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Introduction

In our recent BioFinance Newsletters (Volumes 1 & 2), we shared with you two plenary panel sessions from Day 1 of the 2006 BioFinance meeting, held in Toronto in May. It is with great pleasure that I now present to you the highlights of a third plenary panel, held on Day 2, entitled "**Breakfast with Dealmakers - The Canadian VC Panel**". I trust that the learnings and views summarized herein will have valuable application for other senior executives facing similar challenges in their unique corporate environment within the broader context of the Canadian biotech industry.

Overall, the 2006 BioFinance conference was considered a great success. The meeting attracted more than 700 delegates from a diverse group of organizations, including large publicly traded and smaller listed firms, as well as both early-stage and established private companies. I was particularly impressed with the number of high quality CEO and senior executive presentations, representing 106 life sciences companies in Canada, the US, and Europe. These companies are currently developing a broad range of cutting-edge medicines, devices, diagnostics, medical technologies, research tools and health-care systems.

I would like to thank Nora Cutcliffe, PhD, BioPharma Consultant, for her expertise in preparing this plenary session overview on behalf of BioFinance.

Michael Stinson, Executive Director, BioFinance Canada

Panelists

Moderator: Peter van der Velden, President & CEO, MDS Capital Corp.

Panelists:

Cédric Bisson, Partner, Life Sciences, MSBi Capital
Jeff Courtney, General Partner, VenGrowth Private Equity Partners Inc.
Michael Cross, Senior Vice-President, Fairway Capital Management
Denis Ho, Managing Director, Life Sciences, BDC Venture Capital
Maha Katabi, Vice President, Ventures West Capital Ltd.
Joe Regan, Vice President Investments, Life Sciences, GrowthWorks Capital Ltd.

Plenary Session Overview

Session Title: Breakfast with Dealmakers - The Canadian VC Panel
Session Date: Thurs, May 4, 2006, 8:00 – 9:00 am
BioFinance 2006 Conference

Peter van der Velden opened the session by acknowledging a palpable sense of momentum in the biotech industry, with tremendous recent progress, facilitated in part by the perseverance of many 'veterans'. The industry is now realizing success on several fronts, with fantastic CEOs leading many Canadian companies. Recent MedTech financing initiatives, as well as the Neuromed/Merck record-breaking partnership collaboration are but two examples of this success. In general, the venture capital community has changed significantly over the past 10-15 years. A key objective of this panel discussion will be to address issues beyond day-to-day transactions with investment bankers, lawyers and other service providers, i.e. to provide perspective on key challenges in the Canadian VC financing market.

Panel Introductions

Mr. van der Velden: *I'd like each of you to provide a brief introduction to yourself and your company – stating the nature of the firm, capital under management, number of current life sciences investments (and perhaps capital deployed in the sector), as well as investment objectives for 2006.*

Mr. Regan: GrowthWorks has combined assets under management of about \$850 million, with roughly 25% invested in Life Sciences. We've invested in 20 companies across Canada, through our offices in Vancouver, Toronto, Saskatoon, and our satellite office in Halifax. GrowthWorks has been involved in a broad spectrum of deals, including Series A financings, as well as investments in Neuromed and Angiotech.

Mr. Courtney: VenGrowth is one of Canada's oldest VC firms. We have \$1.1 billion in assets under management, including life sciences, IT/communications, and other special growth opportunities. We have 5 professionals in life sciences, with approximately \$332 million in total assets in this sector. VenGrowth has made about 15 investments in life sciences companies since 2002, with our first exit in December 2005. Our strength lies in Ontario; our offices are located in Toronto (Corporate Headquarters) and Ottawa. We take a true life sciences approach, with about 63% of these investments in biotechnology, and the rest in medical devices and diagnostics/imaging. We typically lead or co-lead investments, and we add value by participating with management to take a closer stake in the business. We usually make larger investments, including A or B rounds, as well as mezzanine financing, with emphasis on Canadian content.

