

Q4/2007 Life Science Sector Review

"When you come to a fork in the road, take it."

- Yogi Berra

At least at the outset, the fourth quarter of 2007 seemed to prove a continuation of the market rebound that had started at the end of the third quarter. With both broader market indices as well as sector-specific indicators reaching new highs in the quarter, it appeared as though the markets - perhaps guardedly - had come to terms with the turbulence in the real-estate sector and the ensuing tightening of credit. And the numbers seem to reflect this sentiment.

The equity markets witnessed the debut of 68 new issues. While down somewhat from the number of go-public events in the year-prior period, remarkably - especially given the third-quarter market tumult - the fourth quarter IPO performance was the strongest of the year and marked a nearly 80% improvement over the third quarter. Perhaps it is the Santa Claus factor, but in three of the past four years, the fourth quarter has proven the most robust.

Activity in the life science sector followed suite. After dropping to an anemic three new issues in the third quarter, activity rebounded in the fourth quarter with 10 new issues coming to market. For the year, 30 new life science issues came to market, 14.5% of all IPO activity, the best performance in absolute numbers and as a percent of total new issues since 2004, when 43 life science issues came public or 19.3% of all 2004 new issues.

Interestingly, the strength of the public market rebound was not matched in the private markets. While the number of venture-backed life science deals completed in the fourth quarter was respectable, the dollars raised, \$1.14 billion, was down nearly 50% from the first quarter highs. And while the \$5.2 billion in full-year venture funding represented a 32% increase over the previous year's tally, notable was the contrast between first half and second half activity with venture funding for life science deals dropping over 33% in the second half - this despite a strong public market.

As it has for all but a few quarters more recently, M&A activity seemingly continues to be the more prominent driver of the sector. The fourth quarter witnessed a 21% jump in number of announced life science transactions from the third quarter and a 33% increase over the year-prior period. More notable, in terms of number of deals, the fourth quarter was not only the most active quarter for 2007 but also - according to our analysis - *the most active quarter in at least the past sixteen*. M&A activity for 2007 also reached record levels and reflected the third consecutive year of double-digit increases in deal numbers. While impossible to escape altogether, we believe broader market influences have had only limited impact. Instead, we see this trend as suggestive of profound structural changes to the industry just over the horizon and believe a convergence of influences - scientific and technological advances

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coupled with the weakened economic position of the US globally together with ever escalating health care costs - will prompt this change in the near-term.

Given the continued weakness in the dollar, not surprisingly foreign buyers continue to jump in with two feet (as is the case in many industry sectors) - Of the seven billion-dollar-plus transactions last quarter, six involved foreign acquirors - GSK's \$1.7 billion deal for Reliant; Reckitt Benckiser's \$2.3 billion acquisition of Adam's Respiratory; Eisai's \$3.9 billion acquisition of MGI Pharma; Philips \$5.1 billion bid for Respiroics; Siemens \$7 billion of Dade Behring and AstraZeneca's \$15.6 billion takeover of MedImmune. Celgene's \$2.9 billion bid for Pharmion represented the only instance of a domestic buyer in one of these billion-dollar acquisitions. We see this as a trend which is likely to persist for some time - foreign companies stepping in to purchase US life science companies for bargain basement prices relative to their currencies (which ultimately may hold dire consequences for this country's ability to maintain its leadership position).

Compounding difficulties - 2008 is a presidential election year. And if the current political winds prevail with the Democrats potentially poised to retake the oval office, big pharma and biotech will likely be in for a challenging time in the markets not only this year but next. Perhaps more attractive will be the non-pharma sectors, in particular the medical device and molecular diagnostic sectors. Opportunity may also be found in the pharma services sector as the outsourcing of non-core activities gain greater permanence.

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