

Capital Markets Trends, Health Care Reform and the Implications for Venture Capital



Presentation to the Medical Device Supply Chain Council

December 1, 2010

Presentation Agenda

- I. The Current Environment
- II. Strategic Themes
- III. The Radius “Venture Growth” Model
- IV. Q&A

Why it matters ...

Select 2010 Medtech M&A Transactions

Date	Target	Acquiror	Enterprise Value (\$mm)	Sector	Description
11/22/10	<i>Ardian</i>	<i>Medtronic</i>	800.0	Cardiology	Catheter-based treatment for hypertension
11/19/10	<i>Sadra</i>	<i>Boston Scientific</i>	400.0	Cardiology	Minimally invasive treatments for heart valve repair
10/22/10	<i>Clariant*</i>	<i>GE</i>	575.2	Diagnostics	Oncology diagnostic testing services
9/20/10	<i>Asthmatx</i>	<i>Boston Scientific</i>	443.5	HomeCare/Respiratory	Catheter-based treatment for asthma
8/17/10	<i>Osteotech*</i>	<i>Medtronic</i>	124.5	Orthopedic	Tissue processing services and related devices
7/12/10	<i>Micrus*</i>	<i>J&J</i>	402.4	Cardiology	Implants for cerebral vascular diseases
7/6/10	<i>LenSx</i>	<i>Alcon</i>	744.0	Ophthalmology	Image guided laser system for cataract surgery
6/25/10	<i>Spiration</i>	<i>Olympus</i>	100.0	HomeCare/Respiratory	Thoracic and intra-bronchial treatment of lung disease
6/16/10	<i>Somanetics*</i>	<i>Covidien</i>	285.3	Patient Monitoring	Real-time blood oxygen measurement in the brain
6/1/10	<i>Ev3*</i>	<i>Covidien</i>	2559.9	Cardiology	Endovascular treatment for peripheral vascular disease
5/27/10	<i>Fermentas</i>	<i>Thermo Fisher</i>	260.0	Life Science Tools	Manufacturing and marketing of biological products
5/4/10	<i>SenoRx*</i>	<i>CR Bard</i>	196.7	Women's Health	Devices for the diagnosis and treatment of breast cancer
4/1/10	<i>Medingo</i>	<i>Roche</i>	200.0	Diabetes	Developer of miniature insulin patch pump dispensers
3/1/10	<i>Apatech</i>	<i>Baxter</i>	330.0	Orthopedic	Provider of synthetic bone graft technologies
1/19/10	<i>Ahura</i>	<i>Thermo Fisher</i>	145.0	Life Science Tools	Developer of ultra-compact analytical instruments
1/6/10	<i>Insound</i>	<i>Sonova</i>	350.0	Hearing	Developer of minimally invasive hearing products
1/4/10	<i>BioForm*</i>	<i>Merz</i>	219.1	Aesthetics	Injectable implant products for soft and hard tissue