Mr. Ho: BDC Capital has been in the VC business since 1975 - about 30 years. Our portfolio size is roughly \$600 million, comprising investments in IT, telecommunications and life sciences, the latter of which accounts for 30% of BDC assets. We are a crown corporation with 9 professionals in the life sciences area across our offices in Vancouver, Calgary, Toronto, and Montreal. We're characterized as an evergreen fund, with a focus on early stage technologies (roughly 70% of which are in preclinical or Phase I trials) spanning a diverse set of sub-sectors, from drug discovery to Ag-Bio. Both in good times and bad, we do roughly 20 financings per year, investing about \$30-40 million on an annual basis, so we are always active.

Mr. Bisson: MSBi Capital is based in Montreal. We are a seed and early stage investment firm, with \$50 million under management. At present, our funds are nearly fully deployed, so we are raising new funds to increase the MSBi investment portfolio. We are also pursuing partnerships with universities as part of this process; this should also allow us to leverage IP assets. Our current focus is inside Quebec, although we anticipate expansion within the North East. MSBi is a balanced fund, investing in InfoTech (such as IT, software, and semiconductors), life sciences which I oversee (including medical devices, therapeutic drugs and healthcare IT) as well as physical sciences (particularly materials, industrial technologies and energy). We tend to be first/primary investors, although we can be involved in all rounds. We prefer to invest in fewer companies, but we do like to work with US colleagues with complementary skills.

Ms. Katabi: Ventures West is one of the largest private VC funds in Canada. The fund was initiated in the late 1970's in Vancouver, and then migrated east to Toronto and Montreal. Ventures West has over \$750 million in funds under management, invested in over 120 companies. Roughly \$250 is invested in biotech (comprising 1/3 of our portfolio), with the remainder in IT, telecom, and cleantech (i.e. power/energy). We typically invest \$10-15 million over the lifetime of a company, from Series A financing through to exit. Some of our current biotech investments include OncoGenex, Caprion, and NeurAxon. Investments in device companies tend to be later-stage, as the technology is nearing commercialization. I am responsible for life sciences in the east (Toronto, Montreal), whereas my colleague Chris Laird manages life science investments in the west (Vancouver, Seattle).

Mr. Cross: Fairway Capital has roughly \$350 million in assets under management, with offices in Toronto, Vancouver, and Montreal. Fairway acts as the new manager of Canadian Medical Discovery Funds (CMDf). The Company anticipates reaching roughly \$40 million in liquid assets in the near future, with the goal of making one or two significant investments in 2006.

Mr. van der Velden: *And to round out the panelist company profiles, MDS Capital currently has \$212 million under management, with roughly \$100 million still to deploy. We're currently pursuing later-stage technologies - about 30% medical technologies and 70% drugs/therapeutics. We're seeing significant opportunities in the US (e.g. Palo Alto region) as well as in Canada; we've led 9 deals to date.*

Canadian Market Issues - General

Mr. van der Velden: *Let's proceed now to a discussion of current challenges and impediments for closing financing transactions, building successful biotech businesses and maximizing exit values. What is uniquely compelling within the Canadian context and how do you manage through these issues?*

Mr. Regan: VCs are most interested in capital, and in Canada, we've got a capital shortage. Investee firms typically need subsequent rounds of financing. It's a challenge to tap into the US arena, although most of us have established networks to attract US VCs north of the border. Another factor is on the management side - Canadian companies don't have well established teams. When Canadian firms are compared to US companies, this is a definite hurdle.

Mr. van der Velden: *Has the panel had any success in counteracting this?*

Mr. Courtney: I agree with Joe. We need a lot of investment for this capital-intensive industry sector. Without

capital, you make compromised choices. There are too many companies competing for too little capital; perhaps some companies should be research projects. Typically, a US company can attract 3.5 times the investment that a Canadian company can. Also, to add to Joe's point regarding management, without a lot of capital, you can't attract the required expertise, so it's difficult to be successful in building the industry. I believe in putting more money into play early on, with fewer bets (on fewer enterprises). If the company has a good value creation strategy, it can attract and retain the necessary management expertise. We have recruited CEOs from the US (i.e. New York, Boston), and we get them in on the ground here to build teams around them. When it comes to closing B round financing, which may take \$20- 40 million, the company has a much a better chance to attract the required capital.

