LIFE SCIENCES SNAPSHOT

A Quarterly Report on Financing Trends

COMPANIES & INVESTORS NAVIGATE THE PANDEMIC ERA
Q2 2020

orrick

Data provided by

PitchBook

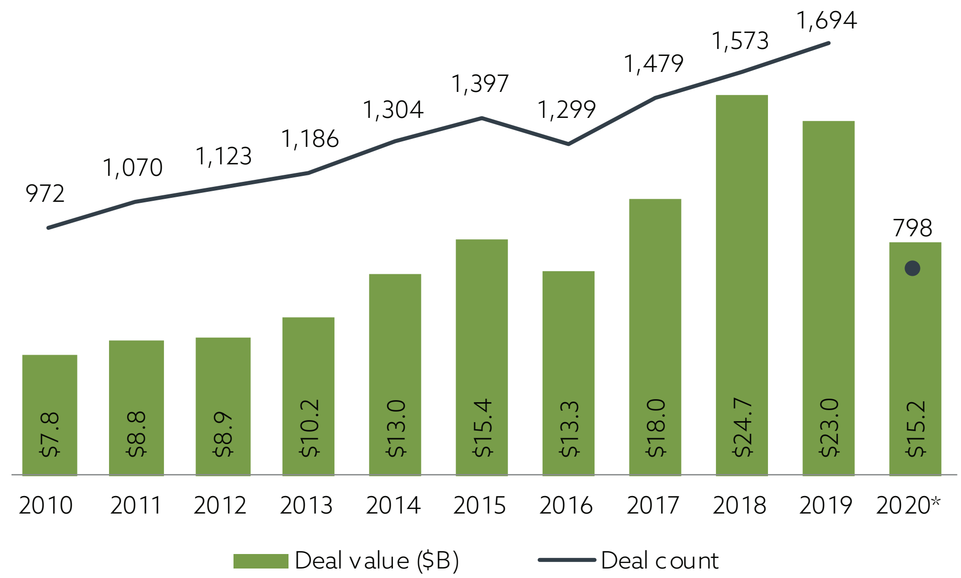
Key Takeaways

In this edition of Orrick's series of life sciences publications, we offer a market update drawing on a variety of PitchBook datasets depicting macro trends in financing across the market, as well as a spotlight on any trends in IPO activity by companies according to their clinical status upon time of listing.

Key highlights include:

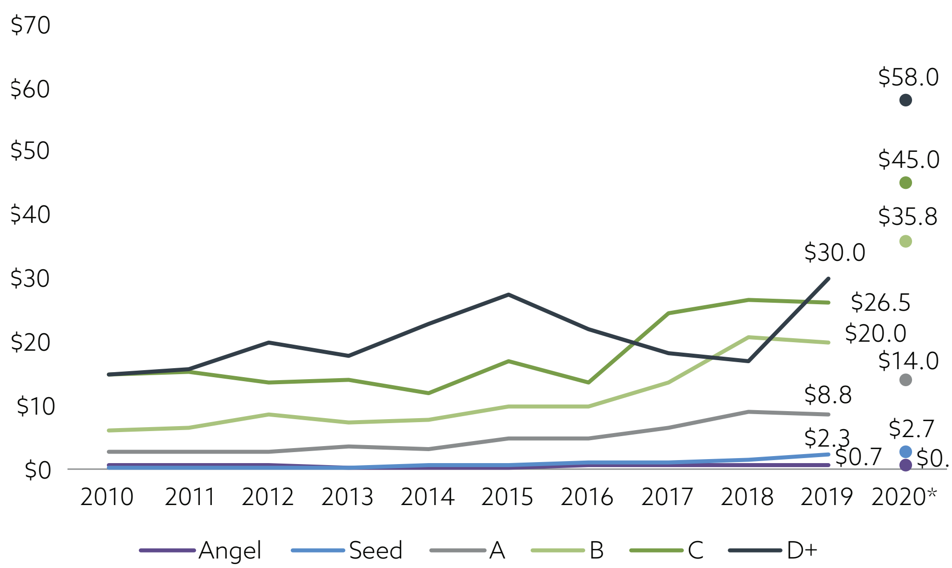
- Even among sectors that enjoyed tailwinds from the COVID-19 pandemic, life sciences stands out with a quarterly high of $7.8 billion in VC investment in Q2 2020.
- Year over year, Q2 2020 saw a surge of over 22% in VC investment, even as volume diminished by 8.6%; Q2 2020 VC investment increased by 7.0% over Q1 2020
- Median financing sizes and pre-money valuations were similarly robust if not at record heights, suggesting investors remain bullish, and thus far any potential negative repercussions from the pandemic have not yet been materially felt.
- Exits overall for venture-backed life sciences companies have been relatively robust in the first half of 2020, albeit at lower volume, with 53 overall for a combined $18.8 billion.
- Although headwinds identified in the prior edition of the Orrick Life Sciences Snapshot persist, they have yet to discourage any significant level of life science investment or overall deal activity.

