

Biomed Expert Stephen Thau: "Get Ready, the Exits are Coming Back"

For years Thau has been associated with exits and massive investments in medical technology companies. While visiting Israel, he speaks to Calcalist about the flattery that often defeats entrepreneurs, the integrity that acquires investors and where the big money is hiding in the industry

Aviva Mishmari, Calcalist magazine, June 30, 2009
(Translated from Hebrew. Posted with the permission of Calcalist)

"I think that over the coming year we will be seeing our first few public offerings. We have already seen cyclical rising and falling markets over history. It took the market two to three years to recover from the busted dot-com bubble, and then things went back to normal. In the meantime, it looks like this crisis is behaving in a similar manner."

These encouraging words were spoken by Stephen Thau, Co-Chairman of the Life Sciences Group at the international law firm of Morrison & Foerster. "The health sector is doing better than other industries," he adds. "Unlike semiconductors or cars, people don't just stop buying medicine. People will always get sick, and the population keeps getting older. Right now, the question is not whether there will be demand; it is mainly about who is going to pay – the government, the health insurance companies or the consumer. This is an intermediate phase that's troubling us now."

Thau is associated with financing transactions in the biomedical industry. At times he represents companies and at times, investors. He also advises in capital raising transactions, offerings and mergers. Morrison & Foerster represented the Israeli medical device company, MediGuide, in its \$300 million sale to St. Jude this past year. "That deal was finished quickly," Thau said, "but it doesn't always work that way. In that case, both sides wanted to work together to reach common ground."

Know Your Partner

Thau, an American Jew on his first visit to Israel, recently participated in the ILSI – 2009 BioMed Israel convention, speaking on the expert panel organized by the BIRD Foundation, which engages in forging business partnerships between Israeli and American companies. At the same time, Thau met with several Israeli start-up outfits, claiming to 'study the terrain' for investors he represents. "There are some exciting technologies in Israel, both in pharmaceuticals and in medical equipment", he said. "My impression is that as far as the scientific quality and technological sophistication go, the level here is as high as in Silicon Valley."

What do Israeli companies need to know about collaborations and transactions with large American companies?

"First, you have to decide what you want from the American company. Funding? Distribution? Access to the American company's intellectual property? It is also important to understand what the American company wants, what it is looking for in Israel. And often, the Israeli company just doesn't understand this. Think: how will your product be integrated into your partner's strategy? Is it looking for a product to sell? Is it interested in using your technology in another product? Or, does it just want to keep your product on its shelf? You have to answer these questions in order to put together a proper structure for your deal, which will maximize the value you will receive and protect your interests.

"Understanding the needs of the large company will help you define your terms. If someone is buying your product to keep it on the shelf, they'd best pay in advance. If they want to market it, the deal had better include royalties, as well as guarantees in case the product doesn't sell. If the bigger company just wants your technology, it is best to limit the usage rights to a single product, particularly if you want your

company's technology to develop a variety of products, and not be a 'one trick company' that's done when its trick is sold."

"Then, you should check to see if the details of the collaboration relates to your strategic goals. Decide which party is responsible for technical support; who is responsible for sales promotion; manufacturing and supply, which seem obvious, also require logistics and if you 'dump' those on your partner, its royalties will grow at the expense of yours."

"Before signing the agreement, you have to research the subject of intellectual property. Every potential partner weighs the feasibility of purchasing a product versus creating it themselves," Thau says, and that means that if the Israeli start-up company's patent application has not yet been filed, the American company may decide that it is better off developing a similar technology in its own labs, instead of purchasing an entire company."

"Finally, you have to be ready for changes in the plans. The strongest collaborations are built when both sides understand what will happen to their relationship if the situation changes radically, which sometimes happens. Decide together what will happen if one side's management changes and the new management wants to cancel the collaboration. Or if one of the companies is purchased by a third party. Consider as many possibilities as you can."

Have you encountered any companies with no experience in negotiations, whose deals are doomed to failure?

"It happens. If they're smart enough, they come to me for a consult," Thau jokes. "But sometimes, younger companies don't have sophistication and business experience, sometimes their management is naive, sometimes they feel complimented by the interest people have in them, think about the short term and sign too hastily. When you're an entrepreneur and your technology is being acquired, it boosts your ego, and you face short-term temptations. You have to look past that."

You meet entrepreneurs and give lectures to entrepreneurs in academia. What is bothering them today?

"Raising money, of course. It is more challenging than it used to be for companies in intermediate stages. Companies that are just starting out with a good idea can still raise money, as can companies that are close to launching a product, who enjoy available and almost risk-free cash. But companies in the middle stages find it hard to raise money. On the one hand they're very far from the market, and on the other hand development has already cost a lot, which makes them hard to purchase, and less attractive. Lately, I have been seeing this problem again and again."

What sub-areas are most attractive nowadays in the biomedical sector?

"Demographic tables show that all treatments related to aging are attractive these days, as well as anything connected to improving quality of life for the elderly. This includes large fields such as orthopedics, cardiology, ophthalmology, as well as adult medicine development."

"Besides those, the field of micro-invasive surgery, meaning incision-free surgery, is still relevant. These are surgeries that use lasers, robotics, ultrasound or catheters. Minimally invasive surgery helps reduce the cost of medical care, reduce the length of hospitalization, hasten recovery and limit complications, as well as reduce the subsequent need for medicine."

"Another field is pediatrics. In the past there have been problems with attention disorder medicine, such as Ritalin and anti-psychotic medicine. Now, as it is understood that this is a timely, big market, it is understood that we need to invest more in research in this field."

What are investors looking for right now?

"As always, they are looking for the sectors they think will get stronger in the future. It's only the bar that's been raised. They're still looking for good technology and good people, with investors sometimes searching for the people more than for the technology."

What do you mean by "good people"? Who is the ideal entrepreneur, as far as a venture capital fund is concerned?

"Someone with two or three successful companies in his or her past, but naturally, there are not many entrepreneurs like that. Someone the investors can trust to be honest and forthright, who can inform them of weak points in the business strategy and technology and can produce solutions. That's important. And of course – someone who knows the technology involved."

Venture capital investors are more careful than ever these days.

"A fitting description. These are challenging times for them due to the shortage in financing from the bodies that usually invest in these funds. Today, the venture capital world is divided into two groups. The first group is made up of funds that were lucky and raised capital in 2008. They are in a terrific position because it's a buyer's market. The second group is made up of funds that have not raised capital since 2004-2005. These have to be careful with their money, and are looking for quick exits. Some of them have started focusing on companies that will show profits over the short term, meaning companies about to market a product."

As someone who works with both sides, investors and entrepreneurs, what would you recommend to entrepreneurs just starting out in the industry?

"First of all, it is important to protect your intellectual property. Second, it is best to surround yourself with the best people you can find to help you. People who will understand the business, who know the industry and have connections. It can be a good lawyer, someone from the industry..."

Or your brother-in-law?

"It can also be your brother-in-law," Thau says and laughs. "These days, you take what you can get. But when you are putting together a deal, make sure that if the investor is 'dumb,' he shouldn't get many future rights. As a rule, it's best to set as much of this stuff in advance, and as carefully as possible."

Original publication in Hebrew: <http://www.calcalist.co.il/internet/articles/0,7340,L-3316505,00.html>