International Journal of Entrepreneurship Education 2(3): 379-404.

The Renovo Story: Venture Capital at the Cutting Edge

Simon Barnes[1]
Imperial College London

Abstract. The case explores the creation and venture capital financing of Renovo, a biotechnology start up created in 2000 at the University of Manchester, UK. The case examines a variety of issues central to the creation of university spin outs from both the entrepreneur's and the venture capitalist's perspective, with the overall goal of constructing a deal acceptable to all parties. In a broader context, the case illustrates the notion of milestone-based financing for venture capital-backed technology start-ups.

Keywords: biotechnology, venture capital, entrepreneurship, university, spin out.

1. 3pm October 18th 2000

Professor Mark Ferguson and Dr Sharon O'Kane sat in the London office of law firm Arnold & Porter, leafing rapidly through page after page of what they hoped would be the final version of a hard fought shareholders agreement. After 18 months of developing business plans, talking to VCs, negotiating with strategic partners and managing expectations at the University of Manchester, their start up company, Renovo, was close to securing the largest first round of venture capital finance ever seen in the UK for a life sciences start up. Atlas Venture and Chase Capital[2] were proposing to invest £8M[3], and with this level of finance, Ferguson and O'Kane would finally be in a position to realise their goal: building the world's leading drug discovery company focused on *scar-free* wound healing therapies.

Until the final documents were signed, however, the deal could fall flat, and there were still outstanding clauses to be finalised by the lawyers. In anticipation of attempting to close the deal that evening the lawyers had asked Mark and Sharon to sign all the agreed sections before they dashed for a train back to Manchester for a meeting with Renovo's patent agents.

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1. This case was prepared by Dr. Simon Barnes, Tanaka Business School, Imperial College London and was made possible through the generous cooperation of Renovo and Atlas Venture. The case is intended as a basis for class discussion rather than to illustrate either effective or ineffective handling of a business situation.
2. Later to become JP Morgan Partners.
3. Exchange rate £1 = $1.70

As Mark and Sharon handed over the final signature page and made their way toward the door, they reflected on the deal so far. Did they raise the right amount of money? Should they have started smaller? Had they agreed to a fair valuation? Were the milestones they agreed with the VCs reasonable or could they have held out for more favourable terms? Would the deal even happen?

Atlas Venture had a great reputation for building early-stage life sciences companies in Europe, but they had been firm negotiators. Perhaps Renovo should have taken other routes to securing finance; perhaps they would have been able to raise more money at a higher valuation if they had approached less experienced investors. Perhaps they should even have taken other routes to commercialising the findings of their research – like doing a co-development deal with a large pharmaceutical company. But then, they expected Atlas and Chase were going to bring more to the company than money: they were expected to bring experience, strategic guidance and above all, access to their existing portfolios of high potential life sciences companies.

2. The Venture Capitalists

In the London offices of Atlas Venture, Rob Zegelaar and Simon Barnes, colleagues at Atlas, glanced at each other as the telephone rang. The by-now familiar voice of Atlas's lawyer, Jonathan Pittal, a partner at SJ Berwin, proclaimed that the deal was progressing but there were still issues to be resolved. He ran through the major points and suggested solutions and counter proposals. However, it was the Atlas team who would need to make a decision on how to proceed. Zegelaar and Barnes reflected with Pittal on their perceptions of the deal and the potential for Renovo to become an outstanding company.

Zegelaar and Barnes were playing a familiar role as lead investors, committing £6M themselves and syndicating the remaining £2M with Phillip Rattle at Chase Capital, a trusted co-investor. Renovo looked like a great opportunity – it seemed to have all the components of a successful biotech start up, and the due diligence had been positive. Indeed, the Atlas and Renovo teams had built a strong working relationship over the previous year – routinely discussing strategy as if the deal was already signed. Zegelaar and Barnes were particularly confident in Mark Ferguson's ability to succeed: after all, enough obstacles had been placed in Renovo's path over the previous year.

Atlas had managed to decrease the risk of investing a large amount of cash by linking the financing round to a set of milestones negotiated with Renovo. The milestones were challenging but achievable and would trigger the draw down of successive *tranches* of funding. In the worst-case scenario the investors had the right to refuse further cash if significant milestones were not met – but nobody wanted to get to that stage, certainly not Atlas, who knew that would signal the beginning of the end.

Despite the milestones, it was a big deal and they were going out on a limb. Would it pay off? Was the opportunity really as big? Did the milestones cover the downside sufficiently, and would the management team be able to deliver on schedule? After all, Ferguson was an academic and the ghosts of other "Famous Professor Deals" haunted Europe's biotech VC graveyard.

3. 5pm October 18th 2000

Ferguson and O'Kane boarded the train to Manchester, hopeful the VCs would sign off on the deal. Sharon had already written her resignation letter to the University, ready to send as soon as the final deal was signed and Mark Ferguson was completely committed to his role as founding CEO. Zegelaar and Barnes drained the last of the coffee from the pot and contemplated the details of the proposal. They still had a chance to pull out.

4. Background to the Deal

Mark Ferguson arrived at the University of Manchester in 1984. At 28 years of age he was the youngest full Professor in the United Kingdom and on the verge of becoming one of the world's most respected researchers in wound healing and scarring.

Mark and his research group initiated a research program into cleft lip[4], a birth defect that left sufferers with the prospect of numerous surgical procedures to restructure the lip and/or palate. In 1986 the group made a startling discovery, in a now-famous series of experiments. Using minimally invasive surgical techniques, they made small incisions in the lips of unborn mice to mimic cleft lip. Later, when healthy mice were delivered at full term the observations were striking. The incisions had healed without a trace; there was no cleft lip and importantly, there was no scar. They had discovered that unlike wounds in adult tissue, wounds in embryonic tissue are able to heal completely scar free.

The fundamental science behind this breakthrough was to fuel the Manchester research group's activities for the next 15 years, and would put Mark Ferguson and his team at the forefront of research into wound healing and scar formation. Even in 1986, it occurred to Mark that if adult tissue could be induced to heal without scars then the commercial potential for this discovery was enormous – not only for surgical procedures, but also for accident and burns

4. Cleft lip and cleft palate comprise the fourth most common birth defect in the US. One of every 700 newborns is affected by cleft lip and/or cleft palate. A cleft lip is a separation of the two sides of the lip. The separation often includes the bones of the upper jaw and/or upper gum.

victims, and those suffering the long-term effects of chronic ulcers that refused to heal under current treatment regimes.

5. Wound Healing and Scar Formation

In 1993, Sharon O'Kane arrived in the by-now famous Ferguson lab as a Research Fellow and quickly established an international reputation as a first-rate scientist. As Mark became Dean of the School of Biological Sciences, Sharon took on many of Mark's roles in designing and directing the research strategies for the group.

The research programmes had advanced considerably since the breakthrough in 1986, and it was now clear that the mechanism behind wound healing and scar prevention was regulated by transforming growth factors (TGFs) released at the site of injury. The key discovery of the Ferguson group was that in adult skin the balance between different types of TGFs – principally TGFß1/2 and TGFß3 – was different to that in embryonic skin and it was this altered balance in adults that was responsible for scar formation.