Mr. Ho: I'd like to kick this up a notch, and inject some additional energy! We've already had some good points, but I get sick and tired of hearing about the same inferiority complex that I've heard ever since I've been in this business. We need to accept the fact that we're smaller in this global business. We do have a lot of good management - some are transplants or repatriated - but we're currently seeing more and more home-grown talent that is developing nicely. While this has been a problem historically, I believe we won't be signing this tune forever, so personally, I'm encouraged. In general, US companies attract significant capital before approaching mainstream VC firms, e.g. from multiple non-dilutive sources, such as NIH grants. So there is a disjoint when we compare Canadian and US firms, particularly since Phase I development status is comparable in both regions. For example, if a US VC comes here to evaluate a Canadian firm in Phase I, they may be anticipating a Series A financing. Yet the Canadian company is actually seeking Series C financing. The problem is that in the early stages, there isn't enough capital, and this problem will not solve itself at a later stage. How do we fill that gap? We still have a bipolar situation regarding early and later stage financing. We need to focus on closing this gap, with major coordinated efforts.

Mr. Bisson: I agree on this issue. We saw a company in Boston that was too big for MSBi. It had already raised \$20 million in Phase II. In fact, the seed Series A was \$20 million. So my advice for Canadian firms is to avoid VCs as long as possible, since once you've got VC financing, the clock begins to tick, and VCs must ultimately "sell the investment". But the lack of other non-dilutive sources is a real problem. Angel networks are not as deep in Canada as they are in the US, and Angel investors strongly prefer local deals, so it's very tough to get US Angels to invest in Canadian technologies. However, I think companies should aim to be as close as possible to the clinic before seeking VC financing, to increase potential for a larger first round. This is very difficult, and we see companies in dire situations since the current Canadian structures are not working, with drastic changes required. Should the companies then undergo M&A transactions? I love to see in-licensing, as this changes the story. But there are many fewer transition stories of this nature in Canada than in the US. CEOs need to be bold to re-jig the company through alternative strategies.

Canadian Market Issues - Financing

Mr. van der Velden: *Let's take this discussion up another level. The key issues are that we have too many companies and investment is broad, not deep. We've got several terrific CEOs, but this is not as obvious. My question is the following – why are we not seeing consolidation and aggregation of management teams, despite a decline in funding?*

Ms. Katabi: First, I want to clarify that I don't believe we have an inferiority complex in Canada. However, we do suffer from a lack of options, both for capital and for other companies to participate in an M&A transaction. We can begin to solve this problem by taking a global focus, and looking outside Ontario and Quebec, but there is no straightforward answer. We can't count on government to take an entrepreneurial view. How does the US do it? We need to involve US VCs early on - in syndicates - and we need to think more broadly early on, overall. So to address your question regarding ways to encourage M&A in Canada, we need to have a global perspective. I believe that if we narrow our focus to Canada alone, companies have no option but to fade away.

Mr. Cross: We all know about labour sponsored investment funds (LSIFs), and that there isn't enough investment capital to go around. While the Canadian industry is maturing, we're still 10-15 years behind the US. Our lawyers are getting good experience. Lou Siminovitch is like a grandfather to all of us, and we do have great science and innovation. Neil Warma of Viron Therapeutics is another great leader who has recently moved back to Canada. We need to bring others back to continue to build our industry. I'm optimistic, but in general, Canada is perhaps too optimistic, and should actually cut some companies loose. We need to force M&A, and have more in-licensing agreements. Every major company that is a success today started from (and was built upon) a strategic licensing deal. Overall, I think we can exploit our own resources.

Mr. Ho: On paper, you can make anything happen. But VCs are all about people, and making them work together is not straightforward. One or two key executives have to step back, and this is a big impediment. There is never an easy solution in handling the egos of CEOs.

