Interview with Allan Marchington, Partner, Apposite Capital LLP

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Apposite Capital LLP

As a partner at Apposite since the company was created in 2006, what was the founding vision of the company and what do you consider have been its major milestones in the last five years?

Apposite was conceived as a new venture capital (VC)/ Private equity (PE) fund that would address healthcare, primarily in the UK but also globally, investing in opportunities in two specific sectors: healthcare services and life sciences. For the healthcare services, we saw a trend in the UK of private healthcare becoming more important given the state of the public healthcare system and the issues that bog it down. Having seen the experiences from the US and other parts of the world, our idea was take the best ideas and care models from other markets and implement them here in the UK. In the life sciences, we saw new opportunities for drugs and companies that already had some investment but needed further invigoration. There were also some great ideas coming out of local universities and spin-out companies that should be financed and nurtured. The healthcare services part of our fund provides lower risk yet still a high potential for returns. Ultimately those investments balance out the higher risk biotech ventures, and therefore we try to diversify our investment portfolio evenly split amongst both sectors.

Given my background of having started and run a biotech company that was later successfully sold, I have been through the full cycle that small biotech companies experience, which has led me to understand what elements are needed for such companies to be successful. Bringing this experience as a venture capitalist, who has been on the other side of the table and knows what it is like to run a company, was another added asset that we wanted Apposite to have. There are not many VC funds in the UK or Europe that have that level of operational understanding, so we saw a real opportunity.

Is Apposite Capital then positioning itself as a differentiated VC fund with a different mindset towards biotech investments?

Yes, thatâ??s the idea. The way we would like to position ourselves is as an investor that has â??been there, seen it, done itâ?•, and one who knows what it feels like to be the CEO of a small biotech company. We try to be understanding of the challenges that these companies face, as well as committed to adding value and leveraging our strong connections with Asia to foster business opportunities, while always keeping in mind how to obtain the highest returns for our limited partners (LP).

What do you consider to be the added value of investing in the biotech sector when there are so many other interesting investment opportunities out there?

To begin with, healthcare and life sciences are recession-proof markets. Although it may sound callous, no matter what happens with the economy people will continue to get ill and older. The demographics will always be in favour of maintaining a thriving life science industry. This is in contrast to say the commodities markets that are in constant fluctuation.

For me personally, and this was also what motivated me when I used to be a pharmaceutical researcher, knowing that we can make a difference in peopleâ??s lives through our investments is also a reason to be involved in these sectors. This is an industry in which you can invest in something and grow a business that will improve provision of care, discover new medicines, diagnostics and devices that will forever impact the lives of people and families. The way I see it, by investing in life sciences you are getting a double â??bang for your buckâ?•, with high economic returns on one side and the added societal value on the other.

As a company, Apposite believes that management excellence makes the difference between success and failure. How exactly do you judge the level of management in a company?

The truth is that we prefer to invest in a company that has A-level management with B-rate technology over another that has B-level management and A-rate technology. If the opportunity to change the management in the latter is possible, then we might consider that as well. Another important element for us is to be the lead investor in the company where we can perform the due-diligence, truly understand the business and take a seat on the board. This also allows us to make decisions on all the key business aspects and to have an open dialogue with management. Ultimately, an element of trust between us and the management of the company is needed, and this is one of the deciding factors for us to invest or not. For example, a management that is able to highlight the risks of their technology is always a lot more credible than one who only sells us the potential success. Our job as a VC is to figure out what the risks in an investment are and how to mitigate those.

What exactly is the timeframe the Apposite looks to stay behind an investment and is there always a predefined exit strategy?

Most VC funds are closed-ended which means that they have a defined time period to make investments and then to generate returns by exiting those investments. Within the time period of the fund we aim to exit our investments in order to hand back the money that was provided by our LPs. The essence of being a fund manager involves thinking about how the companies we invest in will perform within an established time period and how much they can exit for at the end of that period.

There are really only two options for a companyâ??s exit; the first one being a trade sale to a corporate organisation be it a pharmaceutical or larger biotech company, and the second is an IPO. When valuing a company to estimate returns, we will either look at all the individual components of their operations, such as the products they have and how much those could eventually be sold for, or you look at comparable companies on the public market. Considering that most European biotechs are undervalued, the IPO option is generally the least attractive because it means limited returns when you look at the historical data of similar IPOs. At the end of the day it is very tough for us to decide which companies to invest in, and this is illustrated by the fact that we only invest in 1% of the proposals that we review.

Some of our investments are indeed longer-term, for example when you have a company with very-early stage technology that will require 5-7 years to reach an exit point. Those types of investments are done in the earliest stages of the fund and as the fund matures then you invest in late-stage opportunities. We also try to diversify our life science investments across different kinds of opportunities, including technology platforms, biologics and small molecules, amongst others. Our predictions on exit strategies are also based on exchanges we have with thought leaders in the industry who provide us with their opinion on where the industry is headed and what it will look like 5 years down the line.

