General Market Overview

PUBLIC MARKETS

The public markets started off the first quarter of 2014 strongly, with the biotech indices in particular continuing the steep valuation increases from last year boosted by a strong IPO- and follow-on financing market, and a late stage pipeline building high expectations. Then, by end of February, markets turned down over worries about the political stability in Ukraine and numbers showing slower economic growth in China – triggering sector rotation out of biotech and other volatile growth sectors like Internet and social media, and into steadier value sectors like utilities and telecom. Analysts also see that sector-specific concerns about the sustainability of drug pricing may have played a role in the downturn, as it was partly triggered by a March 20 letter to **Gilead Sciences Inc.** from lawmakers, requesting information on pricing methodology for their Hepatitis C drug.

However, despite the correction in March – the BioCentury 100 index fell 14% from February 25, 2014 through quarter end – both BC 100 and the NYSE Arca Biotech indices posted double-digit increases in Q1, and since the beginning of 2013, the BC 100 is up 75%. As a comparison, the S&P 500 and NASDAQ Composite indices only lost 2% from February 25, 2014 through quarter end, but their increases since the beginning of 2013 are 31% and 39%, respectively.

The discussion is ongoing on whether we are facing a larger correction after last years' bull-run, or if the worst time is already in the rearview mirror. Optimists believe the strong fundamentals and growth potential of the biotech sector will attract investor confidence soon again, provided macroeconomic outlook remains steady.

Index	*Q1 2014*	*YTD*
NYSE Arca Biotech	11%	11%
BC 100	10%	10%
S&P 500	1%	1%
NASDAQ	1%	1%
Dow Jones 30	-1%	-1%
BC London	-2%	-2%
FTSE 100	-2%	-2%

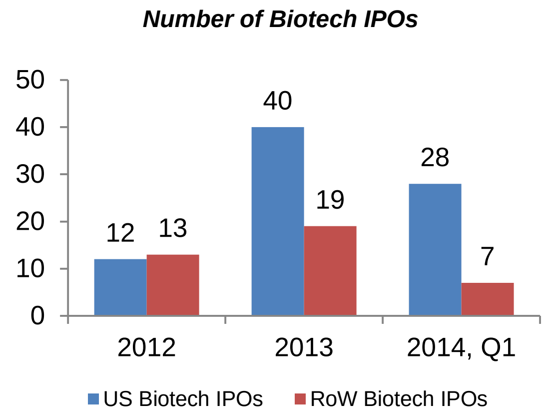
Despite a larger pullback in the biotech indices in March, both the BC 100 and NYSE Arca Biotech outperformed broader indices in Q1, 2014.

Index performance. Source: BioCentury Financial Center

IPO MARKETS

The wide open IPO window showed no signs of closing as 35 biotech went public in Q1, raising almost USD 2.6 billion. Six companies raised more than USD 100m, HealthCap VI company **Ultragenyx** was one of them, raising USD 139 million it its IPO in end of January. Ultragenyx was also the best performing stock in the market cap segment USD 500 million – USD 999 million and from its post-money valuation of USD 628 million, it increased to USD 1.47 billion, the highest market cap of all 36 companies going public in the first three months.

Also, HealthCap III and Annex Fund company **NephroGenex** completed its IPO on Nasdaq on February 10th, raising USD 37 million.



The number of completed IPOs in Q1 is already approaching the totals from the entire 2013. In Q1, most non-US IPOs were completed in Europe.

IPO financings. Source: BioCentury Financial Center.

Positive for the European IPO market is that out of the twelve European IPOs completed since January of 2013, half of them occurred in March of 2014 and the first week of April, increasing optimism about the IPO window in Europe. The GBP 200 million raised by allergy company **Circassia Pharmaceuticals plc**. in an IPO on London Stock Exchange in March was also the largest of all IPOs in Q1, and the largest European biotech IPO ever.

