Life Science Leader

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Paving The Way For Future Funding

Source: Life Science Leader

By Carlos Martinez

Holding yourself to the financial standards of a public life sciences company when your venture is still private or even in the prerevenue stages might not seem like the top priority to many young companies, but looking at your business through the eyes of the Securities and Exchange Commission (SEC) can make a big difference when it comes time to go public.

Carlos Martinez

With thousands of businesses and more than $108 billion in revenue estimated last year, the life sciences industry has been enjoying a time of growth for the past several years, but economic conditions will likely cause that to slow down in the coming years, according to a study by IBISWorld. This tightening could make for a more competitive M&A landscape in the near term, and executives who have their ducks in a row will be more likely to prevail.

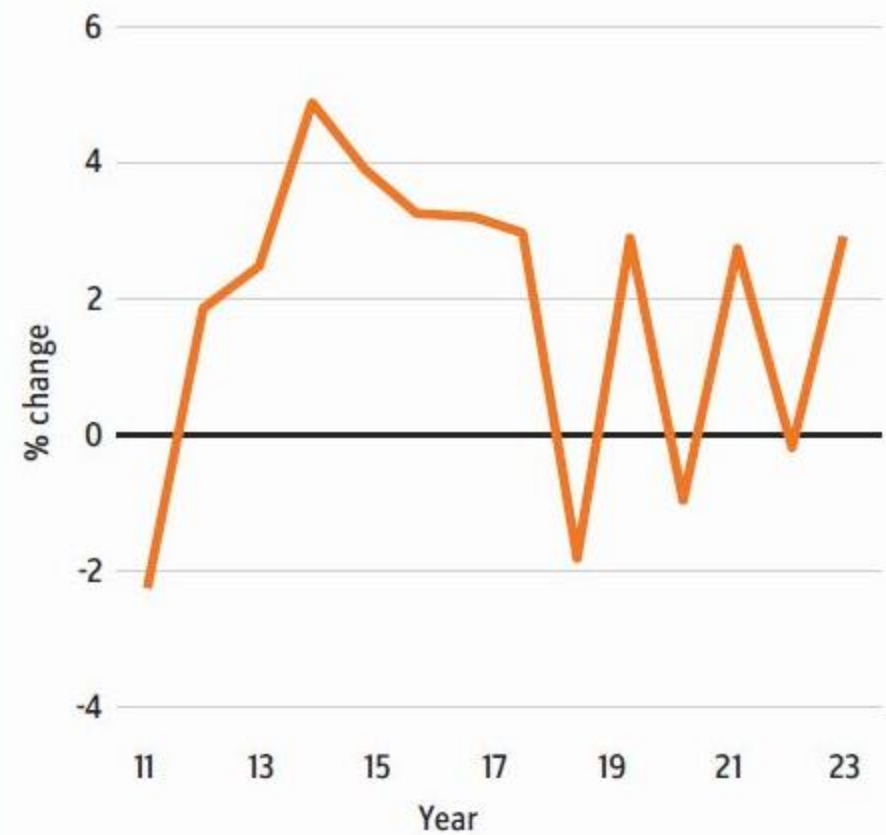
YOUR INVESTORS WILL VALUE PCAOB COMPLIANCE

With many stops along the highway to an IPO, growing a life sciences company will have continuous demands for funding just to pay for initial clinical trials. Whether that comes from a government grant, venture capital/private equity firm, or both, undertaking a commitment to PCAOB (Public Company Accounting Oversight Board) compliance will be valued by potential investors — even if they don't require that higher level of scrutiny in their own investment.

Pursuing an independent audit that upholds the standards of the PCAOB requires more documentation and financial data than the non-PCAOB audits that are popular among private companies. The less-rigorous audit may be appealing when there is so much else on a young life science entrepreneur's plate — things such as developing a viable drug or device and enduring the demands of clinical trials and gaining approval of the FDA at the end of each phase.

BIOTECHNOLOGY INDUSTRY DEFINITION:
Companies in this industry primarily use living organisms or molecular and cellular techniques to provide chemicals, food, and services that meet human needs. The industry excludes companies involved in developing small molecule pharmaceuticals, performing contract research, or manufacturing biological equipment.