According to Mark Ferguson, scar tissue was an evolutionary relic of our distant past. Ancient man had more chance of surviving if wounds closed rapidly to keep out dirt and disease. Hence, natural selection favoured the development of a rapid process for forming replacement tissue, the scar, consisting of linear arrays of collagen fibres. Modern Man is more fortunate – wounds normally heal in clean environments and there is less need for our "ancestral" scar formation mechanism. The mechanism remains, however, and we are left with scars, even in the cleanest medical environments.

6. The Commercial Opportunity

Mark had sensed early that the market opportunity for innovative dermal wound care products could be considerable, amounting to billions of dollars in the US alone. He referred to elective surgery as "wounding by appointment" – and claimed that if wounds could heal post-surgery with no scar then the clinical, aesthetic and cost benefits would be dramatic. The question, however, was whether there was a real business opportunity to build a company engaged in wound healing research, and if so, how big?

6.1. The Healthcare Market

Healthcare constitutes the largest marketplace on the planet, with multiple billions of consumers and an extremely complex value chain, beginning with the

discovery of new medicines and ending with treatment and aftercare for the patient. The intervening steps involve many scientists, doctors, managers and other professionals with the overall costs for healthcare systems reaching astronomical proportions (for example the US healthcare system alone costs trillions of dollars to run). Large and complex marketplaces, with a high degree of innovation tend to be fertile ground for entrepreneurs launching new ventures, but healthcare has its own unique set of issues which impact the ability of entrepreneurs to capture the value of opportunities they create.

The process of taking a new medicine from discovery through to market launch (in other words, delivery to the patient) is dominated by the corporate giants of the pharmaceutical industry (commonly referred to as "big pharma"). Launching a major new drug may take up to 10 years and several hundred million dollars, and only a handful of big pharma companies command the resources needed to launch such "blockbuster drugs". Despite the high costs, lengthy development periods and high risks, the payoffs for successful drugs are huge, with some blockbuster drugs generating close to $1Bn in sales every year. *This is a high stakes, high rewards industry!*

The high costs and lengthy development periods for new drugs are partly the result of the stringent regulatory environment for new products. Once a new drug has been developed in the laboratory, the clinical trials procedure in human patients is divided roughly into three phases, and each may take several years to complete. Phase I trials check that the drug is safe to administer to humans; Phase II trials check that it actually works (referred to as efficacy) and Phase III trials check both efficacy and safety on a large scale with many patients. The regulatory process is controlled by the FDA (Food and Drug Administration) in the US and the EMEA (European Agency for the Evaluation of Medicinal Products) who impose similar (but not identical) criteria for the approval of new drugs.

Gaining approval to launch a new drug is a significant achievement for any company, but it is far from the end of the story. Marketing a new drug requires an educated and highly specialised sales force that is able to talk to doctors and demonstrate the benefits of a new and potentially radical treatment. This highlights a key issue within the healthcare industry: The patient who receives a new drug (the consumer) is rarely the decision maker in purchasing the drug. This role falls to the doctor responsible for prescribing the treatment (usually regarded by pharmaceutical companies as the customer). Perhaps more important, and more confusing, is that in many cases neither the doctor nor the patient actually pays for the medicine!

The "payer" in the health sector is often a government health system (for example the National Health Service or NHS in the UK) or a health insurance company, as is common in the US. Payers such as the NHS or large insurance companies often influence the choice of medicine prescribed by doctors through lists of medicines that are "reimbursed", or in other words are paid for by the health system. Not surprisingly, therefore, healthcare is high on the political

agenda as many countries struggle to meet the increasing costs of caring for aging populations.

The decision to prescribe a newly launched drug often lies somewhere between doctor and payer. In order for a doctor to prescribe a reimbursed drug, it first needs to be on the reimbursed list approved by the payer. It is the doctor who makes the final decision, but there is a growing movement for the patients' right to choose. In the case of therapies to prevent scarring, the element of patient choice may be a specially important factor.

6.2. Market Dynamics and the Biotech – Pharma Divide

With the cost of developing new drugs spiralling ever upward and the launch rate declining, the pharmaceutical industry has been under pressure in recent years to seek new sources of drugs to fill their product pipelines. This has led to the growth of the global biotechnology industry consisting of highly specialised research and development companies. A common strategy for biotechnology firms is to develop new drugs as far as phase II clinical trials before selling these products to big pharma via licensing agreements.

Biotechnology firms play the role of discovery engine, whilst pharmaceutical firms provide a route to market for these products by conducting late stage (phase III) trials and marketing the drugs on a global basis.

6.3. The Wound Healing Market

With the dynamics of the healthcare sector and biotechnology firm strategy in mind, Mark and Sharon set about evaluating the opportunity for a new venture in the area of wound healing.

An analysis of publicly-available databases quickly confirmed Mark's view that the potential market was sizeable – there were over sixty million potential applications for scar prevention and wound healing treatments per annum worldwide.

Table 1: Number of patients treated per annum for dermal wounds.

	US Total	**World Total**
Burn injury	2,000,000	6,600,000
Trauma injury	5,645,000	18,480,000
Cosmetic surgery	529,200	1,750,000
Elective surgery	11,626,000	34,848,000

(Data from publicly available databases)

The available data did not even take into account non-dermal applications such as post-surgical adhesions[5] (accounting for approximately 17.5 million treatable procedures per annum); wound healing and scarring in the eye and the brain; ligaments, tendons and joints in athletes; and restenosis, the re-closure of blood vessels following angioplasty or other procedures. Furthermore, Ferguson believed that scarring served as a paradigm for many chronic fibrotic disorders such as liver cirrhosis. Mark also sensed there were lucrative opportunities for veterinary applications, such as preventing excessive scarring in valuable racehorses.

6.4. Market Growth

Further research showed that the relative importance of acute wounds and scarring was likely to grow as a result of increasing numbers of elderly people and the changing incidence of other major diseases. Reports predicted that the incidence of tissue damage associated with trauma was expected to rise dramatically over the next 20 years (for example, a study assessing the global burden of disease had highlighted trauma caused by road-traffic accidents as the ninth most significant cause of disability in 1990, and this was expected to rise to third place by the year 2020[6]).

6.5. Current Solutions and Competition

Although the ability to treat acute dermal wounds appeared to represent a significant commercial opportunity, inexpensive products including gauze, hydrocolloids, films and foams dominated the market. Acute dermal wounds generally healed without complication using existing wound management products and, as a consequence, there was perceived to be little demand for new therapeutic approaches to accelerate the process.

A number of companies *had* developed artificial skin products for accelerating wound healing, most containing cellular matrices and assorted growth factors. The mechanisms of action of these matrices were little understood, however, and the companies had not performed well in the financial markets.

Very few products were available for the treatment of scars. The most successful was CicaCare from Smith and Nephew, a silicone-based gel applied to

5. Post-surgical adhesions will form in more than 90 percent of the 3.1 million Americans who undergo abdominal and pelvic procedures annually. Adhesion formation is a natural consequence of surgery that occurs when the body tries to repair itself following the trauma of incision, cauterisation or suturing, or as a result of handling or drying-out of tissue due to exposure.
6. *Lancet*, 349, 1997.

the wound that yielded variable results. There was also no readily understood scientific basis for its effects. Treatments for keloid or hypertrophic scars were primitive and of unpredictable efficacy. These included pressure garments, steroid injections, irradiation and injection of anti-proliferative drugs.

With increasing awareness of the costs of prolonged hospital stays, however, Mark felt that any new product that improved the wound healing process to allow earlier hospital discharge would create high market demand from governments and insurance companies responsible for paying the bills for health care.