VC deal activity



Source: PitchBook | Geography: US
*As of June 30, 2020

Median VC deal size



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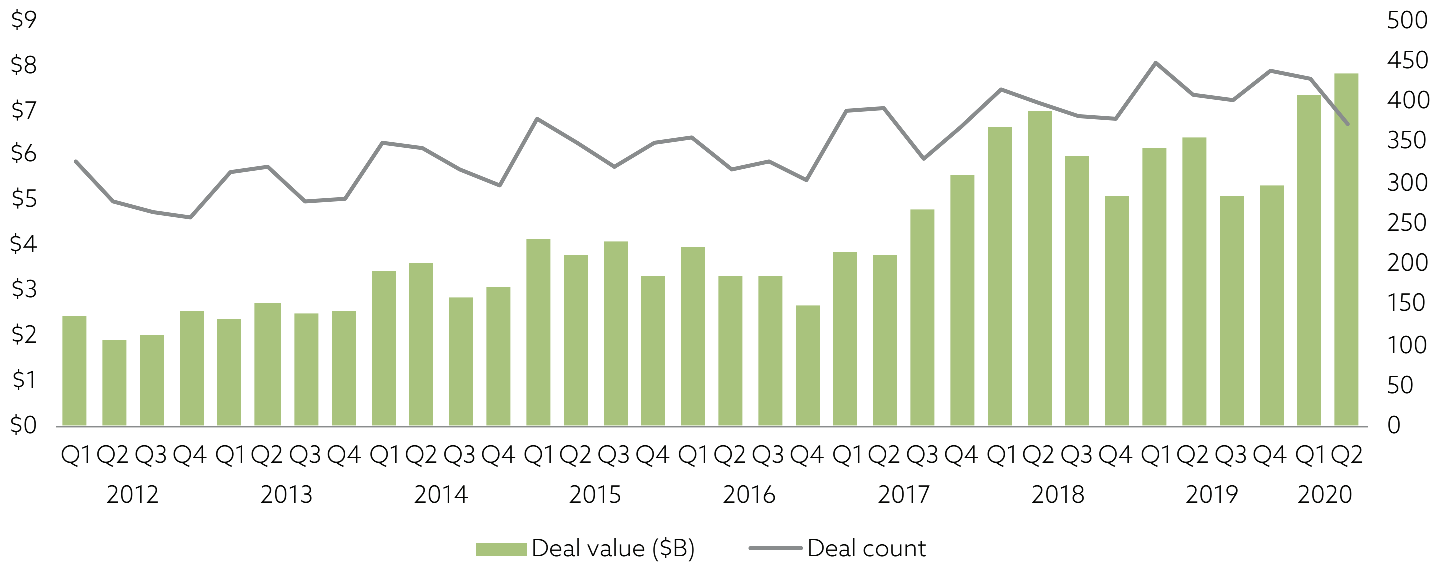
Market Analysis

