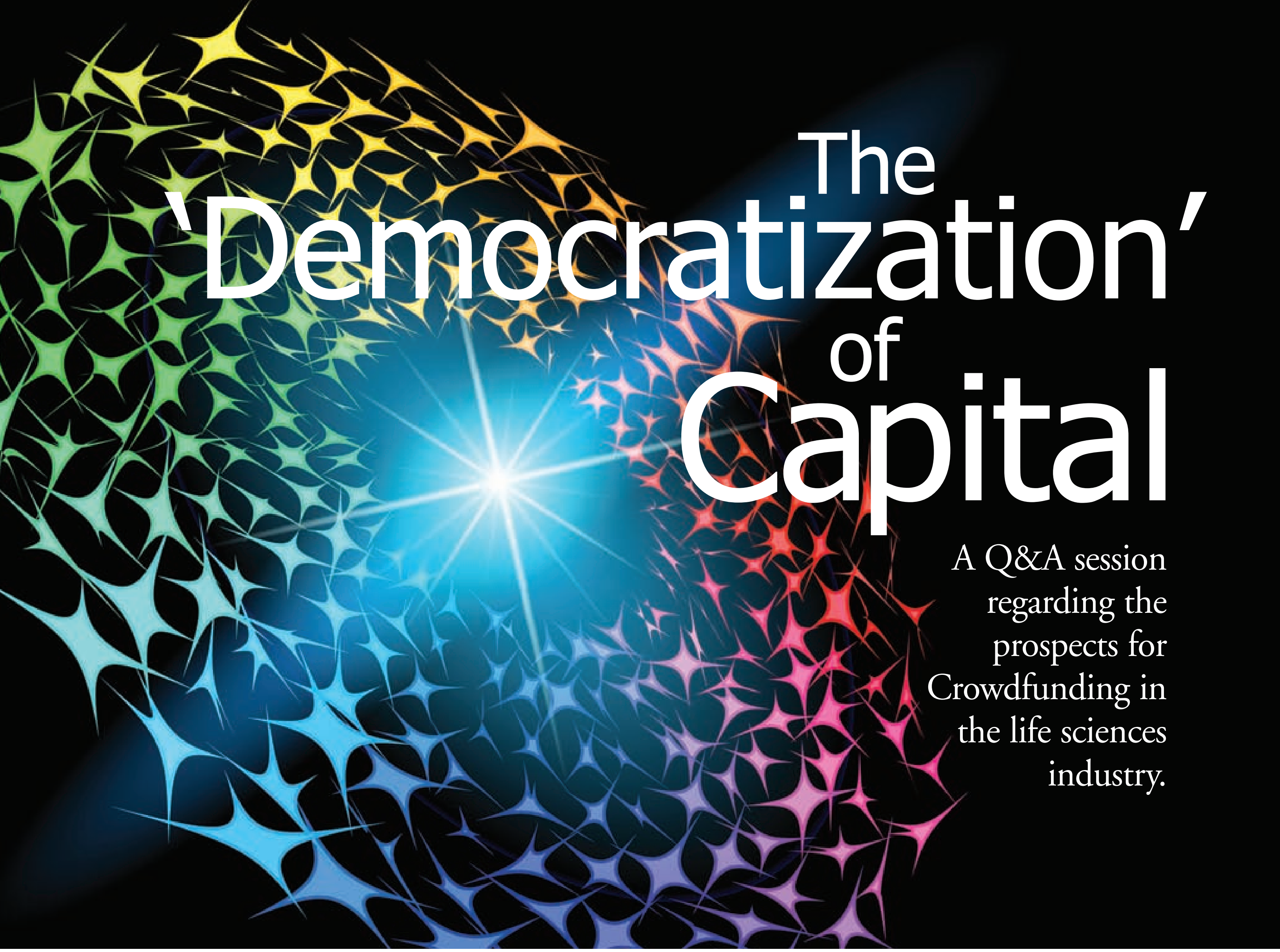

The 'Democratization' of Capital

A Q&A session regarding the prospects for Crowdfunding in the life sciences industry.