Because of the specific physiological mechanisms Mark's research group had uncovered, it was likely that therapies could be devised for two specific areas of medical need:

- *Prevention* of scarring during the normal wound healing process.
- *Acceleration* of healing in *chronic* wounds in aging or diabetic patients.

7. Prevention of Scarring

The formation of scar tissue in place of normal tissue, presented serious aesthetic, functional and psychological consequences particularly in children. In the UK and USA over 60% of burns victims were children under the age of twelve, whilst one in five people underwent elective surgery every year. Moreover, simple scarring was often a source of considerable patient distress, particularly if present on the face. Psychological surveys had indicated that normal scars, considered medically acceptable, caused adverse psychological problems in 67% of all women and 33% of all men in the UK[7]. Mark felt that all these patients would benefit from novel anti-scarring products in several ways:

- scars caused by burn injury resulted in multiple follow-up operations and treatments incurring substantial healthcare costs
- most surgical procedures were designed to minimise wounding and scarring, so that patients could recover quickly, be discharged from hospital and return to work as soon as possible; development of new therapies to accelerate wound healing would, therefore, decrease the overall economic cost of recovery
- scar prevention therapies could also change the basis of many surgical procedures, allowing more direct incisions in accessible areas of skin and decreasing the time taken for surgical procedures.

7. Proprietary data.

Mark believed that anti-scarring therapies provided significant medical and cost benefits and were likely, therefore, to be reimbursed by healthcare organizations such as the UK's National Health Service (NHS), and health insurance organizations in the US. The entire issue of reimbursement, however, was becoming an increasingly serious concern for pharmaceuticals firms at the end of the 1990s (for example, the UK National Institute of Clinical Excellence, NICE, recommended in 1999 that NHS doctors should not prescribe GlaxoWellcome's new Relenza treatment for influenza on the basis of cost versus benefit). Even if governments and insurance companies refused, however, Mark felt that patients themselves would pay for scar-free treatments.

8. Acceleration of Healing

Chronic dermal wounds presented a serious medical problem and comprised three major lesion types[8]: decubitus ulcers, venous ulcers and diabetic ulcers. Unlike "normal" wounds, chronic wounds resulted from an underlying pathology (such as poor blood supply). They were extremely debilitating, caused a major reduction in the quality of life, and often recurred following treatment. Chronic wounds were more common in the elderly and as the population aged so the incidence of chronic wounds was predicted to rise.

Table 2: Number of patients treated per annum for chronic wounds.

	US Total	**World Total**
Decubitus lesions	1,500,000	5,000,000
Venous stasis	500,000	1,700,000
Diabetic ulceration	600,000	2,000,000

(Data from publicly available databases)

Within the US, for example, two to three million cases of chronic wounds were reported each year. The average cost to treat each wound was approximately $1,250, rising to $60,000 in individual (recalcitrant) cases. Most of this cost was accounted for by professional care with six per cent attributed to dressings. As a consequence, the demand to reduce professional nursing costs was immense and one of the main ways to achieve this was via more efficacious treatments.

8. Decubitus ulcers are pressure sores ("bed sores"); Venous Ulcers are one of the most common forms of leg ulcers caused by failure of valves that prevent blood pooling in the legs. Diabetic ulcers of the skin are caused when the skin loses sensitivity or skin circulation is impaired.

9. Routes to Commercialisation

On the face of it, there seemed to be an opportunity to turn the Ferguson lab's technology into real products. The key questions that remained, however, were: what was the best route for commercialisation, and what route would allow the scientists to retain the greatest share of any commercial success?

Mark had been appointed as an advisor to numerous leading pharmaceutical companies and over the course of several years his lab had received research funding from them worth several £million. But he was surprised to find that the research updates he sent had never translated into the launch of development programmes by the companies that funded the research. As Mark explained later,

> It seemed that no internal resources had been assigned to picking up inventions from the academic programmes and no-one seemed to have the time nor responsibility within the companies. When I started to push harder to try to make progress, friends within the company became resentful as if you were trying to push their projects off the agenda. It was perhaps seen as a quality judgement that the external research was better than in-house programmes.

The large pharmaceutical companies (known as "big pharma") that paid for the research never did take assignment of the intellectual property (IP) and allowed their one year in-licensing options to lapse, with ownership of the IP reverting to the University of Manchester. It was clear to Mark that the big-pharma route was unlikely to result in products on the market and he set about examining other routes to market. As far as he was concerned, big pharma had missed the boat.

Mark's dealings with big pharma led him to the clear conclusion they were good at conducting later stage clinical trials and taking a well-developed product onto the market, but they were bad at translating basic research into commercial development programmes. They wanted late stage products, ready to enter clinical trials and this realisation was a corner-stone in the formation of Mark's commercialisation strategy. He decided that before talking to the pharmaceutical industry again, he would try to develop the programmes to as late a stage as possible. He would develop drugs to the clinical trial stage. This way, he thought, they get what they want – ready-made clinical trials candidates – but they will have to be prepared to pay serious money to get them.

At around the same time in 1994, Mark was appointed to chair the British Government's technology foresight committee on health and life sciences. The aim of this committee was to try to establish the future of science and technology research in the UK. During this process Mark was to meet many life-sciences entrepreneurs and venture capitalists. He learned about early-stage biotechnology companies, equity and venture capitalists and realised that both he and the University of Manchester were "missing a trick".

As Dean of the School of Biological Sciences Mark launched a review of the University of Manchester's intellectual property portfolio. It became apparent that the School of Biological Sciences was publishing around 30 patents per year and very little was being done to realise the value of this IP. It also became clear during the review that by far the most mature IP portfolio at Manchester was Ferguson's own. His lab had developed 15 families of patents (300 in total) stretching across the wound healing market and this was to provide the core asset of his future development plans.

The IP portfolio of the School of Biological Sciences alerted Mark and his colleagues at the University to an opportunity. They saw the potential to position Manchester as a centre of excellence for the creation of new life sciences ventures. Along the lines of successful science parks at Cambridge and Oxford, they decided to signal their collective goals for Manchester by building a facility to house spin outs and attract biotech companies to stimulate an entrepreneurial culture. Their ideas crystallised rapidly into a plan: they would raise sufficient money to create a first class building to be named the Manchester BioIncubator.

Mark Ferguson was faced with a choice – pursue his personal goal to develop a wound healing company, or pursue the collective goals of the University of Manchester and develop the Manchester BioIncubator. After much deliberation, he chose the BioIncubator first. Asked later why he made this choice, Ferguson responded: "I agreed to be Dean for three years and wanted to make sure I did the job". He wanted to put Manchester on the map as a place where science became a commercial reality, commenting: "If we did not do anything we were destined to be a backwater".

10. Manchester Biotech and the Manchester BioIncubator

A limited company, Manchester Biotech, was created as the commercial entity to raise funds and manage the development of the BioIncubator. Mark was appointed Chairman and CEO and set about raising the finance necessary to create the incubator. Mark perceived numerous major challenges in building the BioIncubator – not the least of which was his lack of experience of running a company.

Regardless of the challenges, Mark threw himself into raising the money for the building. Ending 18 months later with a list of rejections "as long as my arm" he and his team succeeded, nevertheless, in raising £15M from the European Union Development Fund, The Wellcome Trust and the University itself. Goal number one was achieved.

