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Med Devices, 'Web 2.0' Drive 2Q VC Investment

BY BRIAN GORMLEY

Venture capitalists pumped a record $1 billion into U.S. medical device companies and nearly as much into information services providers last quarter, two trends reflective of an overall upward climb in venture investment, according to industry data released today.

All told, venture firms invested $7.4 billion across 717 deals in the second quarter, both figures up 8% from the $6.89 billion and 663 deals reported in the same period last year, according to Ernst & Young LLP and VentureOne, a unit of Dow Jones & Co., publisher of VentureWire.

It was the ninth consecutive quarter of year-over-year growth in venture capital invested, and the highest total since the fourth quarter of 2001. This year firms have deployed a total of $14.4 billion, 8.2% more than the 2006 six-month sum of $13.3 billion, the data show.

The $1 billion committed to developers of medical-device therapies for heart disease, obesity, and other conditions was 58% higher than the second quarter of 2006; while investment in information services start-ups -- including so-called Web 2.0 companies -- jumped 52% to $979 million.

Behind the growth is rising firms' confidence in their ability to take companies public or merge with larger players. This is giving venture investors the confidence to invest larger sums in small companies. The median amount invested per deal last quarter, $8 million -- up from $7.4 million during the same time in 2006 -- is the highest since the fourth quarter of 2000, the height of the dot-com boom when the median sum invested was $9.5 million.

This is particularly apparent in the device market, where merger and initial public offering activity is particularly strong. In the second quarter, for instance, Boston Scientific Corp. agreed to acquire Remon Medical Technologies Inc., a developer of communications technology used with implantable medical devices backed by Polaris Venture Partners and others, for an undisclosed amount.

In addition, companies such as Xtent Inc., a cardiovascular stent maker backed by Morgenthaler Ventures, Adams Street Partners and Advanced Technology Ventures, among others, have executed successful IPOs this year. This is spurring more firms to increase their focus on devices. Seventy-five device makers raised capital last quarter, the most on record. "Success breeds an appetite for more," said Polaris Managing General Partner Terry McGuire.

Venture firms generally are sinking more money into health care: the $2.4 billion invested last

quarter is second only to the $2.9 billion committed in the first quarter of this year. What's striking is that the amount invested in device start-ups was nearly as much as the $1.1 billion deployed in biopharmaceutical companies. In the second quarter last year, firms put $1.3 billion into biopharmaceutical companies - which usually command the bulk of health care venture dollars - compared with $661 million in device providers.

Increasingly, venture firms see opportunity to displace drugs, which often work in only a small portion of patients, with devices that are effective in nearly everyone, said Morgenthaler General Partner Robert C. Bellas Jr. For example, a medical device treatment for obesity being developed by Satiety Inc. -- which raised a $30 million fourth round earlier this month led by Skyline Ventures -- could be two to three times as effective as obesity drugs have been, he said.

The influx of venture capital in medical devices is driving up valuations for established companies, Bellas said. While Series A round valuations remain stable, companies are seeing significant step ups in later rounds, he said.

John Glushik, general partner of Intersouth Partners, says technology valuations are likely to climb for young companies as late-stage investors migrate down to escape the high prices they're paying to get into later rounds. Despite rising interest in health care, information technology remains the largest sector for venture investment. Firms sank $4.1 billion into technology concerns in the second quarter, 10% more than in the same quarter last year.

Even late-stage investors are starting to find Web 2.0 and other information-services start-ups attractive, Glushik said, because of the potential for companies to get started on relatively little capital and to be acquired early on. A total of 131 information-services providers -- a segment encompassing social networks, blogs, wikis and other Web 2.0 companies -- raised capital last quarter, 56% more than in the second quarter of 2006, the data show.

Intersouth, however, approaches this sector cautiously and prefers start-ups with multiple revenue streams, such as from partnerships as well as advertising, he said. Still, a Web 2.0 company that builds a well-defined community of people with similar interests or characteristics can appeal to advertisers, and generate significant revenue even from a small customer base.

The communications and networking segments of information technology were flat, with the same number of deals in the last quarter, 62, as in the same period last year. The amount invested, however, rose 23% to $839 million because of the $113 million financing led by TA Associates in June for FreeWave Technologies Inc., of Boulder, Colo.

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