



Life Sciences Outlook for 2014

Talk by

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Before talking about what's going to happen this year in life sciences from a Wall Street viewpoint I think it would be helpful to look back first. Some perspective on recent history can make it a lot easier to see where we are going next.

I mean this globally, but also here in the Texas life sciences community.

So, I gave talks at this conference in 2011 and in 2012 and talked about the capital markets and business models that we like.

I should mention that if you have a lot of spare time on your hands, get bored or can't sleep tonight you can to our firm's website

(www.torreya.com) and download a copy of my 2012 talk in the publications section. It has some tables and figures that illustrate some of the points that I will revisit today.

In 2011 I talked about how to make money in an environment where private financing was tight and gave examples of Texas companies that were doing things right. One was ZS Pharma from Fort Worth which had a good idea, used ETF money to get through Phase 1 and was otherwise very capital efficient. Another example was Mission Pharmacal from San Antonio which had built up a great business at the intersection of the nutritional and pharmaceutical industries.

In my talk in 2012 I talked more about where the market as a whole is going. I noted that the IPO market was going to get a lot better – which it has.

And I also noted that the M&A market would be increasingly active but mainly driven by tax-advantaged consolidators such as Jazz and Valeant. That's also turned out largely to be true. The Actavis/Forest deal this week is just the latest example of this consolidation trend.

I also talked about the longer term outlook and noted that growing global wealth and longer lifespans are good news for healthcare spending overall. As consumers live longer and can afford to meet their basic needs more money ends up getting spent on healthcare.

The companies that will benefit most from this trend are those with meaningful medical innovations or that address the unmet needs of an ever older population. Talks by many of you today and discussions at tomorrow's Xconomy conference will help to illustrate some of these important and, in some cases, just amazing innovations.

After I was done with my talks on previous visits, I started walking around the conference and meeting people.

I couldn't help but notice that there was also a lot of excitement about Texas as a place to do business. I saw a lot of interesting companies here in 2011 / 2012. Most very small.

Some have done quite well. Names that come to mind are Apocell, Bellicum, Castle Biosciences, Corrinova and Vapogenix.

Now, it's 2014. What's happened in the last three years and where are we going?

First of all, Texas has happened. In the life sciences, that is. There was no press release. Or story in the newspapers.

Let me illustrate what I mean...

ZS is close to commercialization and deeply indebted to the ETF. This quiet company now has a value well over \$500 million. A big IPO likely with Alta and Rivervest as investors. This deal has generated good buzz on Wall Street. a company that last year

Mission Pharmacal is also still quiet. But, they have doubled in size in just three years. They are now one of the largest private independent specialty pharmaceutical companies in the United States.

Mission has joined the ranks of major life science players that are headquartered in or have come from Texas such as Adams Respiratory, Alcon, Apollo Endosurgery, Arthrocare, Cyberonics, Healthpoint, KCI, Kimberly-Clark. Lexicon and U.S. Oncology.

And, what about the smaller companies?

Most of the companies that I met here have *not* been able to raise venture money. At least meaningful amounts. But they have been able to tap high net worth dollars and pick up state monies in a number of different flavors.

An example would be Vapogenix. A small team with a very good idea – stabilize anesthetics into topicals for the treatment of pain. Now, they are in the clinic and likely to be a big company.

I have personally been very struck by the entrepreneurialism, brainpower and humility of the life sciences leaders that I have met here in Texas. It's a different breed than you'll meet in Cambridge. Or the Bay Area. Low buzz, humble self-driven leaders that have learned to survive outside of a well-developed bio ecosystem.

Now, much to the delight of greedy airline executives I travel too much. I might be in Frankfurt next week and Malaysia the next. I've been at the "all you can eat buffet" of the world's biohubs in recent years. Usually about three months after Mary Tanner or Ed Saltzman has figured out that some place is cool.

So, what I can tell you is that I have not seen a place in the world that has developed their life sciences ecosystem as quickly as Texas has in just three years. In my view, Texas *has* happened in the life sciences.

Credit is well deserved by the people of this State, the leaders of this State and the astute, although sometimes foolhardy, high net worth investors of this State that have made this happen.

So, ok, What is the outlook from Wall Street going forward?

There are a few things we are paying close attention to at Torreya Partners:

One relates to the JOBS Act capital market reforms – which have more than a little to do with the fact that last year was the second hottest life sciences IPO market on record.

In particular, I would encourage you to go the website for the SEC (sec.gov).

You will note two rulemakings listed right on their front page. One on crowdfunding. One on Regulation A reform.

I think crowdfunding is going to be interesting and applaud the groups that are building out platforms in this area including Healthios and Poliwogg.

But Reg A reform is even more interesting. Essentially, private placements of companies with two years of audited financials can become tradeable and get on the exchanges. For about a quarter the cost of doing an IPO. This is a major change that is hitting us in just 90 days and has received little attention. Take a look at the website for WR Hambrecht (www.wrhambrecht.com) to find a good explanation of what is going on with Reg A.

The second place we are paying close attention to is the Fed.

We are in an overall economic environment of cheap money driven by the Fed's response to the Global Financial Crisis. This environment is not going to change soon. In particular, the Fed is replaying something like "Operating Twist" from the 1950s and early 60s where it tried to

flatten the yield curve (and did so for 20 years). The result then was that the long-term cost of money in the U.S. is incredibly low.

The same is true today. Because no one can make money by investing in long-term riskless bonds today, money is flowing fast into riskier asset classes.

But, there just aren't that many good risky asset classes to put money into out there.

We happen to be sitting in the middle of one of them. The life sciences industry is full of scientific ideas that deserve capital. And, right now, that capital is flowing. Into everything from devices, sequencing equipment and personalized medicine.

This is why we think that strong equity markets for good life sciences companies are going to be with us for a long time.

I hasten to add that despite a Ph.D. in Economics I can't tell you that whether the IPO market is going to improve or worsen next week. I also can't tell you where biotech stocks are going tomorrow.

But I think I *can* tell you that we think the IPO market is going to grow for quite awhile and that access to capital for good companies (private or public) is going to improve for some time to come. The M&A market is going to be more than robust. And, of course, we will see ups and downs in the capital markets this year. What some politely call "volatility".

But, overall, our firm's outlook is very positive. We think the growth in the Texas life sciences community in the last three years will continue and may accelerate. Wall Street and the overall global economy will

support this. If you're working on a great idea in the life sciences, this is the time to make something happen. And you couldn't ask for a better place to do it. Right here in Texas.

Thank you.