

Venture Capital

Ambitious young companies make pitch for funding.

By: Wayne Thompkins

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One of Navroze Mehta's first patients was a San Diego physician whose eyesight had deteriorated so badly that he had to give up his medical practice. Mehta's Boca Raton company, NovaVision, had a new, noninvasive device that showed promise in essentially rewiring the brain to partially restore vision in victims of stroke and traumatic head injury.

"He couldn't read anymore" and lamented that he couldn't enjoy the new widescreen TVs, Mehta told last week's Florida Venture Capital Conference in St. Petersburg. "After the fourth module of treatments, he regained his ability to read again. When I went to visit him in California, he asked me to drive with him. I did, and I'm here to tell the tale."

The success shared by both NovaVision and its patients would not have been possible without the millions of dollars in venture capital the company has secured over the course of the decade, allowing it to further both its research and its reach to millions of current and future patients across the country.

The headline of the conference, set against the backdrop of its record attendance of 1,200, is that venture capital — the fuel that sparked such economic hotbeds as California's Silicon Valley, North Carolina's Research Triangle and Boston's Route 128 — is discovering a state long considered a backwater.

"For the first time ever, Florida actually cracked the Top 10 in the amount of money invested in a state," said Mark Heesen, president of the National Venture Capital Association (NVCA). The state's No. 8 ranking comes from the \$627 million invested in Florida companies in 2007, more than double the \$300 million invested in 2006. That's welcome news for Florida entrepreneurs with promising ideas, but no capital to realize their dreams.

"Florida has had a dearth of venture capital presence for years," said Mark Arnold, attorney with Edwards, Angell Palmer & Dodge in Fort Lauderdale. As the state's population and wealth have grown, its universities have matured and experienced entrepreneurs relocate to retire or work, however, "the importance of Florida has grown [and] venture capitalists recognized that this is a place where they need to be doing business."

The addition of facilities such as Palm Beach County's Scripps Research Institute, Orlando's Burnham Institute for Medical Research and Port St. Lucie's Torrey Pines Institute for Molecular Studies provides institutions with the potential heft to anchor a venture-funded research cluster, Arnold said. "The more activity, the better," he said.

Venture capital largely faded from the public consciousness after the fuel that powered the late '90s dot-com boom burned wastefully in a blizzard of failed companies that led to the infamous 2001-02

bust. In the ensuing years venture capitalists hunkered down, flew to quality and began the search for new, more rationally exuberant investments in emerging areas like medical devices and biotechnology. Six years later, the long-term financing vehicle that nurtured such diverse companies as Google, Amazon, Starbuck's and The Home Depot is showing signs of life.

The year of venture capital

While private equity funds stumbled during the second half of 2007, venture capital investment climbed 8 percent to \$29.9 billion nationally for the year, the highest since 2001, according to Dow Jones VentureSource. At the same, venture funds themselves raised \$34.7 billion, also the highest since the bust which saw less than \$4 billion raised in 2002.

Florida, like the rest of the country, last year saw about 30 percent of venture capital funding flow to the life sciences sector. Medical devices were especially popular investments with venture capitalists, a trend that could favor Mehta's NovaVision.

Telecom companies were the second most popular area, accounting for 13 percent of Florida investment, twice the national figure of 6 percent. By region, 25 percent of investment over the past two years has been in the Tampa Bay area, 22 percent in Palm Beach County, 11 percent in Broward, and 10 percent each in Miami and Orlando, Heesen said. While all major areas of the state are sharing in the doubled investment, Florida's fragmentation remains a problem. Companies seeking VC are spread throughout the state.

In contrast, the most famous and successful venture capital-fueled technology corridors, such as Silicon Valley, grew from several such companies clustering together, selling themselves off to corporate suitors, spinning off new local companies and developing a strong "ecosystem" of entrepreneurs, companies, researchers and ideas. No Florida market has attained that critical mass, but the attention the state is now receiving is a crucial starting point.

"We've looked at Florida as a state where there is more opportunity in communications and technology more than health care and life sciences, but I think that is rapidly changing," said Wayne Hunter, managing partner of Birmingham, Ala.-based Harbert Venture Partners, which is looking at several deals in the state. One change that investors like is that Florida's scientists and business people are doing a better job of connecting.

