES OF INVESTORS

VENTURE CAPITAL FIRMS
CORPORATE VENTURING UNITS
BUSINESS ANGELS
INNOVATION CENTRES

VENTURE CAPITAL FIRMS
CORPORATE VENTURING UNITS

VENTURE CAPITAL FIRMS
CORPORATE VENTURING UNITS
DEBT CAPITAL

TIME
AND NEED FOR CAPITAL

Not only money

BY LARS GATENBECK, CEO, H&B CAPITAL ADVISORS AB

Not only money… but excellence in active ownership, in-depth sector knowledge and unique industrial and scientific networks, expertise in corporate governance, lots of time and resources to allocate: that is what the venture capital firm tells the entrepreneur that it contributes. It sounds almost too good to be true, and makes it easy to understand why venture capital is expensive.

Well, is it really true? Do venture capitalists 'walk the talk'?

I have been a venture capitalist in the life science industry since late 1999. With my industrial background as Vice President at Pharmacia and CEO of the Karolinska Hospital, my focus has always been on commercial issues. In our both funds, H&B Capital and Life Equity Sweden, we have positioned ourselves as having a core competence and competitive edge within the strategic and commercial area, with a structured approach to our investment, ownership and exit processes.

What does this mean in practice? Let's take a look at an average working week in my life...

I serve as non-executive director on seven company boards: Aerocrine, a medtech company based in Stockholm; CellaVision, a diagnostics company in Lund; Hormos, a Turku-based drug discovery company; Neoventa, a medtech company from Gothenburg; Profdoc, an Oslo-headquartered public healthcare IT company; and two public Swedish biotech companies, Perbio Science and Pyrosequencing, where I have been involved during a five-year period, through the IPO processes, but which I am now leaving after Perbio was sold to Fisher and Pyrosequencing acquired Personal Chemistry. The first five represent core holdings in one or both of the two life science funds that we are managing, H&B Capital and Life Equity Sweden. In total, we have € 170 million under management and 20 companies in our portfolios.

If I take the previous week as an example, I started Monday in Oslo with an informal board meeting in Profdoc, discussing an outline of their company strategy, dividend policy and acquisition strategy. The company has been growing well and profitably, and has also been able to undertake several smaller acquisitions to further enhance the portfolio and growth in spite of the fact that it is an IT company (software for the doctor's office). I am one of the most active board members and I have three roles, namely (1) together with the chairman to lead the strategy work and evaluate strategic options, (2) to assist management in networking (commercial and political), primarily on the Swedish market, and (3) to coach the CEO.

Tuesday, I spent some time networking at a healthcare seminar in Stockholm, meeting old and new friends, trying to pick up ideas and inputs to the strategy for our own funds. By the time I left after lunch, I had agreed with a board member in one company to have an informal meeting involving one of our portfolio companies, agreed with one expert to meet and discuss collaboration regarding the healthcare information technology area, tried to sell Profdoc products to a key customer, and received a few business proposals. In the afternoon, I had a mergers and acquisition negotiation regarding a portfolio company, where I am not a board member, supporting one of my partners.

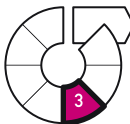
Wednesday, I left early for Copenhagen with another partner, where we had an owners' meeting with BankInvest and Bio Fund regarding the strategy and financing of Hormos. My role as board member in Hormos is usually to facilitate strategy discussions and to provide strategic inputs on drug development and licensing issues. After lunch, I continued to Gothenburg for meetings with founders and key management in Neoventa, trying to resolve issues related to an ongoing turn-around and refinancing process.

An important aspect of our work is to select, evaluate, support and provide proper incentives for management in our portfolio companies. It is without doubt extremely demanding to be the executive of a high-growth technology company, and our chief executives must have as much support as possible. In companies where you serve as chairman (I am currently chairman of CellaVision in Lund) you can at times easily spend a day per week working together with the CEO on important operational company issues, besides the regular work involved in leading the board.

Thursday and Friday were spent on an internal board meeting and meetings with our auditors for the second fund. Moreover, I had time to talk to the Swedish Industrial and Development Fund about CellaVision, had a phone conference with an investment bank about an ongoing process in another company, arranged meetings with Yvonne Mårtensson, CEO of CellaVision (see article on page 42), for next week, had lunch with one executive to discuss new assignments, and a lot of other things.

A normal working week… And, as you can see, a large portion of my time spent is on portfolio company matters and direct contact with CEOs, managers, board members and owners. Not much money spent, but a lot of work… so perhaps it is true what the venture capitalists say, that we really provide active ownership.

" . . .a large portion of my time spent is on portfolio company matters and direct contact with CEOs, managers, board members and owners"



Identifying investors

Most of the time, life science companies are between two rounds of financing. It is not unusual that the process from the initial investor contact to the signing of an agreement with an investor takes six to eight months. It is consequently a good idea to begin to seek financing approximately 12 months before your company will actually need the funds. Getting a late start and running into an acute need for financing can leave you in bad position to negotiate with potential investors, as well in relation to potential licensees and science and technology partners.

The first step is to identify relevant investors. Even if you have three or five investors at the top of your list, you will rarely end up with all of them as your investors. It is thus a good idea to identify and investigate a large number of investors, from which you can then select 20 or so investors who best match your company's needs for capital, knowledge, networks, etc.

Identifying potential investors
In order to ensure that you identify investors whose investment preferences match your company's profile and requirements, you will need to consider the following:

- Do they usually invest in the life cycle or investment stage in which your business currently finds itself?
- Do they usually invest in the industry in which your business operates?
- Can they offer you the amount of financing that you need?
- Does your company match their geographical preferences?

The information needed to answer these questions can generally be found on the websites of the various venture capital providers.

In-depth identification of investors
Beyond the immediate screening criteria reviewed in the last section, many other factors will influence the suitability of an investor for a venture company, and vice versa. A more serious and in-depth identification of the potential investors to target would include investigating the following characteristics of each investor.

- How active is the investor? Some venture capitalists prefer to be very involved in day-to-day operations and decision-making ('hands-on'), while others are satisfied with monthly status reports ('hands-off'). Which type you prefer depends on your company's needs and preferences, but also on the degree of experience and competence of the potential investor. To learn more about an investor's 'style,' it can be a good idea to contact some of their existing portfolio companies.

- What is the investor's track record? Does the venture capitalist have a history of making successful investments in similar firms? Has the investor undertaken any successful exits? It is also necessary to ensure that the investment managers currently employed in the investment company have experience in relevant life science investments. Another important question to ask is how well the venture capitalist has dealt with investment situations that did not work out.

- Does the investor possess a good contact network? A venture capitalist may be able to help your business by providing introductions to potentially important customers, suppliers or other industry contacts. One way to learn more about investors' networks is to look up the geographical location of their past and current portfolio companies, since this will give you an idea of their likely contacts with international co-investors and their ability to introduce you to possible future collaborative partners.

- When does the investor want to exit? As mentioned earlier, a venture capitalist's investment horizon typically spans from three to seven years. A good idea is to check whether the fund from which the investor's capital is raised is at a late stage of its life. If this is the case, you can conclude that the investor is probably looking for a relatively quick exit.

- Does the investor have a lot of portfolio companies? If a venture capitalist has many companies in his portfolio, he also needs to have a large amount of

capital available for re-investment. Otherwise, you might end up in a situation in which your investor cannot afford to re-invest in your company.

The answers to the above questions may be obtained from companies who have worked with the investors in the past, or from the investors' websites, or by directly calling the investors.

International venture capital

A few years ago, it was common practice to seek venture capital solely from local investors. This picture is changing, however, and a growing number of life science companies in Medicon Valley are now including international investors in their investor base.

There can be several reasons for seeking international capital for your company. Your capital needs may be so large that they cannot be met by the local market, and, most importantly, your company may stand to benefit from the expertise and scientific and financial networks that international investors can offer. Receiving international capital can also function as a 'stamp of approval' for your company, as it will have achieved this in competition with life science companies from many different countries. Having an international investor within your group of owners will thus strengthen the general attractiveness of your company. An international investor will often enter your investor base as a co-investor in collaboration with a local lead investor.

It is attractive to raise capital from the USA, as it possesses the largest life science/biotech market in the world. Amongst other things, American investors can help to increase your exit opportunities, for example via a trade sale of your company in the USA. However, you should note that the geographical distance involved can have a negative effect on the interest of American investors in investing in Medicon Valley companies. Moreover, in comparison with their American counterparts, companies in Medicon Valley are often too small for American venture capitalists to invest in. Your chances of raising American venture capital will thus improve substantially when your company has completed its initial rounds of financing and is headed for, say, its third round of financing. Nonetheless, there are exceptions, such as the Medicon Valley companies Symphogen (see page 40) and 7TM Pharma, which managed to raise American venture capital at a relatively early stage.

