
Strategic Value Creation: A Corporate Investor's View

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Why this topic?

In the current environment, a strong focus on Value Creation is possibly more crucial than it has ever been.

Macro-Environment

- Regulators and Third Party Payers will require more, not less; EU loophole will close.
- Massive shift in age demographic will drive up health care utilization; both an opportunity and a threat.
- Significant debt levels in the US and EU will keep pressure on government spending.

Macro-Environment

- Stock market volatility will continue for at least 2012.
- Venture funds face material challenges; there will be fewer funds and smaller funds, all under pressure for return.
- IPO market is showing some improvement but is still very limited.

Macro-Environment

- Realistically, most exits will be a private sale.
- Corporate Balance Sheets will remain strong.
- Corporate P&Ls will remain tight.
- Tax environment in the U.S. will remain unclear for at least 2 more years.

Venture Capital Picture

- Less Funds

| <u>2000</u> | <u>2010</u> |
|-------------|-------------|
| 236 | <100 |

- Declining Value in Health Care VC

| <u>2007</u> | <u>2010</u> | |
|-------------|-------------|------------------------------|
| \$16B | \$13B | (\$2.3B decline in Med Tech) |

- 20% of VC Backed Health Care Companies Achieve an Exit

| | | |
|---------------------|---------|-------|
| Mean Exit Value: | \$156MM | |
| Average Investment: | \$56MM | (2.8) |

Venture Capital Picture

- Smaller funds <\$250MM have greater returns than larger funds >\$250MM
- Fewer liquidity options
- Longer time to exits due to regulatory hurdles
- Tougher initial investment choices/criteria
- More pressure on burn rates
- More diligence for follow-on rounds

Consequences

- Weak value propositions will not survive and even modest ones won't be rewarded.
- Need a strong value proposition and early litmus tests to gain and maintain investor's interest.

Some Elements of Strategic Value Creation

- The job to be done: What are you improving?
- Size and profit potential of the business
- Growth rate and sustainability of the business
- Time to fruition
- Realistic valuation vs investment
- Clear understanding of risks
- Clear understanding of exit strategy and likely acquirers

Choosing the job to be done

- Clear health care and/or economics benefit
- Clear target product profile
- Proving the required claim
- Likely margins vs likely acquirers' margins
- Will risks be mitigated early or late in the investment cycle?
- Channel synergy and business fit vs business size

Current environment favors strong value propositions with early stage risks.

Size and Profit Potential of the Business

Growth Rate and Sustainability

- Smaller businesses can be attractive if an easy fit and fast adoptance
- Generally forecasts >\$500MM are favored by larger corporations
- Dilutive vs accretive margins
- How soon will it be accretive?
- How compelling is perpetuity value?

P&L Impact is currently a bigger driver of the purchase decision than the Balance Sheet

The Investment

- Time to fruition
- Valuation at sale
- Total dollars invested
- Risk Profile (early vs late)
- Isolating and addressing risks

Be sure to understand the end game and work backwards; the numbers need to make sense to attract and keep investors.

Exit Strategy & Likely Acquirers

- The end game in value creation is the enterprise value based on assumptions that can survive rigorous due diligence.
- Model your business like an acquirer
 - Real Assets
 - Synergies
 - Channel
 - Competition
 - Perpetuity
 - Dilution Period
 - Retention of Expertise
 - Discount for Risk
- Understand the “natural acquirer(s)”

Summary

- Choosing what and how much to pursue and being very clear on the target product profile is critical.
- Know the minimum requirement for success, so you know when to walk away.
- Lead your enterprise future backward.
- Keep burn rate as low as possible.
- Isolate value drivers and make sure your management team understands this.

Summary

- Understand the position of your VCs and their needs.
- Set realistic milestones that relate to improving the risk curve and conforming value drivers, not activity based.
- Isolate risks and address as early as possible.
- Model your business as an acquirer would.
- Choose your potential acquirers carefully for full value.