"Most people thought the incubator would not work, especially when a venture capitalist who had committed to invest pulled out", commented Mark. In retrospect, he saw the absence of private investors as a bonus, leaving companies within the incubator free from commercial obligations to investors in the

BioIncubator. Mark took personal responsibility for appointing contractors, even designing the floor plan for the new building right down to insisting that the building had a high-quality restaurant and underground car park. He says this was to ensure that it was perceived as a first class facility on a level with any leading pharmaceutical company. The restaurant would be open to researchers from all over the University and its associated hospitals to become a focal point for ideas and collaborations between academics and companies.

That the incubator was seen by Manchester's academics as a prestigious place to work was going to be crucial to its success within the University. This was emphasised most dramatically when passing through the connecting doors between the aging Biological Sciences Department of the University and the 21st Century environment of the BioIncubator.

Having delivered to the University a £15M state-of-the-art bioscience building[9] as well as £6M in University Challenge funding[10], Mark Ferguson knew it was time to realise his own commercial ambitions and launch a company to develop the anti-scarring and wound healing technologies discovered in his lab. As Mark says now, "The BioIncubator was for rewards in heaven; Renovo is for rewards on earth". He stepped down as CEO of Manchester Biotech and sat down with his lead researcher Sharon O'Kane to begin planning the formation of a company.

11. Launching Renovo

Mark Ferguson had always stuck to his belief that the IP should be developed to the latest possible stage without taking external investment and giving away value. It was now time to form a company and Renovo (*Latin* for 'renewal') was born. For Sharon O'Kane, forming Renovo was an exciting prospect: "For me it was not about the money, it was about bringing benefits to patients, but to do that we knew we had to build a successful company".

The first business plan for Renovo was completed in November 1998 and projected that the company would launch initial clinical trials for three anti-scarring drugs immediately, delivering proof of concept in humans within two years (see Appendices 1 and 2 for a review of Renovo's pipeline of products and a description of the clinical trial process).

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9. The BioIncubator was completed in 1997, on time and £100,000 under budget, and as of July 2001 the BioIncubator's laboratory facilities were full, with expansion plans well under way. Ferguson says he always knew that if he built a great building people would come. He was right. The project has been one of the EU Development Funds most successful projects and has created around 400 new jobs in Manchester.
10. The "University Challenge" scheme provided UK government money to UK universities for investment in their own early-stage spin out companies, usually with a maximum investment of £250,000 per company.

At around the same time that the business plan was being written, Simon Barnes embarked on a tour of UK Universities in search of new deals. He included all the usual suspects; Oxford, Cambridge, Imperial College and University College London. He then heard from a former MBA colleague about Manchester Biotech and a new BioIncubator they had launched. It was worth a visit and, on a bright Spring day in 1999 he arrived on the doorstep of the BioIncubator as newly-printed business plans for Renovo were being prepared to send out to VCs.

A quick run through the slide show with Mike Leek, a technology transfer manager with Manchester Biotech, and it was clear that Renovo represented a strong opportunity. Meetings were organised quickly and the Renovo team travelled to London to present to Atlas.

It went well. Mark Ferguson came across as a first rate visionary, and was clearly a highly driven and committed individual. This first presentation was the beginning of what was to become a series of meetings with the Atlas team, including a trip to Munich to present to the entire European life sciences team of the firm at their monthly life sciences meeting. Atlas embarked on a detailed due diligence exercise and began to discuss with Renovo a number of issues that were felt to be important to any deal that was to be done.

12. The Venture Capital Perspective

From an investor perspective, one of the attractive aspects of the Renovo deal was the late stage of its development programmes. The management team promised the results of initial "Phase 1A" clinical trials providing proof of concept in humans for three new drugs within two to three years of the financing round. With clinical trial results in such a short time frame, this would give the VCs a rapid increase in the value of their shares – ensuring great figures for the internal rate of return (IRR) of the deal.

The Atlas team were used to seeing academic start-ups that began with a discovery phase and projected clinical trials beginning in three years, with results a further three years after that – and that was usually the optimistic scenario. In fact, they normally had to tell founders to think more aggressively. Yet here was an academic founder claiming that clinical programmes would be launched immediately with three lead compounds. The funds would be used to recruit patients, employ clinicians to carry out trials and be in a position to produce clinical proof of concept. Great news, but the advanced programmes also presented a problem – they were expensive.

Renovo required a large amount of money to achieve their first clinical trials results, £8M in total, most of which would be spent before the company would know if the therapies had any chance of success in humans (see Appendices 1 and 2). It could be a "binary deal" – if all went well there was potential to make

significant amounts of money. But if the trials proved to be negative, the VCs would say a quick goodbye to around two per cent of their total investment fund![11]

The hesitation to invest such a large amount of money so quickly was increased by several complicating factors. Firstly, despite Mark Ferguson's and Sharon O'Kane's scientific expertise, they were inexperienced in running clinical programmes. To launch the clinical trials in the right direction Atlas felt that Renovo needed to hire a top-notch clinical trials director who had experience in designing wound healing trials. If trials were designed badly, the results could be disregarded by the FDA[12] or by the very pharmaceutical companies to whom Renovo planned to license the therapies. Mark Ferguson agreed and highlighted several names he felt would ideal candidates for the job.

Secondly, the University of Manchester owned the IP, had funded most of the research and expected a significant stake in Renovo following the funding round. This, coupled with the large amount of money required for the clinical programmes, resulted in a pre-money valuation that Atlas felt was out of line with other opportunities they were investigating. Regardless of the positive aspects of Renovo, it was simply too expensive. Comparing the pre-money valuation of Renovo with the VCs' expectations of IPO valuations (see Appendix 3 for historical IPO valuations in UK biotech), they felt the multiples were simply not high enough to offset the risk.

In addition, the VCs knew that although the first set of clinical trial results was an important first step, Renovo would need to build an even stronger business before conducting an initial public offering (IPO) and providing the VCs with a first chance of a return on their investment. This was especially true in the UK, where unusually rigid market regulations existed for biotechnology companies. On Nasdaq, NYSE and various European stock exchanges the criteria for listing new biotechnology stocks were largely a matter for the Investment Banks.

The London Stock Exchange, however, had taken a different approach, issuing strict Chapter 20 guidelines on what a biotechnology company should achieve before being accepted to the exchange. Even more significant for the venture capital investors was the ruling that "major shareholders" (those with 3% shareholdings or more) could not sell more than 40% of their stock within two years of a listing, severely impacting the IRR of the VCs who could not realise gains for lengthy periods of time. How would Atlas maintain its IRR targets in a UK-based company that even if it were successful would see their stock "locked up" for years after an IPO?

Before any talk of an IPO, however, it was likely that Renovo would need further large injections of private equity to achieve its milestones beyond the budgeted two-year start up period. This presented a choice and a trade-off for the

11. Atlas Fund IV was a $400M Limited Partnership Fund.
12. Food and Drug Administration of the USA, the largest healthcare market in the world, and therefore the benchmark for drug approval.

Atlas team: they could plan to inject all the future cash themselves – and maintain a large stake to maximise the return at exit – or they could invite other investors to participate, so as not to commit too much of their own £250M fund to a single portfolio company. Future financing rounds would be at higher valuations, but the dilution would still impact Atlas's returns unless they participated to some extent.

