

From the Boardroom

Unlocking the funding challenge

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ABSTRACT

Canada plays a significant role in the global advancement of scientific discoveries and their translation into commercial opportunities, but is viewed as not fully realizing its commercial potential. A significant problem has been a lack of sufficient venture capital to take early-stage companies to the next level. Several recent developments may signal the arrival of a more positive venture-funding environment for life sciences and health technology enterprises, including the development of the Canadian government's C\$400 million Venture Capital Action Plan; pharmaceutical companies electing to establish or investing in venture funds and providing strategic support to early-stage ventures, including through the creation of research centres; and recent successful liquidity events for venture investors.

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THE CHALLENGE

CANADA HAS A wide variety of participants from the life sciences and health technology sector, including drug and medical device manufacturers and distributors and internationally top-ranked researchers, universities and teaching hospitals. In several regions the industry operates on a scale comparable to other large-scale bioclusters. However, the majority of early-stage ventures are privately owned small and medium-sized enterprises, with 50 per cent having fewer than 20 employees. These ventures face the challenge of seeking to advance complex innovations that on average take 10 to 15 years and hundreds of millions of dollars to develop. While Canada plays a significant role in the global advancement of scientific discoveries and their translation into commercial opportunities, it is not fully realizing its commercial potential. Among the problems is a lack of sufficient venture capital to take early-stage companies to the next level.

Concerned that Canada was lagging behind other countries in business R&D spending, commercialization of new products and services, productivity and growth, in 2010 the federal government commissioned the “Jenkins Report,” an independent study of innovation in Canada. The report concluded, among other things, that a history of poor returns has contributed to a lack of venture capital to fund emerging life sciences and health technology firms. It also found that although Canada tends to have adequate funding from government, not-for-profit and angel investors at the very early stages of ventures, beyond the initial few million dollars invested, companies were struggling to find additional capital.

History has played a role in the funding challenge. The enthusiasm for venture investing between the mid-1990s and the early 2000s brought a five-fold increase of capital into the venture space. As often happens when supply exceeds demand, poor investment decisions resulted in poor overall financial performance for funds and made investors far more conservative regarding future investments. These factors coupled with the recent economic downturn have made it difficult to attract venture capital to the life sciences and health technology sector during the past decade.

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WHAT THE FUTURE HOLDS

CAPITAL AVAILABILITY THROUGH THE FEDERAL GOVERNMENT'S VENTURE CAPITAL ACTION PLAN

Several recent developments may signal the arrival of a more positive venture-funding environment for life sciences and health technology enterprises.

Following the Jenkins Report, the federal government committed to supporting Canada's venture capital industry. In January of 2013, after extensive consultations with key stakeholders to determine how best to support a sustainable, private sector-led venture capital industry, the federal government announced its Venture Capital Action Plan. The plan calls for the investment of C\$400 million of government funds over seven to 10 years. The funds will be used to:

- Establish new, large, private-sector-led funds of funds in partnership with institutional and corporate investors
- Recapitalize existing large private-sector-led funds of funds
- Invest directly into existing high-performing venture capital funds

It is anticipated that these investments will attract nearly C\$1 billion in new private-sector investments. The life sciences and health technology sector is already feeling the effects of this commitment.

In September 2013, the following government-funded venture funding commitments were announced:

- BDC Venture Capital, the venture capital arm of the Business Development Bank of Canada, announced that it allocated an additional C\$135 million to the BDC Venture Capital Health Care Fund to be used for direct venture investments into innovative health-care technology products and services, doubling its financial commitment to the fund.
- BDC Venture Capital and Fonds de solidarité FTQ announced a C\$35 million commitment to Sanderling Ventures, an investment firm with a 35-year track record of building new biomedical companies. Consequently, Sanderling is well on its way to achieving its US\$250 million target for its Sanderling Ventures Fund VII and has agreed to create a permanent facility in Montréal to facilitate the development of early-stage life sciences investments.