"You'd see somebody trying to bring something to market without having an experienced management team in place and I think you see less of that now," said Richard Brandewie, managing partner of Ballast Point Ventures in St. Petersburg.

Heesen said many companies from Boston and California are doing deals in Florida, though they prefer deals above \$10 million. Florida also has the advantage of not necessarily having to rely on its home-grown talent. "Florida is such a heterogeneous land of opportunity, partly because it's also the place of the relocated entrepreneur," said Alan Taetle, general manager of Noro-Moseley Partners in Atlanta.

“We get deals that have no connection to the state whatsoever that I can see, other than that the entrepreneur wanted to move down here.”

Making their pitch

At last week’s conference, 23 Florida companies selected from among hundreds of applicants made presentations before venture capitalists at the conference. Like NovaVision, all were “late-stage” companies which have already received earlier rounds of institutional funding. Eighteen of 24 companies that presented at last year’s conference in Boca Raton have received more than \$160 million in combined funding, up from \$118 million in 2006 and \$92 million in 2005 presenters received at those conferences.

While technology and life science companies traditionally are most closely associated with venture funding, the presenters included a direct-mail company, a company that detects explosives and a social networking site for recently divorced women — proving that any good idea will catch the eye of venture capital.

“Venture capital in Florida is a little different than it is in Boston or California, and that’s because our companies are different,” said Daniel Aronson, attorney at Bilzin Sumberg Baena Price & Axelrod in Miami. “Even though we have some ‘clean tech’ and some life sciences companies, that’s probably not the leading edge of what we have going on here. We tend to have, in my view, more bread-and-butter companies.”

Such companies seek a “radar band” that they can navigate between and among their peers to become attractive to venture investment. “They don’t tend to be the super rocket shots that a lot of venture funds are used to in Silicon Valley and Boston,” Aronson said. With money fleeing into venture funds from real estate and other troubled sectors, and relatively few companies meeting the criteria of a conservative investment climate, well-positioned capital seekers have an advantage and options they haven’t enjoyed in years.

Venture funds “are looking for something that will change the way consumers behave,” said Nick Robbins, a venture capital attorney at Gunster Yoakley & Stewart in West Palm Beach. “Amazon, Starbucks, Home Depot, technology all have changed the way we behaved. Back in the day, there had be a dot-com in your name. Today, they’re looking more for hard revenues, not the number of visitors. There were a lot of great ideas, they just weren’t great businesses. Today, that’s not a problem.”

Kirk Joseph, whose Delray Beach company, On-Card, made a presentation at the conference, said his product has passed the test of changing consumer behavior: The company makes a direct mail marketing product that far fewer consumers throw straight into the trash. “That is multi-billion dollar problem for direct mail marketers,” Joseph said of the instantly jettisoned junk mail. “We have the only credit card thick mailer with a detachable gift card, and it only took four years to get the post office to approve it.” The 3-year-old company, which is generating \$2.5 million in revenue and has 550 customers, is looking to raise \$5.7 million to take itself to the next level. “Direct mail marketing is a 1 percent response game,” Joseph said. “Marketers offset the falling response rate by sending more mail.” The

product communicates as quickly as a postcard and provides a gift card, which doesn't require opening an envelope the customer may never get around to opening. "We're generating double-digit response rates for many industries," he said.

Mead McCabe Jr., president of Hialeah's GeneEx, may not change consumer behavior, but he will give them peace of mind with a planned line of diagnostic products that are not only simpler to use, but can provide medical test results in minutes instead of days. The company plans to focus its first commercialization effort on periodontitis, group A strep and systemic fungal infections.

"The main problem with infectious disease is that it's very difficult to diagnose," McCabe said. He noted, for example, that the current method of diagnosing periodontitis, probing around each tooth, is "somewhat archaic," GeneEx's Rapid Periodontitis Test, however, requires only a drop of saliva, and is as easy-to-use as a home-based pregnancy test kit.