Moreover, whatever the valuation, and whoever the investors were, Atlas would certainly be expected to show its continued confidence in the company by participating in future rounds, "putting our money where our mouths are", as Barnes said. Given such choices on the future financing of Renovo, the Atlas team needed to decide up front how much of the fund they would reserve to invest in Renovo over the lifetime of this deal, and therefore how much they would need to ask their own investment board to approve.

To add to the "equity question", the founders also wanted to retain a significant slice of the equity. After all, Ferguson and O'Kane were putting aside their academic careers and were taking significant personal risk in doing so. As Sharon O'Kane said later, "other academics regarded starting a commercial venture as selling your soul to the Devil. This was a big career risk for us". Atlas agreed. The founders needed to be motivated – they were going to be the key to success and it was of questionable benefit for the investors to squeeze the founders' stake too much.

In addition, Atlas wanted to create a sizeable stock option pool for recruiting future top-level management including the clinical trials director. As Barnes said, "you find in most start ups that if you add up the equity each party feels they deserve, you *always* get to more than 100%, but Renovo posed particularly serious differences in perception of value".

Renovo had a broad and strong IP portfolio covering many aspects of wound healing. Indeed Withers and Rogers, the patent agents retained by Atlas to review the IP, were impressed by Renovo's portfolio and had never seen an academic so "on top of the patent situation" as Mark Ferguson. However, the world of wound healing IP was a competitive place, and several companies held patents to manufacture the very compounds that Renovo would use to carry out clinical trials. Renovo would have to obtain crucial licenses as well as supplies of the compounds in order to launch the trials on schedule. It was likely that deals could be done as the companies holding the patents knew they needed to avoid legal challenges from Renovo regarding their own programmes. Mark had already initiated discussions and it looked promising – but deals still had to be done and until they were, Renovo could not move ahead aggressively.

13. Walking Away from the Deal

Atlas considered briefly a small investment to allow the management team to develop the plan, recruit key management and do patent deals. Mark Ferguson did not see this as a viable route – he would rather get the patent deals done without taking funding to avoid early dilution. From the Atlas perspective it also became apparent that this was an unattractive route. As Rob Zegelaar said, "Seed deals at Atlas come with a commitment to spend time with the company". Given the strong deal-flow of 1999, he feared this would be an empty commitment. The VCs' limited time, he felt, would be better spent on other, more straightforward deals.

Rob decided Atlas should step back from the deal until Renovo could make progress on outstanding issues, and broke the news to Renovo in a telephone conversation just before Christmas 1999. It was a tough decision, especially for Simon Barnes who had worked on the deal for months, but in view of the other deals he was working on he knew it was the only decision to make.

Mark maintained his dialogue with Atlas but was faced with a choice: plough on regardless of Atlas's comments and talk to different investors, or take on board Atlas's comments and fix the problems. As Mark stated, "Even if I spoke to other VCs, I was likely to be faced with the same issues again and again." There were holes in the plan and he knew they needed to be filled.

Mark was determined from the beginning that any VCs he spoke to had to be of highest reputation, understand biotech intimately, have a proven track record in the field and importantly, they needed to have deep pockets. More than anything, the Renovo team had to get on with them – after all, they would be working together once the company was up and running. Atlas was one VC that fulfilled the criteria but there were other fish in the sea and he would not wait forever.

14. Managing Stakeholder Expectations

As Mark Ferguson was discovering, spinning out a company from within a University was not straightforward. Apart from the perils of dealing with venture capitalists, internal issues at the University were also proving to be a challenge. Mark felt as if he was walking a fine line – courting the external commercial world and managing the expectations of his many colleagues within the University. The University was a melting pot of diverse interests, committees and hierarchies. Some academic colleagues viewed Ferguson with a mixture of jealousy and disdain. Why bother with commercial interests, why stray from pure academic research? Administrators and technology transfer professionals were enthusiastic but had little experience of finance and offered few solutions to Renovo's problems. Most serious were the Universities financial administrators

and their firm views on the equity stake they were seeking. According to Mark, "They wanted to grab as much as they could and to hell with the consequences".

The University's administrators knew that Mark Ferguson was determined to make Renovo succeed but were themselves determined to safeguard the University's IP assets. They would not let the value of the IP go to venture capitalists for a song. On top of that, the size of Mark Ferguson's IP portfolio was now proving to be a dead weight around the University's neck – the University was paying almost £0.5M per year in legal fees to maintain its IP position and this could not go on. Historically, pressure had been put on academics to do licensing deals to ensure a return on the costs of maintaining IP but Ferguson had always resisted, believing that the true potential of the IP would be realised by developing it to the latest possible stage. Now, with Ferguson's (and Atlas's) unwillingness to accept their equity proposal some at the University were losing patience. Finally, Mark was told that he would have to find some form of deal or risk losing the financial support necessary to maintain the IP.

Faced with the prospect of jeopardizing patent rights gathered over 15 years of hard work, Mark informed the University of his answer. If the University refused to maintain the IP, the patents would be useless and Mark was prepared to leave and take his knowledge with him. The last thing the University wanted was to lose one of its most important professors. The chief financial officer (CFO) of the University reached a deal with Ferguson. He would recommend funding the IP for an additional year, during which time Ferguson needed to find a solution to the increasing financial burden it was creating. Furthermore, he persuaded colleagues within the central administration to be more flexible regarding equity in Renovo. They would be faced with a big share of nothing if Ferguson left or if Renovo did not happen. As Mark later commented, the CFO was taking a personal career risk in backing him, and if it did not pay off he would be accused of selling out to VCs.

15. Solving Problems

It looked as though the University was relaxing its position on equity, allowing Ferguson more freedom to strike a deal with VCs. Looking back, Mark sees his position at the University as crucial in winning the University over. He was able to cut through the layers of middle management and go straight to the top. He is grateful to the CFO for helping to provide a way ahead for Renovo. Without his firm action and championing of the deal amongst colleagues, Renovo may have been bogged down in middle management committees for years.

Mark Ferguson had not been idle. Whilst dealing with issues within the University, he got on with trying to solve the issues raised by the VCs. If he was to raise the right amount of money at the right price he was going to have to provide answers to questions. Risking £50,000 of his own money, he engaged

head-hunters to identify clinical director candidates. He commissioned an independent patent review of the TGFß3 sector and he progressed IP licensing and materials supply deals with several pharmaceutical companies.

By April 2000 when he was invited by Simon Barnes to speak at Atlas Venture's European Life Sciences Conference in Amsterdam, he had made considerable progress toward his goals and received interest from several VCs. The other VCs wanted to make small initial investments to allow Renovo to reach its early milestones. Mark believed the company could reach these without VC money, turned down their offers and continued regardless. By June 2000 when Simon Barnes placed a call to Mark Ferguson to check on progress, aware that Renovo was talking to other investors, he was intrigued to learn of the progress the company had made.

16. Term Sheets and Closing a Deal

Barnes spoke with Rob Zegelaar and updated him on progress. A short list of candidates for the crucial role of clinical director was now available, a number of high profile figures had expressed their interest in joining the board, and initial discussions for IP licensing deals had taken place with pharmaceutical companies (although they were not yet signed). Importantly, the University had finally reached agreement with Ferguson on the range of equity they were prepared to negotiate with the VCs and it was not too far away from Atlas's own expectations.

Not only had Renovo made progress, there had also been some changes at Atlas that changed the profile of the deal. Atlas had raised a new £500M fund[13] and was, therefore, in a stronger position to make larger investments. They needed to think through the future financing strategy for the company but the bigger fund opened up more possibilities. Atlas had completed most of the due diligence six months ago and moved swiftly to discuss progress with Renovo before other VCs got into the frame.