- BDC Venture Capital announced its commitment to invest C\$35 million in two Canadian life sciences venture funds, C\$15 million going into the CTI Life Sciences Fund II and C\$10 million going into the Lumira Fund II.

CAPITAL PROVIDED BY THE PHARMA INDUSTRY

Another growing source of venture funding and other forms of support for early-stage life sciences and health technology companies is the pharmaceutical industry. Many pharmaceutical companies have significantly reduced their internal R&D programs and farmed out the risk of drug development to start-up companies. However, faced with expiring patents on a number of significant drugs and fewer blockbuster drugs coming to market, the pharmaceutical industry's need for new products remains critical. Consequently, pharmaceutical companies have a significant interest in the success of early-stage drug companies and are taking various steps to identify and partner with or invest in strategic early-stage companies.

One tactic adopted by a number of pharmaceutical companies is establishing or investing in life sciences venture funds. For example, in 2011, GlaxoSmithKline established the C\$50 million GSK Canada Life Sciences Innovation Fund. In 2012, Merck Canada committed C\$35 million to the Merck Lumira Biosciences Fund and C\$5 million to Lumira Capital II LP, and Eli Lilly joined Teralys Capital and others in investing in the C\$150 million TVM Life Science Ventures VII fund. Each of these funds has a mandate to invest in early-stage life sciences companies.

Another approach has been to provide early-stage ventures with strategic support, including through the creation of research centres. In 2012, AstraZeneca and Pfizer Canada Inc. partnered with the Province of Quebec to create the NEOMED Institute, a life sciences research institute that acts as a bridge between academic research and the private sector. The NEOMED Institute was established with a commitment by its founders to invest C\$100 million over five years. In early 2013, MaRS Innovation announced a strategic partnership with Pfizer Inc. to advance early-stage technologies. Through this collaboration, MaRS and Pfizer will identify investment opportunities to which Pfizer will provide funding over a three-year period. In late 2013, MaRS and Pfizer announced the first project to receive financial support under the collaboration. Also in late 2013, Johnson & Johnson Innovation and its Janssen unit announced collaborations with both the NEOMED Institute and MaRS Innovation.

IMPROVING LIQUIDITY OPPORTUNITIES

Liquidity events for venture investors typically come in the form of a sale of shares in an initial public offering or through the sale of the business to a strategic investor. For a number of years, there seemed to be little opportunity for life sciences companies to undertake an initial public offering (IPO) or alternative “going public” event (such as acquisition by a publicly traded capital pool company or a reverse take-over). In 2013, the eleven “going public” events for life sciences companies reported by the Toronto Stock Exchange and TSX Venture Exchange was more than double the number in the prior year. In addition, this number does not take into account Canadian companies, such as Acquinox Pharmaceuticals, that elect to pursue a U.S.-only IPO. However, it is important to recognize that, while this increase represents a significant improvement over past years, it does not match the approximately five-fold increase in the number of life sciences IPOs seen in the US in 2013.

The past year also saw significant M&A activity, including the acquisition of several significant public Canadian life sciences companies, including LifeLabs

Medical Laboratory Services’ acquisition of CML HealthCare Inc., Patheon Inc.’s going-private transaction, Endo Health’s acquisition of Paladin Labs, Emergent BioSolutions’ acquisition of Cangene Corporation and many other significant acquisitions, such as Cardiome Pharma Corp’s acquisition of Correvio LLC.

The example set by these successful liquidity events will play an important role in attracting further investment capital to Canadian life sciences and health-care technology industry participants.

CONCLUSION

While the question of how Canada can effectively and efficiently address the lack of adequate venture capital for life sciences and health technology companies is not fully answered, these developments appear to signal an improvement in funding and liquidity opportunities and the prospect of further improvements. With creativity, flexibility and a bit of luck, early-stage companies can access the investment capital required to take their projects to the next stage, and investors can find successful liquidity events.