* Companies acquired after having gone public

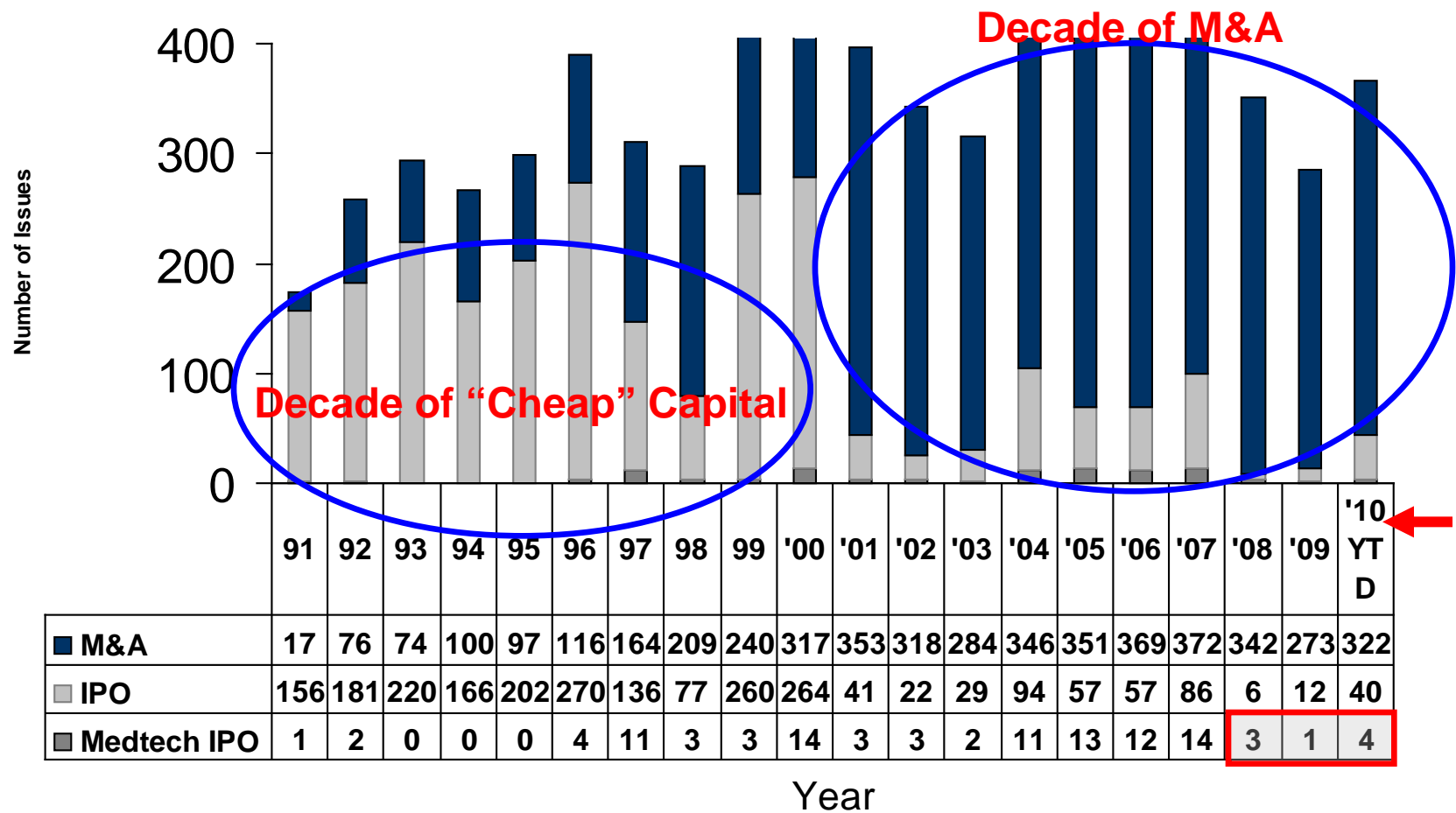
Source: Capital IQ, BMO Capital Markets and Venturesource

Trends that matter ...

- **The IPO market for small, venture-stage companies will remain relatively dormant, while ...**
- **The M&A market will remain active**
 - M&A deals led by strategic buyers and mid-market buyout funds continue to be the primary path to liquidity
- **Not only does it take more time to position a company for an exit ... it takes more money**
- **Exits tend to be at or below \$200 million**