Despite increased flexibility from the University, and a new fund, the negotiation between Atlas and Renovo was always going to be tough. Atlas was looking for deals with the potential to make ten to twenty times their investment, yet Renovo wanted to retain as much equity as possible. The Atlas team knew that valuing early-stage biotechnology companies was always difficult. The University usually looked at the amount it had spent on R&D and patenting and compared that to its expected share of the company. The founders usually looked at how much of the company they would retain after the financing round and the VCs looked at their fund performance, and tried to estimate a likely exit valuation for the deal (Appendix 3 summarises the historical data for UK biotechnology IPOs from 1994 until July 2000 – the time at which the Renovo negotiations

13. Atlas Venture Fund V was a $750M Limited Partnership Fund raised in early 2000.

commenced; Appendix 4 provides an overview of the market indices for biotechnology stocks in US/Europe and in the UK alone from 1992 to July 2000).

Finally, after many hours of negotiation, Atlas and Renovo agreed a valuation and a set of milestones around which to construct the financing round. On 1st August a non-binding term sheet was signed that outlined the basis for the legally binding investment documents (Appendix 5 shows an example of a standard term sheet used by Atlas in UK private equity deals *circa* 2000). The legal negotiations through August and September were complex but the Atlas team believed the milestones they had agreed with the founders would protect the fund in the event of serious delays in progress. They also knew privately that there would be flexibility in the milestones as long as the company stayed on track and if Renovo were a success, Atlas, the founders and the University would all make serious money. If Renovo failed they would all feel the pain, financially and personally.

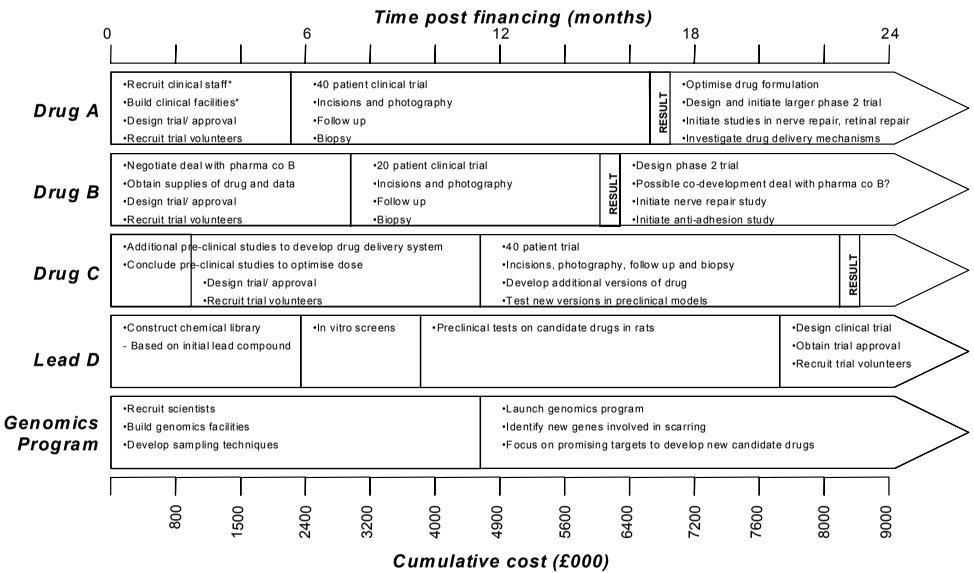
17. 8pm October 18th 2000

That was all in the past ... and "twelve weeks of legal fees later", as Barnes liked to put it, they were faced with final decisions on the deal. As Mark Ferguson and Sharon O'Kane stepped off the train in Manchester, Mark's mobile phone rang out. It was Rob Zegelaar.

APPENDICES

Appendix 1: Overview of typical drug discovery pipeline and relative positions of Renovo programmes at the time of negotiations.

The product pipeline of many biotechnology companies begins with a genomics programme to discover new "biological targets". Having identified such targets, chemical libraries are screened to identify compounds that bind to targets in the hope that they will modify the disease process when given to patients. Such "candidate drugs" identified by the screening process then undergo extensive pre-clinical testing to measure efficacy and safety. Those that are successful enter clinical trials in humans. It is here that Renovo's pipeline differs to most. The specific techniques used in Renovo's clinical trials, and the fact that the results are (literally) visible meant that initial "phase 1A" trials may be carried out on volunteers to yield proof of concept in humans rapidly. This is different to most clinical trials procedures for new drugs that normally take several years of analysis before yielding data on the effectiveness of the new drug. The previous discovery and development activities of the Ferguson lab at the University of Manchester place the newly formed Renovo in the position of having three candidate drugs about to enter phase 1A clinical trials. The approximate positions of Renovo's major programs in the overall drug discovery pipeline at the time of the case study are marked. For reasons of confidentiality the names of the drugs have been withheld.



Appendix 2: Detailed plan of activities for Renovo in first 24 months post financing

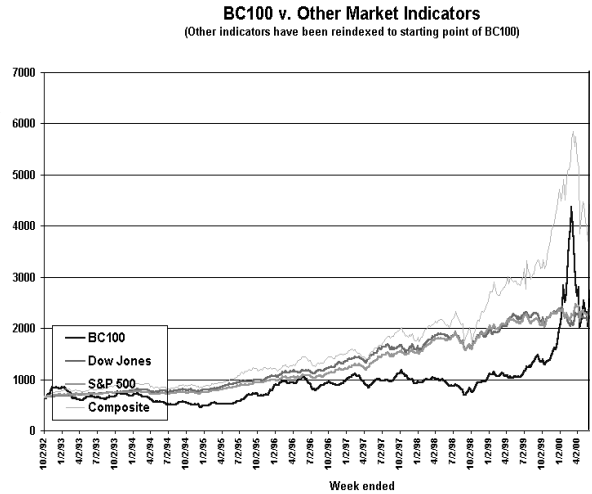
The above diagram describes the proposed activities and milestones for Renovo in the first 24 months following launch of the company. The lead programs Drug A, B and C are ready for entry into phase 1A clinical trials immediately after financing – a highly unusual situation for a start-up company. Detailed clinical trials protocols need to be put in place for all programs and approval for the trials must be obtained from the regulatory authorities. For Drugs A and B, The University of Manchester owns the patents to use these chemical compounds in wound healing and scar prevention but the patents for the structure and synthesis of the chemical compounds are owned by 2 different pharmaceutical companies. Deals must, therefore, be signed with 2 major pharmaceutical companies to gain access to supplies of these compounds before trials can begin. A draft agreement exists for Drug A. Some points are still under negotiation but the deal should be signed within a few months of the financing round. Mark Ferguson has made significant progress with negotiating access to Drug B but there are still some points to iron out before the agreement can be drafted. If all goes to plan, Renovo will be in a position to know if Drugs A, B and C work in humans within 2 years. The chemical screening experiments and the genomics program are earlier stage programs and will form the basis of the future pipeline. Drug C is a natural compound, the structure of which cannot be patented. The University owns patents, however, for the use of the compound in wound healing and scarring. For lead D the University owns patents for both the structure and use of the compound. Early data suggests this may well prove to the be jewel in the crown. The patents owned by the University of Manchester will be transferred to Renovo in exchange for equity when the company raises finance. Note: clinical trials facilities and staff for trials of Drug A will also be used in the other programs.

