Financing Alternatives for Biotechnology Companies: A Case Study of Seattle Genetics

Eric Dobmeier
Chief Business Officer

“Life science startups are the only companies that are forced to define their corporate strategy as a function of their financing rather than to gather financing in accordance to a previously well-defined corporate strategy”

- Steven Burrill
  Stanford Technology Venture Lecture Series
Seattle Genetics
Corporate Overview

- Biotechnology company focused on monoclonal antibody-based therapies for cancer & autoimmune diseases
- Founded in 1998
- Located in Bothell, WA – outside of Seattle
- ~180 employees
- Publicly traded (Nasdaq: SGEN)
- ~$700 million market capitalization

SGEN Product Pipeline

<table>
<thead>
<tr>
<th>Lead Agent</th>
<th>Preclinical</th>
<th>Phase I</th>
<th>Phase II</th>
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<tbody>
<tr>
<td>SGN-40</td>
<td>Non-Hodgkin’s lymphoma</td>
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<tr>
<td></td>
<td>Multiple myeloma</td>
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<td></td>
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<tr>
<td></td>
<td>Chronic lymphocytic leukemia</td>
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<tr>
<td>SGN-33</td>
<td>AML, MDS</td>
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<tr>
<td>SGN-30</td>
<td>Anaplastic large cell lymphoma (ALCL)</td>
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<tr>
<td></td>
<td>Hodgkin’s disease</td>
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<tr>
<td>SGN-35</td>
<td>HD, CD30+ hemat. malig.</td>
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<tr>
<td>SGN-70</td>
<td>CD70+ hemat. malig.</td>
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Global collaboration with Genentech
National Cancer Institute
Traditional Biotech Financing Sources

Stage

- Venture Capital
- Grants
- Angels
- Strategic Alliances
- IPO
- PIPEs
- Follow-On Public Offerings
- Convertible Debt


SGEN Funding Sources

- $37M: Private Equity
- $188M: Public Equity
- $64M: Technology Licensing
- $66M: Product Partnering
- $355M: Other capital sources include:
  - Government grants
  - Employee stock option exercises
  - Interest

Other capital sources include:
- $37M
- $188M
- $64M
- $66M
- $355M

$ in millions


YTD

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Speaker 5: Eric L. Dobmeier of Seattle Genetics, Inc.
Government Grants

- Grants can provide modest amounts of capital usually for early-stage biotechs
- U.S. Small Business Administration (SBA) recently reinterpreted SBIR grant eligibility
  - SBA rules have always required grantees to have <500 employees and be at least 51% U.S.-owned
  - New interpretation requires at least 51% ownership by U.S. individuals
    - Excludes venture capital funds, institutional investors, etc.
  - Effectively prevents most venture-backed and public biotechs from receiving SBIR grants
- BIO is working with Congress to introduce changes to 15 U.S.C. 638 to alleviate this issue

Equity Financings

“No biotechnology company ever went out of business due to dilution”
--Attributed to many
1998 Angel Financing

- SGEN spun-out of Bristol-Myers Squibb in 1998
  - Many biotechs start as “science projects”
  - But SGEN had several clinical-stage programs and substantial IP and technology assets when it was founded
- First financing ($1 million) from angel investor
  - $500K-$1M can be hardest capital to find
    - Too small for most VCs and too large for most angels
    - Most angel financing is for less than $500K
- “Chicken and egg” problem
- Angels tend to invest locally and be relatively passive (compared to VCs)

1998-1999 Venture Capital Financings

- Series A—$7 Million led by OVP Venture Partners, Sofinnova Venture Partners and Suez Ventures
- Series B—$30 million led by Bank of America Ventures, Cascade Investments (Bill Gates) and Vulcan Ventures (Paul Allen)
  - All Series A investors also re-upped
  - Genentech participated too (part of partnering deal)
- Typical venture capital deal structure
  - Reps and warranties
  - Preferred stock with liquidation preference, anti-dilution protection and voting provisions
  - Board representation
  - Registration rights
  - Right of first offer
### Venture Capital Financing: Pros and Cons

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<th>Pros</th>
<th>Cons</th>
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<tr>
<td>Can invest substantial $'s over several rounds of financing</td>
<td>High cost of capital (dilution) due to strong valuation pressure</td>
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<td>Can provide validation and industry connections</td>
<td>Usually comes with lots of “bells and whistles”</td>
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<td>Can provide strategic depth and add rigor to decision-making</td>
<td>Take substantial time to manage</td>
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<td>Often lack operational experience</td>
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<td>Primarily financially (often short-term) motivated</td>
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<td>IRR demands exit strategy</td>
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<td>&gt; Pressure to go public or do M&amp;A to create liquidity</td>
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### 2001 Initial Public Offering

- Raised $53 million in March 2001 led by JP Morgan, B of A and CIBC
- Offering took place after the “bubble” burst
  - Very few biotechs went public in 2001
  - Offering range adjusted downwards from $11-$13 to $8-$10; priced at $7
- Simultaneous investments by strategic partners
  - Genentech bought $2 million as part of IPO
    - Helpful for marketing efforts
  - Medarex bought $2 million in a private placement
    - Integration issues (new Regulation D release in August 2007)
## Going Public: Pros and Cons