GeneEx also plans to launch a saliva based, rapid antigen detection test for group A streptococcus (GAS) to both professional and over the counter markets, that could soon displace the conventional throat swab test for strep throat. Like RPT, the GeneEx test will detect only the virulence markers produced by active infections, not just the presence of GAS, and reduce unnecessary prescription of antibiotics.

The buzz of 'clean tech'

The perceived urgency — and business opportunities — of global warming and energy alternatives, however, produced the undisputed buzz word of this year's conference.

"Everyone is talking about 'clean tech, clean tech, clean tech,' and I have been trying to lower expectations about clean tech," Heesen said. "The press is making it sound as if all of our money is going into clean tech." Heesen said that while clean tech is an emerging sector, it still accounted for only 7.5 percent of all venture investment in 2007, about 10 percent in Florida. Among the sector's limitations are its capital requirements — often requiring the building of a large factory — but also what some see as a troublesome "gold rush" mentality infecting the sector.

Ravi Ugale, an executive with Crossbow Ventures in West Palm Beach, even referred to a clean tech "bubble" during a conference panel discussion. "I think too many companies are getting funded at too high a valuation," said Ugale, whose company does not invest in the sector. "Any industry has some survivors and some consolidation. There's a lot of euphoria, a lot of money is being raised, for technologies like solar, which is exactly what happened in some sectors in 2000."

Ugale is not alone. While VCs overwhelmingly predict that clean tech will attract higher levels of venture financing in 2008, 61 percent believe that sector would be overvalued next year. The sector is sure to produce winners for the savviest investors, however.

"Clean Tech will continue its pace as the fastest growing venture category of the past several years," said Ira Ehrenpreis, general partner of Technology Partners and chairman of the 2008 Clean Tech Investor Summit. "In its quest to solve some of the most important energy and water issues of the 21st

century, the sector will also attract the interest of some of the best and brightest entrepreneurs, executive teams and technologists.”

According to Dow Jones, there were 2,648 venture capital deals in the U.S. last year, 42 percent of them in California. There are nearly 800 firms in the U.S. managing about \$236 billion. “The industry is now investing in a mix of sectors that is much more capital intensive than it has been in the past,” Heesen said. “Despite the capital needs of industries such as clean technology and life sciences, we only saw a single-digit increase in deal volume, which suggests that a fair amount of discipline is being applied to investment decisions.”

The life sciences sector, which includes biotechnology and medical devices, set an all-time record for venture capital investing in 2007 with \$9.1 billion in 862 deals, compared to \$7.6 billion in 786 in 2006, according to a study performed for the NVCA. Life sciences retained its position as the No. 1 investment sector for 2007. While both industries experienced double-digit increases over the prior year, the most significant growth was seen in the medical device industry, which rose 40 percent in 2007 to \$3.9 billion going into 385 deals. Venture capitalists are forecasting an active year for the industry with high growth in the clean tech sector, an improving IPO market and fewer venture firms in 2008, according to the NVCA 2008 Predictions Survey. The survey also showed that venture capitalists believe that fund sizes will become larger and returns for limited partners of venture capital funds will improve in both the short and long term horizons.

“For venture capital firms, 2008 will be the year we begin to see larger funds raised at a faster pace, as many firms in the industry will focus on sectors that have increasing capital requirements such as life sciences and clean technology,” Heesen said. Seed and early-stage investment and smaller, regionally focused firms will also be very active, particularly in the Internet and new media spaces. “By its very nature, venture capital investment is long term so the ultimate winning strategy won’t be clear for some time.”

The survey was conducted in December and includes predictions from more than 170 venture capitalists from across the U.S. VCs are predicting moderate investment growth next year with 71 percent of respondents pegging 2008 venture investment levels of between \$20-29 billion, with the average forecast of \$27 billion, with a quarter predicting the \$30-39 billion range. Investment in medical devices and wireless telecom are expected to grow moderately with more than half predicting static or declining investment in these sectors. Semiconductors and software may prove undervalued.

NovaVision’s Mehta said one way to look at venture capital is by measuring the effect it has on a company’s bottom line. He prefers to measure the effect it has on human lives. “Seventy percent of our patients have had meaningful changes in their areas of daily living,” he said. “The good news is the results are permanent. They can read and go golfing again.”