General Market Overview

Public Markets

The public markets of 2013 turned out to be spectacular for the biotech industry. Most indices reached new highs as the sector benefited from an increased risk-willingness of generalist investors, boosted by the record year of FDA approvals in 2012, and with biotech companies showing improved commercial execution ability with funding to back it up. At least 46 drugs developed and marketed by biotech companies are expected to have more than USD 500 million in 2013 sales, of those 26 are expected to surpass USD 1 billion, according to BioCentury analysis. Also, a respectable list of 2013 approvals are on the radar of potential future blockbusters, with Xofigo as one of them – the prostate cancer drug developed by HealthCap IV company **Algeta** approved by both the FDA and EMA in 2013. Algeta's share price closed the year at NOK 358.8, a 132% increase over the year, following an acquisition offer from partner **Bayer**, which will be described in the M&A section below.

Analysts conclude that the biotech sector has entered a new cycle relying on fundamentals – regulatory approvals, high-profile breakthrough therapies and commercial execution skills – rather than hype which was the driving force of the bull run of year 2000. Products and revenues constitute the valuation platform and will be the key for maintaining the sector's steam in the year to come.

The biotech sector's P/E ratio crossed 25 in 2013 for the first time since the financial crisis and closed the year at 25.7, up from 18.4 at the start of the year, but still far from its most recent high-water mark of 35 set in 2005.

Large cap segments has now gained for six consecutive quarters and were the top performers in the fourth quarter of 2013. The BioCentury 100 index surpassed its all-time high in the ending quarter and closed the year 59% higher than the closing price of 2012, despite a modest slowdown at the latter part of 2013 due to what investors see as a combination of profit-taking and some high-profile setbacks that has started some sector rotation of generalist investors into more defensive sectors.

Index	*Q4 2013*	*2013*	*2012*
BC London	↑ 30%	↑ 62%	↑ 15%
BC 100	↗ 7%	↑ 59%	↑ 26%
NYSE Arca Biotech	↗ 7%	↑ 51%	↑ 42%
NASDAQ	↑ 11%	↑ 38%	↑ 16%
S&P 500	↗ 10%	↑ 30%	↑ 13%
Dow Jones 30	↗ 10%	↑ 26%	↗ 7%
FTSE 100	↗ 4%	↑ 14%	↗ 6%

The S&P 500 index gained 30% in 2013, its best performance since the late 90's.
Overall, all leading indices followed up a good year in 2012 with an even stronger performance in 2013.

Index performance. Source: BioCentury Financial Center

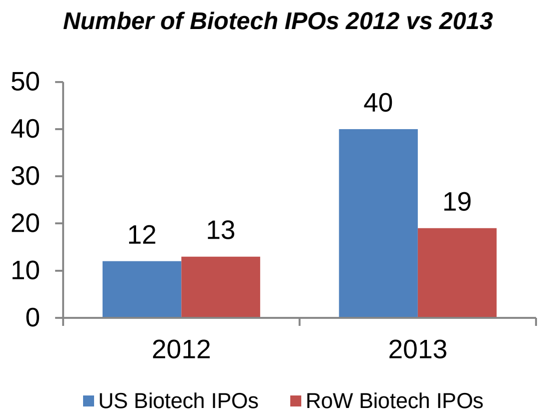
HealthCap III company **Orexo** followed up the 79% increase in 2012 by appreciating another 231% in 2013 on the back of two approvals. FDA approved Zubsolv for maintenance treatment of opioid dependence and Japanese authorities approved breakthrough pain drug Abstral from partner **Kyowa Hakko Kirin Co Ltd.**

IPO Markets

As reported earlier in 2013, the current IPO window is considered the most encouraging and robust IPO window since the turn of the century. The first companies to go out public in 2013 – there were only six of them in the first quarter – were companies with steady revenues or products ready to be commercially launched. They pushed the window wide open and the following two quarters turned out to be a hot summer with oversubscribed IPOs pricing at the top of the range, before the climate cooled down in the last quarter, where only three US companies completed their IPOs in December, at discounted prices. A total of 59 biotech raised more than USD 3.8 billion in IPOs in 2013, up from 25 in 2012, and the number of companies in line puts expectations for 2014 to end up somewhere around 40 IPOs, starting after the JP Morgan conference in January.

Two US based HealthCap portfolio companies have filed to go public early in 2014. **Ultragenyx Pharmaceutical** filed in November to raise approximately USD 86 million, and **NephroGenex**, filed in December to raise USD 46 million.

At year end, the 59 biotechs breaking IPO waters in 2013 were up a median of 39% from their initial valuations, with the six going public in the first quarter being rewarded with a median market value doubling.



Even though the IPO window opening was global in 2013, it was specifically obvious that there was a long line of good quality biotech companies waiting to go public in the US.

In 2013, HealthCap portfolio companies **PTC Therapeutics** and **Five Prime Therapeutics** completed their IPOs raising USD 125 million and USD 62 million, respectively. Five Prime priced in the middle of their pricing range, whereas PTC was able to price the offering near the high end of its projected range.