VC deal activity by quarter



Source: PitchBook | Geography: US
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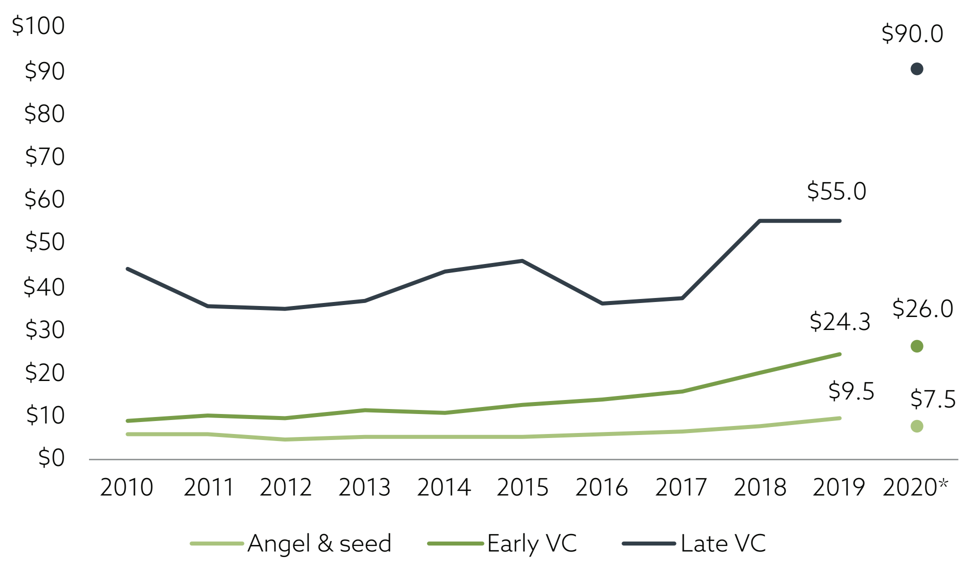
Even among the sectors that enjoyed accelerating tailwinds due to the COVID-19 pandemic, life sciences stands out. Venture investment soared to a quarterly high of $7.8 billion in Q2 2020, even as the volume of transactions slid somewhat. Both early- and late-stage median pre-money valuations were at all-time highs in the first half of the year. Instructively, these trends are in direct contrast to what occurred within the sector from 2008 to 2009, when an initial dip after Q1 2008 led to a persisting plateau of modest financing volume. Q2 2020 saw a 22.2% increase in VC investment over Q2 2019, even as volume declined by 8.6%. Even quarter-over-quarter increases were marked; VC investment rose by 7.0% between Q2 2020 and Q1 2020, even as volume contracted by 12.7%. Large rounds are clearly still bolstering overall capital-invested tallies regardless of any decline in volume.

Median pre-money valuations by stage and year



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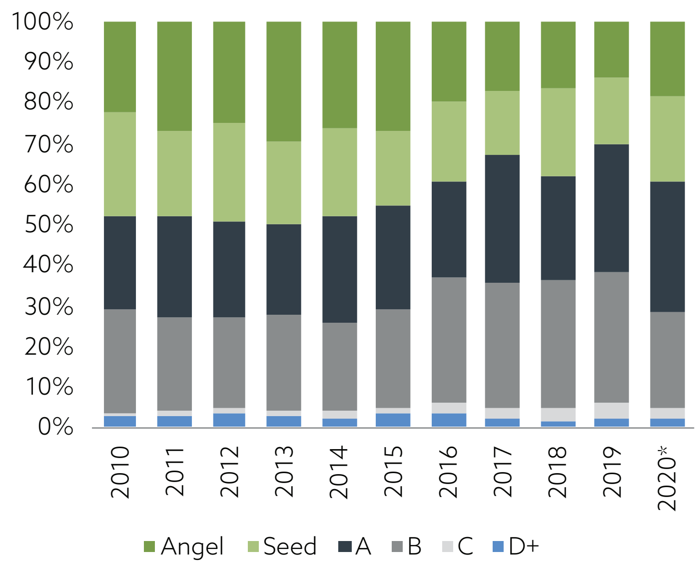
VC deals ($) by series