Get help to identify and approach international investors

In the latter part of this guide, we profile a number of international investors. It can however be very time-consuming and difficult for companies to approach international investors without previous experience with such investors, or network contacts with them. In such cases, it can be a good idea to seek help. Having a strong local venture capitalist as an initial investor is the best way to create contacts with international investors, as a venture capitalist often has stronger and more relevant contacts with international venture capitalists than most consultants. However, if you wish to approach international investors who are not part of your own or your investors' networks, consultants can provide useful contacts. Large accounting firms and investment banks will often have departments and networks that can help you to improve your contacts with potential international investors.

The process of selecting the consultants that are best suited to help your company will however also depend on the geographical area in which you intend to seek capital. If you are seeking capital from the UK, you will have to identify consultants with a good foothold and network in the British market; likewise, consultants with good connections in the American market will be qualified to handle your company's interests if you are seeking capital in the USA. It is normal for consultants to charge a basic fee to cover their expenses, as well as a percentage of the capital raised. Please note that you will generally need to seek at least € 10-13 million if you wish to involve corporate finance departments or an investment bank.

Some investors may prefer your company's management team to raise international funds independently of consultants. They may feel that strong companies are better able to seek international capital on their own. If your management team is unable to do so, investors may consider the team to be lacking in competence.

HENRIK NILSSON FLORIAN SCHÖNHARTING CHRISTIAN HANSEN

How to make your local business international

BY FLORIAN SCHÖNHARTING, PARTNER, CHRISTIAN HANSEN, PARTNER & HENRIK NILSSON, INVESTMENT ANALYST, NORDIC BIOTECH ADVISORS

According to a recent analysis of the capital needs of all Nordic biotechnology companies by Danske Bank, the demand of capital is in great excess of the local supply thereof. As we are approaching the end of 2003, this supply primarily is confined to specialized venture capital funds, as other investors such as pension funds, cross-over investors and the like are widely absent. This is not set to change imminently, in spite of the markets having improved; however, yet not provided us with the needed IPO market to refinance the venture capital funds.

Thus, the pre-eminent issue for almost any biotechnology company in the Nordic region is the question: how and when do we attract foreign capital?

Firstly, the question could be at what stage one should approach the international venture capitalists. Recent history has provided us with examples of various stages, from series A (7TM Pharma A/S, Biolipox AB) to pre-IPO (Genmab A/S, Biovitrum AB), thus no clear empirical picture is seemingly emanating. The answer seems to be that capital is received when the company is dressed up in the right way, not determined by age. In order to get dressed up in the right way, it seems vital to have local investors involved who know how to act in the 'big world', and who have a track record and a network. In particular HealthCap would have these features in the Nordic countries. At Nordic Biotech, we also continuously work to further improve and perfect our qualities in these aspects, in our strive to be best-practice.

Second, the question is how to attract the international capital. There are several elements to this. First of all, choice of the initial investor will send a signal to the outer world in terms of what kind of due diligence was performed before the seed investment was made. Who are the advisors, the specialist(s) retained to do the analyses etc? Clearly, the world has changed in favor of a specialized biotech investor setup. Furthermore, the investors chosen will be a permanent part of the company, and very seldom would even a really hot company manage to raise international capital, if the seed investors are less than impressive in the eyes of the international investor. Many international VC´s will not touch investment proposals unless they are from the right source, validated through many years of interaction, personal contacts and by track record. The right VC will have the know-how as to what an important company will look like: This is reflected in the management team, the network surrounding the company and the proposal at hand. At Nordic Biotech we always ask ourselves: Why could the world not live without this company? It is a tough criterion. On the other hand, the true winners in biotechnology are

"...very seldom would even a really hot company manage to raise international capital, if the seed investors are less than impressive in the eyes of the international investor"

exceedingly rare, but can usually address this question affirmatively. The clear positioning of the company in a global context determines whether the company is fundable.

Lastly, there is the 'choice' of international investor, a privilege that most recently was experienced in the fanatic year of 2000. Basically, these are not the times for a biotechnology company to be choosy. Most VC´s with track records in the UK and/or US will add favorably to the picture with their network, know-how and aggressive mentality, known to facilitate the pushing of companies towards an exit. In Europe, the teams are 'younger', necessitating some more careful considerations. Overall though, it is a buyers market, so you should feel lucky if you get the attention of those who 'guard the capital'.

"...capital is received when the company is dressed up in the right way, not determined by age"

Raising capital in the United Kingdom

BY MATTIAS JOHANSSON, SENIOR CONSULTANT, SWEDISH TRADE COUNCIL IN THE UK

UK investors are contacted on a daily basis by a large number of companies and can only set up meetings with a small number of them. The first meeting seldom lasts for more than an hour, and there is a saying that the decision of whether to proceed to more detailed evaluation is made within the first ten minutes. A common mistake in company presentations is that companies focus too much on their technology/ research and neglect the commercial and investment-oriented aspects of their case. Areas that the venture capitalist will want to hear about are the company (its history, owners, capital and management team), its business strategy (markets, competitor analysis, sales plans and costs), product uniqueness (patent and other factors explaining why competitors cannot copy the product) and customer demand. All the incorporated information needs to be well-presented and as accurate as possible, to ensure the venture capitalist that the commercial opportunity is justifiable and that the company has a strong understanding of its competitive environment. The amount of effort required in preparation for the fundraising process should not be underestimated. Moreover, the company should also be ready to undergo more detailed due diligence at a later date.

Benefits of raising UK capital

When a company manages to raise capital in the UK, this typically involves larger amounts of capital than on the Scandinavian market. Often, the minimum investment amount is £ 1 million pounds and, ironically, investments can be rejected because the funds required by a business are too small.

Another benefit of raising UK capital is the access it provides to a sophisticated investor base with the capability of undertaking considerable first round and follow-on funding. Knowledge and access to the quoted sector are also added benefits. Scandinavian companies can expect an enhancement of their PR profile. As a number of UK venture capital firms have extensive portfolios, there can also be possibilities of creating synergies through collaborations, and potential merger or acquisition opportunities.

UK interest in Scandinavia

UK investors have shown a strong tendency towards an increased interest in the Scandinavian life science market. Since they are working on a global market, and can seldom focus on any specific market (except the UK), they need all the help they can get from Scandinavian stakeholders. Examples of such help could be: in-depth introductions to the Scandinavian market, well-trained and experienced brokers who can approach the venture capital companies in an accurate and efficient way, and being well-prepared when

approaching the investor (using an international business strategy plan, which shows in detail the development costs, sales costs, expanding strategies, competitor analysis and income for the next five years).

> "UK investors have shown a strong tendency towards an increased interest in the Scandinavian life science market"

When and how to approach UK investors

Generally, venture capitalists enter at a company's second investment round and plan to exit within three to five years. There are nonetheless a number of smaller UK venture capital firms operating at the seed stage, as well as business angels that will enter at an earlier stage or at the first round of financing.

The most effective way to contact a venture capital firm in the UK is to use a broker that has a well-established network. It is also recommended to use this broker before the contact stage, and to use his knowledge during the preparation phase, for example in developing the presentation for the first meeting. Another reason for using a broker based in the UK is that you benefit from having just one point of contact in the UK, which helps manage the fundraising process efficiently. Most UK venture capital firms do not have an office in Scandinavia and appreciate an efficient local contact to facilitate communication.

First impressions last

It is very rare for a company to get a second chance following a poor presentation or business plan, so be prepared and do not forget personal chemistry. This has a big impact on the first meeting, since the venture capital firm is (hopefully) going to work with your management team for the next three to five years, and they are looking for a group that can deliver results. Fluent English is an advantage, as most business plans are presented in English. If language is an issue, then the multilingual skills of a broker would be useful to employ.

Continuing dialogue

Many companies and brokers make the mistake of being too pushy during the evaluation process, expecting instant feedback. It is important to accept the venture capital firm's busy schedule for evaluating new opportunities and managing existing investments. Most venture capitalists will have a structured process for evaluating investment opportunities and will get back to the company in good time, if they are interested.

Once the company has raised capital, the venture capital firm may require a seat on the board of directors and a formalised reporting schedule to monitor investment progress. This will be the main route of ongoing post-investment dialogue.

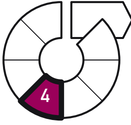
Summary

Three things to remember: be prepared before you start your fundraising, make sure the business plan and presentation are of a high quality, and consider the importance of personal chemistry.

□ THE SWEDISH TRADE COUNCIL in the UK supports companies with business development services and helps them to build an internationally sustainable corporate structure, generate revenues, raise capital and find future partners for global expansion. Examples of business development services are activities such as:

- Market analysis - assist the company to evaluate the attractiveness of the UK market
- Evaluation of entry strategy
- Perform a partner search and evaluation of which partner strategy to use
- Sales and marketing activities
- Raise new venture capital and keep good relationship with strategic investors.

