Speaker Notes: C-Suite Networking Dinner (04.24.19)

Bay Area Healthtech & Bioscience Leaders

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Ed Albini, CFO at Sutro Biopharma, on IPOs

Background

- Has performed 2 ½ IPOs – Sutro Biopharma, Novacea, and a major public round at Lynx Therapeutics (considers it half an IPO)
- Lynx Therapeutics (genomic analysis):
    - Considers this a "half IPO" as they had a major public financing round and achieved higher-level Nasdaq listing.
- Novacea (oncology):
    - Company focused on in-licensing, developing, and commercializing therapies for the treatment of cancer; product failed in phase 3.
    - Went public in 2006, reverse merger in 2009.
- Sutro Biopharma (oncology):
    - Next generation cancer and autoimmune therapeutics
    - Current CFO for past 6 years. IPO in September 2018

IPO--- Finance/Accounting "Beware" Areas

- Cap Table & Stock Administration:
    - Especially important if you've had multiple private rounds of financing, particularly with any preferred-to common conversion price adjustments stemming from "down rounds."
    - Make sure your stock administration person (in most cases, a paralegal at your external corporate counsel while private) is ultra-meticulous and ultra-responsive.
    - While it sounds redundant, not a bad idea to also track cap table internally for cross-checking and for "dilution impact" modeling for existing major investors/Board members.
- Independence Review by Auditors:
    - Build the length (and $) of such into any IPO initial filing timing and be adaptable.
        - Examples:
            - *Audit partner cautioned about aggressive IPO timeline, mentioning the estimated length of the independence review (which then could take up to 45 days) at significant cost, given tight timeline: Mid-Dec 2005 start*

to mid-Feb 2006 initial S-1 filing date (stale date for Q3 2005 financials in initial S-1 filing).

- *Went from a private co. (90+% of the way thru being acquired) to a public company 5 months later. (Company was nearing a merger and had consolidated org. charts with the other company, but deal fell through late in the process and Board/Management decided that going public was next best move.)*

- Complex Accounting Issues:
  - Work with your auditors as extensively as possible while a private company.
  - Accounting for collaboration arrangements can be tricky (particularly with upfront payments). Spend time with auditors and run through these potential complex areas early on. Stock-based compensation is also an area of focus of the SEC and can pose issues in the filing process, so you need to pay attention to this early on as well.
  - Find an established external consulting firm to assist your team with particularly significant accounting matters.
    - Ideally, some external group with which your auditors have a favorable impression based on prior work or knowledge.
- "Reverse Stock Over-Split":
  - Understand clearly from the bankers and equity capital market people their pricing & valuation estimates.
  - When a company is trending towards a particular IPO price per share, and employees are paying close attention to 409A common stock FMV per share, you need to be able to explain the effect of a stock split so that they don't have unrealistic valuation expectations for their equity holdings.
  - Overall, you should have an internal communication plan to educate your Company on the Reverse Stock Split.
- Strong Team---Build It Before:
  - Don't scrimp -- hire a top-quality controller!
  - As a CFO who always wants to be the initial "author" on the S-1 Business section, make sure you assign key sections to others.
  - Additionally, you should always be comfortable using external expertise, particularly when your internal staff have limited bandwidth and may not be able to tackle additional IPO responsibilities.
  - "CFO's can come from any background."
    - From External (Wall Street) Banker or Analyst to Internal Accounting/Finance
- #1 Key Piece of Advice:
  - "Always have a rising stock price – things are easier when the price only goes up"

<u>Jason Throne, Former GC at NeoTract, on Acquisitions</u>

Background:

- 5 years at Cooley Godward
- 11 years at Thoratec as Assoc. GC:
    - Public company
    - About 1 acquisition every 18 to 24 months
        - Tried to buy main competitor but got blocked for antitrust reasons.
        - Sold major subsidiary (diagnostics division). Had buyer walk between sign and close; sold for 50% discount within months.
        - Extremely successful sale to St. Jude in 2015 - ~40% premium.
- GC at NeoTract:
    - Private company going public. NeoTract filed confidential S-1 within weeks of Jason joining, but were dual-tracking and Teleflex came in.
    - Very successful sale to Teleflex:
        - $1.1B potential
        - >10x trailing 12 months revenue
        - ~1/3 of purchase price in earnouts