Current Decade has been Dominated by M&A

Venture Exits: Reversing the Tide

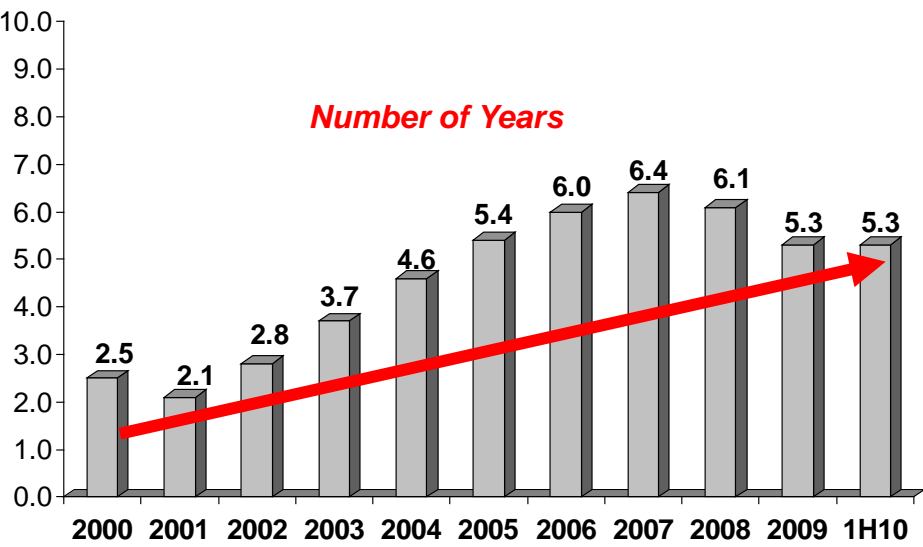


Source: Thomson Reuters, NVCA, BMO Capital Markets and Capital IQ

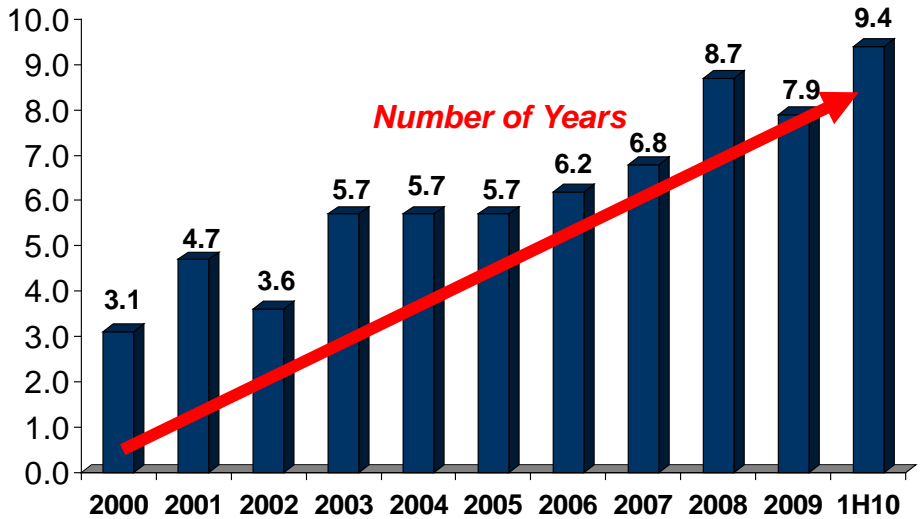
More Time ...

