

Contributors

Medical devices: Silicon Valley's emerging glamour sector

By Robin Bellas 09.6.06



Robin Bellas

Editor's note: We asked Robin Bellas, a partner at Morgenthaler Ventures, to write a guest post about the medical device sector. As we've [mentioned before](#), this may not be as sexy as Web 2.0, but it's a good deal more reliable. When was the last time you heard of an Internet company go public? Morgenthaler has two device companies about to go public (Thermage and Xtent), and both could be worth \$1 billion or more. We'll stop there. Don't want to make Bellas' point for him.

All my Valley colleagues searching for the proverbial “New New Thing” need to reorient their gaze. Don't scan the hazy IT horizon; don't look all the way to Asia. Instead, look around you at that longtime VC backwater: medical devices. With almost no attention from the media, that sector, largely based in California, has been taking on many characteristics usually associated with more glamorous sectors.

In just the last couple of years:

- The valuations of mature private device companies have risen three-fold.
- The valuations of younger private companies, after a predictable lag, are up 2.5-fold. (We've seeing \$2.50/share paid for a Series B rounds that two years ago would have fetched just \$1/share.)
- Although starting from a smaller base, medical device funding has been outpacing most other established VC categories. (Last quarter it was up by 30%.)
- The “window” for medical device company initial public offerings, rarely opens, except for a speculative year in 1996, has now stayed open for three whole years. Even though

the window is narrowing of late, there still appears to be room over the next six months for high quality candidates.

For a long time, medical device investing was a “hits” game—steady singles, doubles and triples, but rarely home runs. We’d look at the gaps in the product portfolios of the big medical technology companies (Johnson & Johnson, et al) and develop a new valve or closure device to fill them. A typical good hit would be an exit via a \$50-\$100 million acquisition. Now we’re seeing more and larger hits: Conor Medical Systems (stock market valuecap: \$1 billion) or Kinetic Concepts (stock market valuecap: \$2 billion) for example.

Why the change?

1). Medical devices are getting better. Better materials, improved designs and less invasive procedures that replace difficult and dangerous open surgical procedures—open heart surgery, lung surgery, bariatric surgery, face lifts, etc.—with comparatively simple outpatient procedures. Who wants to have their stomachs cut open and their intestines re-plumbed, then convalesce for weeks, when they can control obesity much more easily? Satiety, one of our portfolio companies, has just completed early clinical trials that shrink stomach size by painlessly stapling the stomach smaller via a scope down their esophagus—all in a one-hour outpatient procedure.

2) A large, aging population that wants to live gracefully until the end and is willing to pay for it. Cosmetic surgery, increasingly knifeless, and using such energy sources as lasers and RF, has become a standard feature of middle class life. A future of wrinkle-free faces and attractively-contoured 80-year-old bodies lies before us!

3) Certain markets have become large enough to support independent companies and thus their IPOs. The most obvious is the \$6 billion market for drug-eluting stents, where we expect procedures to double over the next five years. Other potentially large markets include aesthetics, the spine and the eye. In the future I also expect a combination of stem cells and improved device technology to produce nearly lifelike shoulder, hip and other implants—and some more IPOs.

Finally, I’d like to remind my IT VC colleagues of one other major advantage we device VCs enjoy: Faster exits. To qualify for an IPO, most IT ventures must now be almost completely mature companies with clear-cut profits, after expensing Sarbanes-Oxley and other new regulatory costs. That adds years and shrinks the investor’s return. Device companies, for the most part, don’t face that. Many device companies just need clinical proof of principle in a small number of human cases to either find a corporate buyer or even to go public. For the Valley, that’s always got to be exciting.

Robin joined Morgenthaler Ventures in 1983 after ten years of general management experience in emerging growth companies. Robin was General Manager of the Electronics division of Harshaw before joining Morgenthaler. Earlier, Robin held sales and marketing roles at Acurex, a venture-backed startup in Mountain View, California.

After business school, Robin began his career at SHM Nuclear, a startup in Sunnyvale, California, that was acquired by EMI Medical. Robin has been responsible for Morgenthaler's investments in numerous Life Sciences and Information Technology companies that have completed public offerings or successful mergers. He is a Director of Ardian Medical, Cabochon Aesthetics, CareMedic, Ensure Medical, ForSight Labs, the Foundry, IPC–The Hospitalist Company, Satiety, The Foundry, Xtent and Wave7 Optics. In addition, he served as a Director or was actively involved with Arbor Health Care (AHCC) (acquired by Extencicare), Athena Neurosciences (ATHN) (acquired by Elan), CardioThoracic Systems (CTSI) (acquired by Guidant), Executone (XTON), The Liposome Company (LIPO), LuMend, Managed Health Network (acquired by Foundation Health), Medaphis Corporation (MEDA), National Medical Diagnostics (acquired by GE Medical), Perclose (PERC) (acquired by Abbott Labs), Sequana Therapeutics (SQNA) (acquired by Arris Pharmaceuticals), Surgical Health (acquired by HealthSouth Rehab), Thermage, Verifone (VFIC) (acquired by Hewlett-Packard) and Vical (VICL). Robin is a past Director of the Western Association of Venture Capitalists, and of the Stanford Business School Trust. Before Stanford, he served as a line officer on nuclear fast attack and ballistic missile submarines. Robin holds a BS in Engineering from the United States Naval Academy, and an MBA from the Stanford Graduate School of Business. Robin lives in Portola Valley with his wife Terrye, and can be reached at rbellas@morgenthaler.com

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