Leverage/Negotiating/Timing

- <u>Leverage - Inherent vs. Created</u>:
    - Leverage -- "the ability to get your position or way" -- can be inherent or created, but there is always a need to stay disciplined. Remember: leverage determines everything.
        - Stick to what you care about, and you can create leverage:
            - *In Thoratec's acquisition by St. Jude, it might seem as if Thoratec would not have much leverage due to relative size of St. Jude. But Thoratec stayed disciplined and stuck to what was important to them, so they could maintain negotiating leverage. Ultimately, Thoratec stayed disciplined in their own economics and understood their worth. They made sure the purchase agreement had protective provisions, especially for Thoratec employees.*
        - Inherent – high performer and optionality (ability to go a different route)
            - *In the NeoTract acquisition by Teleflex, the revenue growth and optionality of being able to go public was the negotiating leverage.*
    - Willingness to Walk Away Over What You Care About
        - Be careful of bluffing too early or too often
    - Don't negotiate points 1 by 1 or let other side go over the deal team's head
        - The deal team (internal and external lawyers/business development) will work to get the best deal possible. Make sure that deal team is included in all discussions – don't let the other party go over the deal team's head to try to get individual point concessions (playing on an

executive's desire to seem in control). Do not concede to anything as a CFO/CEO without consulting the deal team.

- Timing creates pressure and leverage
  - Think hard about imposing timing pressure – can give away leverage

Deal Structure

- Align structure with interests:
  - E.g. earn outs based on milestones that buyer has every interest in achieving
    - *In NeoTract deal, Teleflex has every interest in achieving the revenue growth on which the earnouts are based.*
  - No incentive to come up just short and not pay
- If milestones, spend time on them and post-closing covenants to drive behavior toward success:
  - Understand what drives the success of the acquired business and then protect through post-closing covenants.
    - *In NeoTract deal, ensured compensation of sales force wouldn't be cut and no other products could be added to their bag (so as to avoid distraction).*
- Pick the right partner, especially if earn-outs:
  - All buyers say same thing ("why would we ruin a good thing", "we're buying the people, not just the technology", "we expect to learn from you").
  - But look at past track record; and how does acquired business fit in structure and mission of acquirer.
  - Important even if public deal – future success of product and impact on retained employees.

Compliance Matters

- Marketing, customer/doctor interactions, regulatory, reimbursement education and policies, FCPA, privacy
- Start-ups are risky; mature acquirers aren't
- Buyer views that they are buying liability and integration challenges
- Think about revenue projections (and effect on earnouts):
  - If based on aggressive programs, what happens if acquirer dials back those programs?
- Effect of compliance issues:
  - Transaction slow down, affect purchase price, change leverage, increase escrow/indemnification survival, deal structure (asset instead of stock)

Anti-Trust

- Careful what you say, what you model – educate team early:
  - If considering deal with a large enough company, get attorneys in early to advise team on good practices for internal documentation. The regulatory agencies will review everything during antitrust review, including emails, so there is the potential for documents to be taken out of context and used against the deal.

Other

- Avoid leaks and guessing by employees:
    - Distraction -- you want to control message
        - *The company will need employees to continue to move business forward. People notice suits in the office (e.g. due diligence meetings) and internal gossip could be hurtful to business initiatives and morale.*
- Earnouts – executive team may need to stay for a while to achieve
- Prepare for diligence early:
    - The deal will happen fast, and management will need to produce the right documents in a timely manner.
- Get compensation/benefits counsel early:
    - Executive severance benefits are important – any changes to bring up to market will need to be done before the LOI is signed.
    - 280G issues need to be considered and factored into timing
- Keep employee equity value expectations grounded:
    - They don't understand the IPO reverse split
    - They'll think management sold out in acquisition

Justin Kao, Co-Founder at Helix, on Partnerships

Background

- Prior roles: Vice President in Healthcare Group at Warburg Pincus, Healthcare and Tech Team at Boston Consulting Group, Corporate Development at Onyx Pharmaceuticals (played a key role in the acquisition of Proteolix).
- Co-founded Helix, a personal genomics platform company creating an ecosystem where people can explore diverse and personalized applications powered by DNA insights. Leads all Business Development and Partnerships for Helix.