More info: *www.swedishtrade.com/uk*



Approaching investors

By this time, your company will have received authorisation from the board to go out and contact potential investors. The company's needs and requirements will have been identified, and target investors selected.

Be prepared: Conditions for engaging in direct dialogue with your target investors
The amount of effort required to prepare for a fund-raising process should not be underestimated. Moreover, in addition to presentation material, the company should be ready to undergo more detailed due diligence at a later date (see Chapter 6). The initial material should encompass the business plan, an executive summary, which we will describe in this chapter, and a company presentation (PowerPoint, slides, etc), which will be described in Chapter 5.

Also prepare an 'elevator pitch' around a unique selling point. This should be a very brief and focused oral presentation of why your particular company is worth investing in. This is the first time that investors will hear about your company, and they must be able to instantly comprehend how your venture differentiates itself from other ventures.

The business plan

Having a complete and accurate business plan is crucial. As mentioned earlier, the venture capitalist's objective is to achieve a profitable exit within three to seven years, sometimes less, so the business plan should outline the investment case. It must contain your company's business strategy, operational plans, and technology and milestone schedules. All the incorporated information needs to be well-presented, and must be as accurate as possible. The information should include a market analysis and details on the competitive landscape. Investors must be able to feel confident that the commercial opportunity presented is a viable one and that the company has an in-depth understanding of its competitive environment.

If you have not already completed a SWOT analysis of the Strengths, Weaknesses, Opportunities and Threats facing your business, then do so before you begin contacting investors. Put yourself in the investor's place and generate an objective evaluation of your company's current and future business prospects. The SWOT analysis will help you to identify strengths and weaknesses that you might not have considered beforehand, thereby making you better prepared for the meeting with the investors. On page 33, you will find a list of important issues to cover in your company presentation to the investors. You could potentially use this list as a starting point for your SWOT analysis.

There is a wealth of literature describing how to formulate a good business plan, so we will not deal with this in further detail in this guide.

The executive summary

The executive summary is placed at the front of the business plan. It explains why there is a market for your technology, and how your business can address unmet needs in a way that existing businesses cannot or do not. The executive summary must be no more than two to three pages long. It is vital to devote a significant amount of thought and time to this summary, as it may well determine the amount of consideration the investor gives your proposal.

The contents of the executive summary are determined primarily by the unique characteristics of the company you represent. Make it clear to the reader why there is a market for your technology, what the unmet needs are, and why you can do it better than your competitors and/or the existing products on the market. You must highlight the greatest sources of value for your company, whether these are your technology, your product, your target market or your management team.

If your company is currently developing a product, then present it alongside a description of your R&D efforts. If your company has not yet reached the product development stage, then emphasise something else, such as your technology or research strengths. Explain why your business has excellent future prospects and emphasise any valuable assets to your company, such as strong protection of your intellectual property

or an experienced and skilled management team.

The presentation of the contents of the executive summary must be simple and elegant. Avoid overly technical details, which will clutter the summary and lose the attention of the reader. Bear in mind that the reader you are addressing is not necessarily a scientist, but a person with a commercial perspective.

Before you meet the investors, it is a good idea to familiarise yourself with key financial terms.

How to make the initial contact with potential investors

Personal contacts are crucial in gaining access to the venture capital market; it is very much a market of 'introductions'. Venture capitalists rely heavily on informal networks of venture capitalists, lawyers, accountants and bankers to help identify potential investment subjects. Consequently, the best way to get the attention of potential investors is to be introduced to them by someone they know and respect. Business plans or executive summaries sent to an investor without any prior introduction or communication rarely make an impression.

You can use your own contacts or your existing investors (if your company has any yet), as they may know your target investor and could prepare him for your call. Naturally, you will sometimes have to present your company to an investor with whom you have no prior relationship or means of personal introduction, in which case you will just have to call him up and present your elevator pitch as best you can.

We recommend that you contact the selected group of potential investors within one to two days. It is important to keep the process within this time frame, since investors talk amongst themselves!

If you have managed to arouse the investor's interest in your business concept over the phone, you must send relevant material to him via email while your pitch is still fresh in his mind. All your material must therefore be ready for immediate send-off. Some investors will wish to see a business plan, others to see an executive summary; it depends on how familiar they are with the market in question. If the investor is not very familiar with your technology, product or industry, it can be a good idea to give him the executive summary, which provides an overview of the current situation and the future prospects for your company and the market.

If a potential investor shows interest in your business case, contact him regularly with added and updated information on your company and its development efforts. This will allow the investor to familiarise himself with your case over time, while observing your operational progress.

It is important to ensure that only one person from your company contacts a potential investor and reports back on status.

Most investors will get back to you within a couple of weeks of sending your executive summary or business plan. If you have not heard from them within a month, you can follow-up on your enquiry with a phone call, but note that the speed with which investors process new cases can vary greatly.

Increase or maintain your investor network

You can increase or maintain your investor network by presenting your company at 'investors-meet-companies' events. Such partnering events take place in various forms and under various names several times a year in Medicon Valley and other bioregions. These provide a good opportunity to achieve exposure for your company in front of several investors, and can help you to obtain important investor contacts before the next financing round. The time allotted for presentations at partnering events is often shorter than for presentations at traditional investor meetings; however, partnering events generally offer opportunities for one-on-one meetings with interested potential investors subsequent to the presentation.

Journal

As your company will be making contact with a number of potential investors, it can be difficult to remember who you spoke to and what you spoke about. As this information may be very valuable, it is a good idea to keep a journal in which you note the names of investors contacted, as well as the date you contacted them and the subject of your conversation.

Looking beyond borders

BY BENNY LYNGE SØRENSEN, PARTNER AND HEAD OF ERNST & YOUNG'S LIFE SCIENCES GROUP IN DENMARK

Looking beyond borders in a new and creative way is 'a must' for the management in their efforts to reduce the risks involved in raising capital.

When used in connection with business activities, the term 'creativity' often has an odious ring to it. However, under the right circumstances, creativity – or the search for other alternatives – can be the answer for the executive management of a biotech enterprise when they are to protect the enterprise against the going concern problems resulting from investors' reluctance against making investments. Even through good times, the management should have a contingency plan – as the market trend will reverse eventually. The supervisory board should ensure that the management has an alternative plan or maybe even several alternatives.

As such, 'Beyond Borders' is not only the title of our latest report about the European biotech industry, but also a key term when it comes to taking a closer risk management look at financing. 'Beyond Borders' is also a term describing the current state of the biotech industry, regarding eg. the establishment of cross-border alliances, a wider investor focus, etc. in Europe or maybe even globally. From a more local perspective, it is now time to go beyond borders in relation to risk management issues.

"From a more local perspective, it is now time to go beyond borders in relation to risk management issues"

As auditors and professional service providers for Danish biotech enterprises, we have seen how some enterprises have started focusing on alternative paths, but the question is whether biotech enterprises in general have searched the market thoroughly enough? Even enterprises which have already passed the initial phases and financing rounds and which, furthermore, have met their milestones may find it difficult to understand the financial markets' reluctance to provide financing when the investment climate is poor. And rightly so, since these factors do not – even if the underlying fundamental assumptions for the size of the market and the unique features of the development project are intact – increase the possibilities of obtaining additional capital.

An alternative plan, a 'plan B', should include considerations as to where the investment climate is least 'volatile'.

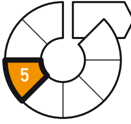
> "Focus should be put on the alternatives – as demonstrated by the volatility of the investment climate"

A business partner or joint venture partner from the pharmaceutical industry could be an obvious candidate, but hardly a potential investor through all phases of the biotech enterprise's life. The reason is particularly the new trend for pharmaceutical enterprises to 'outsource' the development phases to the biotech industry, thereby reducing the risks inherent in the early development phases.

The pharmaceutical industry is, however, willing to pay a premium to be able to invest in the development results later, if relevant. The fact that several biotech enterprises' R&D activities can often be applied in several therapeutic ways could suggest that it may be too limited and narrow for a biotech enterprise to cooperate with one single pharmaceutical enterprise. Biotech enterprises should consider whether joint research/development activities could be extended so as to comprise more non-competing pharmaceutical enterprises for which the project could have different applications. One 'synergy' could be the fact that, even though something is 'passed on', the sphere of interest for the biotech enterprises' activities is expanded at the same time. Another obvious possibility is for the biotech enterprise to obtain knowledge about potential business partners through their investors. The broader based – also geographically – the investors are, the bigger is the network which will typically open up to the biotech enterprises. In this connection, the geographical area should not necessarily be limited to, say, Denmark, Scandinavia or Europe. The enterprises' potential and other characteristics will have to determine this.