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<tr>
<th>Pros</th>
<th>Cons</th>
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<tbody>
<tr>
<td>Access to public markets enables larger and more efficient fund-raising strategies</td>
<td>Significant valuation pressure for early-stage IPOs</td>
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<td>Creates liquidity for investors and employees</td>
<td>Compliance with SEC regulations, including Sarbanes-Oxley, is expensive and time-consuming</td>
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<td>Increases public awareness</td>
<td>Managing disclosures is challenging and can have competitive ramifications</td>
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<td>Stock price volatility can be difficult to manage</td>
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<td>Low volume and limited public float often hamper liquidity</td>
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<td>Interacting with investors, analysts and bankers takes a lot of time away from running the business</td>
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## 2003 Private Investment in Public Equity (PIPE) Financing

- Raised $40 million led by JP Morgan Partners and Baker Bros. Investors
- Public company sells unregistered stock generally at 7-10% discount
  - Subject to securities law restrictions on resale
- Considerations
  - Pre-set price with no market risk
    - Still risk of market disclosure
  - Often comes with control provisions, registration rights, etc.
  - Generally smaller $ size than marketed follow-ons
  - Nasdaq shareholder approval requirements
2004 Marketed Follow-On Financing

- Raised $62 million led by B of A, CIBC and WR Hambrecht
- Considerations
  - Enables large capital raise
  - Often effective at raising investor awareness, diversifying investor base and increasing public float
  - Multiple banks can participate
    - Rewards covering analysts
  - Offering document and roadshow take significant management time
  - Company bears market risk while on the road
    - Average file-to-offer price decline of 5-15%

2004 Marketed Follow-On Stock Performance

*Start of roadshow ($10.66)*

*Pricing ($8.25)*
2006 “Bought Deal”

- Raised $43 million through B of A and CIBC
- Also known as a “block trade” or “overnight deal”
- Banks buy stock directly from the company at a discount (usually 5-10%) and then resell directly to investors (often within 24 hours)
- Considerations
  - Requires effective S-3
    - New SEC rules on well-known seasoned issuers (WKSIs) simplify this for companies with >$700M non-affiliate market capitalization
  - No management roadshow or offering document
  - Little company control or input into which investors participate
  - Doesn’t increase public float or diversify investor base as much as a marketed deal
  - Banks bear market risk, but resale may still have negative impact on share price

Strategic Alliances

A Biotech-pharma deal is like “a dance between an elephant and a flea”

--Ed Saltzman, President of Defined Health

“In biotech, partnering is such sweet sorrow”

--Daniel Levine, SF Business Times
SGN-40 Genentech Collaboration

Genentech provides:
- $60M upfront
- >$800M in milestones
- $20M of milestones committed in first 2 years
- Pays all costs of R&D, manufacturing and commercialization
- Will pay increasing double-digit royalties starting in the mid-teens

Seattle Genetics
- Exclusive worldwide license agreement
- Phase II compound
- Option to co-promote in U.S.

Genentech
- Leader in antibody therapies for cancer
- Strong hematology franchise
- Commercial infrastructure

Financial Impact of Product Partnering

NPV to Licensor ($ in millions)

Unpartnered = Mean NPV Given Failure
Co-dev Deal = Mean NPV Overall
Out-license = Mean NPV Given Success

-200 0 200 400 600 800 1000
**ADC Technology Deals**

- ADC licensees
  - More than $60 million generated
  - Future revenue streams from milestones and royalties

- 50:50 co-development agreements:

**Typical Licensing Deal Structure**

- Deal signed
- GLP tox
- IND
- Ph. I
- Ph. II
- Ph. III
- Approval
- Commercialization
- Clinical Trials
- Development milestones
- Sales milestones
- Royalties
- Fees: R&D support
  - Material supply
  - Annual maintenance
- Upfront payment
- R&D
- Upstream lag
- Clinical Trials
- Commercialization
Strategic Alliances: Pros and Cons

<table>
<thead>
<tr>
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<th>Cons</th>
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<tbody>
<tr>
<td>Generates near-term cash flow and longer-term milestones and royalties to offset internal R&amp;D costs</td>
<td>Licensor relinquishes some amount of long-term value potential</td>
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<td>Supplements internal resources for clinical trials, manufacturing and commercialization</td>
<td>Partnering deals may reduce or eliminate M&amp;A possibilities</td>
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<td>Non-dilutive financing alternative</td>
<td>Supporting collaborations can distract internal teams from focusing on proprietary programs</td>
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<tr>
<td>May increase overall chance of success</td>
<td>Majority of alliances fail</td>
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<tr>
<td>Provides validation</td>
<td>Termination of an alliance by a partner can taint a product or technology</td>
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Roads Not Taken by SGEN

- Venture Philanthropy
- Venture Debt
- Exotic Financing Alternatives
  - Special purpose entities (SPEs)
  - Off-balance sheet joint ventures, SPARCS, SWORDS and RDLPs largely eliminated after Enron
  - Royalty deal
  - Symphony Capital
- Convertible Debt
- M&A