Partnerships

- Helix is focused on long-term partnerships - this can be different for different businesses. Be very mindful of what kind of partnerships you form and the importance to the business.
- Critical to determine whether partnerships are strategic or ancillary to the business. It's ok if they are ancillary, but then acknowledge (internally) that they are for optionality, not core.
    - Set goals and priorities for your relationships with partners.
    - Define what that partnership means for the company and set realistic expectations.
- If partnerships are core to the company strategy, then to be successful they can't be ancillary -- Helix has a dedicated team for this.
    - To build an internal partnership team, it takes focus and leadership.
    - Align personnel with partners - separate business development team from partnership management team as different skillsets and priorities. Make sure to hire teams that are incentivized with partner success metrics. Difficult to support partnerships with

core/internal teams as there will always be a push and pull of work the partner requires vs. company roadmap.

- There will be natural tension between partner-facing teams and internal teams: recognize and acknowledge this tension.

- Upfront: Think about values and business alignment.
  - Example: Helix's successful partnerships with Renown Health, the Mayo Clinic.
    - *CEO of Renown put his reputation on the line to make sure Renown forged the right partnership with Helix. Personal relationship between the executives at the two companies. Best partnerships are where management can be candid with the other side, including with mishaps. Trust is everything, and that trust can ascribe value to your business as well.*
    - *Mayo Clinic: Helix was small/early stage when the partnership was first formed. Helix wasn't looking for investment, but Mayo Clinic had felt strongly about product, trusted the team, and wanted to invest. Mayo also believed each person is entitled to own their own data. This was a culturally good fit and worked out for both parties.*
- Avoid a partnership if it's a novelty or doesn't matter to both sides.
  - Partnerships fail when reduced to a "shiny object."
    - *Helix has learned to assess why a partner wants to work with them and whether DNA is important to drive part of their business strategy. New technologies can easily be reduced to "wanting to seem innovative" or a press release that is splashy, rather than a long-term business driver. Partnerships have not worked when Helix invested time and energy to give the company what was the equivalent of a "gold star" (the product was not of intrinsic importance to that partner).*
  - Realistic and attainable goals are key.
    - *Dig upfront to understand what the KPIs are for your partner, and what will make the partnership a success from their standpoint. Example: Helix decided not to form a partnership where the partner's team was compensated and incentivized based on a Gross Margin target. The corporate gross margin target was not set in a place where the DNA product realistically had any chance of hitting it based on the physical costs of processing DNA, which would have set up the partnership on shaky footing. Helix and the partner had a candid discussion and that preserved the relationship even though both sides decided not to move forward.*
- Don't do free pilots: if the partner won't pay, they don't care about you.
  - How to compete? Others offer free pilots!
    - *Helix has seen competitors that offer free pilots to try to win business. However, there's usually a catch - in this case, the company performing for free wanted to own all of the data in order to monetize it. Helix showed the partner that Helix's*

business model was more aligned, because they monetize their product when they deliver value to patients/researchers (aligned), rather than trying to seek ownership of the partner's data outright. The partner decided that they wanted to be affiliated with a company like Helix that is aligned strategically, even if that meant paying for services upfront.

- Culture and relationship matter, as does trust.
    - If too good to be true, it usually is. Ask what the partner's business objective is and keep asking until you understand it.
    - Be transparent about what your objectives are. Quotas? Revenue? Data? What is your business model? If you don't truly understand what partner wants, it’s hard to trust.