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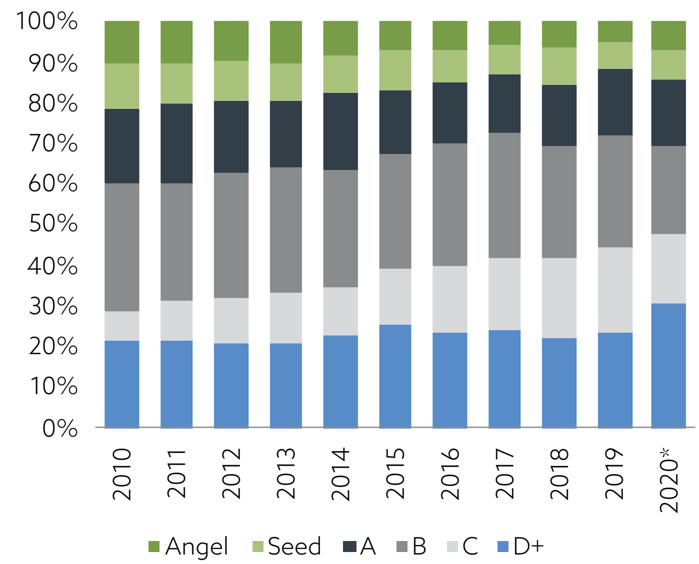

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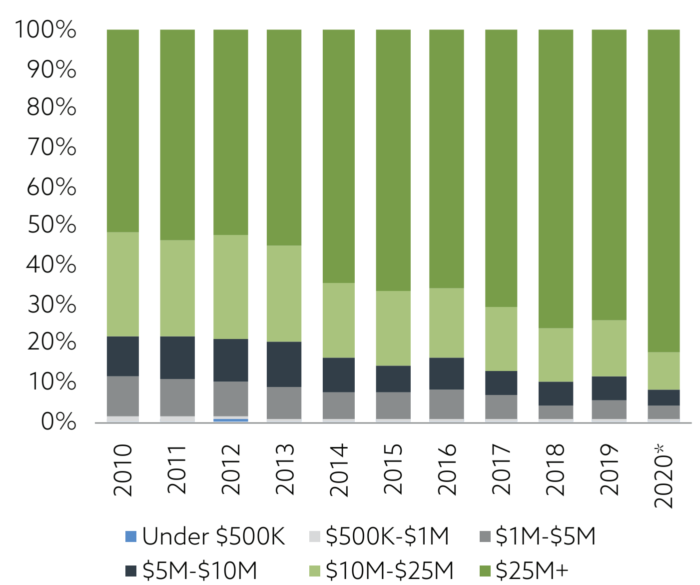
VC deals ($) by size



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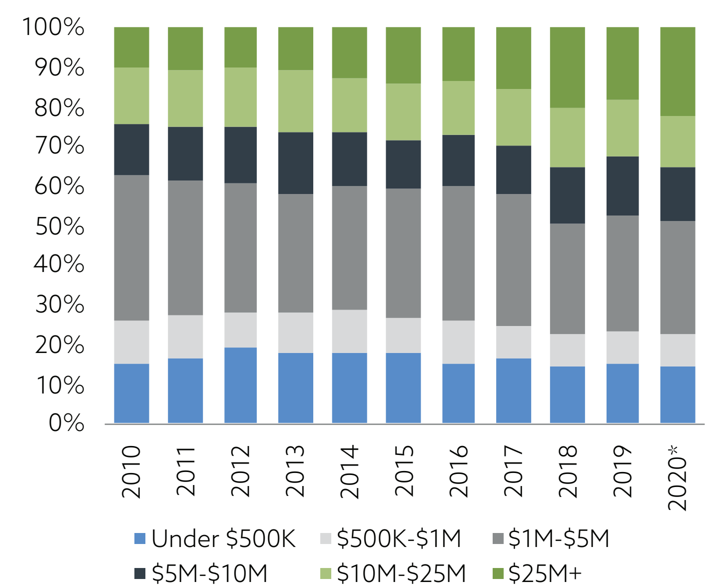