M&A AND DEALS

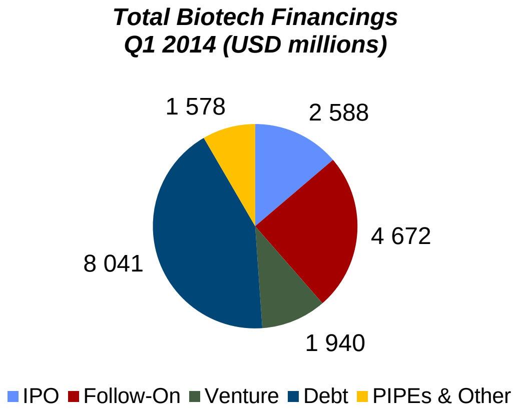
In the backwater of the hot IPO market last year, little attention was paid to the fact that the biotech M&A market posted another strong year with total upfront transaction value reaching USD 50 billion in completed deals, whereof European deal value more than doubled to USD 22 billion, compared to the year before. BioCentury data also shows that private biotech M&As reached USD 5.5 billion in deal value on upfront payments alone, even excluding the large Valeant takeover of Bausch + Lomb. That is significantly more than the USD 3.6 billion raised in IPOs.

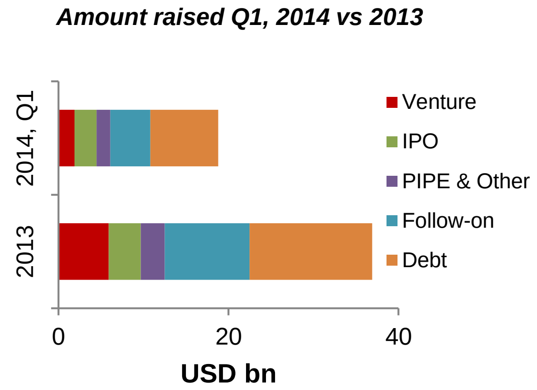
The oncology area turned out to be the most attractive following strong drug approvals. The 15 trade sales of cancer companies in 2013 generated total upfront transaction payments of USD 13 billion, up from USD 2.5 billion the year before. **Bayer Healthcare's** acquisition of HealthCap IV oncology company **Algeta ASA** was one of them, announced in 2013, but completed in 2014, for a cash consideration of USD 2.9 billion.

OTHER FINANCINGS

Not only was the IPO market strong in Q1, other financings showed confident numbers as the amount raised during the first quarter is up to half the amount raised last year in total. Taking advantage of the favorable public market, companies completing follow-on financings collectively raised almost USD 4.7 billion, led by **InterMune,** raising USD 246 million in a follow-on financing in March. HealthCap IV investment **Five Prime Therapeutics** also closed a USD 43 million public offering in February.

USD 18.8 billion was raised in the first quarter, when all financing categories reached high numbers, even though debt financing has lost some of its importance as half of the USD 8 billion came from **Gileads's** USD 4 billion senior notes financing in March, intended to be used for general corporate purposes including the fulfilment of its share repurchase program.





Biotech financings. Source: BioCentury Financial Center.

Last year, all financing classes except debt financing increased compared to 2012, and 2014 has certainly started encouraging, reaching half of last year's amount in the first quarter alone. Last year was also the tenth straight year venture financing surpassed the USD 5 billion mark, and the USD 2 billion of venture financing raised in Q1 of 2014 sets a high pace for this year.

CLINICAL PIPELINES

In the opening quarter of 2014, seven new molecular entities (NMEs) were approved by the FDA, in line with the average of 26 per year in the last decade. Last year, an impressive one-third was considered first-in-class, using a new and unique mechanism of action for treating a medical condition. Among them was Xofigo, developed by HealthCap IV company **Algeta ASA**. Inspiring for the biotech industry is that many analysts consider the pipeline of late-stage studies in biotech companies to be the most impressive in years, and as reported before, big pharma companies fill their pipeline either through in-licensing or corporate acquisitions. In a recent report, Goldman Sachs lists ten drugs that could transform the industry, and three out of four drugs originate from a different company than the company owning the rights today. Also, Deloitte research highlights that almost two-thirds of the top 12 big pharma late stage pipeline valuations stem from external innovation through licensing, acquisition of co-development, and only one-third from internal innovation (line extension and NMEs).

The steepest point in the so called patent cliff was in 2012, and the effects of lost sales to generics drove big pharma companies to lay off over 20,000 employees in 2013, but analysts consider the downturn to be temporary, as the strong, innovative, pipeline creates anticipations of staff expansions in the near future.