THE MARKETECH GROUP MINUTE

INTERVIEW

The Near Future of Venture Capital Funding

Interview with Pete Bernardoni

Interviewer: John Walter, TMTG

JW: We heard that earlier this year, some VCs returned funds to their institutional investors. What is the current situation?

PB: Most of the attention over the last two years focused on web-companies and IT. That investment frenzy mirrored biotech of the late 80's, with similar outcomes. VCs with exposure in the dot-com area are re-trenching. Some returned funds to their institutional investors. The pace of raising funds for the IT arena remains low.

The good news is that more money is being invested in life science companies and funds are being raised to support additional investments. I do not keep track of the dollar volume invested, but the overall trend is higher. One reason: life science firms received little funding during the dot-com frenzy. Many of the larger firms discontinued investing in life sciences, forcing their partners into becoming dot-com investors. The short-term return was too high to ignore. Today, that trend has reversed—money is starting to flow into life science companies.

JW: Within Life Sciences, where are the funds going?

PB: Approximately 75% of the funds are being directed to biotech companies. In this area, investors favor companies developing a platform technology over those developing a specific application. [That philosophy lowers the risk to investors. Selecting one application requires choosing the righ technology, its use, and the ultimate target market.]

For example, companies that develop new drug discovery approaches might identify an efficacious drug faster. Many different pharmaceutical companies could use such a platform.

JW: What triggered the HIPAA regulation, which is fairly new? Enacted, I guess, in 1997.

PB: What triggered HIPAA was the sudden use of the Internet. Until the Internet, the physician was the custodian of patient private information, but with the development of networks and the Internet, the physicians' ability to control patient information was no longer possible or doable. So, there were concerns, and consumers asked for some form of protection to circumvent or prevent the injuries that would be caused to them as far as privacy protection.

JW: What is happening to the remaining 25% of funds invested?

PB: Funds are supporting a myriad of medical device and IT companies. These companies, though, are lagging behind biotech companies in receiving additional investment. Late round financing is taking longer to occur.

JW: Is there any common theme among the non-biotech companies that are getting funding?

PB: There is not enough money is available to define a common theme. They are reviewed on a case-by-case basis.

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JW: You did not invest heavily in the dot-com companies. Why?

PB: We knew that things had to change. We could not get ourselves to make investment decisions quickly. We have a lengthy process. We would just be starting the process when the company would be fully funded.

We also knew that life sciences would not go way. Baby boomers are driving healthcare investment. During the dot-com craze, investing in life science companies was extremely attractive. There was no competition for the funds.

JW: We've heard that the pendulum has swung to strongly favor VCs. Deals are investor friendly and term sheets are tougher. Good projects receive funding but it takes longer. Is that perspective accurate?

PB: In the broad IT sector, that's certainly true. Step-up financing is very difficult. In most cases, valuations are flat or decreasing in additional rounds.

Life Science companies experienced a financing retrenchment during the Dot-com era. These companies are now finding financial options better than two years ago and better than other sectors.

JW: Have VCs returned to focusing on business fundamentals? Where and when will investment pick-up again?

PB: Clearly, there has been a shift in what's considered interesting. Performance counts! VCs now look more for demonstrated revenue and near term profitability. We are not looking for revolutionary technology. We avoid technology 'stories', that promise a solution but carry high risk. Investment banks are also emphasizing the bottom line. Top-line [revenue] is important but not to the exclusion of a reasonable forecast for profitability. In these regards, the VC community is returning to fundamentals.

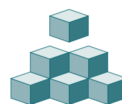
When will it pick up? We are probably close to bottoming out. There is certainly no near term 'segment of frenzy', as was the case with biotech or dot-com.

JW: We have seen few initial public offerings in the life science arena during 2001. What is the near term future of such 'exit' strategies?

PB: A couple of companies have completed their IPO. Several others have had strong secondary rounds. A half dozen biotech companies are in IPO registration. A few companies that we invested in during 2000 are now looking at their exit strategy. Acquisition offers are being reviewed.

JW: Is the difference between VCs and Angels decreasing?

PB: During the dot-com frenzy, the differences were decreasing. There were numerous single investors who had the personal finances to take major positions in companies, just like a VC. Some Angel organizations, like Tenex in the Bay Area, were highly organized and had group due diligence on new companies. The dot-com collapse has likely re-established these entities as separate, meeting the needs of companies at their different stages.



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