Median Time From Initial Equity Funding to Exit

M&A Transactions

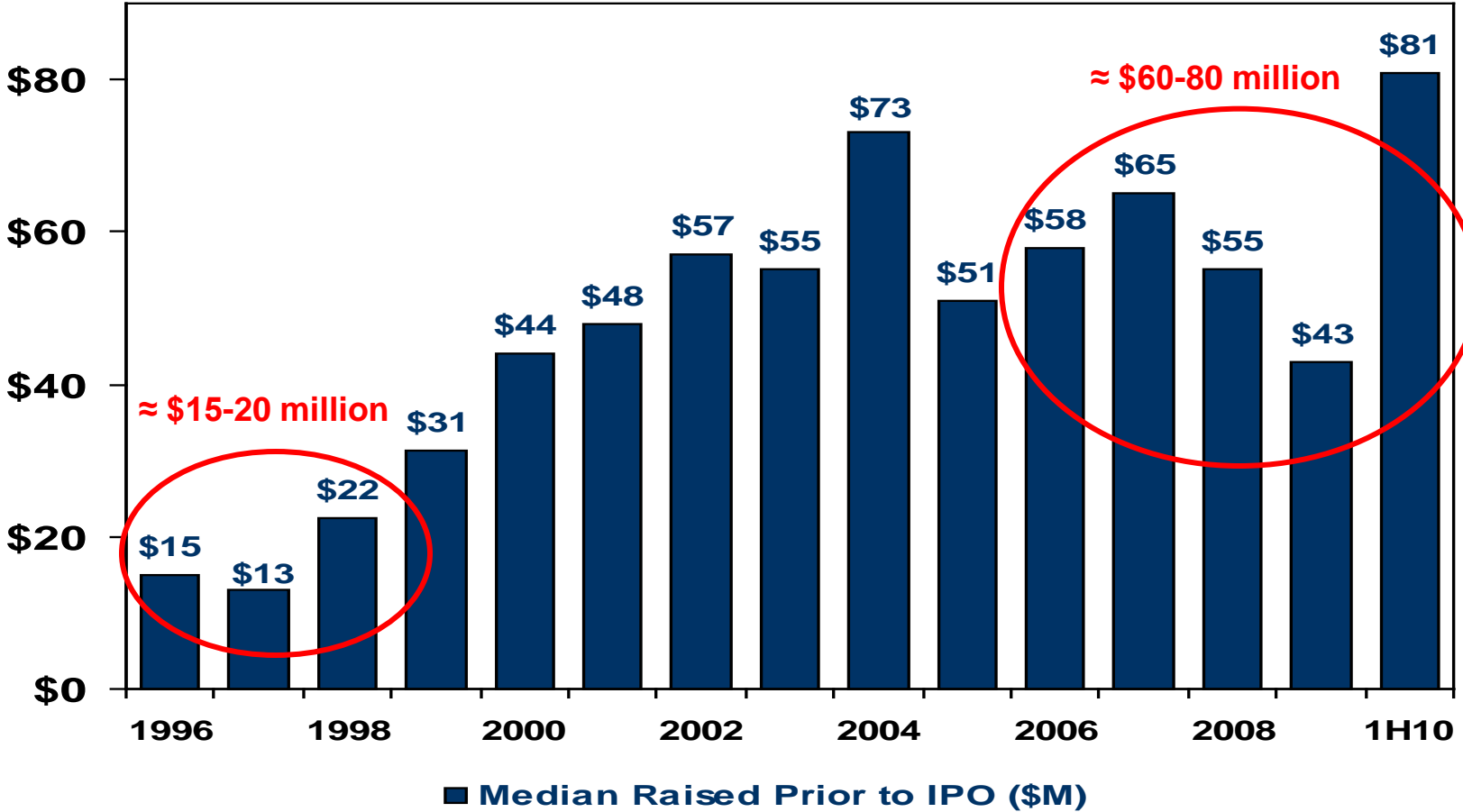


Initial Public Offerings



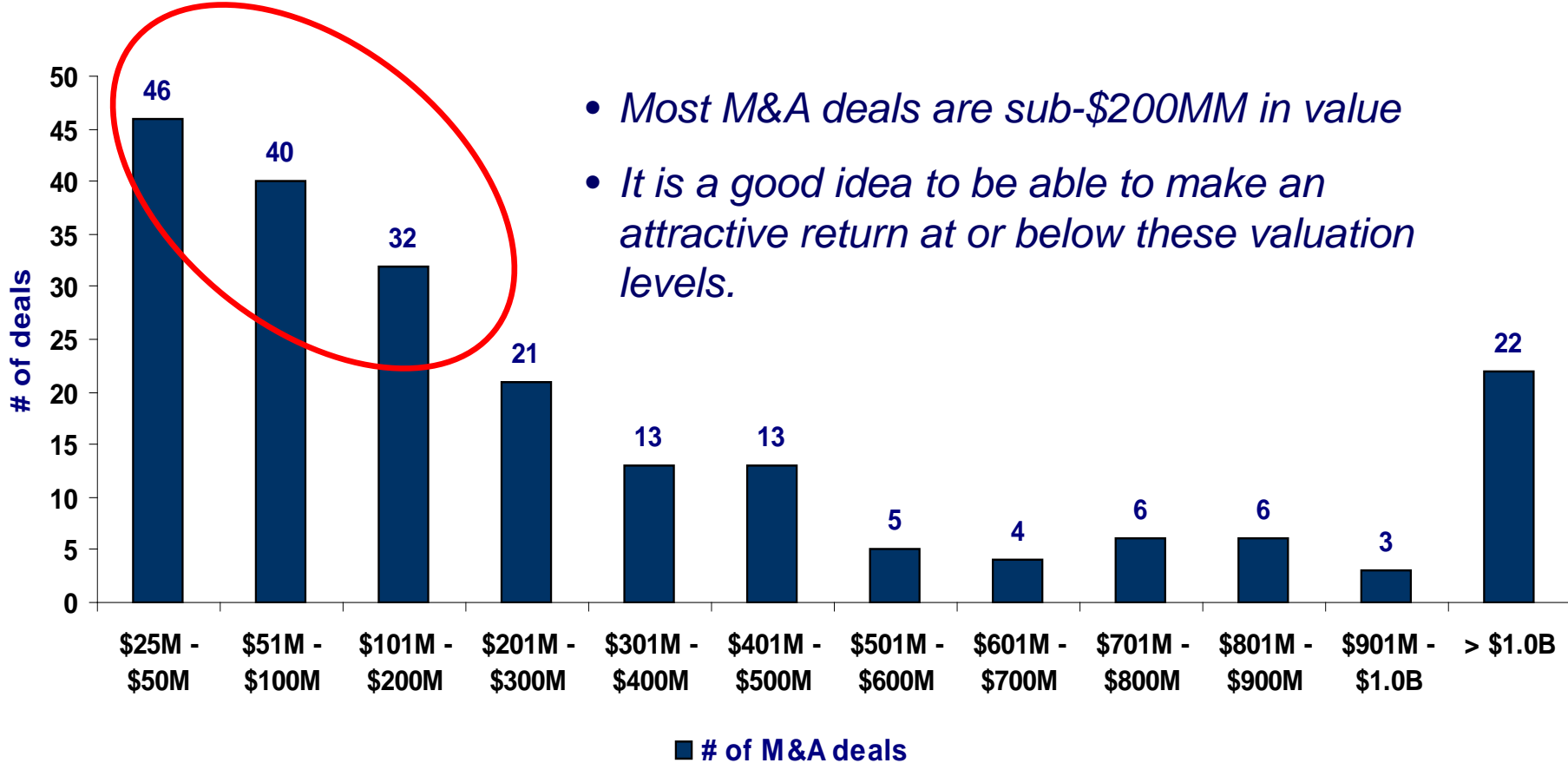
More Money ...

