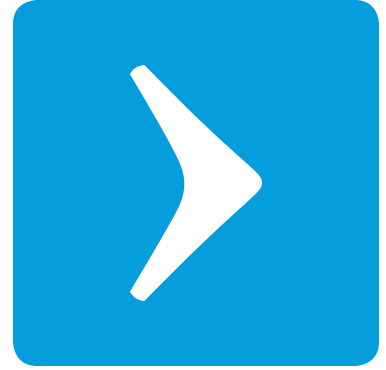


Bringing Home the Bacon: A Look at Recent Life Science Exit Data



Have you wondered how many really good life science M&A exits happen every year? Are the big guys even buying? Do these exits actually provide returns that materially affect the venture funds that are investing?

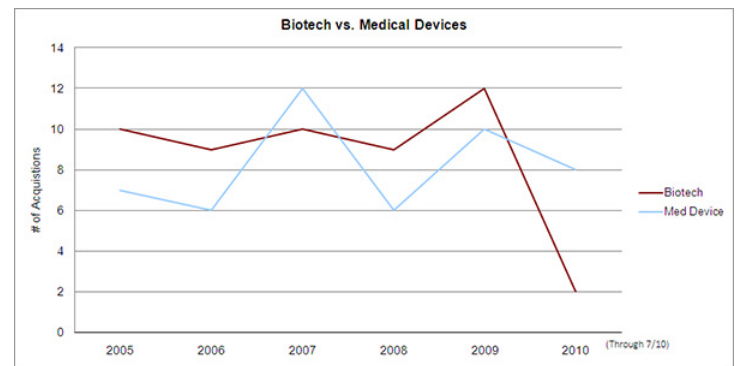
This article examines U.S. venture-backed life science exits over the last 5+ years and focuses on private M&A “Big Exits”. We define Big Exits as acquisitions of private venture-backed life science companies in which the upfront payment was about \$50 million or more in cash for device companies and about \$100 million or more in cash for biotech companies¹. We measure only the upfront cash payments, not milestone payments or earn-outs. The data is based on 49 device acquisitions² and 53 biotech acquisitions from 2005 through August 2010. The term Big Exits may not be entirely accurate, as some companies require substantial investment to get to Big Exits, but may return little if any capital; however, the vast majority of these exits represent at least a 1X cash on cash return on venture investment. We have added venture-backed diagnostic and services companies to the device section in order to include these exits.

Fairly Consistent Big Exits

As Exhibit 1 shows, Big Exits over the last five years have been fairly consistent³. On average, there are eight device and 10 biotech Big Exits per year. The oft-extolled perspective that a small group of investors receives a

disproportionate amount of larger exits does hold true in our analysis. Exits do tend to congregate around the same firms. The top three device investors earned nine, eight, and eight Big Exits each. In biotech, the top three investors had nine, seven and seven Big Exits. Overall, the top four life science venture firms achieved 13, 13, 12 and nine Big Exits in this period. Accounting for overlap, at least one of these four firms were investors in 39 percent of all Big Exits since 2005.

Exhibit 1: M&A Big Exits Per Year



Source: VentureSource, press release, conversations with life science experts.

Biotech Blues

The year 2010 has been a disappointing one for biotech, with only two Big Exits to date. Why? There are a few possibilities to consider, including the return of the IPO market as well as the continual consolidation of Big Pharma. Let's tackle the IPO market question first. Is the slowdown in Big Exit biotech M&A a function of the open IPO window? Could companies be spurning acquisition offers and instead becoming public? I don't think so. The historical totals of Big Exits stayed constant

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even in the years of the open IPO window. In 2005-2007 there were 48 U.S. venture-backed life sciences IPOs, but during that span Big Exits still averaged about 10 per year.

I think part of the answer lies in the recent consolidation activity, as this can take Big Pharma/biotech's eye off restocking their pipeline, despite the very real patent cliff many of these companies face with large revenue products losing exclusivity in the market and having to compete with generics. Many believe this consolidation has led to a general slowdown, if not inability, to complete partnering deals in Phase II assets and has quelled the appetite for acquiring companies outright.

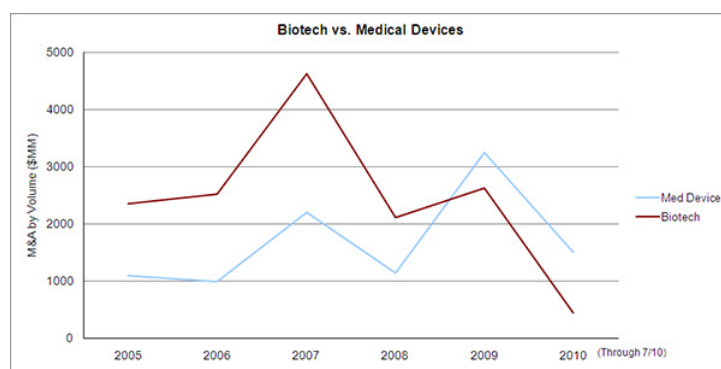
In addition, the slowdown could be gamesmanship between acquirers and the venture industry. The very real threat of low reserves in older funds and the pressure to deliver some liquidity to LPs translates into an advantage to the buyers. In turn, this trend spawns a waiting game between the two parties, resulting in lower offers with reduced up-front payments from acquirers being weighed against the ability to take an asset through the next trial or milestone on inside venture support alone.

Situations like this can cause quite a bit of discussion in the board room, as each venture firm measures its active dry powder available to invest and its own fundraising plans. These factors absolutely affect a firm's ability to wait out possible delays in exits. It would not surprise me to see resurgence in exits in the fourth quarter as many of these discussions come to a resolution.