The possibilities for searching the market for sources of finance are numerous. We recommend biotech enterprises not only to consider financing channels such as venture capital and banks, but also independent professional service providers, in their search for capital as well as business partners. Such independent professionals' networks cover the global biotech industry and can be actively applied. Another advantage is that these advisors are independent of the investors. In principle, the advisors' only mission is to provide the biotech enterprise with the optimal solution.

The possibilities are numerous, and you might in fact say that it is simple enough – if only you can see them. Creativity is the key word, but creativity is a difficult 'phenomenon', which does not come out of nothing. Creative thoughts often derive from interaction with business partners, venture capital enterprises, banks, professional services providers, among others. Focus should be put on the alternatives – as demonstrated by the volatility of the investment climate.



Meeting the investors

"You only get one chance to present your company." That is what most investors say. As a result, your first meeting with an investor is extremely important, which places considerable importance on your preparation of the company presentation. This chapter offers some good advice on how to prepare in the best possible way, and tips on what the investor expects to find out at the meeting. As explained below, there is a tendency for companies to provide too much information on their technology and too little on how the technology can be commercialised.

Preparing the presentation

This will be the first time that you meet your potential investors, and they will not just be looking for great ideas and technology. The meeting will be a lot like a job interview – as mentioned earlier, investors invest in people, so they will be evaluating you.

Seek constructive feedback

Seek constructive feedback on your presentation before meeting with investors. Since you will normally only get one chance to present your company, it is extremely important that your key messages emerge clearly from your presentation. This will depend not only on your personal style and the graphic presentation, but also on the organisation of the contents of the presentation. Experienced biotech executives strongly recommend that you seek help from communication consultants and possibly biotech executives before meeting with investors. An expenditure of € 2,000-3,000 for consulting services is a reasonable price to pay to significantly improve your chances of obtaining € 3,000,000-15,000,000 in funding. Remember that the more you practice, the better and more professional your presentation is likely to appear to investors.

Know your audience

It is essential to have the right person presenting your company, to get someone who knows what he is doing to make the pitches. Presenters who are too 'academic' typically don't manage to get through to investors. Prepare yourself for the audience for whom you will be making your presentation. What are the investors' particular interests, levels of knowledge and investing styles?

Tell an interesting and credible story

Investors like good ideas and great stories. However, any stories you tell about your company must be credible. The really excellent presentations are simple, concise and compelling. Ideally, you should be able to communicate your passion for and belief in your business case while steering clear of clichés, buzzwords and hype in general.

When presenting your company, remember that the investors' primary objective is to earn money. This cannot be stated too often. Just because you have an interesting technology does not necessarily mean that you can turn it into a good business. Many presentations focus too much on the technological details of a venture and too little on its profit potential. Such situations can be avoided by seeking help and constructive feedback while preparing your presentation, as suggested above.

"… good science alone does not equal a viable business. Novel technology may grab the attention of those [venture capitalists] with a more scientific bent. In today's very conservative financing environment, however, interesting science or technology by itself will not attract investment. Initial presentations should focus primarily on the business opportunity and how the company will realize it, leaving extensive details on the science and technology for later due diligence efforts. Leave the raw data slides at home — or keep them for backup."

BioPeople Magazine, July 2003

Contents of the company presentation

The company presentation as a whole must show that you, as the CEO or CFO, have understood how your company should commercialise its technology in order to allow your investors to obtain a return on their investment that will meet their expectations.

Below you will find a list of elements which may be included in your presentation. This is not an exhaustive list, but should be seen as inspiration.

Company

- Company name, activity and history
- Your name and title
- Who is(are) the founder(s) of the company? When was it established?
- Who are the members of the management team? (Present CVs, experience and track records)
- Who are the members of the company's board and scientific advisory board? (Mention any relevant experience and expertise possessed by the members)
- What is your human resource situation? How many employees does your company have?
- Do you have any partnerships/ alliances?

Technology and market

- Describe your pipeline, including key products/technology and any proof-of-principle/concept (in vitro, animal, clinical). Present any (medical) needs/ demands for your product/technology and explain how your company can meet these needs/demands
- What is the status of and strategy for IPR? Do you have freedom-to-operate? Do you need any in-licensing or cross-licensing of technologies?
- What is the realistic size of the market for your products?
- How is your technology unique, in comparison with competing technologies/companies?
- What does your competitive situation look like? Who are your key competitors and competing/alternative products? Describe both the current status and what you expect the competitive situation to look like some years into the future.

Financing and business strategy

- How many financing rounds has the company completed so far, if any?
- When was the last round of financing? How much capital did the company raise? What do your company's current investor base and ownership structure look like?
- What is your current cash position and burn-rate?
- Has your company passed any milestones, and, if so, which?
- How much capital is the company seeking in this round? ('pre-money' and 'post-money')
- What are your future milestones? Using timelines, describe how the company will attain the target position, which resources (financial and human) will be required, what the risks are and how you intend to avoid them, and which milestones you will need to reach before the next round of financing.
- What is your company's earnings potential? When do you expect to reach break-even? Outline your projected licensing strategy
- What is the company's expected exit strategy?

The presentation of the company's technology must be in layman's terms. A good rule of thumb is that the presentation of the technology should fit onto just one slide, after which you should go on to discuss its potential applications and value. Illustrate your points with easy-to-understand graphics.

How should the presentation be organised?

A presentation will typically last between 45 and 60 minutes, during which time it is crucial that you quickly catch the attention of your potential investors. When introducing your unique selling point, you are generally expected to be able to convey your key points at the very beginning of your presentation. If you cannot do this, do not expect to get a second session with a potential investor.

"Usually you have 10-15 minutes to get all the concepts across. You might sit there for 45 minutes but they [the investors] are already gone."

Zahed Subhan, CEO of Nuevolution

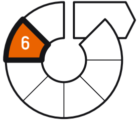
Your presentation should contain between 10 and 20 slides. The ideal structure of a presentation will vary from one business case to the next. Nonetheless, as inspiration, we have outlined an example of how the many points of a presentation can be prioritised:

Agenda for the presentation

- Unique selling point
- Company history, key people, investors
- Vision, mission
- Technology platform
- Pipeline
- Market needs and competitive position
- Business strategy
- Partnerships, collaborations
- Milestones
- Intellectual property rights
- Risks (specific to this project or company)
- Valuation and financing needs ('pre-money' and 'post-money')
- Exit scenarios.

Be prepared: Have back-up slides ready

The best presenters anticipate the questions that potential investors might ask, and are well prepared to respond. Have back-up slides ready, which you can use to support your answers. Avoid the situation in which the investor to whom you are making your presentation knows more about the competitive and technological factors affecting your business than you do.



Before the agreement

By now you have met the investors, and they have shown an interest in investing in your company. There is, however, still a long way to go, up to six to eight months, before you have a signed agreement in place. The investors will want to make sure that they obtain a detailed description of your company, which will require several meetings. The investor is going to initiate a due diligence process, valuation must be undertaken, and you must complete negotiations on the nature and form of the transaction. This chapter offers only basic insight into these processes. Please note that most of these processes will occur simultaneously.

Term sheet
One of the very first documents to be drafted and negotiated will often be the term sheet, or similar documents to that effect and purpose, such as a memorandum of understanding (MoU) or a letter of intent (LOI). This will set out the basic terms of the transaction: the object of the transaction, the expected time frame, and perhaps also financing, if this is known at this point in time. The term sheet, MoU or LOI may be structured as an offer from one party to another. Some of the material issues to be dealt with may be:

- Confidentiality
- A legally binding and exclusive offer, and the expiry date of the offer
- Necessary approvals (board approvals or other)
- Structure of the transaction
- An overview of the expected costs and expenses in connection with the transaction
- Purchase price/financing
- Completion of the transaction.

Due diligence
Generally speaking, the investor's main objective in undertaking due diligence is to increase its understanding of your business, to ascertain whether the initial assumptions that it has made about your business case still hold under close scrutiny.

Due diligence carried out by the investor within the field of life science will typically, but not exclusively, attend to the following areas:

- Legal
- Financial
- Commercial
- Technical/scientific
- IPR
- Management/human resources.

The investor will require substantial and documented information on your company on the above mentioned areas - aiming at identifying issues that could influence the investor's decision to either go ahead with the investment, or withdraw from it.

During this process, the investor will challenge the presented business plans and other information that he has received either from you or from other external, publicly available sources.

The due diligence process will often be very disruptive to you and your organisation, and will require your full attention.

The venture capital fund will typically draw upon external advisors in the form of professionals within the individual areas to be covered in the process. Not only will the venture capitalist usually need to obtain an approval of the potential transaction from an internal investment board, but the venture capital fund will also have its own shareholders to answer to. They expect the venture fund to exercise an appropriate degree of caution in its investment process - a crucial aspect of which is the due diligence process.