UK Biotech IPOs 1994-Summer 2000.								Initial Stock Performance ($)		
Year	Company	Ticker	Business Category	Amt raised ($M)	Shares sold at IPO (M)	Shares outstanding	*Market cap ($M)*	Date completed	IPO	Year end	Location
1994	Chiroscience Group plc	LSE:CRO	Drug discovery	67.2	30	67.9	*152.10*	27-Jan-94	2.23	5.57	Cambridge
	Xenova Group plc	LSE:XEN	Cancer, cardiovascular	10	1.25	10	*80.00*	08-Jul-94	8	5.5	Slough
							116.05				
1995	Peptide Therapeutics Group plc	LSE:PTE	Infectious diseases/ inflammation	38.7	12.5	33.92	*105.02*	30-Oct-95	3.08	5.48	Cambridge
	Biocompatibles plc	LSE:BII	Biomaterials/ skin/ wound	23.3	10.3	43.35	*98.06*	13-Apr-95	2.82	12.25	Farnham
	PolyMasc Pharmaceuticals plc	AIM:PCP	Drug delivery	7	5	20	*28.00*	19-Dec-95	1.54	2.99	London
	Stanford Rook Holdings plc	LSE:SFK	Autoimmune/ inflammation	2.8	3.5	17.5	*14.00*	07-Apr-95	0.801	6.512	London
							61.27				
1996	Vanguard Medica Group plc	LSE:VGD	Neurological	74.3	11	24.8	*167.51*	02-May-96	6.75	11.59	Guildford
	PPL Therapeutics plc	LSE:PTH	Biomanufacturing	53.7	7.8	22.36	*153.94*	11-Jun-96	6.93	9.02	Roslin
	Skyepharma plc	LSE:SKP	Drug delivery	39.2	594.44	1139.24	*75.13*	04-Jan-96	0.066	2.08	London
	Shire Pharmaceuticals plc	LSE:SHP	Neurological/ Cancer	35	12.57	60.9	*169.57*	15-Feb-96	2.7	6.25	Basingstoke
	Phytopharm plc	LSE:PYM	Autoimmune/Inflammation	19.5	7.4	30.9	*81.43*	19-Apr-96	2.63	5.24	Godmanchester
	Oxford Biomedica plc	LSE:OXB	Cancer, Gene/Cell therapy	8.5	5.79	63.69	*93.50*	13-Dec-96	1.46	1.66	Oxford
	Alizyme plc	LSE:AZM	Metabolic	7.8	8.33	17.29	*16.19*	15-Jun-96	0.93	0.87	Cambridge
							108.18				
1997	Galen Holdings plc	LSE:GAL	Drug delivery, Cardiovascular, Autoi	76.7	30.27	121.27	*307.28*	10-Jul-96	2.54	9.59	Craigavon
	Cambridge Antibody Technology Group plc	NASDAQ:CATG	Antibodies, Functional genomics	66	8.25	21.8	*174.40*	19-Mar-96	8.09	6.09	Melbourn, UK
	Powderject Pharmaceuticals plc	LSE:PJP	Drug delivery	57.3	18.92	59.1	*178.99*	17-Jun-96	3.03	5.34	Oxford
	Core Group plc	LSE:COG	Drug delivery	40.4	10	29.08	*117.48*	03-Mar-96	4.05	4.26	Kilmarnock
							194.54				
1998	Oxford Glycosciences plc	LSE:OGS	Proteomics, Cancer, Metabolic	51.1	11	36.8	*170.95*	07-Apr-98	4.64	7.03	Oxford
	Quadrant Healthcare	LSE:QTH	Drug delivery	39.4	18.5	47.7	*101.59*	19-Feb-98	2.13	2.13	Cambridge
	Bioglan Pharma plc	LSE:BGP	Dermatology	34	8.2	78.69	*326.28*	17-Dec-98	4.15	7.38	Hitchin
	Oxford Asymmetry Intl plc	LSE:OAI	Chemistry	30.7	6.9	41.3	*183.76*	17-Mar-98	4.85	14.7	Abingdon
	Antisoma plc	LSE:ASM	Cancer	17	28.6	71.4	*42.44*	17-Dec-98	0.59	1.22	London
							165.00				
1999	Enzacta Group plc		Cancer, Drug delivery	1.6	2.01	6.44	*5.13*	08-Sep-99	0.8	N/A	Salisbury
							5.13				
2000	Gemini Genomics plc	NASDAQ:GMNI	Genomics	96.6	6.9	63.8	*893.20*	25-Jul-00	14	N/A	Cambridge
	Weston Medical Group plc	LSE:WMG	Drug delivery	81.4	30.86	123.5	*325.76*	03-May-00	2.64	N/A	Eye
	Pharmagene plc	LSE:PGN	Functional genomics databases	61.8	14.29	49.85	*215.59*	25-Jul-00	4.33	N/A	Royston
	Profile Therapeutics ltd	LSE:PTP	Drug delivery	39.4	14.71	47.65	*127.63*	24-Mar-00	2.68	N/A	Sussex
	ReNeuron ltd	AIM:REN	Neurological	28.3	10	33.8	*95.65*	09-Nov-00	2.83	N/A	London
	GeneMedix	LSE:GMX	Generics	28.1	22.28	289.66	*365.33*	01-Dec-00	1.26	N/A	London
	Genetix Group plc	LSE:GTX	Supply/Service, Genomics	23.8	21.4	74.8	*83.19*	22-Nov-00	2.1	N/A	New Milton
	ReGen Therapeutics plc	AIM:RGT	Neurological	7.9	17.86	51.54	*22.80*	24-Mar-00	0.44	N/A	London
	Fulcrum Pharma plc	AIM:FUL	Supply/Service	1.6	33.33	79.91	*3.84*	15-Mar-00	0.048	N/A	Hemel Hempstead
							237.00				

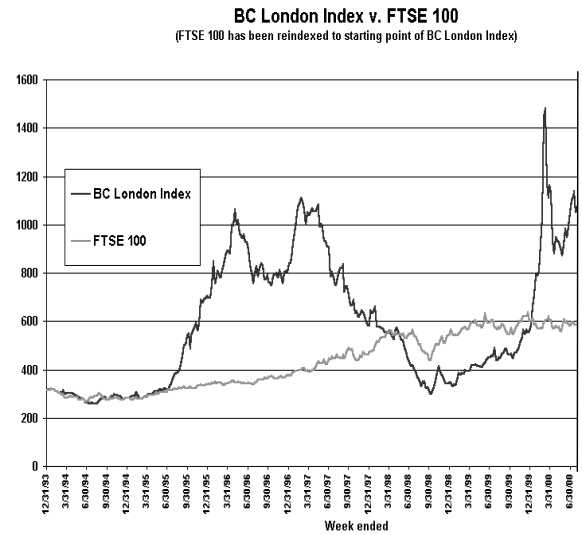
Appendix 3: Biotechnology Initial Public Offerings in the United Kingdom 1994- Summer 2000

Clue for students: The summary table outlines the amounts raised by biotechnology firms in the UK in the years preceding the case. It is possible to calculate the pre-money valuation of the firms just prior to the IPO (by subtracting the amount raised from the market capitalization after the IPO) to arrive at an approximate range of IPO valuations (pre-money) historically in the UK. If Atlas assumes that Renovo can IPO at a similar valuation range it is possible to work backwards toward an approximate post-money valuation for Renovo at the time of the negotiations. To do this assume that the VCs want to see a 20x increase from the post-money valuation of the first round (after they put their money in) to the IPO. Note this calculation is a rough guide and does not take into account the dilutive effect of future financing rounds.