Dandy Devices

Device, on the other hand, has shown quite a bounce-back recently, despite continued lack of clarity on clinical trial makeup and approval path. In 2009 Big Exits handily surpassed 2008 totals and 2010 to date is just behind the full-year total for 2009. It is also interesting to note that device crosses over biotech in total value of Big Exit M&A, despite a higher number of Big Exits in biotech in 2009 (see Exhibit 2). Again, this reflects the movement in biotech to staged acquisitions with smaller up front payments.

Exhibit 2: Total Acquisition Amount Per Year

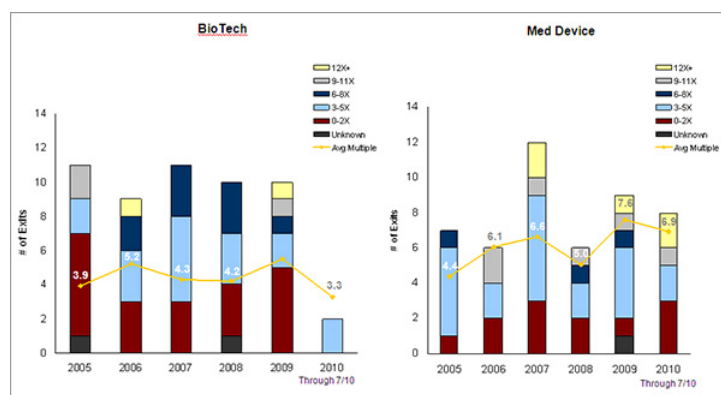


Source: VentureSource, press release, conversations with life science experts.

Big Wins are Real!

Big Exit average multiples in the last five years (see Exhibit 3) show a healthy 4.4X cash-on-cash in biotech and a robust 6.3X cash-on-cash in device⁴. Interestingly, device multiples on average are higher than biotech in each year since 2005. Larger multiples (9X and higher) account for 22 percent of all device Big Exits and 10 percent of all biotech. What is the reason for the discrepancy? High exit multiple deals distinguish themselves in two different ways: either in the total overall exit value or the total venture money in. The average Big Exit values in device and biotech are similar, but the average venture money is quite different, with biotech at \$82 million and device at \$41 million during this five year time frame.

Exhibit 3: Exit Multiples by Year in Private VC-Backed M&A



Big Exits 2005-Present biotech M&A >\$100 M. Med device M&A > \$50M.

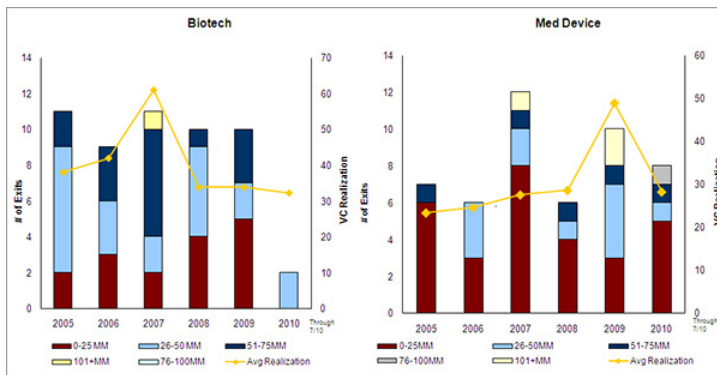
Source: VentureSource, press release, conversations with life science experts.

Show Me the Money?

The other question (one asked quite often by the LP community) is how these Big Exits translate into realizations. We analyzed Big Exits and created a model to determine individual VC realization from a single exit, assuming a 15 percent ownership in the company at the time of exit. In this model, 70 percent of biotech Big Exits and 82 percent of device exits provide less than \$50 million back to each VC.

Our initial assumption (which was proven out) was that biotech exits would provide larger realizations based on dollars in and a higher average Big Exit value. Biotech average realization was \$41 million and device was \$31 million. However, an interesting point to note is that this analysis yielded four deals in which the realization was \$100 million or more, and three of the four deals were device deals.

Exhibit 4: VC Realization Per Year in Private VC-Backed M&A



VC realizations defined as money realized by a single VC based on assumption of 15% ownership at the time of M&A.

Big Exits 2005-Present. biotech M&A>\$100M, Med device M&A>\$50M.

Source: VentureSource, press releases, conversations with life science experts

Breakfast is Served

So what does this all mean? Are funds generating returns to the LPs? If you analyze the top firms by number of exits and calculate the realizations based on an assumed 15 percent ownership, you would find the top three venture firms had projected realizations of \$684 million, \$524 million and \$455 million since 2005. The numbers show

that these private M&A exits provide substantial money back to the firms and to the LPs through distributions.

If you measured these realizations as a percentage of capital raised between 2000 and 2007, the top three venture firms in this category would have realized 131 percent, 98 percent and 86 percent of their respective capital raised — not exactly setting the venture world on fire, but at least a good start. Note that these realizations do not take into account any additional VC gains that come from IPOs, PIPES or public company M&A events.

In summary, while it would be fair to say that there is an overcrowding of private, venture-backed companies waiting for exit, when these companies do get a Big Exit, it often is a substantial return. This is good news for LPs who remain hungry for distributions and for many venture firms that are nearing the end of the active investing cycle of their current fund and need to ramp up the marketing machine to hit the fundraising trail in 2011.

- ¹ Announced cash upfront (via press releases and other public data) is the measure used for Big Exit calculation. A small percentage of exits are estimated based on anecdotal conversations with Life Science experts.
- ² Diagnostics and Services companies included in device data
- ³ Date of acquisition is when deal is announced.
- ⁴ Calculation of exit multiple is upfront cash divided by total venture investment

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For purposes of this article, the author referred to VentureSource reports, press releases, and publicly available information. A small percentage of the exits were approximated using anecdotal conversations with Life Science industry experts.

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