Valuation
Valuation is a process whereby financial models are used to estimate the value or monetary worth of your company or an individual project.

A valuation is a subjective toolkit which creates a mutual (vendor/buyer) understanding of value drivers and value creation. It thus establishes a framework that enables the two parties to agree upon a price, which is nonetheless also dependent upon other terms in the sales and purchase agreement.

An example of an important question that you should ask yourself when raising new capital is: "How large a share of ownership should an investor be offered in return for a given amount of capital?" Or, in other words, "How should future value created by the company be allocated between the founder of the company and the providers of capital?"

As will be described in further detail below, valuation is essential in a number of situations, and as it is a complicated process, you should always consult a financial adviser.

Why are investors interested in the valuation of your firm?

Investors rely on valuation because it helps to turn uncertainty into manageable risk. Young companies are characterised by extensive uncertainty surrounding the company's technology, management skills, growth and earnings potential, the expected market potential for its products and the time-to-market, etc.

Investors cannot manage uncertainty, since it is intangible and thus cannot be measured. Valuation turns the uncertainty surrounding your company into a form of risk, based on financial figures and calculations, which can be measured, compared and managed by investors.

Your approach to valuation

The valuation of life science companies and projects is a field that demands special skills; some of the larger auditing firms have departments and specialists who advise within the areas of valuation and life sciences.

Nonetheless, it is an advantage for everyone dealing with potential and actual investors to familiarise themselves with the financial terms and the basics of valuation practices in your company. This will not only be useful in negotiations, but will also allow you to critically assess how the investors are valuating your company. This is particularly important, as investors are generally interested in obtaining the lowest possible valuation of your company, while you may be interested in obtaining the highest possible valuation of the future prospects of your business.

How accurate is firm valuation?

Keep in mind that the valuation of a firm will always be 'noisy', meaning that it will never be 100% accurate. This is due to the fact that valuation models require a large number of projected and approximated figures, which means that a valuation will always be an estimate of a firm's or project's value. Partly due to the 'noise' inherent in valuation, many investors rely less on the valuation of individual firms than on the valuation of a firm relative to how comparable firms are valued on the market at that time.

Negotiating the deal

Before you reach the negotiating table, we strongly recommend that your management team retains external legal counsel to assist them in structuring the best possible deal. When forming a syndication, each venture capital firm must retain its own external legal counsel, so as to ensure that their individual interests are best served at all times without having to worry about whether or not their counsel has a conflict of interest in relation to other players, due to representing more than one party at one time.

The following section is intended to introduce you on a general level to some of the documents that your legal counsel may find it useful to draft, in order to ensure that your investment is optimised and secured from a legal point of view. The purpose of this is to provide your management team with a basic understanding of the issues to be negotiated and an idea of what you may reasonable expect from the legal documentation.

Below are a number of documents listed in 'chronological order', i.e. in the order that they will normally be drafted and negotiated. Under the heading of each document title, we have raised some general issues that you and your management team should discuss with your legal counsel. Needless to say, this account of the possible documentation to be drafted and negotiated in no way purports to be exhaustive: no two negotiations will be identical and they may differ materially due to, for example, cultural differences between the parties, the line of business, the financing structure, intellectual property rights, etc.

Engagement letter

Before retaining external legal counsel you may wish to consider obtaining an engagement letter from the legal

JOHAN SCHLÜTER

correspondent law firm of ARATOR

Johan Schlüter law firm specialises in IPR and related areas

Johan Schlüter law firm, Sundkrogsgade 9, DK-2100 Copenhagen Ø, Tel.: +45 33 63 96 50, Fax: +45 33 63 96 60, www.jschluter.dk

counsel, setting out the terms on which counsel will be retained. The engagement letter should include the names of law firm employees assigned to assist you, applicable hourly rates, and perhaps an overall estimate of legal costs. Also, you may wish to make sure that the legal counsel is given a certain time frame within which to carry out all tasks to be undertaken.

Share purchase agreement

The next document to be drafted and negotiated will most likely be the document regulating the terms and conditions of the actual transaction.

This might for instance be a share purchase agreement, if the ownership of a company is to be transferred in whole or in part as a result of the transaction. The share purchase agreement may contain the following main points:

- Shares to be sold
- Purchase price
- Closing of the transaction
- Information disclosed to buyer prior to closing
- Representations and warranties of the seller (the main part of the agreement)
- Representations and warranties of the purchaser
- Covenants of the seller
- Covenants of the purchaser
- Conditions precedent to the purchaser's obligations
- Indemnification
- Governing law and venue.

In addition, it may be relevant in relation to a share purchase agreement to draft a disclosure letter, the purpose of which is to specifically disclose matters subject to the relevant representations and warranties of the share purchase agreement.

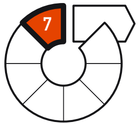
Shareholders' agreement

If there are other shareholders, these shareholders will normally enter into a shareholders' agreement that regulates the following material issues:

- Main strategies of the company
- Shareholders' meetings
- Financing
- Approval of transfers
- Acquisition of new business
- Pre-emption rights on transfer
- Dilution
- Tag-along/drag-along
- Management of the company
- Directors and chairman
- Realisation of shares
- Pledge of shares
- Default and bankruptcy
- Non-compete obligations.

Loan agreement /share pledge agreement

Most transactions will have an element of third party financing, which will be formalised in the form of a loan agreement and perhaps a share pledge agreement. Such agreements will usually be of a standard nature and will be drafted by the counsel representing the lender/secured party.



Collaborating with your investors

Now you have secured funding for your company, and are ready to enter into a partnership with your investors.

"Use your investors actively" is a strong recommendation from experienced biotech executives. A good, collaborative relationship with your investors can be a valuable asset to your company. Not only will it allow you to benefit from your investors' knowledge and network, it will also allow your investors to closely monitor the progress of your venture. Collaboration between the company and its investors is thus mutually beneficial. Investors can provide useful help, including:

- Developing business strategies
- Experience in recruiting staff for the management team
- Setting up the board of directors
- Monitoring competitors
- Internationalising the company
- Experience in negotiating collaborative arrangements with other companies
- Network relationships with potential collaborative partners
- Network relationships with new, potential investors with a view to further fund-raising
- Planning and executing exit strategies.

Establishing a dialogue

In many cases the investors will be represented on your company's board, and you will thus establish a dialogue with them. But it can be advantageous to further intensify this collaborative relationship, e.g. by establishing a dialogue which extends beyond the official contact necessitated by board activities.

Since investors generally have a busy day, you should be selective about which issues to raise. Ensure that you only bring up relevant and important issues.

In addition to receiving good advice, a close dialogue with your investors has another key advantage: when you are between two rounds of financing, it is important for investors to understand why you need to raise capital again.

An ongoing dialogue with investors provides them with better insight into and influence over the operation and development of the business. This can also make them more motivated to invest in the next round of financing or to help you locate new investors.

The intensity of your collaboration with your investors will vary greatly from one case to the next, and from one investment stage to the next. In general, you can expect the most intense contact to occur at the beginning of the relationship and when your company is young. As your company matures, the intensity of your contact with your investors will gradually decrease over time.

Possible consequences for the management team

As members of a company's board, investors can influence the composition of the management team. As the company grows and matures, it may develop requirements for new sets of management skills. Consequently, the board may wish to recruit a new CEO, making the existing CEO the CSO, which can be a frustrating experience, especially for the entrepreneurial founder of a company. However, similar management changes have taken place in a number of life science companies.

Reporting requirements

Dialogue with your investors will also take place through formal reporting. We recommend taking a look at the European Venture Capital Association's guidelines for reporting. For more information, see *www.evca.com*.

Furthermore, it is important to clear up the reporting demand of your investors. A well-structured reporting practice can also act as useful documentation in the dialogue with potential investors in future financing rounds.

Dealing with US venture capital

AN INTERVIEW WITH THOMAS FELDTHUS, CFO

Symphogen A/S

ESTABLISHED **2000**
HEADQUARTER **COPENHAGEN, DENMARK**
STAFF **40**
FINANCING ROUNDS **2**
RAISED SEED CAPITAL **DKK 6.5 MILLION**
RAISED CAPITAL 'A' ROUND **DKK 125 MILLION**
WEBSITE **WWW.SYMPHOGEN.COM**

Few European biotech companies succeed in attracting US venture capital as early on in their lifecycle as Symphogen did. Symphogen was established with the aim of commercialising a novel, patented polyclonal antibody technology, the Symphage™ technology. This proprietary technology offers a method for the production of unlimited amounts of highly purified, antigen-specific, polyclonal antibody preparations, termed symphobodies. We had the opportunity to interview Thomas Feldthus, CFO of Symphogen, about the implications of being financed by US venture capital.

Thomas Feldthus has served as Investment Manager at Novo A/S. Between 1996 and 1999 he was Corporate Development Manager at Novo Nordisk A/S.