Mr. van der Velden: *I agree. You can have a great strategy, and put 3 CEOs into room, but you will get a cat fight. It's very, very tough.*

Mr. Courtney: It's not just about people, though, since M&A is an industry problem as well. There are valuation issues, companies often wait too long, and usually there is a large degree of desperation, rather than strategic planning. If a brick is sinking and you tie it to another brick, you don't typically get a balloon! Companies need financing, and the story must make sense at the time the transaction is done. You need good preclinical data and a clinical pipeline, with good capital to support development. There is a role for VCs in consolidation, and while this is now happening, it's not pervasive. We've seen two mergers, and 6-7 acquisitions, so it's definitely starting to happen.

Ms. Katabi: If I may interject a question here, who should initiate the transaction – management or VCs?

Mr. Courtney: Both, in my view. With an experienced board, taking a proactive approach, M&A can be viewed as value creation, i.e. you 'sell' through acquisition. But if the company is out of money, then the deal tends to be VC driven.

Mr. Bisson: We like to encourage companies to be bold. Look for complementary assets and decide what makes sense. Often programs are dropped, and I must note that 2 bricks sink faster than one! If both CEOs resent the merger, this is extremely tough. You need to have an active Chairman leading the discussion, after thinking about it for months or years in advance. The Board needs to proactively consider these issues, not just the daily burn rate. Longer term strategic planning is currently lacking.

Mr. Regan: In the context of displacement, there is a huge fear factor. Of course, we all think that our own kids are better looking than any other kids. But look at the recent deal in which Pfizer acquired Rinat Neuroscience; Rinat realized that Pharma wanted something unique in terms of pipeline development. You need to be aware of what the customer wants, and be in a position to deliver exactly that.

Mr. van der Velden: *We're currently seeing an uptick in US VC investment in Canada, with \$300 million in US capital flowing into the Canadian biotech market last year. What has the impact been on your portfolios?*

Ms. Katabi: I believe this trend will continue. In driving towards an exit, if the company is still in Phase II, it will need more capital. This problem won't go away. We encourage our companies to seek broad investments early on, i.e. to open up more options. We see offices on both sides of the border, for example, in Vancouver and Princeton. Regarding the question of whether all companies need to migrate to the US after a certain point of development – this is not necessarily a *de facto* decision, but we need to be aware of the trend.

Mr. Courtney: US investment is essential, but I'm more pessimistic. The situation is difficult since VC investment is all about relationships. We need strong domestic pools to bring in US dollars. Otherwise, US VCs will come in and cherry pick, so we need to have partnerships to attract broader investment. A lot of US money has already been invested – about \$3.9 billion since 1999. Roughly 4% of this investment has gone into life sciences, with the majority going into technology ventures. This is very little overall, and typically, these are later stage transactions. So how do we improve on this? We need to build our domestic industry to attract more US investment.

Mr. Ho: US investment in Canada isn't going to go away anytime soon. I'm generally an advocate of Canadian investment as a good alternative for US VCs. However, Canadian companies may have a limited ability to participate in the "value capture". For example, without Series C and D capabilities as an alternative, we don't get the best deal. Our second objective is to build a real Canadian biotech industry, with critical mass and solid infrastructure. In 5-10 years, we don't want to be dealing with the same issues as we are today. While I have no aversion to global companies, we need domestic viability here, so I'm concerned by the fact that we continue to export our assets.

Mr. van der Velden: *If we build the industry today, we can achieve wealth, and entrepreneurs will return. Last year, US VCs deployed about \$20 billion, with Angel investments in the range of \$50 billion. Some US companies have had several rounds of Angel investments before being considered by VCs. This drives LPs to invest capital, so the infrastructure continues to evolve.*

Mr. Regan: My view is that we need to give something now in order to get something back later. So time will tell whether US VCs will cherry pick, or whether they will be involved more broadly and over the longer term.

Mr. Ho: Regarding value capture, if I'm able to make some Canadian rich in the US (through VC investment in Canada), then Canadians will be easy to recapture back across the border. They are already passionate about Canada. In general, we need more top Canadian executives like Bill Hunter, CEO of Angiotech. However, many of our senior executives tend to migrate away.

Ms. Katabi: Attracting Canadian executives often depends on whether the CEO is also Canadian. Typically

however, we're seeing US management. Overall, we should aim to keep our Canadian talent, and not just "hand them over" to the US.