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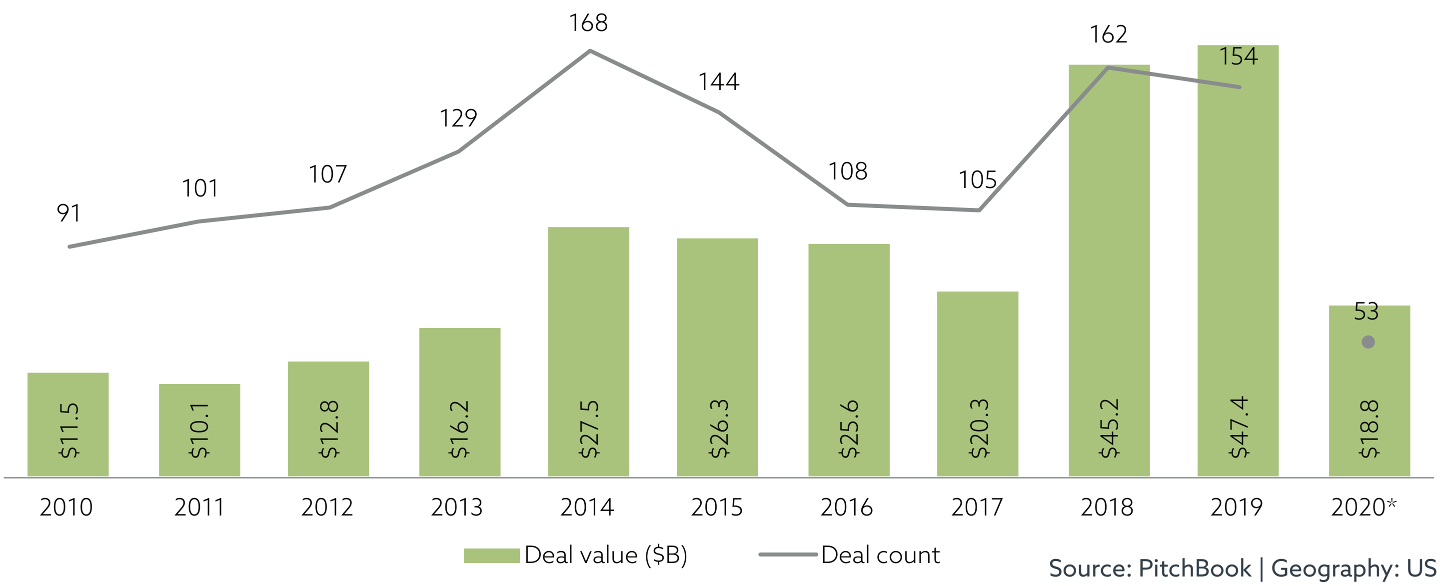
Spotlight

VC exit activity



Source: PitchBook | Geography: US
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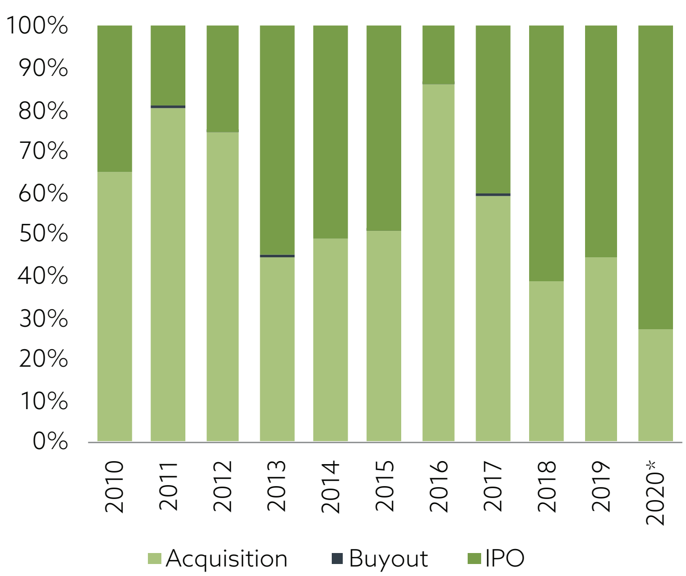
Exits overall for venture-backed life sciences companies have been robust in the first half of 2020, albeit at lower volume, with 53 overall transactions for a combined $18.8 billion. IPOs have generated their largest proportion of exit value in years, accounting for $13.7 billion across 22 debuts. For comparison, that is already just over half of the $26.3 billion raised by venture-backed life sciences companies last year across 49 IPOs. The rise in IPOs can be explained in part by the surge in life sciences investment overall during the 2010s; many biotechs opted to raise more money privately because capital was readily available. When these businesses finally did go public, they were able to command larger sums. The public market appetite for early-stage companies has also increased.