How did your contact to Essex Woodlands Health Ventures develop?
It developed in a rather unusual way. They actually contacted us, already during the seed phase. We had been to both the UK and the US, but Essex Woodlands had spotted our technology – I believe they had found it in a patent database. They were interested in developing a company based on this technology, so they called us and we subsequently came over for a visit.

Did you have a conscious plan to attract international capital?
Yes, we have been looking for international investors since we were in the seed phase. The biotech industry is a global industry, and it is therefore natural to have an international investor base. In Symphogen, we are also international in the way we communicate. All communication takes place in English. This means, for example, that when you have to undertake due diligence in connection with a new financing round, then all information is in English.

In your opinion, what were the primary reasons which led Essex Woodlands to invest in Symphogen?
Our technology and our management team! All of our material is presented in a very professional way, and Essex Woodlands were comfortable with the Danish investors.

What are the main benefits of collaborating with an American investor?
It has provided us with several contacts to other US investors and collaborative partners. Essex Woodlands have a good contact network and are a good sparring partner. They have a great level of technical understanding, and their

board representative has, as many other US investors, hands on experience with starting up his own businesses.

Can you give any other reasons why companies should seek international capital?
When raising capital, you should not only think about the current finance round, but also on the next finance round. By going exclusively after local capital, you may well experience that there isn't enough local funds to follow through on your investment and that it becomes increasingly difficult to obtain an arms length valuation of the company in subsequent finance rounds due to a limited number of local 'intelligent investors'. Therefore, you have to go international and you might as well take the step onto the international scene immediately. As soon as you have e.g. an American investor, a whole new market opens up for you in the USA.

What are the key differences between working with Essex Woodlands and working with local investors?
We are very pleased with both Essex Woodlands and our local investors counting SLS, Novo A/S, LD, Danske Bank and Vækstfonden. Essex Woodlands, Novo and SLS provide significant contribution to our company at board level albeit at various fronts due to different backgrounds, experience and capabilities of the individual board members. Of the more generic differences I would say that Essex Woodlands adds an international touch to board work. This also goes for the chairman of our board who is British and lives in London. At our board meetings we therefore get a sense of what is happening at that very moment in the USA and in the UK. As a matter of fact, our board meetings are an event, where we set aside an entire day. I don't think that this would have been the case if we only had local investors. Also, I think that it gives some comfort to everybody when all around the clock become excited with the stuff we are doing.

How close a dialogue do you have with Essex Woodlands?
We have four board meetings per year. Moreover, we also meet on an informal basis, for example when we are in the US. In addition to this, we e-mail and talk on the phone several times a month.

What are your exit plans, and when do you expect to exit?
An IPO in 2006 could be an option. Our technology makes it possible for us to enter into a lot of collaborative agreements, which speaks in favour of an IPO. On the other hand, a trade sale would also be an option, because our technology is interesting to a lot of antibody-producing firms and vaccine companies.

Can Essex Woodlands improve the chances of a successful exit?
Well, there's no doubt that they improve the chances for a successful exit, but they're not a prerequisite for one. This is a task, which we must carry ourselves, it is not something which we can expect Essex Woodlands to take care of. The IPO is likely to take place in Copenhagen, as there is a general tendency to trade companies where they are physically located.

"When raising capital, you should not only think about the current finance round, but also on the next finance round"

"As soon as you have e.g. an American investor, a whole new market opens up for you in the USA"

CEO in close collaboration with the board

AN INTERVIEW WITH YVONNE MÅRTENSSON, CEO

CellaVision AB

ESTABLISHED **1994**
HEADQUARTER **LUND, SWEDEN**
STAFF **40**
FINANCING ROUNDS **5**
RAISED CAPITAL **SEK 225 MILLION**
WEBSITE **WWW.CELLAVISION.COM**

CellaVision develops software products and hardware platforms, which speed up the process of performing blood analyses and making diagnoses in hospitals. CellaVision has two product lines DiffMaster™ and MICRO21®. We had the opportunity to meet with CEO Yvonne Mårtensson (M.Sc. in Engineering) who has been with the company since 1998. During our meeting, we talked about her experiences running a company which is financed by venture capital.

What made CellaVision attractive to investors?
Well, if you listen to the investors, then when things go wrong, the problem almost never goes with the product, the market or the technology; the problem almost always is connected with the management. So, management is extremely important. Our management team and I are here because we have experience from and knowledge of the industry which we sell to. However, it can sometimes be quite unpleasant to have so much emphasis placed on management, because it puts you under investigation.

How great a role did your technology and potential market play?
Yes, well, developing high technology is almost a requirement to even be considered eligible for venture capital. Part of our attraction lies in the fact that we develop high technology which can be applied to a broad and varied range of applications. We have also identified a large market for it. Our target market is, generally speaking, hospitals around the world. We work with routine analyses, not research, which implies that our market is extremely large.

How do you identify new investors?
Here is a good, concrete tip that has been really useful to us: We have appointed a financing committee, which consists of three members of our board. The committee handles all work in relation to finding new investors and

"We have appointed a financing committee, which consists of three members of our board"

reports on an ongoing basis to the board on their progress. This means that I do not need to be involved unless they need me, and they can also make a lot of contacts and visit investment banks and investors without me being there. I don't come in before they have something real and substantial, which is really good, because that would take up far too much time for the company.

Why was the task of identifying new potential investors assigned to the financial committee?

Well, if we look at our board, then five of our seven board members work in investment companies. So five of them know exactly what to do, and five of them also have daily contact to other investors. So they know the market. As such, they have a huge network of contacts, which makes contacting new investors a lot easier. So doing that is not my job. I am here to represent the company, develop strategies and take responsibility for the operational work.

Which role has the board of directors played in CellaVision's development?

The board played a significant role, particularly in the early phases of CellaVision's development. As a young company, we did not have all the necessary Competencies within the company, and consequently the board functioned as an extended management group. Then, as we grew larger, and developed and employed more competencies, it became easier to separate the responsibilities and tasks of the board from those of the management team. Today, I still work intimately with the board on matters related both to raising capital and to strategy and development.

Tell us about your experiences working with investors.

Lars Gatenbeck (see article on page 20) is the chairman of the board and therefore my boss, so it is extremely important to get along with him, to find a good way of working together. We have now been collaborating for three years, and at first I thought that he was a little bit too much into nitty-gritty. But then, with time, you learn how you can work together in the best possible way, by identifying what works and what doesn't. That's how it is in every professional relationship. But it works really great now.

How often do you communicate with or make reports to the investors?

On the one hand, I write a detailed monthly report which summarises developments within the following functions: finance, market, sales, development, quality assurance and human resources. In addition to this, the investors receive a copy of the company's monthly financial statements. We meet a minimum of eight times per year. Moreover, we communicate frequently on the phone. But then again, it's not as if everyone on the board is equally active. I do however have weekly contact with at least two of the board members, including Lars Gatenbeck.

Can the board refuse to extend the ownership group with additional investors?

Absolutely. That is a question of ownership, so they must agree on such matters. They can also decide not to co-invest with a particular investor. The more owners you have aboard, the more complex everything gets, particularly in an exit situation where everyone must agree when and how to exit, as well as on the value of the company.

What is your projected exit strategy – are you headed for an IPO?

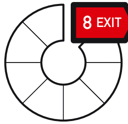
Well, we were planning an IPO in 2001, but we closed down that project. It was simply not the right time. So today we have no concrete plans of undertaking an IPO. It is still an exit option, and it is possible that it will come into play again at a later stage, but we are not currently looking at it. At the moment, it is generally said that you should have a turnover of 100 million and a continuously positive cash flow to be listed on the stock exchange. This is the case now; two years ago the situation was completely different.

What about a trade sale?

Yes, a merger would definitely be an option, but it is not something that we are actively working on. It's just a question of when you are most attractive to an acquirer. Potential acquirers could have an interest in the lab market and sell or develop products for the lab market. And, in that case, we are primarily talking about American and Japanese companies. These are also the companies which we currently work with on distribution, so we are already in contact with quite a large number of them.

Do you have any advice for younger companies that are seeking capital?

I think you need to be very focused from the beginning on what you want to do. You must know who your customers are, what the market looks like, what you can charge for your products and services, and also how to get paid. Focus is absolutely a key word!



How to exit?

The ability to make a profitable exit lies at the heart of venture capital investing. Exiting an investment is the final phase of the venture capital cycle, and at this point investors will ideally turn their investment into cash. Most funds are then reinvested in new ventures. Although you may feel that you and your venture capitalists are a team, don't forget that their primary and often sole objective is to generate a financial return on their investment, which implies that they will make their exit as soon as this becomes possible in a timely and profitable manner.

This chapter will outline various options for exiting an investment, namely trade sale, initial public offering (IPO), refinancing, repurchase and involuntary exit. We will round off the chapter by emphasising the importance of considering how your business strategy and the path that you have chosen for your business today may affect your exit possibilities in the future.