Questions From The Floor

Mr. van der Velden: *In closing, I'd like to thank our panelists for their insight, and we do have time for a few questions from the audience before wrapping up.*

Mr. David Shindler, Executive Director, BioDiscovery Toronto: I look at sector differences, and I think we're fortunate to have a few hundred companies in the biotech area. This is positive, not negative, in my view. My question is this – do we have a glass ceiling in place, such that companies can't achieve optimal valuation before being bought? In other words, are Canadian firms undervalued, and acquired before they achieve a certain size?

Mr. Bisson: We do seem to have a psychological road block, in that we create our own ceiling. This seems to occur for all industries, including retail and even a few international champions. So this is a broad societal comment, not just for the biotech industry. The good news is that a few of our biotech companies compete on a global sale, such as QLT, Angiotech and BioChem Pharma. They have been successful players, and they remain Canadian.

Mr. Cameron Groome, Director, Investment Banking, Blackmont Capital Inc.: My comment is in response to Dennis Ho's remark regarding the lack of alternatives for C & D series rounds. At the same time, we don't have deep Angel investment in early stage Canadian technologies. As a result, VCs are forced to act during that initial window. So we need to step up other early stage investments. I believe that part of the solution to this problem is to improve communications between the buy and sell sides. Both sides need to be brought through the entire cycle of biotech development and investment, from A to Z.

Bios

Peter van der Velden, MDS Capital Corp.

Peter van der Velden, B.Sc., M.Sc., M.B.A., is the President and CEO of MDS Capital. He recently joined the company from Fusion Capital Partners where, as one of the firms' co-founders he was instrumental in building it into a leading Canadian private equity investment banking boutique focused on technology companies. Throughout his career Peter has sought to leverage his entrepreneurial drive, academic background, and business experiences to help talented entrepreneurs build outstanding businesses. He started in the venture capital industry in 1988 with Vencap Equities Alberta Ltd, arguably one of Canada's most successful venture capital firms, and from there took on the role of Vice President, Business Development for a venture capital backed drug delivery development company where he led their international licensing initiatives, established their subsidiary operations in Australia was instrumental in raising more than \$70 million in private and public equity, as the company evolved to become a TSE 300 listed company. His experience also includes, four years as a partner at a Canadian merchant bank and a short time as a partner at a public equity investment bank. Peter holds B.Sc. honours and M.Sc. (Pathology) degrees from the Queen's University at Kingston, and an M.B.A. in finance and policy from the Schulich School of Business.

Cédric Bisson, MSBi Capital

Cédric Bisson joined MSBi Capital as Partner, Life Sciences, in 2002. Prior to joining MSBi, Mr. Bisson was an associate principal at McKinsey & Company, a leading global management consulting firm, where he co-led the Canadian healthcare and innovation practices. He was based in Montréal with previous appointments in New York City and Paris. At McKinsey & Company, Mr. Bisson served a number of large multinational pharmaceutical companies, private equity players, government institutions, global energy companies, as well as successful smaller enterprises on a wide range of topics including strategy, mergers & acquisitions, business building, operations, organization, and public policy. Mr. Bisson holds a medical degree (M.D.) from McGill University and a law degree (LL. B.) from Université de Montréal.

Jeff Courtney, VenGrowth Private Equity Partners Inc.

Jeff joined VenGrowth Private Equity Partners Inc. in 2002. He has more than 20 years of experience in the life sciences industry with in-depth expertise across multiple therapeutic areas in quality assurance, regulatory affairs, business development, marketing and sales. Jeff has a proven track record of building organizations and driving revenue growth for both emerging and established life sciences firms - particularly within the sub-verticals of medical devices and pharmaceuticals. Prior to joining VenGrowth, Jeff was a Partner and Co-President of the Scientific Advisory Board at CDP Capital - Technology Ventures (formerly CDP Sofinov), where he was involved in leading investments in life science companies in Canada and the United States. Jeff also served as President of

Hospital Pharmaceuticals at Faulding Canada Inc, EVP Marketing and Sales for Pharmascience Inc., as well as 11 years of numerous senior leadership roles with Johnson & Johnson Medical Products. He has served as a Director on the Board of multiple Canadian and US life science companies, including and is currently an active board member of VisualSonics Inc., Axela Biosensors Inc., and Zelos Therapeutics Inc., Metrigenix Inc., Kadmus Pharmaceuticals Inc., Activbiotics Inc., Interface Biologics Inc., and Targanta Therapeutics Inc. Jeff holds a Bachelor of Science (B.Sc.) in Microbiology from the University of Guelph.