While you invest in many sectors of the life sciences in several parts of the world, Apposite has a biotech and European focus. In this context how would you characterize the biotech sector in the UK?

The UK market is differentiated by the number of pharmaceutical companies that are based here, not only commercially, but more importantly through research operations. This has been a major driver of the successes we have seen come out of the UK. When you couple this with some of the worldâ??s leading universities with great science and entrepreneurial initiatives, as well as easy access to capital and capital markets, you end up with a highly competitive market. In other countries you might have one or two of these elements, but not all of them at the same time. Usually it is the strong pharmaceutical base that is lacking, and this is major driver of research and collaboration opportunities. There are a couple other European markets that have managed to bring these elements together, such as Switzerland with Roche and Novartis, as well as France with Sanofi.

Nonetheless, the UK remains the foremost competitive European market for biotech, also because we have the advantage of language that facilitates business with the US and other countries. Overall the UK biotech industry began earlier than the rest of Europe and is therefore more mature with an increasing number of second-generation entrepreneurs. The trend in the biotech sector is that once an entrepreneur has successfully grown and sold a company, then all of those involved in that venture will go out and start a number of other new companies. This trend also generates a pool of experienced managers in the sector that have been through the ups and downs of the industry.

Given this up-and-down cycle that you mention, where do you consider the industry is today?

The biotech sector is experiencing a very difficult period right now. Capital markets are not rewarding innovation the way they should be, and this is not due to a lack of new technologies and innovation, but rather is tied to investor risk appetite and perception of limited returns linked to drug approval and market access. For this reason, early stage innovation is very hard to get funded today, so what we are seeing is a major gap between the early ground-breaking science that is worthy of funding to the point where you get a drug into the market. That time period can be longer than the typical 10-year lifespan of a VC fund making it difficult for us as investors to become involved with those companies at such an early stage while still achieving our goals on returns within a set period of time. This trend is pushing the biotech sector to rely more heavily on funding from the pharmaceutical industry, the government and charity organizations, which limits the amount of available capital.

Does this explain why the world has not seen a major biotech success story coming out of the UK comparable to some of those in the US, such as Amgen and Genentech?

There have been British companies that could have become the next Amgen, such as Cambridge Antibody Technology and Celltech, but they were eventually bought out by larger companies. Investors in Europe tend to have less patience and look for earlier returns than perhaps those in the US. Furthermore, US public companies are able to raise large amounts of capital through the PIPE investment structure, unfortunately in the UK due to the â??pre-emptionâ?? legislation of the Companies Act, new shares must be offered to existing shareholders before being offered to new investors. Consequently, it is difficult for UK companies to raise large sums of capital for late stage clinical trials. I think if the pre-emtion legislation was abolished here, then we would start to see some larger companies emerging.

Should the UK be branding and marketing is life sciences industry more effectively to attract foreign capital?

More US investors are recognizing the technology opportunities in Europe and the fact that assets are generally undervalued here. The only problem is that having operationally and logistically it can become very complicated for Americans to manage a UK biotech company simply because of the distance. Generally the UK does a good job at selling itself and the scientific opportunities it has to offer, but certainly this can still be done much better.

One of the problems we have in the UK is that we have a number of biotech hubs spread out throughout the country, such as Cambridge, Oxford, London, Dundee and Manchester and these all tend to think of themselves individually. If you think about it, the distance between Oxford, Cambridge and London is about the same as the greater Boston area biotech cluster. Nevertheless, all three of them market themselves as individual clusters when in fact they should be selling themselves as one unified UK biotech cluster. By doing it individually, it also means that they are competing against each other and wasting resources that could be much more competitive if they were pooled together.

What should we expect from the UK biotech sector in the future and what will it look like in five yearâ??s time?

In five years the market will be very different and we will see some very exciting terms. We are currently in the uptrend of the cycle and people have learned the lessons from tough times making them a lot more realistic as to what kinds of ventures will be funded and ultimately successful. The government has also understood the importance of the sector and is now placing its support behind it and beginning to fund it. We will also see entirely new models as to how companies are set up and this will involve greater partnership between the biotech sector and the pharmaceutical industry. I like to think of it as the maturation of the pharmaceutical industry, which is only about 50-60 years old today. As a whole the industry is learning to source its products and technologies in the most efficient manner while keeping up with constantly changing regulations. There is a supplier-customer model that is evolving as we have seen in other major manufacturing industries such as the automotive and aerospace industries. Pharmaceutical companies will be the ones to sell the final product while the biotech sector will serve as the suppliers of the parts. The only difference with the pharmaceutical industry is that it is very process driven while the biotech sector requires a lot more freedom and creativity to be efficient. We are only seeing the beginning of this today, but once we manage to bring those two elements together, then we will see major growth in both sectors with new medicines and devices becoming available to patients.

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