Signing of the JOBS Act (April, 2012) signaled a new era for the "Democratization" of capital providing Accredited and Non-Accredited (pending final regulations/approval from SEC and FINRA) investors unprecedented access to private companies/start-ups through Crowdfunding - method of raising capital in small amounts from a large group of people using the Internet and social media. Crowd Finance Platforms inspired by the JOBS Act including *HealthiosXchange – "Healthcare's Investment Marketplace,"* and *FundersClub's "Managed Venture Funds"* (technology sector focus), were subsequently launched to meet investor demand for early-stage investments (invest in the next "Google") while meeting the need for diversification across a number of start-ups via low investment thresholds (as low as a $2,500 per investor per Company).

Below are excerpts from a Q&A session between Scott Jordan, CEO of *S. Jordan Associates (SJA) – Crowdfunding Investment Bank*, and a major pharmaceutical publisher regarding the prospects for Crowdfunding in the life sciences industry.

Why did you decide to get into Crowdfunding?

As an investment banker, I observed the contraction of early-stage development financing sources (*i.e.*, Venture Capital) over the past five years. In response to the consolidation of these traditional sources of capital, early-stage companies attempted to secure capital from alternative sources ("Retail") including Angels, Accredited investors, entrepreneurs, and family offices with limited success given the inefficiencies and costs associated with attracting capital from a disparate and unfamiliar investor base.

Crowdfunding and Social Media tools including "ePlatforms" (ePayment, eDocuments, eCustodial, eDue Diligence, eFinancial Reporting) have improved the odds of raising capital from "Retail" investors by streamlining the process of identifying, attracting, and securing capital.

What is your approach to Equity Crowdfunding?

SJA's approach is to complement the prevailing investment interests (lowering follow-on financing risks) of traditional life science "ecosystem" constituents including Angel and Venture Capitalists throughout the financing continuum of "Seed to Exit." SJA is in a unique position to educate and build partnerships with these ecosystem members given the Company's institutional investment banking and large pharma/biotech pedigree.

Why does Crowdfunding work? How does Crowdfunding work in niche markets?

Crowdfunding works by democratizing the flow of capital to promising start-ups. When the JOBS Act receives FINRA/SEC approval, Non-Accredited investors will have the opportunity to invest in private companies leveraging Crowdfunding technologies to diversify holdings across early-stage privately owned companies. Advancements in Crowdfunding technologies (*i.e.*, eDocuments/Payments, online due diligence and financial reporting) will assist early-stage companies raise capital from Non/Accredited investors more efficiently than current strategies which are largely opportunistic at best. Promising Crowdfunding platforms such as *FundersClub* and *HealthiosXchange* are utilizing these Crowdfunding technologies to attract investors interested in funding early-stage privately owned companies but currently dissuaded by existing Angel Group models requiring cumbersome time commitments (meetings), obligations to pay annual dues, and high investment threshold minimums (inability to diversify within a risky asset class).

Niche Crowd Finance platform such as *CircleUp* (focused in the consumer goods industry) and *HealthiosXchange* (healthcare sector) are ideally positioned to capitalize upon their domain expertise (both companies originate deals and have institutional pedigrees) and "Rolodex's" of industry ecosystem members (Large Pharma/Biotech, Venture Capital) to successfully Crowdfund Non/Accredited investor capital. As evidenced by the recent collaboration of *CircleUp* with *Procter & Gamble*, Fortune 100 companies are seeking to partner with Crowd Finance platforms that can identify promising companies attracting capital.

What's the future of Crowdfunding? Is it just a fad?

The Financial sector along with Education and the Defense Industries have experienced limited disruption *vis a vis* other industries (*i.e.*, Media/Music) given high levels of government regulation. Crowdfunding has the potential to both disrupt and augment these regulated industries by increasing capital fundraising efficiency and lowering costs for Reg D/Rule 506 offerings. The relevant questions are not "if" but "when" and "by" how much will Crowdfunding impact the financial industry.

FundersClub and HealthiosXchange attract investors interested in funding early-stage privately owned companies but currently dissuaded by existing Angel Group models requiring cumbersome time commitments, dues, and high investment threshold minimums.

How would you describe the current environment for funding for biotech/life sciences companies?