(a) *BioCentury 100 Index:* Index of leading public Biotech companies in USA and Europe



(b) *BioCentury London Index:* Index of leading public Biotech companies in UK



Appendix 4: Biotechnology stock market indicators 1992-99

Appendix 5: *Pro forma* term sheet used in UK venture capital deals

SUMMARY OF TERMS FOR PROPOSED FINANCING

("the Investor(s)") have agreed with the directors of [Target Company Limited] ("the Company"), subject to contract, that the Investor(s) will make an investment ("the Investment") in the Company subject to its investment committee approvals and to the following terms and conditions:

Aggregate amount of financing	£*
Pre-money valuation (fully diluted)	£*
Use of proceeds	The funds raised by this round of investment shall be used for operational capital expenditures and general working capital purposes (*milestones to be specified*).
Form of investment	The Investment will take the form of cumulative, redeemable preferred ordinary shares ("Prefs").
Coupon	The Prefs shall be entitled to receive a cumulative fixed dividend of * per cent per annum on the subscription price of the Prefs payable [quarterly in arrears / on redemption] and compounding monthly.
Liquidation and sale preference	A mechanism will be included to ensure that upon the liquidation (or other return of capital) or sale of the Company [where, in each case, the Investor would not receive in excess of * times the subscription price paid for its Prefs, prior to distribution of the assets or proceeds to all shareholders on a pro rata basis,] the Investor will first be entitled to receive an amount equal to all arrears of dividends on and the subscription price for its Prefs.
Voting rights	The Prefs will carry one vote per share on an equal basis with the existing ordinary shares of the Company.
Pre-emptive rights and tag rights	If new shares are issued or a member proposes to offer any shares (excluding shares issued in connection with the "Option Pool" or pursuant to any agreed permitted transfers), these shares will first have to be offered to the existing members on a pro-rata basis. Further, at the option of the Investor, upon any such sale (other than by the Investor), the shareholder will also have to ensure that the purchaser acquires an equivalent proportion of shares from the [other shareholders / Investor] on the same terms.
Anti-dilution	If the Company issues additional shares (excluding shares issued to employees in the form of share options) at a subscription price less than that paid by the Investor in this Investment, the number of shares acquired by the Investor in this Investment will be adjusted on a [full ratchet / weighted average] basis.
Employment and restriction on Founders	The Founders will enter into service agreements with the Company, which will contain appropriate protections in favour of the Company including restrictive covenants and provisions dealing with the Company's ownership of IPR. In addition, the Founders will in the shareholders' investment documentation give [12] month non-competition and non-solicitation undertakings in favour of the Investor. All Founders shall be restricted in the transfer of their shares in the Company without the consent of the Investor, until a sale or IPO.

Compulsory transfer	In the event that a Founder or other management/employee shareholder leaves the Company in circumstances involving his being dismissed for cause, such employee (a "Bad Leaver") will be required to transfer all of his shares to the Company at the lower of his cost or the market value of such shares at such time. In the event that a Founder or other management/employee shareholder leaves the Company but is not a Bad Leaver, a proportion of his shares may, if [the Investor / Board] so determines, be subject to transfer or repurchase by the Company at the market value of such shares at such time. The relevant proportion shall be * per cent. if such person leaves on or prior to the first anniversary of completion of this Investment and thereafter the remainder of the shares shall vest [monthly / quarterly / over a * year period]
Drag rights	At any time, members entitled to cast not less than * per cent of the votes at a general meeting shall have the ability to force all members to sell their shares to a bona fide third party offeror on terms no less preferential in all material respects than are available to them. At any time after * years from completion of this Investment, if no sale or IPO has occurred, the Investor shall have the right to initiate and conduct a formal sales process in which the Company and all shareholders will co-operate and the Investor shall have the ability to force all members to sell their shares to a bona fide third party offeror on terms no less preferential in all material respects than are available to them.
Board position	The Investor shall have the right to appoint [a / two] member[s] of the board of directors (or any committee) for so long as it holds an interest in the Company at the annual fee agreed with other non-executives, plus reasonable expenses. It is intended that the Investor will appoint *. The Investor shall be entitled to nominate an observer to attend in the place of such director(s).
Minority protections	The Investor shall be entitled to minority rights and protections, and receive warranties and indemnities from the Company and the Founders as are customary in a transaction of this nature. The Investor shall be granted such management rights as may be required to ensure that the Investment is ERISA compliant
Veto rights	The Investor will have the right to consent in relation to specific matters having a material effect on the value or structure of the investment having a material effect on the operation and/or management of the Company. Such matters shall include, but will not be limited to (i)any further issue of shares; (ii) any amendment to the Company's constitutional documents or the rights attaching to any shares; (iii) any sale or listing; (iv) any liquidation or winding up of the Company; (v) borrowings which in aggregate exceed £*; (vi) acquisitions and disposals; (vii) varying or making any binding decision on the terms of employment of any of the Founders or any other senior employee or increasing or varying the salary or other benefits of any such person; (viii) the appointment or removal of any person as a director; (ix) the conduct of material litigation; and (x) the implementation of or variation to any share option or pension scheme
Registration rights	The Investor will have two demand registration and unlimited piggy back and S3 registration rights, in each case with all expenses to be paid by the Company

Option pool	* per cent of the fully diluted equity shares at completion will be reserved for issue to employees, consultants and strategic investors pursuant to a share incentive plan to be adopted as soon as practicable following completion and as approved by the Investor
Pre-conditions to completion	This investment shall be conditional upon (i) execution of definitive legal documentation to be drafted by the Investor's solicitors, S J Berwin & Co on the terms of this term sheet; (ii) commercial, legal, tax and accounting due diligence; (iii) Investor investment committee consent and [(iv) approval from the Inland Revenue to the proposed adoption of the new articles of association]
Costs	The Company will be responsible for the Investor's reasonable expenses in connection with the Investment on completion or will be so responsible if during the exclusivity period the Company withdraw without reasonable cause or the Investor withdraws for reasonable cause
Timing	The Company, the existing members and the Investor agree to use their best efforts to sign definitive legal documentation to complete this round of investment on or before * 2001
Confidentiality	The terms of this term sheet and the fact that the Investor is considering making an investment in the Company shall remain strictly confidential and may not be disclosed to any other parties except to respective professional advisers under terms of confidentiality
Exclusivity	In consideration of the Investors committing time, money and resources to conduct its due diligence on the Company and draft, and negotiate the definitive legal documentation, the Company agrees not to discuss any potential investment in the Company or to continue or initiate any such discussions with any other potential investors. This right shall expire at 12:00am on * 2001
Governing law	This term sheet and the definitive legal documentation required to effect the Investment shall be governed by and are to be construed in accordance with the laws of England and the parties hereby agree to submit to the exclusive jurisdiction of the English courts
Legal effect	This term sheet is not legally binding save that the sections regarding costs, exclusivity, confidentiality and governing law will be binding immediately upon the Company countersigning this term sheet

We agree to the terms and conditions set out above:

....
for and on behalf of Date
[VC Entity]

....
for and on behalf of Date
Target Company Limited

....
[Founders] Date