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## Venture capital funding for medical devices on the rise

PHILADELPHIA (Dow Jones/AP) -- A healthy increase in venture-capital funding of medical-device companies has helped lift overall investments in life-sciences industries, even as biotechnology deals have tailed off.

Companies that make artificial joints, heart stents and other devices are attracting VC dollars because investors see rising demand for such products as the U.S. population ages and people live longer. An active mergers-and-acquisition market among device companies also has fueled VC interest in the sector. The enthusiasm for device companies also is reflected in the public markets, where device stocks have performed well over the past year.

"There's just huge investor appetite for companies they perceive are going to grow because of demand in the marketplace," said Tracy Lefteroff, global managing partner of the VC practice at PricewaterhouseCoopers. "The Baby Boom generation will make huge demands on the health-care system and health-care products in general."

In 2005, VC investments in biotechnology and medical-device companies rose to a combined five-year high of about \$6 billion from \$5.8 billion in 2004, according to the MoneyTree Survey by PricewaterhouseCoopers, Thomson Venture Economics and the National Venture Capital Association.

Investments in these industries, together known as life sciences, accounted for about 28 percent of all VC investments in 2005. The number of life-sciences deals rose to 608 in 2005 from 589 the year before.

But the mix of investments is changing. Investments in the biotech industry -- a leading recipient of VC dollars in recent years -- declined to \$3.86 billion from \$4.15 billion in 2004, according to the MoneyTree survey. Total funding declined despite an increase in the number of biotech deals to 357 from 340.

More than offsetting the biotech funding decline, however, was an increase in medical-device funding to \$2.11 billion from \$1.71 billion in 2004. The number of medical-device deals inched up to 251 from 249 in 2004. A separate survey from Ernst & Young LLP and VentureOne, a unit of this newswire, found similar trends in funding for biotech and medical devices.

One medical-device startup recently received big VC money by thinking small. New York-based Small Bone Innovations Inc., which makes small bone and joint replacements, raised \$42.2 million from NGN Capital, 3i Group and several other VC firms. The deal, publicly announced in early January, was identified by the MoneyTree survey as the biggest medical-device VC investment of 2005. Small Bone Innovations said it was the biggest VC investment in orthopedic devices ever, based on data from Venture Source, a unit of Dow Jones.

Allan Ferguson, a partner with 3i, said Small Bone Innovations is an amalgamation of several independent companies specializing in the small-bone field. "This is really a rollup strategy of identifying important companies that have interesting products that could benefit from stronger distribution" as part of a bigger company, he said.

Another recent 3i investment was TransMedics Inc., of Andover, Mass., which makes a system that keeps human organs functioning during transport to a transplant operation.

Last week, 3i led a group of about eight firms that invested about \$29 million in TransMedics, he said.

3i had been an earlier investor in the company, whose product was used in a successful "beating-heart" transplant in Germany in January.

"In medical devices you can be an early investor and get a reasonable return," Ferguson said. "We generally try to find device companies that can be free-standing companies," as opposed to companies that are dependent upon partnerships or being acquired by larger companies.

Corporate investors also are funding medical-device startups. New Brunswick, N.J.-based Johnson & Johnson's investment arm and J&J's DePuy Spine unit recently led a \$35 million financing round for Archus Orthopedics Inc., a Redmond, Wash., company that's developing an implant to treat spinal damage.

VCs are mindful they have decent opportunities to cash out if these device companies succeed in advancing their products. Although the overall IPO market isn't terribly strong, some venture-backed device deals are getting through. In early February, Cardica Inc. of Redwood City, Calif., raised about \$35 million in an IPO. The maker of devices used in heart surgery previously received funding from Sutter Hill Ventures, Palo Alto, Calif.

While medical-device investing is on the rise, Lefteroff and other VC experts played down the significance of last year's decline in biotech funding. They noted that 2005 biotech investments still were substantially higher than the average annual total from 2001-03, the years immediately following the bursting of the VC bubble.

"I don't think it was anything where there was a macro-economic souring," said Joseph Muscat, Americas director of the VC advisory group at Ernst & Young. "We're still generally on the up trend from just a few years ago."

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