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Analysts predict downward trend will continue for life sciences VC

By *Rene Letourneau, Editor*

NEW YORK – Venture capital (VC) funding in the life sciences sector, which includes the biotechnology and medical device industries, decreased 39 percent in dollars and 22 percent in number of deals in Q2 2012 compared with Q2 2011, according to PricewatershouseCoopers' recent MoneyTree report. Many industry analysts think this downward trend is likely to continue.

The report, which is based on data from Thomson Reuters, reveals that venture capitalists invested a total of $1.4 billion in Q2 2012, the lowest level since the fourth quarter of 2010. Deal volume was also down, dropping 6 percent from Q1 to 174 deals.

During the second quarter, biotechnology and medical devices each accounted for 10 percent of total funding. In comparison, during Q1 2012, biotechnology captured 14 percent of investment in the sector and medical devices accounted for 12 percent of the total.

Biotechnology investing decreased by 17 percent in both dollars and deals compared to the prior quarter, with $697 million going into 90 deals in Q2 2012. Medical device investments remained flat in dollars quarter-over-quarter while the number of deals increased 11 percent during the same time period.

"The long time horizon often required for a liquidity event, regulatory challenges and large amount of capital often needed to fund life science companies likely contributed to this sector's investment decline during the past four quarters," said Tracy T. Lefteroff, global managing partner of the venture capital practice at PwC US, in a press release.

Industry analysts largely expect the downward trend to continue.

"There are multiple segments of the life sciences industry, and these segments have experienced varying levels of venture capital activity," said James W. Childs, Jr, chair of emerging growth companies team and co-chairman of life sciences industry team at law firm Bradley Arant Boult Cummings LLP. "Expectations are that the regulatory pathway for many life sciences companies will continue to become less clear, longer and more costly. Also, the timeframe and path to liquidity are much less certain. This is due in part to the uncertainty of macro-economic conditions such as M&A and IPO markets and in part due to strategic buyers/partners desiring greater clinical data and less risk as a condition to an acquisition or investment."

Jonathan D. Kipp, vice-chair of emerging growth companies team at Bradley Arant Boult Cummings LLP believes venture capitalists are looking for investments that involve less risk.

"It is anticipated that less federal grant funding will be available in the future to provide a source of non-dilutive capital to life science companies. The general trend in the venture capital industry is a continued movement down-stream to companies that are later in clinical trials to decrease investment risk," he said.

Steven M. Monroe, managing editor at Norwalk, Conn.-based healthcare M&A data publisher Irving Levin Associates agrees that risk aversion is playing a part in the decreased investment volume.

"I believe the main factor for the decrease is because the risk/reward of successfully bringing new drug candidates to market, as well as the limited exit strategies available to the investors since the IPO market has not been too welcoming in recent years, to say the least," he said. "It may continue because there is going to be nothing but pricing pressure in the future as payers want to keep health costs down."

There are a number of factors contributing to the current investment climate, said Chad A. Grange, shareholder in Salt Lake City, Utah-based law firm Kirton McConkie.

"Clearly there has been a downward trend over the last several years. There are myriad factors at play, and it's difficult to definitively say which one has had the biggest impact," he said. "To start, there is enough uncertainty in the broader U.S. and global economy that different and more questions are being asked by investors than were asked ten or even five years ago. There is also a fear held by both the entrepreneurs and the investors that the government (i.e., the FDA) will be picking the winners and losers, which has had a bit of a chilling effect on investment dollars. From my vantage point, only the better life sciences ideas are getting the financing these days."

Despite the challenges, Grange said he feels optimistic about the future of life sciences VC investments.

"Stars in the sector will continue to shine and attract deserved attention and investment capital," he said. "Acknowledging the very real headwinds, I bet on entrepreneurs finding a way to power-through and prove that biotech can regain some of its stability and attractiveness in the marketplace. Less capital chasing fewer companies, with more disciplined and investors, offer a combination that bodes well for attractive returns from early stage biotech investing."

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