Median Venture Dollars Raised Prior to IPO



Majority of Deals < \$200M

Healthcare M&A Deals – Volume by Size (Q1 2009 – Present)



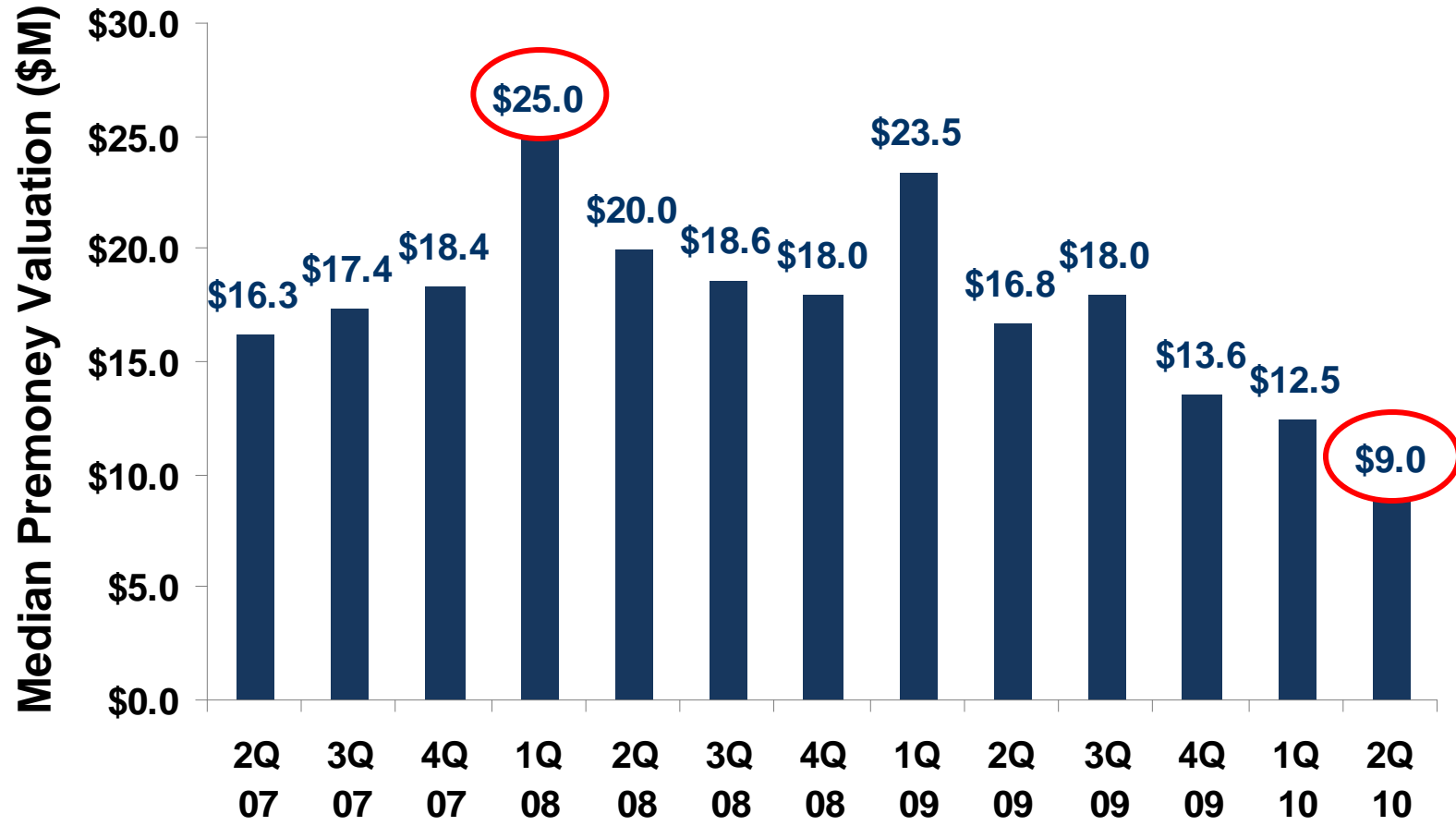
Source: Capital IQ
**Includes M&A of public and private healthcare companies

Key Points from Prior Slides

- **There is an active M&A market, but deals are getting done at modest exit valuations**
- **Therefore, companies need to make significant progress on fewer dollars (i.e. *capital efficiency*)**
- **As a venture capitalist, when you deploy capital, it has to be at the right price (i.e. *valuation*)**