The time span from investment to exit can be as little as two years or as much as ten years or more. The two primary forms of exit are trade sales and an IPO on the stock market. In the case of each individual exit, the investor will weigh the possibility of selling the company to a third party against the option of undertaking an IPO.

The likelihood of making a profitable exit is also influenced by the investors' ability to time their exit. Investors may postpone an exit if market conditions are unfavourable, or exit earlier than anticipated if conditions are favourable.

It is important to keep in mind that venture capitalists have several mechanisms that serve to ensure that firms are exited at times that they perceive to be optimal, and to select the best possible form of exit. E.g. venture capitalists will typically make deals regarding blocking rights or disproportional voting rights over key decisions, such as the sale of the company or the timing of an IPO. Investors will use their board seats and powerful control rights to get their own way. Founders should therefore expect this stage to be a source of debate and discussions, and one that will sometimes lead to problems for the founders of the company.

Exit options

We will now turn to a brief description of each of the five main exit options. Please note that if you are considering using any of these, you will need the specialist advice of experienced professional specialists.

Trade sale

A trade sale involves selling the company's shares to another company. Usually, the acquirer operates in the same industry as the acquired company and hence has a strategic objective in purchasing the company. For this reason, trade sales often lead to higher sales prices than the company could achieve through an IPO, because the valuation of the company reflects the acquirer's strategic interests in the business.

Initial public offering (IPO)

An initial public offering or IPO is a popular exit strategy with venture investments, partly because of the visibility and media attention it generates for the company. An initial public offering is the process by which a company is quoted or listed on the stock market, which means that a significant proportion of its shares are sold directly to the public for the first time. It is important to note that investors do not exit on the day the company is listed; they are in a 'lock-up period' for another 6-12 months to prevent sending signals to the stock market that investors want to cash out. For a deeper understanding of the requirements a listed company will need to fulfil, please see Hanne Leth Hilleman's article on page 46.

Refinancing

Refinancing denotes the purchase of the venture capital investors' shares by another investment company. Refinancing is thus an attractive exit strategy when a company's investors wish to exit and the company is unwilling or unable to undertake an IPO or a trade sale.

Repurchase

A repurchase occurs when the venture capital investors' shares are repurchased by the company and/or its manage-

ment, placing the business back under the control of its original founders.

Involuntary exit

An involuntary exit occurs when a company goes into receivership, or when a failing company's assets and operations are controlled and reorganised by a court-appointed agent, or in the case of liquidation, the final termination of a company's operations.

Exit strategy considerations

It is important that companies consider their likely future exit possibilities at an early stage of their lifecycle, and that they develop their business strategy accordingly, since the wrong business strategy can destroy even the most appropriate exit strategy. A large pharmaceutical company might for example choose not to acquire a firm if that firm has a large number of licensing deals with the potential acquirer's competitors.

One way of determining the most appropriate exit option for your business is to examine your technology. If your company has a technology with a narrow R&D focus, the possibilities of successfully undertaking an IPO are relatively small. In this case, the ideal exit situation might involve the acquisition of your company by a large firm with a view to incorporating your R&D efforts into its existing R&D activities. By contrast, if your company has a broad technological focus, for example in the form of wide applicability in many different areas, or has made efforts to develop a broad range of products, on the basis of which some technologies could be licensed out, then an IPO could be the ideal solution.

In recent years it has become difficult to exit through an IPO, which has led to an increased interest in exiting through trade sales. Consequently, it is very important to identify potential buyers of your company and to develop a strategy for how to approach them.

The buyer in a trade sale is often a large pharmaceutical company. The possibilities of a trade sale are greatest in the USA, where most potential buyers are located. Consequently, if you are interested in a trade sale, you should work to develop collaborative partnerships with US-based companies, and make an effort to attract American investors in order to increase your company's visibility for potential buyers.

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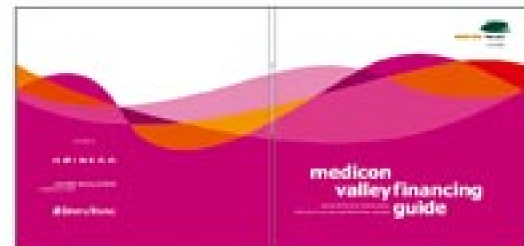


A listing puts major demands for your investor profiling and communication

BY HANNE LETH HILLMAN, SENIOR ANALYST, GUDME RAASCHOU INVESTMENT BANK

Sharpened demands
By a listing on the stock exchange, a biotech firm can raise new capital without having to give up its independence. Hence, in many ways the stock market is seen as an attractive source of financing. The management of privately-owned companies often prefer this form of exit from the venture capital market to an industrial sale or a merger with a larger company.

It is important, however, that managements in privately owned companies fully realise that a successful IPO and the subsequent listing on the stock exchange puts large demands on management in relation to marketing, investor relations and market communication. Recent years' negative developments on the stock markets have seriously hampered investor confidence and led to much stricter requirements in terms of companies' communication and profiling. Although this year has seen renewed optimism and increasing equity prices and – in the US – a tentative recovery of the market for company listings (the IPO market), also for life science companies, it would be naïve to expect a return to the euphoric days of 1999 and 2000, when investor demand for new stocks was almost uncritical and insatiable.

A very different investor base
The most noticeable factors involved in the shift from being a venture company to becoming a listed company relate to changes in the investor base. A privately owned company typically has a limited number of stockholders/owners, who are characterised by relatively high levels of commitment and specialised knowledge. In contrast, a listed company is generally backed by a varied and broad mixture of stockholders, ranging from specialised, institutional investors to generalists and private investors – with corresponding differences in knowledge base.

For a publicly listed company, competition for investor attention and favour is generally much more intense than on the venture capital market. Venture investors generally have a limited portfolio of investments and a comparable degree of commitment to each investment. On the stock markets, individual investors often have a broad area of responsibility – i.e. covering either a large geographical area or a large number of industrial sectors – and therefore have a substantial number of potential investments to choose from. Time pressure

often requires selection of investment subjects to be based on an overall and thematic decision-making process.

Good investor communication is vital for a listed company

The varied nature of investors on the public stock markets necessitates a more far-reaching and indirect form of communication than on the venture market, where the dialogue between a company and its owners can be close and direct. For a listed company, good profiling and optimal information communication puts significant demands on timing, formulation and precision. In spite of the diverseness of stock market investors, an honest and open profile combined with an easily comprehensible business model or investment case will always attract attention. It is very much about 'story telling', and a privately owned company with IPO plans would benefit from profiling itself broader in the market a while before its introduction. Such profiling would include issuing press releases, ensuring increased media coverage, establishing analyst contacts etc.

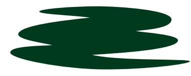
A key aspect in communicating with the stock market is expectations guidance. It is crucial to avoid presenting either overly positive or negative scenarios and instead present a realistic and updated picture of the future, including specification of future milestones which will affect your company's share price. It is extremely important always to promptly update the market when the assumptions behind announced expectations change. Failure to meet established expectations or milestones may significantly harm investor confidence, which can be difficult to restore. It is also important to ensure consistency in the way the picture is presented, since mixed signals give rise to uncertainty among investors and risk hurting management's credibility in the market. Such conditions may seem tough, but should be seen as a consequence of investors' broad focus: why spend time on a company that has disappointed you when there are a multitude of other potential investment subjects within the same sector?

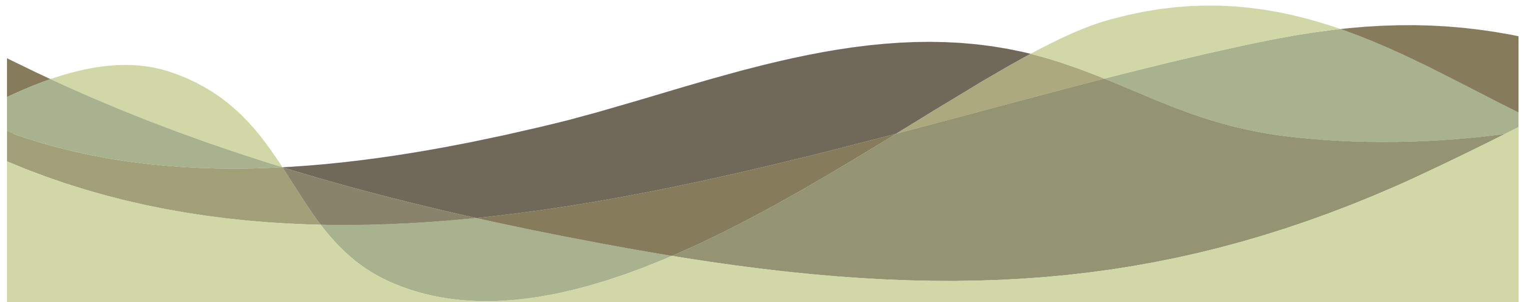
Expectations and news flow drive share prices and a high frequency of stock market announcements helps maintain a high degree of investor attention. It is also important to ensure prompt news communication and ensure that news influencing share prices is immediately conveyed to the market in the form of stock exchange announcements. Listed companies must find an optimal balance between an open and far-reaching investor communication and the need to hold back sensitive company information.