The current funding environment is still reliant upon traditional ecosystem members including Incubators/Accelerators/Angels (early-stage companies) and Venture Capitalists. Raising capital from Accredited Investors has been inefficient due to the challenges associated with identifying investors and inability to provide a financial vehicle wherein these investors can diversify. Provided only one out of 20+ life science companies succeed, developing viable platforms including those leveraging the Form D exemption (*FundersClub*, *HealthiosXchange*) are critical for providing diversification across a number of early-stage healthcare companies.

Though the amount of capital invested last year in life sciences is near historical averages, the distribution of capital ("Bell Curve") across a range of companies has decreased in tandem with the rise of larger syndicates investing in "hot" targets/technologies (*i.e.*, cancer stem cells and epigenetics in oncology) and focus on later-stage companies. As a result of this investment concentration, companies with compelling technologies are not receiving funding or capital in a timely fashion impeding the advancement of pre/clinical programs and contributing to the "innovation gap."

How important is this early stage funding for companies?

Very important. The emergence of Crowdfunding (Non/Accredited) and "Hybridization" of this capital with traditional sources of financing could never be timelier. Most industry experts agree given the large amount of capital required, Crowdfunding alone will not be the answer to most emerging growth healthcare company's capital needs. However, Crowdfunding is projected to be a valuable source of capital for companies suffering from the "Valley of Death," (lack of investment capital in early-stage companies), advancing development programs to "proof of concept" and hopefully institutional validation and exit.

Is Crowdfunding a feasible alternative to other types of funding streams for life sciences and biotech? Could it raise enough money? Research suggests $300–$500K...

Industry experts project $300–$500k as the most probable range for raising capital from Non-Accredited Investors (JOBS Act) given the JOBS Act requires Audited financials for companies seeking over $500k in capital. This capital range will provide limited value for advancing pre/clinical programs to proof of concept given the high costs associated with preclinical studies (Toxicology and PK/PD), IND filing costs, Intellectual Property submissions, and other expenses. However, Crowdfunding capital is expected to be utilized in conjunction with more traditional sources including Angel/Venture Capital or what is defined as "Hybridization." Crowdfunding capital within these ranges may also be of value to companies interested in funding via "Rolling Closes" or capital distributions matched to meeting certain milestones.

Conversely, Crowdfunding capital from Accredited investors ("Rich Man's Crowdfunding") is projected to be much higher as evidenced by recent financings completed by Crowdfunding site *CircleUp* in the consumer goods industry through Reg D/Rule 506 ($2.5MM investment in one company).

There is currently a relatively lack of interest in funding life sciences companies through Crowdfunding. What is the explanation?

Primary reasons for the perceived lack of interest in in funding life sciences companies through Crowdfunding are due to the capital intensive nature of the industry and prevalence of alternative markets (*i.e.*, Consumer Internet) with more favorable risk/reward profiles (limited or no clinical, regulatory and commercialization risks). There is also the perception that Crowdfunding capital and the resulting fragmented "Cap Table" will be unappealing to Institutional investors wary of "Retail's" history of being litigious. Leading Crowdfunding Portals (*HealthiosXchange, FundersClub, CircleUp*), have implemented creative ways to take "Retail" capital and make it look "Institutional" via Special Purpose Entities (SPE's) and by issuing stock classes with varying voting/registration rights. If these creative deal structures can deliver on the promise, Institutional and Accredited Investors will feel more comfortable co-sponsoring investments in the life sciences sector via Crowdfunding.

HealthiosXchange is implementing other strategies to make the life sciences industry more appealing to high-net worth investors/Angels including providing easy-to-use Crowdfunding tools including online due diligence and communities, transparency and security of capital (custodial, ePayment, financial reporting), and facilitating investments/support throughout a company's life cycle "Seed to Exit" including investor liquidity via the Company's secondary trading platform (*LiquidEvents*).

Under Equity Crowdfunding, investors receive ownership in a privately owned company and are motivated by return on investment.

What is the legality of Crowdfunding?

Raising capital from Accredited investors has been legal and vibrant for many years in the United States under existing Reg D/Rule 506 exemptions. In 2011, companies raised over $905 billion through Reg D offerings. Even though a majority of this capital was raised in "yield" and "asset-backed" securities including oil and gas and private non-traded REIT's, it still illustrates the power of this financing vehicle.