RESEARCH & DEVELOPMENT EXPENDITURE



SOURCE: IBISWorld Industry Report NN001, Biotechnology in the US, May 2018

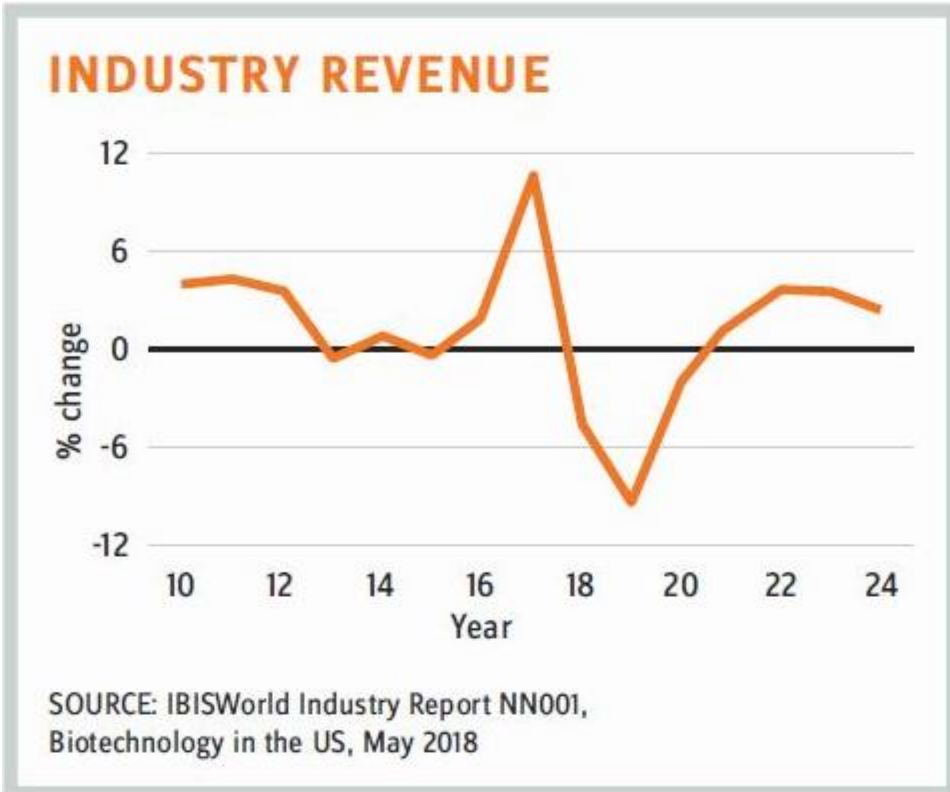
However, the sooner you solidify an advanced level of accounting and reporting systems, the happier you'll be when seeking capital. The premium lies in the trust and financial soundness of the company as well as the promise of a smoother road to an IPO, which is when early equity investors can really cash out.

WHAT YOU NEED TO BE "FINANCIALLY PREPARED"

Throughout 2018, there had been consistent chatter within the private equity community about tons of cash sitting on the sidelines, awaiting the end of the bull market. With the industry projected to slow down for the next few years, locking down a slice of that capital is going to mean getting financially prepared now — not later.

In order to look ahead, though, life science executives must first look back. Investors generally require, at a minimum, audited financial statements for the last two years. Having this documentation before the venture capital phase, in addition to being prepared both structurally and strategically, is ideal.

A company in its early stages will commit to best practices in governance by establishing a proper board of directors and creating all the appropriate sub-leadership committees, including nominating, compensation, and audit committees. All of these systems will need to be in place before filing for an IPO, but preferably much sooner than that.



Life sciences companies at all stages need a controller or CFO who knows generally accepted accounting principles (GAAP) and someone who can handle public reporting. Having that kind of expertise will help better prepare your company for the auditors, venture capital funds, underwriters, and eventually the SEC and the investing public. If you take the quick and convenient way, even if you plan for it to be temporary, it can come back to bite you.

For example, a technology startup had been planning an IPO not realizing it had met only non-PCAOB standards. Structurally, it was good to go, but the company's CPA firm was not registered with the PCAOB. The company was already getting equity offers, and its founders wanted to go public, thus they ended up having to reaudit the financial statements under PCAOB standards shortly before the launch of the road show and were unable to make the deadline they had been working on for months.

In the end, they paid a great deal for auditors who didn't get them where they wanted to be and had to find a new firm to reaudit them for the past two years under PCAOB standards. This all happened in late October, and the company was planning to go public in time for the holidays. Unfortunately, with all the rescheduling, it was well into the new year by the time they fixed all their issues and were finally able to go public.

The best strategy for early-stage life sciences companies is to act like the company you want to be — not the one you are.

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