VC exits ($) by type



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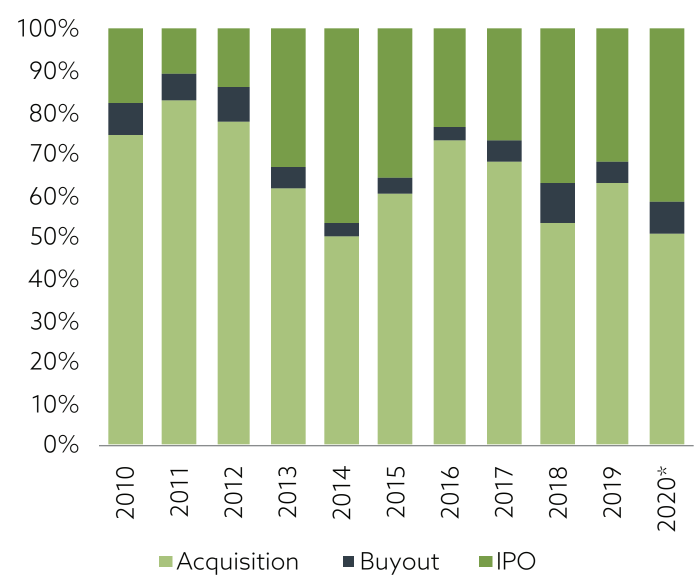
VC exits (#) by type



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Roundtable

Our esteemed panel of life science investors joined Orrick's Neel Lilani to discuss financing trends in the current climate.

Panel

Facilitator

Neel Lilani
Managing Director
Orrick

Contributors

Thomas Hawes
Managing Director
Blue Venture Fund

Garheng Kong
Managing Partner
HealthQuest

Deepa Prasad
Managing Director
WestRiver Group

How has your investment criteria shifted in the current COVID-19 climate?

Garheng: The Covid-19 dynamic has affected a lot of companies. While we are not focused on companies that are developing COVID-19 treatments, our overall investment criteria has not changed. We have always sought to invest in innovation that makes care more accessible (whether that's virtual care or moving care out of the hospital), and the pandemic has highlighted the need for those investments in an urgent way. Are we going to get comfortable making investments in this new normal? Our team is spread throughout the country, and they joke that maybe they can drive to visit new and existing portfolio companies. We all want to look at ways to make it work because we want to keep investing.

Deepa: We are also not focused on COVID-19 treatments, but the pandemic has accelerated development in the digital health market tremendously. Patients, providers, and payors are seeing the benefits of virtual health consults—so why go back? The digital health market is getting pushed forward at a rapid pace; virtual medical visits are going to be the new norm with the added benefit of lower cost of care.

Thomas: We do not have a focus on COVID-19 per se, but we continue to look at businesses that address health inequalities that have been made even more apparent by the current pandemic—companies that are working to enable more home care versus hospital care and making behavioral health care services more accessible. Additionally, we are looking for diagnostic companies that can offer testing in the home or that can offer better and faster information more cost efficiently and ideally outside the walls of the hospital. The pandemic has accelerated the appreciation of the value of diagnostics.

What is your view on making investments entirely virtually (never having met the founders in person)? Are references more important than they were? Are there particular sub-sectors that you think are more appealing investments in a remote environment?