HealthiosXchange, launched by a leading healthcare investment bank, Healthios, is leveraging the Reg D exemption to launch the company's *Ex.PR.E.S.S.* securities platform designed to raise follow-on capital ("Side Cars") for Angel and Venture Capital-backed companies with strategic validation (partnership with large pharma/biotech), and near term exit potentials (12-24 months). Improving the risk/return profile for retail investors via platforms like *Ex.PR.E.S.S.* are critical since private companies in the life sciences sector do not yield (interest) or have short investment horizons both important to retail investors.

The JOBS Act will enable Crowdfunding from Non-Accredited investors (Title III of JOBS Act). The SEC/FINRA have set preliminary investment thresholds per investor per year subject to change, based on the investor's net worth and annual income. These governing bodies have been slow to implement this JOBS Act language given sensitivities surrounding the potential for fraud. Title III of the JOBS Act is forecasted to be signed by the end of 2013/early 2014.

Title II (Reg D) and Title IV (Reg A+) of the JOBS Act seem to be gaining more support/traction with regulators as a result of the focus on an approved investor base, Accredited Investors. Title II contains provisions for General Solicitation of securities (no pre-existing relationship required to solicit investments) and increases the shareholder cap from 500 to 2,000 investors before a company would be required to "go public," both integral to the proliferation of Crowdfunding Accredited capital under Reg D. Title IV expands the capital ceiling for Reg A offerings from $5 to $50MM (Reg A+).

What is the difference between equity Crowdfunding and non-equity Crowdfunding?

Equity Crowdfunding differs from Non-Equity Crowdfunding in that under Equity Crowdfund, investors receive ownership in a privately owned company and are motivated by return on investment (ROI) whereas non-equity Crowdfund participants are motivated by intrinsic and/or "reward" goals such as prepaying for a product.

The optimal strategy for emerging growth companies is to target all sources of capital including Equity and Non-Equity Crowdfunding in an effort to meet the capital requirements of advancing therapeutics to approval. Viable sources of capital available to emerging growth companies includes the following:

- Crowdfunding Accredited Investors under Reg D (Title II) and Reg A+ (Title IV) of the JOBS Act
- Crowdfunding Non-Accredited investors under Title III of the JOBS Act (approval required by SEC/FINRA - JOBS Act)
- Non-dilutive capital via charities, Foundations, and high-net worth individuals with "Compassionate Use" goals
- Angels
- Venture Capital
- Venture Debt
- Royalty-based financing
- CRO Investment mandates

What can Crowdfunding offer that donating to research charities can't?

Crowdfunding allows donors to control the allocation of their contributions and monitor those investors over time. One major charitable group dedicated to philanthropy, Foundations, are realizing the advantages associated with self-directing capital into the most compelling life science companies.

Based upon the successful Vertex/Cystic Fibrosis Foundation collaboration (approval of *Kalydeco),* Foundations are increasingly pursuing direct investments in life sciences companies via L3C models wherein Foundations invest in "for-profit" companies without impacting their tax-exempt status. This model has proven to be as or more successful than traditional Foundation models of investing in academia or charities who oftentimes allocate funds to organizations more for publicity/fundraising purposes (recent investment by a prominent charity into large pharmaceutical company, Pfizer). To meet this change in strategy, *HealthiosXchange i*s launching a portal called *Foundation Place*, empowering "Venture Philanthropy" or the funding of emerging growth healthcare companies "directly" with economic return being one of the goals (cannot be primary driver — social good being the primary goal).

What areas, i.e., therapeutics, do you think will most benefit from Crowdfunding?

Most life sciences sectors should benefit from Crowdfunding given the immense clinical unmet need across many disease states including infectious disease, oncology, and neurological/CNS. However, as with institutional capital sources, Crowdfund investors will seek investments with optimal risk/return profiles, strong management teams, validated molecular targets, strategic validation/partnerships, and those pursuing orphan drug designations and later-stage compounds.

Hybridization, or the aggregation of capital from various sources, is the future for Crowdfunding in the life sciences industry. There are two ways to approach Hybridization, 'top down' and 'bottom's up.'

As for Crowdfunding non-dilutive capital, disease states with high emotion return ("Compassionate use") and clinically unmet need will gain a large percentage of Foundation/charity capital including: Alzheimer's, Parkinson's, Cancer, CNS/Depression.

Is there a risk only the more sexy diseases will get funded?

