

Venture Investors Find Comfort in Health Care

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After several years of languishing in the shadows of blockbuster Internet start-up companies, deals involving health-care and medical companies are making a comeback.

While the overall picture for Silicon Valley venture capitalists is dismal -- with few initial public offerings in the pipeline and big corporate acquirers buying fewer start-ups -- four of the five venture-backed companies that went public in this year's first quarter operated in health-related industries.

Last year, venture investors poured \$9.1 billion into health-related deals, the most ever and up nearly 20% from 2006, according to the National Venture Capital Association and Thomson Reuters. Morgenthaler Ventures, Kodiak Venture Partners, Mohr Davidow Ventures and Flybridge Capital Partners, among other firms, are beefing up their health-care practices, convinced some medical deals may yield fatter profits than conventional technology investments.

Pockets of Health

Number of U.S. venture-backed IPOs and mergers and acquisitions, quarterly data



Sources: Thomson Reuters; National Venture Capital Association

Many of the medical concerns snagging cash from venture capitalists today are a far cry from the risky, classic biotechnology companies so popular with investors in the 1980s and 1990s. Many of those drug-focused companies sucked up hundreds of millions of dollars from investors and then ran into delays or outright failures, leaving investors holding the bag.

So today, many health-care investors are playing it safe. They are putting money into companies that make more-predictable products, such as medical devices, tests for cancer and services for hospitals. Many of these companies have revenue by the time investors get involved.

[CardioNet](#) Inc., a venture-backed company that makes wireless devices to diagnose heart arrhythmias, was profitable when it went public in March. A month later, it reported 68% revenue growth. Shares are up 54% to \$27.75 since its IPO in March. Similarly, [IPC The Hospitalist](#) Co., a provider of outsourced doctors for cost-conscious hospitals, was profitable when it went public in January. Its shares are up 40% to \$22.46.

Among venture capitalists in the past year, "it just seems like there's a lot more interest in health-care services," compared with standard biotechnology, said Mark Brooks, a managing director at Scale Venture Partners in Foster City, Calif., which at one point owned a third of IPC's shares. "We made a very, very big gain," Mr. Brooks added.

Scale Venture also has put money into a company that runs occupational-health centers and another, called National Healing Corp., which operates a chain of specialized centers for people with chronic wounds that won't heal.

Technology-focused Kodiak Venture Partners of Waltham, Mass., last year lured life-sciences executive Andrey Zarur as its first health-care-investing partner. The firm made the move partly because it noticed that many of the technology companies in its portfolio were moving into the medical sector. Wireless-networking start-up Enfora Inc., for example, started off selling its tracking technology to companies such as trucking companies. Now some hospitals, increasingly focused on monitoring and cutting costs, use its technology to keep track of medical supplies, said Dave Furneaux, a Kodiak founder.

Kodiak won't be searching for new drug-discovery start-up companies, however. Mr. Zarur is more comfortable placing smaller bets on companies such as Allegro Diagnostics Inc., a Boston start-up that has isolated a special gene mutation linked to lung cancer. Allegro uses it to detect lung tumors earlier than typical tests. Kodiak provided the majority of a \$4.2 million financing round for Allegro this year, and the company's product may be on the market in nine to 18 months, Mr. Zarur said.

Plenty of venture capitalists still are backing big-money drug start-ups. Clarus Ventures, Versant Ventures and Polaris Venture Partners, among others, continue to gamble on conventional, big-ticket biotechnology.

In many ways, their job is easier these days: With big pharmaceutical firms facing patent expirations on some of their most profitable drugs -- and lacking new products to fill their research pipelines -- the drug industry has stepped up its acquisitions of small but promising companies. That is good for venture capitalists, who generally turn a profit only when the companies they back go public or are sold.

Still, lots of investors remain wary. Morgenthaler partner Robin Bellas said his Menlo Park, Calif., firm will still invest in some start-up drug companies, but only those for which clinical trials are relatively short. Cancer drugs or antibiotics "either solve the problem or not," he said.