Pre-Money Valuations are Down

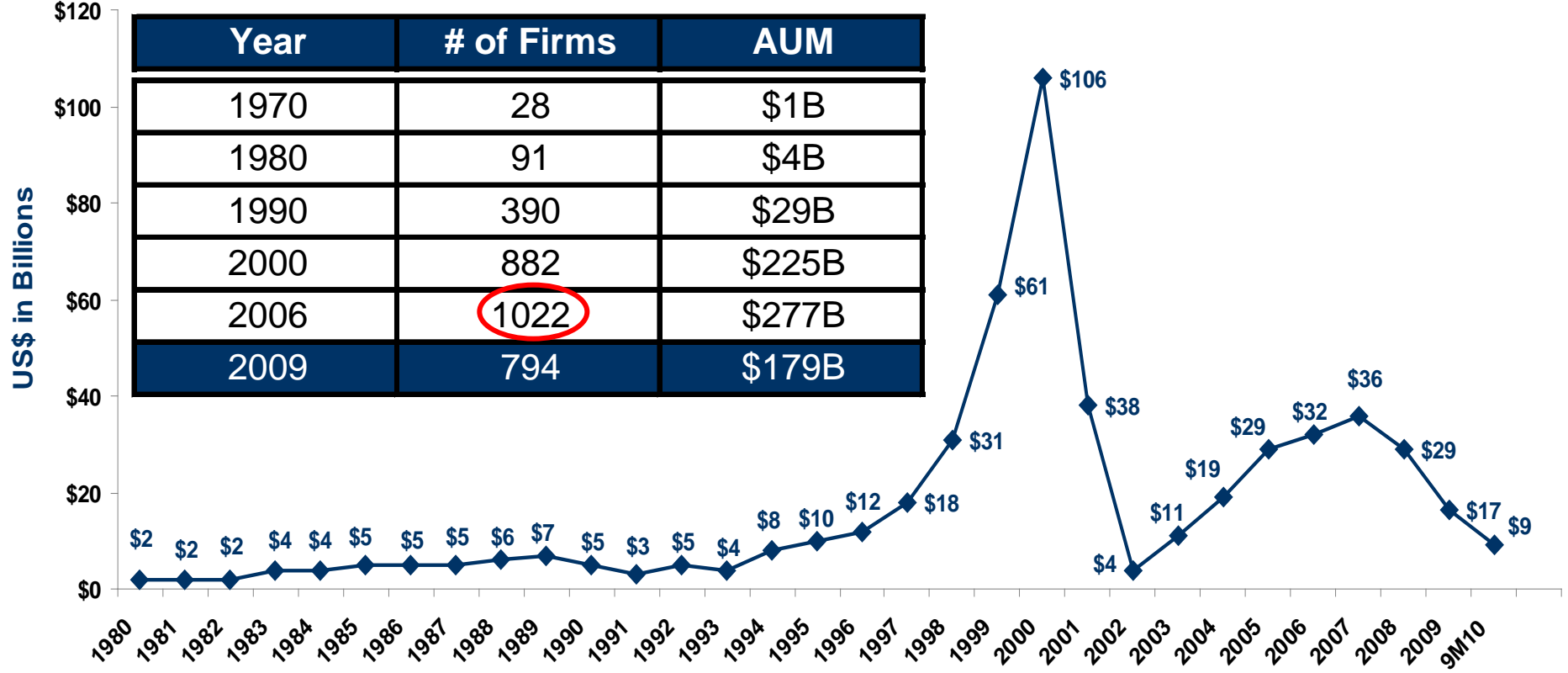
Median Pre-Money Valuation for VC Financings



Source: Thomson Reuters

Fewer Commitments to Venture Funds = Shakeout

The Number of VC Firms and AUM have Peaked



Commitments to Venture Funds (1980-2010)

Healthcare Reform Highlights

- **Every eligible American must carry medical insurance**
- **30 million Americans currently uncovered will have to obtain coverage or pay a financial penalty**
- **2010: Children can stay on parents policy until age 26; no preexisting conditions for children under age 19; lifetime caps eliminated and recession of policy prohibited**
- **2011: MLR Mandates: Large Groups > 85% and Small Groups > 80% reimbursement rates for primary care increased**
- **2012: Quality bonus phased in for Medicare**
- **2013: Medicaid to pay primary care physicians Medicare rates**
- **2014: Health care exchanges established in each state; prohibition for annual limits; individual mandates**
- **2015: High value plans—excise tax**
- **2020: Medicare donut hole closed**

Impact of the Midterm Election

- 1. Highly unlikely that the law will be repealed**
- 2. Republicans may refuse to approve funding for exchanges, commissions, demonstration projects**
- 3. Health care costs will keep double digit increases**

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Is there a fertile opportunity in healthcare?

Let's start by identifying the BIG problems

- Healthcare spending is ruining the US economy
 - \$2.6 trillion in 2010 and 17.5% of the GDP → unsustainable costs
 - ≈ \$90 trillion of unfunded liabilities (*Regina Herzlinger*)
- Health reform doesn't solve many problems, but it is certainly creating systemic havoc for key players
- The healthcare industry has entered an era of slower / declining growth and substantially lower profits

Is there a fertile opportunity in healthcare?

Where does the spending go?

National Health Expenditures Projections (\$B)

Year	Total Expenditures	Healthcare Services and Supplies				
		Total	Hospital Care	Physician and Clinical Services	Prescription Drugs	Nursing Home Care
2010	2,624	2,458	830	552	256	151
2011	2,770	2,596	877	577	272	159
2012	2,931	2,746	932	604	289	168
2013	3,111	2,916	993	636	308	177
2014	3,313	3,107	1,056	675	330	188
2015	3,541	3,322	1,125	719	356	200

Is there a fertile opportunity in healthcare?