Yes, that is a concern but is consistent with the democratization of capital meaning capital flows will be based upon supply/demand. However, since Crowdfunding capital is sourced from various donors/entrepreneurs with myriad goals and aspirations, Crowdfunding capital should flow into a large number of disease states. Investors are also projected to invest in sectors of healthcare with lower capital requirements/regulatory risks (*i.e.*, Healthcare information Technology) and sectors generating EBITDA (*i.e.*, Healthcare Services).

The product pipeline is dwindling at many pharma/biotech companies. Is Crowdfunding a solution to plugging the "innovation gap?"

Crowdfunding is one of the solutions to the "innovation gap." Crowdfunding is an ideal platform for aggregating capital, information, and data since this funding vehicle "Crowdsources" information from many different sources lowering costs of managing and communicating data and increasing productivity/levels of collaboration ("Share is the new Search"). The web has a proven track record of reducing costs and increasing efficiencies in many other industries and the same will hold true for Financial markets. The degree of impact may be less given the financial markets are highly regulated. However, change is imminient and constituents with high cost structures (broker dealers, State Regulators) will experience disruptions to their business models as a result of Crowdfunding.

What happens later on when the company needs additional financing?

Hybridization, or the aggregation of capital from various sources, is the future for Crowdfunding in the life sciences industry. There are two ways to approach Hybridization, "early-stage/

Non-Sponsored" and "Institutionally Sponsored." Healthios' Crowdfunding portal, *HealthiosXchange*, utilizes both approaches for raising capital. From an institutionally sponsored perspective, the Company's *Ex.PR.E.S.S.* securities offer Crowdfunders the ability to invest alongside institutional/Angel "lead" investors whereas the Company's *Crowd Finance* Portal is designed to raise capital from Angel's and Entrepreneurs not part of Angel Groups who want exposure to early-stage companies (Non-Venture Capital backed companies).

Healthios is executing this "Seed To Exit" pathway to assist emerging growth healthcare companies raise capital throughout their life cycle. Healthios motto is "Compliment" not "Disintermediate" existing constituents who are valued members of the financing value chain (~Venture Capitalists).

What do you think is the biggest challenge for Crowdfunding in life sciences?

The biggest challenge is gaining the support of key ecosystem members. As example, many Angel's still view Crowdfunding as disruptive and a threat versus a platform to leverage for capital, deal flow, and membership growth. For Venture Groups, Crowdfunding is viewed from indifference (won't raise enough money to be meaningful) to opposition (don't want to partner with vehicles/investors known to be litigious and with limited appetite to provide follow-on capital let alone the resulting fragmented cap structure). For emerging growth biotechnology companies, many see Crowdfunding as a viable alternative to existing funding mechanisms that have turned them away, however, others see challenges associated with the time commitments needed to communicate with a diverse set of investors, and the potential loss of Intellectual Property. ■

For more information

Life Sciences Equity Crowdfunding white paper

Learn how life sciences companies can raise investment capital via Crowdfunding. When should life sciences' companies raise Equity Crowdfunding Capital? What are the benefits of diversifying the investor base through Equity Crowdfunding? How can Equity Crowdfunders and Angels/Venture Capitalists work together? This paper answers these pressing questions posed by industry executives and financiers. **Read it here ▶**

Venture Philahthropy L3C Crowdfunding white paper

Foundations are required to give at least 5% of their yearly assets to a charitable cause/purpose in order to maximize tax-exempt status. In this White Paper, learn how L3C Crowdfunding can be used to raise capital from Foundations, and individuals with "Compassionate Use/Charitable" intent. **Read it here ▶**

ShareVault Webinar on Crowdfunding

In this webinar hosted by ShareVault, Scott Jordan describes the different platforms available to Life Science companies including Equity and Non-Equity/"Compassionate Use" Crowdfunding. He also reviews the JOBS Act and its provision for Equity Crowdfunding. Finally, Scott assesses the value of Equity Crowdfunding for Life Science companies including Seed, Bridge and Side Car financings. **Watch it here ▶**

HealthiosXchange

Learn more about the Crowdfunding portals at *HealthiosXchange*, including *Foundation Place, Ex.PR.E.S.S.* and *Crowd Finance.* **See the presentation here ▶**

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