The Art and Science of Forming a Syndicate

Nextech Insights

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Forming a syndicate to finance an oncology company can be a complicated task with far-reaching consequences for the company and its investors. In this article we would like to elaborate on the key aspects of a successful syndicate and share lessons learned based on Nextech's experience.

The investor universe in oncology is multifaceted and consists of investors with different strategies each playing a distinct role in the market. As highlighted in Figure 1, different entities are active at the various development stages of a company, ranging from seed investors and early stage Venture Capital firms to late stage investors that finance mezzanine or pre-IPO rounds. In this article we would like to focus on classical Venture Capital (VC) and Private Equity funds as they typically participate in most of the financing rounds and are regarded as "qualified investors" for private oncology companies.

At each stage of a startup different skill sets are required from the investors. An investor that is specialized in the initial launch of companies needs strong operational skills, as well as an extensive network of entrepreneurs, scientists, and academic centers. On the other end of the spectrum are late stage investors that have to possess expertise in clinical development, company governance, regulatory and commercial capabilities. The specific expertise and "value added" of each syndicate partner should be carefully considered to align interests within the syndicate in the beginning. Any lack of alignment can create tensions and considerable obstacles for good governance, negatively impacting the future of the company. To avoid misalignment, deep knowledge of the syndicate partners, their overall strategy, reputation, and incentive structures is essential. The most common reasons for misalignment in a syndicate are caused by a different understanding of the corporate strategy, exit scenarios, and anticipated investment period. It is crucial to avoid situations, in which the investors are not aligned before forming a syndicate. Such situations will create distractions, legal costs, and tensions in the board that can harm the company.

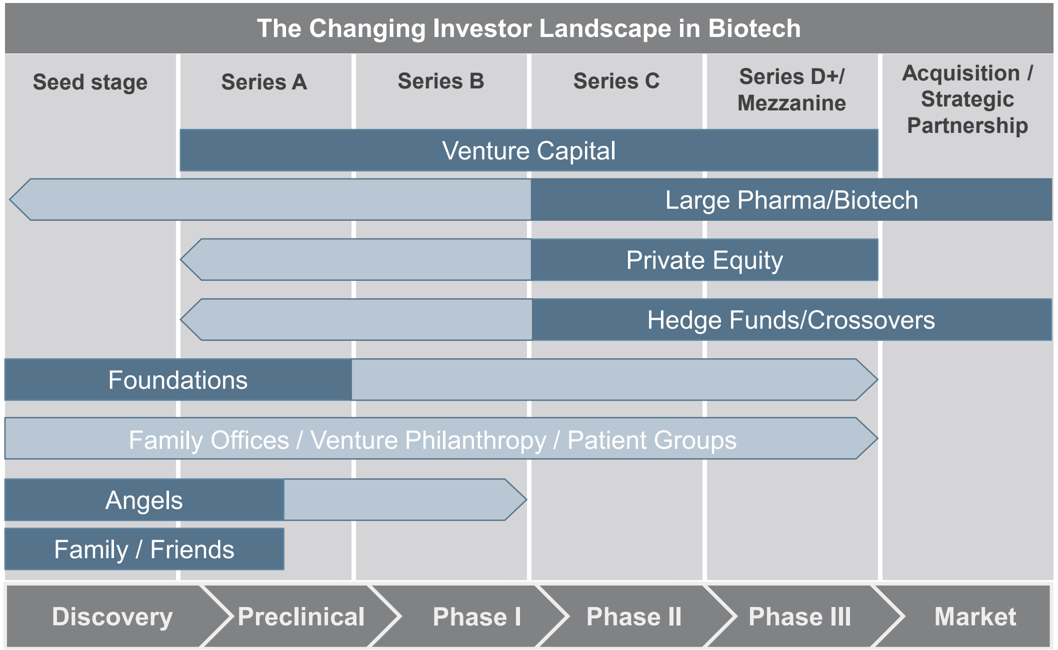

Figure 1: Changes in the investor landscape in Biotech.
Adapted from: Ford and Nelson, Nature Biotechnology, 2013

In addition to the above mentioned issues, we put high emphasis on understanding the added value of each investor to the company overall, its scientific expertise, financial strength, overall integrity, and network with the key opinion leaders. Over the last 10 years of investing in oncology companies we have worked with over thirty different investors. In our last four investments we have formed or participated in the syndicates highlighted in Figure 2. Each consisted of early and late stage VCs, crossover investors, scientific experts and generalists.

While we had the pleasure to work with excellent syndication partners, we would like to share our experience of scenarios that have been difficult.

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> *Financially weak syndicate*: While the success of a Biotech company is largely driven by the science, and we are self-sufficient in our assessment in this regard, the financial strength of each investor in the syndicate may profoundly affect the value creation in the company as it impacts the negotiation position towards potential buyers, partners, and new investors as well as new employees. The art is to ensure the highest level of capital efficiency.

Figure 2: The investor syndicates of the four most recent investments of Nextech Invest.

> *Exit scenario*: If investors have divergent views on the exit strategy, may it be concerning the valuation or timing; the majority of votes typically dictate strategy. We have experienced such situations, for instance, where a new investor had the vision to build the company over the next ten years into a fully integrated Biotech company contrary to our position to exit within approximately three years. We avoided this potential long term conflict by selling our stake to new investors and thus were able to secure attractive returns for the fund in line with our target holding period and expected return.

Besides these examples we would also like to offer our thoughts on the key criteria to building a successful syndicate as well as which pitfalls to avoid:

> *Size*: As a basic rule one should try to keep the syndicate as small as possible but as large as necessary to have the financial power the company requires. Especially in the start-up phase, it is beneficial to have no more than two investors as speed is highly important. For a later stage company, with 20+ employees, the requirements change and a broadly balanced board becomes important.

> *Vision*: A syndicate should consist of like-minded investors that have similar holding period objectives and return expectations for the investment. They should have the same vision for the company: from anything between building a next Genentech to selling a single asset company as fast as possible.

> *Balance*: Avoid a syndicate that is dominated by one investor unless you have extensive experience working with this party. In a balanced syndicate no single investor should own more than 30% of the company.

> *Independence*: Involve experienced, independent experts early in the company and try to avoid building a board that is driven by investors only.

> *Secure key ingredients of success*: Maximize financial strength as well as scientific expertise and network with key opinion leaders in the syndicate to strengthen the negotiation position and increase the quality of scientific rigor and guidance in the company.

> *Network*: Group investors that have complementary networks in the industry; 60% of deals or acquisitions are based on an existing relationships.

> *Track Record*: Successful science-driven investors will increase the attractiveness of the company towards other investors and potential buyers.

In conclusion, forming a syndicate can be a complex matter. From our experience we have learned that taking into account a few key points: scientific expertise, alignment of interests, and financial strength will substantially increase the chances of success.

Thilo Schroeder joined Nextech Invest in 2012. He serves as observer on the Board of Directors of Peloton Therapeutics and ImaginAB and previously held positions on the board of directors of Blueprint Medicines and as observer of the board with Tracon Pharmaceuticals.

Prior to joining Nextech Invest Thilo Schroeder has gained in-depth experience in protein engineering and biotechnology. He holds a PhD in biochemistry of the University of Zurich, Switzerland, specializing in the development of Designed Ankyrin Repeat Protein (DARPins) as specific protein inhibitors. Thilo Schroeder was president of SiROP, a web based technology which connects leading universities in Europe and world-wide.