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RA Capital: Flexibility builds innovation



Peter Kolchinsky, Managing Director, RA Capital Management

Flexibility is the watchword for investment at RA Capital Management. As Peter Kolchinsky, managing director, explained, “Investors should be as flexible as possible. Therefore, we’re a crossover fund manager. We invest in biotechnology companies whether they are public or private companies and, increasingly, are putting our efforts into company formation.”

RA Capital Management chooses not to limit itself to early stage, late stage or other categories. Instead, he said, “We want the flexibility to invest in any way that is appropriate for a given concept. If, for example, a company already is public and is the best at what it does, we want the flexibility to invest.” Conventional fund structures could restrict that option.

By eliminating such restrictions, the company retains many ways to invest. They may include direct investments, private placements, stock purchases on the open market or follow-on financings, for example. Additionally, it also has the flexibility to develop a company around a compelling idea.

“This flexibility creates a continuum, so we can approach a company at any point of its lifecycle. If we focused only on venture capital, for example, we would cut ourselves off from some great public companies,” Kolchinsky said.

We originate conviction

That flexibility comes with a clear investment philosophy. Chief among its rather pithy values: “We originate conviction. We do not borrow it from others.”

This means, Kolchinsky said, “that when presented with data we find compelling, we are willing to be the first to invest. If everyone waits for someone else to be first, who will capitalize the idea? Successful entrepreneurs by definition originate conviction in an idea and in themselves. They typically need at least one investor to appreciate the merits of their idea. We try to be that investor.”

Formed by managers who all began their careers as scientists, RA Capital Management has the courage of its convictions. “You have to speak the language of science and parse data to invest well in life sciences,” Kolchinsky said.

“We try to be as proficient in healthcare and in the life sciences as possible, to originate conviction based on our analysis of the data and assessment of professional competency of the management team.” Once convinced, RA Capital can catalyze the formation of an investor syndicate.

Not all investment firms have deep scientific expertise and such confidence. As he said, “Some investors are confident they know the science and can distinguish between good and bad ideas and approaches. Others are clear that they will only invest once there is a lead investor. Many vary depending on the deal. An investor who leads an investment in one area he or she knows well, maybe cancer, might be less confident in another, like gene therapy, and only join after someone more specialized has validated the idea.”

Stock fluctuations

To highlight the implications of adhering strictly to trend reports, he cited stock sell-offs. “When a stock drops, some people become desperate to sell it. They are losing confidence in that stock because other people are selling it. Prices dip lower, yet often the fundamentals of the company haven’t changed.”

When that happens, he said, ask why the stock price dropped and whether the fundamentals are changing or just perception. “Science moves slowly relative to the ups and downs of financial markets,” Kolchinsky pointed out.

“Among investors who don’t understand the data well enough to say the crowd is wrong, a declining stock price is a powerful motivation to sell,” he said. “Investors who, instead, anchor themselves to the fundamental value of the company will buy that stock and halt the fall. At the nadir is an investor who originates conviction,” and by that conviction catalyzes renewed enthusiasm among investors. Kolchinsky said RA Capital is always striving to be that that key investor.

Kolchinsky advises companies to take a long view of the stock market. “If you look at the past five or ten years, the recent fluctuations are merely a blip. If a company is well-capitalized, it can still move full speed ahead without changing its plans. If, however, a company has only one year of cash left, the near-term stock market conditions may affect its ability to raise funds.” The implications of stock fluctuations, therefore, are relative.

Data-driven decisions

To build conviction, RA Capital focuses on evidence-based investing. Kolchinsky likens this to physicians who make decisions based on data rather than relying solely on their own personal experiences. In medicine, he says, evidence-based decisions ensure that treatments are chosen because they have been proven to work in trials, not because of anecdotal reports that a few patients improved. Like savvy physicians, “We’re driven by the data.”

RA Capital Management’s employees, in identifying the company’s pervading values, said, “We address the elephant in the room,” which is to say that they do not hesitate to address their concerns so that they can be discussed and hopefully resolved. “Some people play their cards close. We believe in letting companies and each other see our thought process,” Kolchinsky added. He expects the management team at companies of interest to do the same.

For example, when assessing the management teams of potential investments, “We look for earnestness and competence. We don’t want embellishment. If there’s a problem with a program – and they all have some problem – lay it out for us and show us several strategies to resolve it. Don’t make us dig for it.” If investors have to dig to find something, he says, it makes them wonder what else may be hidden.

Individual merits

In evaluating companies in which to invest, RA Capital looks at each option as a special case. Within the life sciences, “we have no hard and fast rules regarding what we consider as potential investments,” Kolchinsky said.

“We believe in maximal flexibility and being prepared. We generate good returns on investment by finding underappreciated, innovative companies in our space. You never know where or when the next breakthrough will emerge. We look at public and private companies in medical devices, drugs, diagnostics and other areas, though typically drugs offer the most upside.”

As part of its research, RA Capital maps drugs and technologies within therapeutic areas to understand the competitive landscape for treating each disease, including the drugs and the companies developing them. For example, he said, “dozens of companies are targeting lung cancer with EGFR, ALK, and other kinase inhibitors, PD-1, various kinds of vaccines, and chemotherapy. How do these technologies relate to one another and combine to give a patient the most benefit? Which companies have all the best elements so as to both beat the disease and beat other companies?”

“Think of our maps as chessboard diagrams, showing individual drugs as the pieces. In this analogy, the maps facilitate collaborations between the bishop and knight, for example,” he said. In practice, these maps help identify

promising companies for investment, as well as potential synergies among compounds or companies that may lead to innovative collaborations or acquisitions.

“We also hope to employ this approach in a collaboration with a leading contract research organization (CRO) to design some of the most sophisticated oncology trials ever conducted. It’s in the vein of the earlier I-SPY trials and involves pooling drugs into one clinical trial, enabling patients to benefit from the therapies that are best for them,” Kolchinsky said.

To further catalyze innovation, RA Capital also champions its Executive-in-Residence (EIR) program in which “people who have a background of forming or managing companies join our company, see the industry and hundreds of companies from our perspective, evaluate available technologies, and use these insights to inform their next career moves,” Kolchinsky said.

“We want to see how someone we respect with real industry experience, when empowered by our platform, chooses from among all the options to invest their precious time and reputations, because maybe our capital should follow.” For the EIR, it’s an opportunity to see how investing is done from the inside as they consider forming new companies or joining existing organizations.

Focus on solutions

“Our philosophy focuses on solution development. A company should define itself by the problem it aims to solve, not the drug it hopes to develop,” he said.

Hepatitis C therapeutics are one example. In 2014, three years after commercialization, Vertex took its first-in-class protease inhibitor Incivek™ (teleprevir) off the market, ceding that space to Gilead and AbbVie’s better combination therapeutics. “Patients didn’t need a protease inhibitor. They needed a cure.”

Vertex, in the meantime, shifted its focus to cystic fibrosis, developing the first potentiator and corrector, Kolchinsky said. “It combined them into one regimen that did more than either the potentiator or corrector could do alone. Many of its competitors have only one or the other.”

RA Capital Management’s flexible approach to investing highlights the best in public and private companies, large and small. It is designed to bring bright people together to innovate in ways that would be unlikely or even impossible alone. There is no limitation on innovation, so why should there be limitations on investing?

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