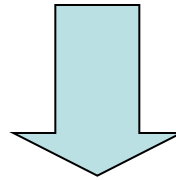
What the future holds for providers:

- **Contracting procedure volume (today's cash cows)**
- **Declining reimbursement**
- **Great accountability (global bundled payments)**
- **Demands for better outcomes**



Is there a fertile opportunity in healthcare?

Yes ... but what is a durable investment thesis?



Address and solve intractable pain points in today's healthcare system

For example: Big Pain Point – **Cost Urgency**

“Taking down the cost structure by 20%”

- Ed Murphy, CEO of Carilion Health System (VA)

Overarching Theme

Bring value to the healthcare system with products and solutions that manage costs, reduce waste and improve outcomes

Target Market	Problem	Solution	Portfolio Company
Hospitals	Hospitals waste millions of dollars annually on purchasing and managing their clinical inventory	Use advanced supply chain technology and processes to gain control of hospital inventory spending	<i>Management Health Solutions</i>
Hospitals	Hospitals waste millions of dollars annually on inefficient internal logistics	Use advanced technology and processes to reengineer logistics	<i>Aethon, Inc.</i>
Post-Acute and Senior Care Providers	The loss of patient independence among seniors drives up healthcare costs exponentially	Use technology and improved protocols to inexpensively monitor patients safely in the lowest cost settings	<i>Healthsense, Inc.</i>

Overarching Theme

Bring value to the healthcare system with products and solutions that manage costs, reduce waste and improve outcomes

Target Market	Problem	Solution	Portfolio Company
Hospitals, Physicians, Patients	Medical technology often drives increased costs to the system with inadequate ROI and patient benefit.	Minimally invasive, safer, better and labor saving technologies.	<i>EndoGastric Solutions</i> <i>Medingo</i>
Pharmaceutical Industry	Drug pricing pressure, dwindling pipelines and the threat of generics is forcing the pharma industry to embrace cost-saving, efficiency solutions	Use advanced outsourcing processes to reengineer R&D logistics and facilities planning.	<i>Biostorage Technologies</i>

Overarching Theme

Bring value to the healthcare system with products and solutions that manage costs, reduce waste and improve outcomes

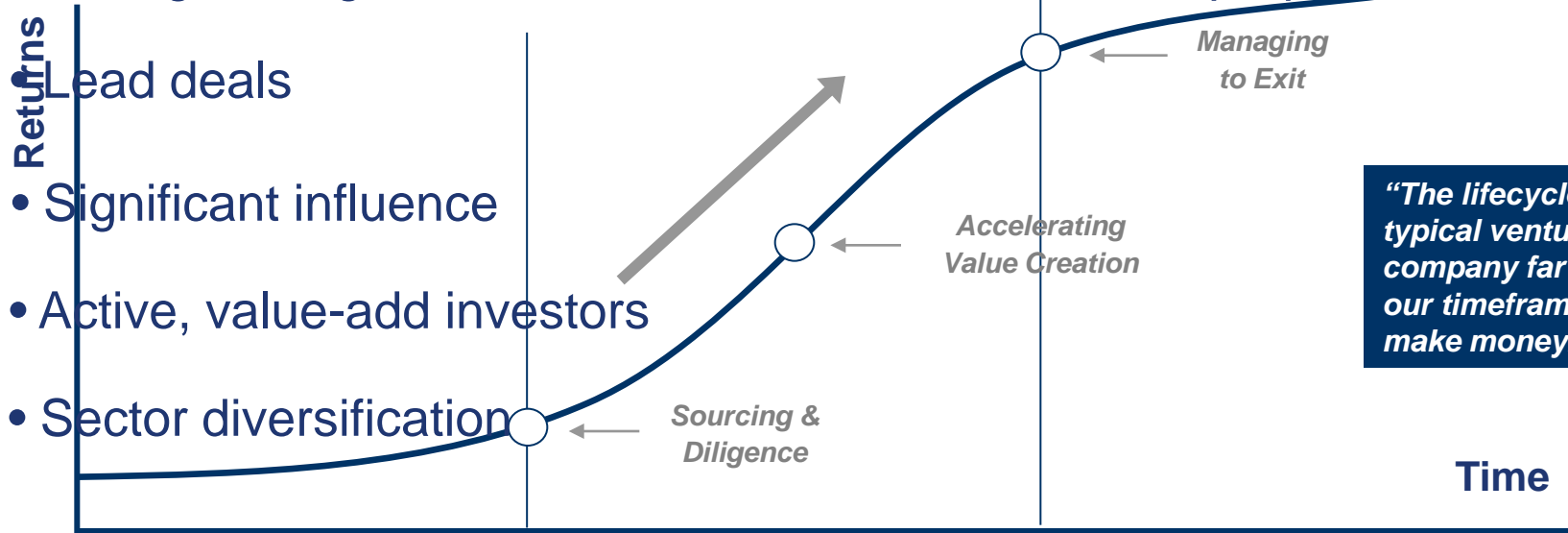
Target Market	Problem	Solution	Portfolio Company
Hospitals, Physicians, Patients, Pharma, Academia	Most drugs are effective on only 50-60% of treated patients. We are in a “trial-and-error” based healthcare system leading to significant side effects, adverse events, overutilization and increased costs.	Personalized medicine (i.e. genomic research to determine the right treatment, for the right patient at the right time – ensuring an optimal clinical outcome).	NuGEN BioStorage Technologies Ambit Therapeutics