M&A and Deals

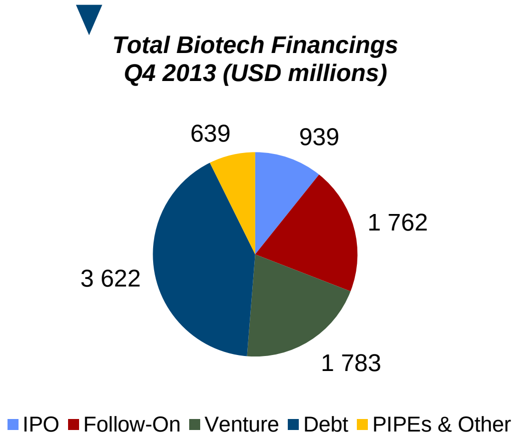
Although the M&A activity was lower in the first half of 2013 than the year before, deal volume and value in the end managed to surpass the numbers from 2012. According to BioCentury data, there were 73 completed M&A transactions in the sector in 2013. Twenty-four public biotechs were acquired for USD 33.5 billion, where two deals accounted for nearly two-thirds of the value with the USD 10.4 billion takeout of **Onyx Pharmaceuticals** by **Amgen** and the USD 9.2 billion takeout of **Elan Corporation** by **Perrigo Co**. Forty-nine private biotechs were acquired, where almost half of the value derived from the USD 8.7 billion acquisition of **Bausch + Lomb** by **Valeant Pharmaceuticals**. Total disclosed deal value summed up to USD 52 billion in 2013, compared to USD 44 billion in 2012 and the average of USD 31 billion during the time period from year 2000.

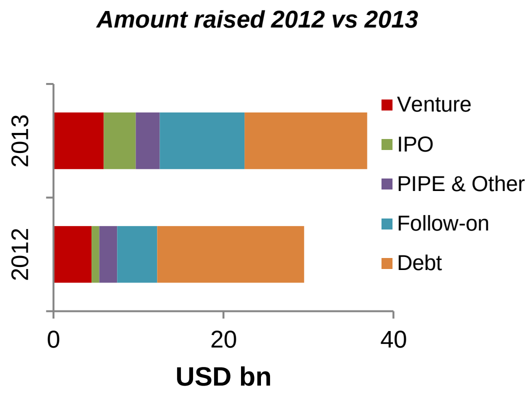
Notable deals in the last quarter of 2013 were **AstraZeneca's** USD 4.3 billion buyout of diabetes joint venture with **Bristol-Myers Squibb**, including six marketed products, and **Bayer Healthcare's** USD 2.9 billion offer to acquire HealthCap IV company **Algeta**, a 37% premium to Algeta's closing price on November 25, before Algeta disclosed it received an initial offer from Bayer. HealthCap IV, the largest shareholder with an undiluted ownership of 14%, has accepted the offer under certain conditions and the deal is expected to close during Q1 of 2014.

Other Financings

Debt financing played a less important role to the heavily debt financed market cap tiers above USD 1 billion, as the follow-on financing climate has been favorable. At year end, follow-ons were up a median of 24% from their post-money valuations, led by a 13 times increase in the valuation of **Idera Pharmaceuticals**, from its May offering of USD 16.5 million. **Valeant Pharmaceuticals** raised the largest follow-on financing since 1994 with its USD 2.3 billion raised in June.

In Q4, USD 8.7 billion was raised, less than the USD >10 billion raised in both Q2 and Q3, but more than the USD 5.8 billion raised in Q1 of 2013.





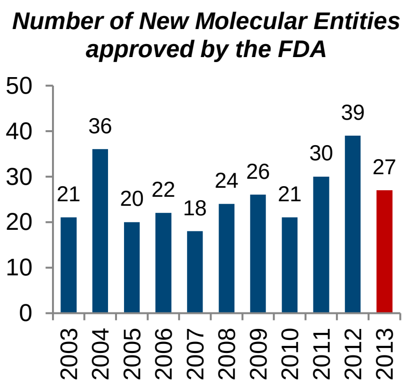
Biotech financings. Source: BioCentury Financial Center.

In 2013, a total of USD 37 billion was raised, including 14.4 billion in debt, the only financing class declining from the year before. Follow-on financings more than doubled to USD 10 billion in 139 follow-on deals and IPO financings posted a four-fold increase up to USD 3.8 billion.

Regulatory Environment

Two cancer drugs and one hepatitis C treatment were the first three drugs to be approved with the FDA's breakthrough therapy designation, granted to a total of 37 investigational therapies that may offer major advances in treatment over existing options, since the pathway was enacted by the FDA in July 2012. Out of the 27 new molecular entities approved by the FDA, 9 had orphan drug designation, in line with the share we have seen since 2011.

The FDA approved 27 new molecular entities in 2013. Lower than the 39 approved in 2012 – which was the highest since 1997 – but still a good year.



NME approvals by the FDA. Source: FDA