Some general guidelines for good stock market communication can be summarised in the following way:

- Make your business model transparent and prepare a clear and comprehensible presentation of your investment case
- Immediately communicate in a stock exchange announcement any information that may affect your stock price
- Maintain a continuous dialogue with the market → your financial results must not come as a surprise to investors!
- Address the focus areas of the stock market – including negative issues
- Establish a close correlation between your company's values, image and objectives
- Ensure investors/analysts have easy access to your company's CEO, CSO and CFO
- Ensure that the news flow from your company to the market is as consistent as possible.

INVESTOR BASE	THE VENTURE MARKET		THE STOCK MARKET
COMPOSITION	HOMOGENEOUS	→	DIFFERENTIATED
LEVEL OF KNOWLEDGE	SPECIALISED	→	MOSTLY GENERAL
LENGTH OF THE DECISION-MAKING PROCESS	LONG	→	SHORT (TO MEDIUM)
LEVEL OF COMPANY SPECIFIC COMMITMENT	HIGH	→	MEDIUM TO LOW
ATTENTION	SPECIFIC	→	BROAD





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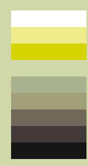

- **creating** a scientific environment of global excellence
- **transferring** knowledge, technology and new ideas from research to industry
- **exploiting** transferred knowledge and technology

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75 INVESTORS

Page 52 - 92 present 75 national and international life science investors with contact info, profiles and key figures. These pages are only available in hard copy.

Price - hard copy of Medicon Valley Financing Guide
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DKK 950 / EURO 135: All others

Glossary / index

Blocking rights p. 44
A shareholder in a company possesses blocking rights if he or she has the right to block decisions regarding the appointment of new members to the company's board, or decisions on matters of company policy.

Burn rate p. 8
The rate at which a venture company requires additional cash in order to finance its expenses and maintain operations prior to generating a positive cash flow.

Business angel p. 16, **17,** 19, 27

Buyout investing p.16
An investment strategy (a subset of private equity) that involves purchasing a controlling interest in a venture company.

Break-even p. 33
The point at which a company's revenues equals its total expenses.

CEO p. **8** (a.o.)

CFO p. **8** (a.o.)

CSO p. **8** (a.o.)

Co-investor p. **17,** 22, 23
A partner in a co-investment, i.e. one investor in a group of venture capital organisations who agree to jointly invest in a company.

Corporate venturing p. 16, **17,** 18, 19

Debt capital p. 16, 19
Raising capital by borrowing money through commercial loans, which must be repaid, usually with interest, within a specified period of time. In contrast to equity financing, in which investors acquire shares in a company in return for capital, the lender in Debt capital does not acquire an ownership interest in the borrowing company. Debt capital is appropriate for companies with a low level of risk and assets that can be used as collateral to secure the loan.

Disproportional voting rights p. 44
A situation in which particular shareholders in a company possess voting rights greater than that to which they would otherwise be entitled by their shares in the company. When disproportionate voting rights exist, the majority shareholder in a company has disproportionate voting rights in relation to minority shareholders when electing members of the board of directors and in matters of company policy.

Due diligence p. 24, 26, 28, 32, **35,** 40

Equity financing p. 16
Raising capital by offering shares in a company to private, external investors. Equity financing thus trades ownership in the company for money to finance operations, which is not required to be repaid. It is appropriate for ventures with a high level of risk and/or no assets that can be used as collateral to secure a loan. The principal alternative to equity financing is debt financing, which involves raising capital through commercial loans which must be paid back, usually with interest.

Executive Summary p. **28,** 29

Exit p. **44, 45** (a.o.)

Follow-on investor p.**17,** 26
An investor who makes an investment in a company which has previously received venture capital.

Freedom-to-operate p. 8, 33
The freedom to research, develop and commercialise a product or technology without infringing on someone else's intellectual property rights. Freedom-to-operate may be obtained through such methods as in-licensing and cross-licensing, or by 'inventing around' existing patents.

Fund p. 22
A pool of capital, raised and held by an investment company.

Initial public offering (IPO) p. **44** (a.o.)

Intelligent capital p. 9
Venture capital that is accompanied by the advice, experience and networks of an investor with expertise in the industry, experience in running young companies and getting products to market, strong domestic or international investor networks, and/or a solid track record in bringing investments in start-up companies to a successful exit.

Investment company p. 22, 44
A company, such as a private equity or venture capital company, that pools a large number of investors' funds and invests them, typically according to specific investment preferences.

Investment stages p. 16, **18,** 19

Investor base p. **7**, **8**, 17, 23, 26, 33, 40, 46, 47
The collective group of investors with equity stakes in a company.

IPO see *Initial public offering.*

Lead investor p. 9, **17,** 23
An investor who leads a group of co-investors in a joint investment, and who is chiefly responsible for contacting, advising and monitoring the investee company. The lead investor is often, but not always, the investor with the largest share in the investee company.

Limited partnership p. 18
The investment vehicle or legal structure

used by most private equity/venture capital funds. A limited partnership consists of one or more investment partners with limited liability, i.e. their potential loss is limited to the amount they invest in the partnership.

Liquidation p. 45
The process by which a company's operations are terminated. The company's assets are sold, its liabilities are settled, if possible, using its proceeds, and any remaining funds are paid out to the company's shareholders.

Lock-up or **lock-up period** p. 44
When venture capitalists exit through an initial public offering (IPO), they do not exit on the day of the IPO. Instead, they become subject to a 'lock-up' provision which prevents them from selling their stake in the venture company at the time of the offering, to avoid sending a signal to the market that investors want to cash out. The lock-up period typically lasts between 6 and 12 months.

Mergers & acquisitions (M&A) p. 8, 10, 17, 20, 21, 26, 46
Mergers and acquisitions (M&A) involve the amalgamation of two separate companies into one company, either through a merger, the combination of the economic interests of equal partners, or through an acquisition, in which one partner obtains the majority ownership in another company.

Mezzanine investment p. 16
A type of financing (a subset of private equity) that combines debt and equity, and which provides capital for a growing company which is unable to obtain equity financing or which does not wish to dilute its existing shareholdings, e.g. shortly before an expected initial public offering. Mezzanine investment provides the investor with some degree of influence over the operations of the company.

Milestones p. 17, 30, 33, 34, 47
Key events or achievements in a company's development which can be used to plan and mark the company's ongoing progress, and in the staging of venture investments.

Portfolio company p. 7, 16, 17, 18, 21, 22, 26
A company in which an investment company invests funds.

Pre-seed see *Seed.*

Private equity p. **16,** 18

Receivership p. 45
A type of bankruptcy in which the assets and operations of a failing company are examined, preserved and restructured by a court-appointed agent called a 'receiver'. The receiver preserves the company's assets for the benefit of affected parties. Unlike liquidation, receivership does not necessarily mean that a company's operations will be terminated.

Refinancing p. 21, **44**

Repurchase p. **44**

Round of financing p. 7, 11, 17, 23, 27, 29, 30, 33, 39, 41
A company's current financing stage. A venture company will typically engage in three to four rounds of financing, including its chosen exit strategy.

Seed p. 16, **18,** 24, 27, 40
The first of five investment stages. This stage marks the venture company's preliminary efforts to formulate, evaluate and fine-tune a business idea. Financing during this stage is used to develop the business concept, e.g. through market research, the generation of a business plan or the development of preliminary prototypes. Note that a distinction is sometimes made between the 'pre-seed' and the 'seed' stage of a venture company's development, depending on the extent to which a business idea has been defined.

Staging p. 16
A process whereby venture capitalists provide capital to a venture company in multiple instalments, usually prompted by the company's attainment of milestones that were set prior to the investment. Staging thus limits the venture capitalists' potential losses by limiting the amount of funds invested, while the venture company must continually prove its worth and meet planned targets.

Syndication see *Co-investor.*

Trade sale p. 12, 16, 23, 41, 43, **44,** 45

Valuation p. 11, 34, **35,** 36, 41, 44

Venture capital p. **16** (a.o.)

Venture capitalist p. **16** (a.o.)
The three main types of venture capitalists are business angels (individuals who invest personal capital), venture capital firms (who invest the capital of outside investors), and corporate venturing (firms or departments that invest capital owned by a corporate parent). The venture capitalist realises a return on an investment by making an exit from the venture company.

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