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FOR INSTITUTIONAL INVESTORS & ASSET MANAGERS

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Biotech and innovation

James Williams interviews Peter Kolchinsky of RA Capital Management.

Peter Kolchinsky is a founder, Managing Director and Portfolio Manager at Boston-based RA Capital Management, which runs the USD1 billion Crossover Fund. The Fund specialises in funding innovation in private healthcare and life science companies in the early stages of development, helping them fund IPOs, as well as provide follow-on financing when they become public companies.

The fund portfolio is split roughly 50:50 between private and public companies and has a unique structure as one part private equity/venture capitalist – "We like to get involved and roll our sleeves up," says Kolchinsky – one part stock picker that operates as an 'intellectual activist', and one part seeder, backing companies from day one.

At the heart of RA Capital lies a think tank called TechAtlas; a 35-strong team of experts and PhDs in biotechnology and other life sciences that scour academic journals and drug research development programmes globally to map out the latest advances in gene therapy, infectious diseases and so on.

"Since 2012, when we started pursuing this 'crossover' strategy in earnest, it has worked very well. We've proven that there is a viable new integrated model for investing across the risk-reward-liquidity continuum instead of the orthodoxy of hedge funds investing in only the best public or VCs investing in only the best private companies. The best science isn't constrained by this divide and neither should we be," says Kolchinsky.

Kolchinksy's argument is that most healthcare and biotech companies would do well to go public whenever they can, at whatever price they need to. In that respect, RA Capital acts as a platform that allows management teams to tap the markets the best way possible. "They can join as a private company, and we will help them crossover to the public markets and lower their cost of capital by reaching a broader investor base," says Kolchinksy, who continues:

"The platform has recently expanded to company formation, allowing us to get involved with a great team and technology at inception. We just formed one such company and own 80 per cent of it from the outset. So our investors are now seeing the next phase of our evolution, having moved from a purely public to a crossover fund manager, and now to one that is a fully integrated investment platform that we think gives them the best chance of capturing alpha from biotech innovation.

"We invest in the companies with the most compelling risk-return-liquidity equation, not just the best risk-return on the private side or best risk-return on the public side."

Overseeing the management of a USD1 billion biotech fund wasn't exactly the path that Kolchinksy envisaged when he graduated from Harvard University with a PhD in virology 14 years ago.

Prior to graduating, Kolchinsky ran into Rich Aldrich, a co-founder of drug developer Vertex Pharmaceuticals, at an investors' conference. Upon graduating in 2001, Kolchinsky contacted Aldrich to see if there were opportunities to work in business development. Aldrich replied. He had just left Vertex to set up an investment firm/consultancy and was looking for someone young, hardworking and with a science background.

"It was a great opportunity to learn the ropes from one of the most experienced and respected people in the industry. Rich wanted me to oversee an account that had USD4 million of cash and shares of public biotech companies. My job was to advise on what he should be buying or selling in that account," explains Kolchinsky.

Kolchinsky soon discovered that his scientific expertise enabled him to make shrewd stock picking decisions, identifying companies that had innovative products that the market was overlooking and underpricing. One of these was Triangle Pharmaceuticals, whose stock tumbled while running a trial of an HIV drug in South Africa when the Ministry of Health declared that HIV did not cause AIDS and terminated all research in the country.

"I'm a virologist so if there was ever a case where I could say: 'No, you're wrong about that', it was that moment. Gilead bought Triangle at the end of 2002 and the drug ended up creating a lot of value for Gilead.

"I got a taste for buying at the bottom while the rest of the market had given up on a stock. That encouraged me to seek out more undervalued companies that were still in the development stage.

"There's not much financial analysis to do on these companies – they have a certain amount of cash and are burning it at a certain rate. You don't need to be a CFA. You just need to decide if the drug or technology they are working on is likely to prove valuable in the time they have left before they run out of money," states Kolchinsky.

As Kolchinsky continued to hone his skills at identifying the best public biotech stocks, Aldrich's USD4 million

RA Capital Management team (L to R): Andrew Levin, Managing Director; Tomas Kiselak, Managing Director; Peter Kolchinsky, Managing Director & Portfolio Manager; and Rajeev Shah, Managing Director & Portfolio Manager

portfolio soon grew, to the point where, in 2004, Aldrich gave his permission to convert his personal portfolio into a proper fund structure. RA Capital, as an institution, was born.

"In 2004 I hired Raj Shah (now also a Managing Director and Portfolio Manager) and together, we have built the firm into a crossover fund manager that currently has 50 employees and approximately 200 investors," says Kolchinksy. "We built a database to populate with our thoughts and notes so that, if either Raj or I started doing diligence on a company, the other could finish it. This centralised knowledge system and our collaborative principles evolved into what we now call our TechAtlas division, the research engine of over 35 people at the heart of our organisation that is continuously mapping out the research and drugs, diagnostics, and medical devices of thousands of companies around the world fighting the battles against cancer, Alzheimer's, Parkinson's Disease, diabetes, etc."

The TechAtlas team works to identify which smaller companies the big biotech and pharmaceutical companies might need to acquire to out-compete their peers at creating the best treatments for particular diseases.

Many private companies are unlikely to stay independent long enough to become large operating companies. As Kolchinsky notes: "They are more likely to be assimilated into existing public companies and we're trying to assist in that process with TechAtlas."

The types of questions it asks are: What are all the different drugs that the scientific community is trying to bring to bear on particular problems? Which companies have the best drugs that work in various complementary ways to combat MS, for example, from multiple angles, not just relying on one drug?

"That's how we analyse all the different drugs and companies out there to make sure we can identify those that will end up being on the right side of history.

"Take Novartis for example. It is well equipped in the MS space, but there are some gaps in its offering. So we ask: 'Which small private companies could Novartis potentially acquire to close those gaps and be more competitive with Biogen, one of the dominant MS competitors?' Once we have an answer, our assumption is that Novartis will reach similar conclusions and pursue acquisitions that are in its strategic interest.

"Novartis and Roche have anti-CD20 antibodies that can treat sufferers of progressive MS, but Biogen and Teva don't. TG Therapeutics, which we own in our portfolio, is one small company with an anti-CD20 antibody, so we figure there are at least these two potential buyers, Biogen and Teva, for this one rare asset," explains Kolchinsky.

Currently, the Crossover Fund holds 20 public company positions and 20 to 25 private company positions.

Although the TechAtlas looks at global companies, much of its focus is on the US where cities such as Boston and San Francisco continue to dominate global biotech.

The typical size of investment that RA Capital makes in a private biotech company ranges between USD3 million and USD20 million. Not that the size of investment necessarily correlates to the potential return on offer. A USD10 million position in a private company could end up being more compelling, from an expected return perspective, than a USD20 million position in a public company, according to Kolchinsky.

He says that with respect to private company investments, RA Capital commits not only financial capital, "but also intellectual capital. We put a lot of work into helping our portfolio companies in any way we can. We roll up our sleeves and do the same sort of things you might hear about in venture capital.

"In that sense we are truly active investors, though we are not 'activist' in the conventional sense of trying to force management to do anything. We are always thinking about what our portfolio companies can do, tactically and strategically, and sharing our best ideas, constructing and presenting our arguments, but it's up to the management teams to decide if the ideas are good enough to act on. You could say we are an intellectually active manager."

RA Capital's 50-strong investment and research team represents the highest amount of bandwidth, relative to AUM and in all likelihood has "the highest deal flow of any fund manager operating in biotechnology", Kolchinksy says.

The Crossover Fund has now re-opened to investors as the firm looks to build further assets. "We believe the strategy can put a considerable amount of capital to work," concludes Kolchinksy. ■