

## Q3/2010 Life Science Sector Review

“Nothing shocks me – I’m a scientist.”

–*Indiana Jones*

While the markets’ performance in the third quarter may have not been shocking, it is likely that even Indy himself would have called it quite surprising. Despite the tepid nature of the economic recovery and a general consensus among economists that the tough slough is likely to persist for some time, the broader indices rallied sharply, the Dow’s 8% advance in September its best since 1939 – following a sharp retreat in the second quarter. Yet while questions remain as to whether there is real underlying support for the improvement or whether we are to experience a near term microburst, given what we have come through, we will take it (for at least a brief moment).

The biotech and med device sectors also turned in strong third quarter performances. This strength was reflected in the performance of the NBI, the index gaining 11.9% for the quarter, ending at 895.33. Importantly, though, it appears that the gains in large part simply made up for ground lost during an overly pessimistic second quarter. The NBI still remains well below its March high of 963.38. Market sentiment did allow three new issues to price, with Trius Therapeutics, NuPathe and Electromed completing IPOs. Evidence perhaps of extremely fractious investors, issues coming public the entire year have priced below the range indicated on the reds – often well below. Third quarter IPOs have been no exception. NuPathe priced at \$10.00 per share, down from an indicated range of \$14.00 to \$16.00 and Trius came public at \$5.00 per share, down from an indicated range of \$12.00 to \$14.00. We understand that in both cases, top-tier institutional investors bought into these deals, but only at levels where they perceived the downside risk palatable - in other words, next to none. (Ironically, these issues have traded lower post IPO).

Overshadowing the med tech sector continues to be the FDA’s saber-rattling related to possible changes to the current 510(k) approval process, including the introduction of a new 2(b) device category which would require extensive clinical testing prior to approval. The comment period ended just after the end of the third quarter with industry weighing in quite forcefully that while certain adjustments to the system may be warranted, the current 510(k) process has proven effective and efficient for an extended period. Moreover, any radical overhaul would only create additional regulatory and financial burden with the net effect being dampened enthusiasm to pursue innovation – and finance its development. We believe the FDA will respond over the next quarter or so.

Regardless, private venture financings displayed continued strength relative to the year prior period, with third quarter performance reflecting the strength seen in the second in terms of both number of deals completed and dollars raised. Year-to-date, deal volume is up 14.6% and dollars raised is up 24.1% over a decidedly weak 2009. Tracking the issues getting public, biopharmaceutical deals predominated, accounting

for two-thirds of the financings. The remainder was fairly evenly divided between the diagnostic and device sectors.

M&A activity also mirrored the second quarter's strength and is likely to remain a core theme both for the sector and the broader market. Clearly, all eyes this quarter were focused on the Genzyme saga and Sanofi's \$18.5 billion quest for the beleaguered company – first indirectly through rumor and suggestion and now through the public market going directly to Genzyme shareholders. While strengthening aging product portfolios continues to be a primary driver of these larger deals, earnings growth through consolidation and rationalization is also a likely motivation. Wringing out costs was yesterday's growth driver. Other billion dollar deals announced during the quarter included Endo Pharmaceutical's \$1.2 billion bid for QualiTest and Johnson & Johnson's \$2.3 billion offer for Crucell. Overall, the number of announced deals increased 65% over the third quarter of 2009 and year-to-date is up 50% over the same period last year. Dollar volume increased 21% to \$11.0 billion for the quarter, even after removing the Genzyme deal from the equation.

What remains to be seen is if we are in for a dose of shock therapy.

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*Johnston Blakely & Company, LLC is a Boston-based investment bank offering private equity placement and merger & acquisition-related financial advisory services exclusively to companies in the life science sector. The firm incorporates the venture capital tradition of comprehensive company involvement into investment banking engagements to deliver superior results for its clients. Member FINRA/SIPC.*

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