

Recaps and turn arounds don't always work out. Board's choices when that imminent Series B does not happen

(Case prepared by Raza Shaikh)

Executive Session after the Board Meeting: August 29, 2021, 4:30pm

You are on the Board of Directors of the Alzheimer's Early Diagnostics Corp (AEDC). A board meeting has been called to discuss what company should do as it has so far failed to raise money including the latest Series B lead that fell through.

Background:

1. **Company:** AEDC is creating and developing a simple, innovative, non-invasive eye scanning test for the early detection and diagnosis of Alzheimer's Disease called Sapphire II. The test is based on detecting Beta Amyloids and is envisioned as a special ointment application and then a scan with their reader instrument like what one sees at the optometrist office. With 50+ issued patents the core IP of the company is solid. AEDC has been around since the 2005 and over time has brought the nascent science into potential for commercialization. The regulatory pathway for the company requires clinical studies and demonstrating high specificity and selectivity for their diagnostic test and ultimately to receive an FDA approval for their test. The current gold standard test for detecting Alzheimer's is a PET scan costing around \$8K but AEDC a test that is less invasive and more importantly that Beta Amyloids develop in the eye much earlier hence provide early detection which can be crucial for early intervention. With recent approval (though controversial) of the Biogen's Alzheimer drug AEDC got a new life as now something can be done if such a test was available.

2. **Fundraising History:** AEDC went through several rounds of financing with venture & equity money as well as non-dilutive research grants. In total the company has raised more than \$40M to date. Bulk of these investments were made by the corporate venture arm of a major conglomerate and a large/famous family office with alignment with the mission. However, by 2019 despite good tech and great promise the company was faltering, mismanaged, and burned through a lot of cash without reaching a milestone allowing it to be sold. At that point the large CVC and family office investor gave up on the company and pulled any further financing. The CEO and some top management left. In October 2019 AEDC raised \$2M from angel investors on a pre-money valuation of \$4M on a recap round dubbed as "Series R". This was an attractive deal for a company with some solid assets and a lot of money in. You all became board members with this round of financing and a new CEO was brought in, who also invested, as part of this recap round. The stated goal now was to use the \$2M for enough progress leading to a Series B raise of \$15M that allows milestones to be achieved that the AEDC can exit via acquisition in the next 2.5 years!

3. **Since Series R:**

- The new CEO Jane Smith got to work bringing in several new clinical, regulatory and manufacturing consultants, a scrubbed development timeline including needed change in a manufacturing supplier, a preparation of a \$2.3MM SBIR grant submission due May 1, 2020.
- Of course, the pandemic hit, and everything went virtual and had a good amount of impact on the pace of work.

- In April 2020 the CEO asked the board to approve the extension of the Series R round to \$3M allowing to ask for another \$1M from the same angel investors. The company raised most of it.
- AEDC spent on a range of operational issues in preparation for the final trial required to achieve FDA approval. These included updating the device software, changing the manufacturer of the eye ointment, building a team of staff and consultants to manage the final product approval, and maintaining the portfolio of intellectual property.
- By this time, the company was running out of money again as the conversations with venture capitalists and family offices for the Series B raise were not bearing fruit which was a little surprising to the board. AEDC consequently raised another \$1M on a convertible note with a \$12M cap on the valuation.
- One important goal for the Series R was to convince the FDA to award the “Breakthrough Designation” to this test allowing the FDA process to be expedited. AEDC took much longer than expected but ultimately did receive breakthrough designation.
- The board has been working with Jane Smith on the oversight of Series B fundraising efforts. She has insisted on engaging a broker to help with the raise and the board interviewed and did not think the broker was good. Jane Smith still went and engaged with the broker as consultant but ultimately did not result in a successful fundraise.
- On another occasion the board itself found in their networked, vetted and guided Jane Smith to work with another fundraising facilitator and despite the promise that she will follow-up, she completely ignored it.
- We are now approaching May 2021 and there are other signs of slow progress from the board’s perspective. The board also is observing that zoom-only meetings allow Jane Smith to tightly control the information to the board with consultants working in silos.
- The board has become very concerned on Jane Smith’s capability and skill to do a fundraise even in a hot fundraising environment. The board during this time had found from others that Jane Smith was litigious towards her last employer, was combative and did not demonstrate good execution skills.
- The final straw was the falling of an exciting term sheet from a well-known VC firm in town for reasons that pointed to Jane Smith’s ability to close the deal.
- The company today has about four months’ worth of cash left in the bank

4. **Jane Smith’s Employment Contract:**

- Jane Smith herself had made a nominal cash investment at the time of her joining as the CEO
- She did not take any pay while Series R was raised
- Employment contract has provisions for any Accrued Obligations (unpaid salary, PTO etc.) to be paid at the time of the severance
- The severance clause of the employment contract requires 12-month pay and any additional “severance bonus” in case of termination for good reason where the CEO is asked to resign.
- In case of a termination without cause Jane is not entitled to the severance bonus
- The company also has to cover the healthcare insurance costs for the severance period

The board is meeting without Jane Smith on the request of two directors representing the Series R and attended by the other two non-management directors. They have the following questions to ponder.

I. Discussion Agenda:

- 1.** As a board, we have seen now many signs putting it in doubt whether Jane Smith is the right CEO. Have we reached the point where we must find a replacement?
- 2.** Having a new CEO requires enough capital to incentivize him/her and we are running out of capital with less than two months of cash left. How can we find and incentivize a new CEO?
- 3.** The board truly believes that there are good assets and IP here. Series R was already a recap and without raising the Series B should we as a board consider shutting the company down and selling the IP assets?