Michael Cross, Fairway Capital Management

Michael Cross, held the position of Senior Vice-President and Portfolio Manager, Fairway Capital. On May 5, 2006, Jovian Capital Corporation announced that its wholly-owned subsidiary Jovian Asset Management Inc. had partnered with Fairway Asset Management Corp of Toronto. Dr. Cross is currently Senior Vice President, Venture Investments of Jove. In this capacity, Dr. Cross has responsibility for providing investment management services to investment products managed by Jove, including portfolio and investee company analysis and structuring and negotiating investments and all ancillary activities necessary to complete investments and build value and liquidity. Previous to Fairway Capital/Jove, Michael had lead operational responsibilities as COO of a public oncology company where he helped bring an anticancer product into worldwide pivotal clinical trials. In addition, Dr. Cross was Managing Director of a contract manufacturing organization that he helped build and provide liquidity to its shareholders. From 1996 to 2003, Dr. Cross held a variety of senior positions at MDS and MDS Capital Corp. He was most recently Vice President of the protein analysis division of MDS where he was responsible for various financial, operational and business development activities. Prior to this, Dr. Cross was an investment manager of MDS Capital, where participated at the Board of Directors and the Executive Committee levels of investee companies. Before joining MDS, Dr. Cross spent seven years with the Department of National Defence, including serving as a Post-Doctoral Fellow with the Trauma and Physiology Group, Defence Research Agency in Toronto. Dr. Cross received both his Masters in Business Administration and his Doctorate in Philosophy from the University of Toronto. Dr. Cross' doctoral work focused on the neural control of growth hormone secretion during different physiologic states and the hormone's influence on metabolism and the immune system.

Denis Ho, BDC Venture Capital

Denis joined BDC Venture Capital in 2003 as Managing Director, Life Sciences. Denis Ho has over 20 years of experience in the North American financial markets including years with MDS Capital Corp. as venture partner, Forbes Capital Canada Inc. as partner, KPMG as partner and Mercantile Bank of Canada as account manager. Denis holds an MBA, University of Western Ontario, an M.Sc. in Medical Microbiology, Queen's University and a B.Sc., from the University of Toronto.

Maha Katabi, Ventures West Capital Ltd.

Dr. Maha Katabi joined Ventures West as Vice President in 2004. She focuses on deal generation and portfolio management in the Life Sciences sector. Prior to joining Ventures West, Maha was Vice President, Business Development of Chronogen Inc., a drug discovery company developing human therapeutics to treat age-dependent diseases. Prior to joining Chronogen, she was responsible for managing investments in the Life Sciences field with T²C²/Bio, L.P., an early stage biotechnology venture fund. She currently serves as a Director on the Boards of NeurAxon Inc., Resonant Medical and Reseau Capital. Maha holds a Ph.D. in Pharmacology from McGill University.

Joe Regan, GrowthWorks Capital Ltd.

Joe Regan is a Vice President, Investments at GrowthWorks Capital. Joe joined GrowthWorks in early 2003, bringing a decade of life sciences venture capital and pharmaceutical industry experience. He has been active in both company creation and the strategic growth of portfolio companies. Joe has an Honours BSc (with distinction) from the University of Guelph and an MBA (Dean's List) from McMaster University. Joe currently serves on the Boards of Cytochroma Inc., Kytogenics Limited, Targeted Growth Inc., Dynacon Inc., Molecular Templates Inc., SimEx Inc., Sunnybrook Working Ventures Medical Discovery Fund Inc. and Working Ventures CMDF Queen's Scientific Breakthrough Fund Inc.

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