

Raising Money in the Development Stage

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Is there another way to raise money for a development stage life science company? If so, is it a worthwhile option?

Here is a case in point:

In late 2004, I joined Somanta Limited, a London-based development stage oncology company founded by a CEO who is both a medical oncologist and a serial entrepreneur. Somanta had a portfolio of very promising cancer drug candidates including one with significant human clinical data. Somanta had in-licensed the right to these drug candidates from U.S. and UK academic organizations, and they appeared significantly better than existing cancer therapeutics.

One challenge was deciding whether to pursue venture capital financing to fund the long and expensive path to FDA approval. Heading out on the road to see many of the premier life science focused venture funds, we realized our timing was not great. Time and again we found that a development stage company fit poorly with the venture capitalists' portfolios. Many VC's were investing their 2000 and 2001 vintage funds. These venture funds did not have successful liquidity exits of companies in which they had invested and a poor IPO and partnering market had pushed valuation and returns to a cyclical low.

Since early 2005 only thirty four life sciences IPOs had come to market and nearly 50 percent of these were currently trading below their IPO price. It seemed like many VC's were keeping their uncommitted funds to support their existing portfolio companies. To add to the challenge, there are only about forty life science-focused venture firms in the U.S. who can lead a financing that will provide a company with a total investment of \$50 million to \$75 million required to get each new drug candidate to FDA approval.

The VC's passed on our company while praising Somanta's diversified portfolio of drug candidates, the experience and expertise of the management team, and our "low cost" virtual company approach. Venture capitalists, to be sure, offer great advantages to a company. Not only are they a valuable "smart money" endorser of a company's technology, they bring valuable introduction to other investors, management and board members, strategic partners, and collaborators. They also provide valuable tactical advice during the formative period in a company's development.

Next we began evaluating other options, two in particular. First was a listing and public fundraising on the AIM (Alternative Investment Market of the London Stock Exchange) . Second was a reverse merge with a U.S. publicly listed company and a related PIPE (private investment in a public equity) fundraising.

The AIM market holds some appeal, but the United Kingdom-based advisers we consulted with indicated that for biotechnology companies the investment dollars and liquidity were still centered on the American Stock Exchange and NASDAQ. An AIM listing typically provides publicly traded stock with lower regulatory and public-company costs than a U.S. listing. Currently, the AIM market is dominated by mining and Internet gambling stocks and has a relatively thin liquidity. My prediction is that the AIM will have a broader place in companies' fundraising strategies in the coming years.

Next we explored a "reverse merger" with a publicly listed company (reporting to the SEC) since Somanta did not have the maturity to do an "underwritten" initial public offering where the threshold for going public is a target market capitalization of a \$300 million. Our homework unveiled that approximately thirty life sciences companies had successfully completed reverse mergers and fundraising since early 2005.

Based on the review, we found the following "pros" and "cons" for pursuing a reverse merger:

Pros

- Access to capital on reasonable valuation and terms.
- Breadth of the investor base with over 250 institutional investors including VC's, healthcare and institutional investors, and high net worth individuals.
- Increased visibility to potential drug development partners.
- Greater visibility to inventors with drug development candidates who are looking for a licensing partner (nearly one new opportunity per month).
- Common stock as a currency to make acquisitions.

Cons

- Limited visibility and no initial analyst coverage for a new "Over the Counter Bulletin Board" company.
- The costs of being a public company including Sarbanes-Oxley compliance.
- Not a "liquidity" event for current investors, only an initial institutional fundraising.
- The discomfort of becoming a company under public scrutiny.

In August 2005, we merged Somanta Limited with a private U.S. company, which provided some cash and another drug candidate with significant human clinical data. In September 2005, we signed a merger agreement with a public shell company with no operating or stock trading history with 700 stockholders.

Through investor presentations over the next three months, we attracted eight healthcare institutional investors who invested \$5.8 million in January 2006. We considered this to be a great start.

While significant management time is spent on increasing investor and analyst awareness of the company and raising a second round of funding, the reverse merger is beginning to show us a path to future success.

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