Deepa: WRG is looking at two investments now via Zoom calls. For one, we have not met the CEO, but we do have connections to the board, which gives us comfort. So yes, references are important. We utilize other metrics too, but you need to be adaptable given the data available. For example, I was virtually introduced to a CEO and developed a meaningful relationship over emails, texts, and Zoom calls; the round is oversubscribed, but given the relationship we built, the CEO is pushing to get WRG an allocation. Knowing and trusting the management team is critically important.

Thomas: The Blue Venture Fund is scheduled to close our first investment in a company we did not meet with in person prior to funding, although we had been tracking them pre-pandemic. It is certainly different developing a relationship virtually. The company we are investing in was already operating in a distributed team model, so they were comfortable communicating and building relationships remotely. We are not letting the "new" world keep the Blue Venture Fund from investing in companies that we would like to pursue.

Garheng: The more mature the company is, the more data you have to draft off of. Having a track record of performance is good. Digital health services and diagnostics are easier to analyze as they have more customers and are easier to diligence.

How is your deal flow? Do you see it decreasing or remaining the same?

Deepa: We are seeing a huge increase. Money is pouring into healthcare from all sides. Investors want to put their money into healthcare.

Garheng: Deal flow has gone up pretty meaningfully; it's up about 50% year over year.

Thomas: Whoever said summer was supposed to slow down was wrong. We have never been busier! We just added three people to the team to help. Our workload is definitely up.

Are check sizes changing? Staying the same?

Thomas: There has been increased interest in healthcare investments overall. It seems as if that interest will continue to increase.

Deepa: Rounds are actually more oversubscribed. More interest in these deals is making it more competitive now to participate.

Garheng: As funds are getting larger, there is more capital to put to work, and round sizes are ticking up.

Let's talk about your LPs. Have they shifted their views and investment outlook?

Thomas: They haven't. Our LPs are staying the course. Given our LP structure, we look for businesses that add to or help them accelerate change. The trend, even before the pandemic, is that our LPs have either created or are expanding their own direct-investment teams. Accordingly, when our LPs have an outsized interest in a portfolio company, we will help them make a direct investment.

Garheng: There hasn't been a meaningful change in our LPs' outlook. That said, healthcare is attracting increasing interest (especially as a long-term investment), so we are seeing more demand for increased allocation.

Deepa: I second both of these points. Existing LPs have longer time horizons.

Is there anything on your mind we haven't covered that you were not thinking about three months ago?

Garheng: COVID-19 has not changed our outlook very much, but it has sped up the timelines for investment in certain sectors.

Deepa: There's such an emphasis on the money going into healthcare, and less emphasis on the huge savings and benefits from investments in the sector. For example, ER costs will come down. Patients can receive treatment virtually and not have to spend the money on an ER visit. This will generate a lot of cost savings for payors. With virtual visits and remote monitoring, there will be better patient compliance leading to additional savings down the road, as well as more standardized care across the spectrum.

Garheng: I agree with these points.

What trends are you seeing in hospitals and visits?

Thomas: BCBS' (Blue Cross and Blue Shield companies) clients have been looking to see how they can support providers in value-based care. This was happening before the pandemic, but the pandemic clearly highlighted the need to shift away from fee-for-service payments in many specialties where providers will need to weigh and balance financial risk with delivering great health outcomes for their patients. There should be an incentive to keep people out of the hospital, on their medications, and involved with their healthcare providers. The "Blues" (Blue Cross and Blue Shield companies) are trying to think through how to best keep the small- and medium-sized physician practices alive as the in-person volume goes down. This is still a work in progress, but there is a lot of activity in that area.

Deepa: Hospitals are going to have to get on board with the new paradigm.

Let's talk exit opportunities and the M&A market. Are SPACs being discussed?

Garheng: We're seeing lots of SPACs. We're being asked to form SPACs. It's part of the natural evolution, and they are very available. Who knows if this trend will continue? On the M&A side, there's a little more friction.

Deepa: Our investments are too early at this time to discuss exit opportunities.