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Principles

- Inflection point approach
- Strong management teams that embrace our value proposition



- Lead deals
- Significant influence
- Active, value-add investors
- Sector diversification

"The lifecycle of a typical venture-stage company far exceeds our timeframe to make money."

Our core principles have remained the same over the last decade, but we've refined our implementation to reflect the current environment

Profile (i.e. what we look for)

Revenue Stage	No need to take pre-revenue risk ... plenty of upside with revenue stage companies that have a visible revenue trajectory (the 3-5X formula)
Hyper-Growth Potential	The enduring source of value creation over the last two decades
Capital Efficient Operations	Back companies that do not require massive and regular influxes of fresh capital to reach breakeven and become profitable ... <i>“put in a little, sell for a lot”</i>
Large/Attractive Markets	Healthcare has many large, multi-billion niches which offers emerging winners great upside
Scalable Business Models	Not all companies grow profitably – we need to be astute about financing the right models
Compelling Value Proposition	Nothing drives adoption faster than a terrific, validated value proposition. Management teams need to develop and articulate a “bullet-proof” ROI
Adoption Dynamics	Time is money, particularly when ramping up. Fast adoption means cash flow from operations; slow adoption means financing operating losses for longer time periods
Well Established Set of Acquirors	In today’s capital markets environment, companies need to be built for acquisition, not for an IPO – research the exit before the entry

Companies with this profile have excellent upside with mitigated downside risk

Professionals

Jordan Davis

Managing Partner

- Morgan Stanley
- KBL Healthcare

Daniel Lubin

Managing Partner

- Schroder Wertheim
- KBL Healthcare

Neenah Jain

VP of Finance

- Lehman Brothers
- PwC

Justin Silver

Senior Associate

- Ferghana Partners
- NEA

Vince Conti

Venture Partner

- Maine Medical (CEO) †

Floyd Loop, MD

Venture Partner

- Cleveland Clinic (CEO) †

James Mead

Venture Partner

- Capital BlueCross (CEO) †

Dilip Mehta, MD PhD

Venture Partner

- Pfizer R&D (SVP) †

George Milne, PhD

Venture Partner

- Pfizer R&D (Pres) †

Kathleen Regan

Venture Partner

- Warburg Pincus †
- Robinson-Humphrey †

Advisory Board

Industry

- **Scott Garrett**, *Beckman Coulter* *
- **William Hawkins**, *Medtronic*
- **David McGibney, MB, ChB**, *Pfizer* †
- **Jan Rock**, *J&J (VP)* †
- **Vinod K. Sahney Ph.D.**, *BCBS Massachusetts* †
- **Arthur H. Spiegel III**, *CSC Healthcare* †
- **Barry Wilson**, *Medtronic* †

Clinical

- **Thomas O’Donnell, MD**, *Tufts Medical*
- **Mehmet Oz, MD**, *New York Presbyterian*
- **Leon G. Smith, MD**, *St. Michael’s*

Professional

- **Brian Brille**, *Banc of America Merrill Lynch*
- **Steven Epstein, Esq.**, *Epstein Becker* *
- **Javier Lopez Madrid**, *Villar Mir Group* *
- **James McLaren**, *Asante Partners*
- **Stephen Pagliuca**, *Bain Capital*
- **David Pitts**, *Pitts Management Associates*
- **Mark S. Speers**, *Health Advances*

(Value) Proposition

- Be a vital growth catalyst to our portfolio company management teams
- Assemble and cultivate key strategic relationships that can support our own value proposition
- Leverage our organizational talent and relationships to add significant value in four distinct areas:
 - ❖ Business model transformation and optimization
 - ❖ Developing, articulating and validating the value proposition
 - ❖ Providing ‘C-Suite’ access to major client prospects, strategic customers, and potential sales and marketing channel partners (*accelerating the revenue trajectory*)
 - ❖ Full spectrum advice and support around core operational functions including team development, finance and sales & marketing

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Thank You

