Evaluate Vantage

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Huge medtech venture rounds mean start-ups starve

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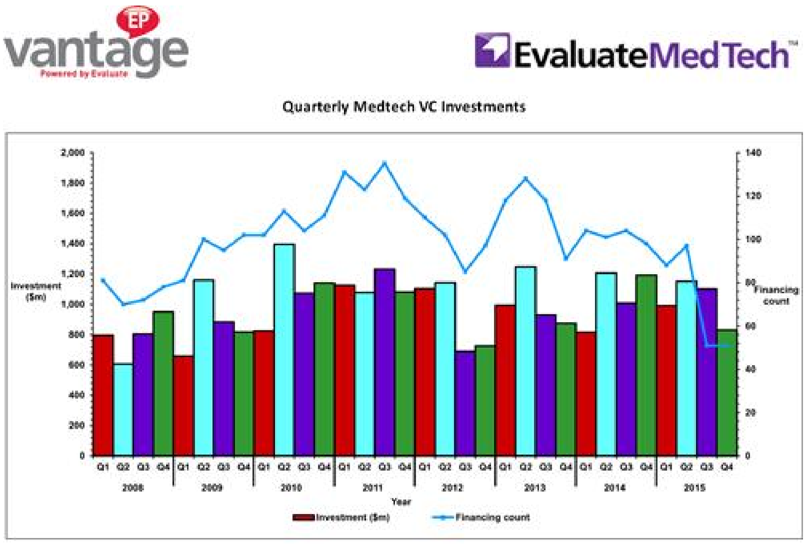
The funding situation for early-stage medtechs just gets worse. The amount of venture cash available to the industry has stayed steady for the past few years – in fact the 2015 total is bang on the five-year average of $4.1bn. But with only 287 rounds closed, compared with 407 the year before, it is clear that VC money is going into large rounds for established companies.

The same pattern can be seen on a quarterly basis (see charts below). So few financings were closed in the third quarter of 2015 that the average size in this period, at $21.6m, was the highest for 15 years. The trend to bigger, later rounds is so pronounced that it is worth wondering what sort of future smaller groups can hope for.

10-year low

The third and fourth quarters of last year saw 51 funding rounds each in the medtech industry – a 10-year low. This is despite the amount raised in each quarter of 2015 being well within the same range as last year, as a glance at the graph below shows.



The ongoing and intensifying reluctance of VCs to back early companies is partly to do with the exceptional glut of large mergers the sector has seen over the past couple of years (*All-time high for medtech M&A, January 18, 2016*). As buyers work to integrate their takeover targets they have less bandwidth for the kinds of smaller acquisitions that provide an exit for start-ups and their VC backers.

But the wave of huge acquisitions appears to have crashed; if smaller purchases become more common then hopefully venture investors will find smaller, younger companies more appealing. Trends in rate of medtech IPOs are also at play here, of course, but most VCs have a strong preference for an exit via trade sale.

By contrast, established companies with devices already approved and on sale are able to haul in increasingly large sums. And, if rounds are getting larger, they are also getting later: there seems to be nothing VCs like more than investing in a group they have already backed.

The top 10 rounds of 2015 include no fewer than three series H rounds. The radiology company Mevion Medical Systems' H round takes the top spot, but sequencing and diagnostics specialist Adaptive Biotechnologies pulled off the astonishing feat of two fund-raisings of nearly $200m each in a single year.

Top 12 rounds of 2015		
Company	**Round**	**Investment ($m)**
Mevion Medical Systems	Series H	200.0
Adaptive Biotechnologies	Series F	195.0
Adaptive Biotechnologies	Series E	189.5
Oxford Nanopore Technologies	Series H	109.0
CeQur	Series C	100.0
Silk Road Medical	Series D	57.0
Natera	Series F	55.5
Calhoun Vision	Series G	52.0
Outset Medical	Undisclosed	51.0
= EndoGastric Solutions	Series H	50.0
= Cohera Medical	Series E	50.0
= Guardant Health	Series C	50.0

Adaptive is developing technologies to allow the sequencing of B-cell and T-cell receptors to tailor drug therapy to a patient and track its effectiveness. No prizes for guessing the therapy area on which this is focused: only oncology can command this kind of cash.

The Seattle group is primarily focused on treatments for solid tumours, though it says its technology is applicable to many other diseases too. It also offers a straight-up diagnostic, ClonoSEQ, designed to detect minimal residual disease in patients with lymphoid cancers.

Mevion is also cancer-focused. The group develops proton therapy, which despite being expensive is attracting a lot of interest from all sorts of investors – witness IBA Group's 136% share price rise last year (*Sector trends dictate smaller medtechs' share performance, January 14, 2016*).

Clustering

Further evidence of the clustering of money at the top is given not only by the average size of each round in 2015 but also by the number of rounds over a certain threshold. There were 12 rounds worth at least $50m last year, the same number as in 2014, but there were five of $100m or more, compared with just two in 2014.

Annual VC investments				
Date	**Investment ($bn)**	**Financing count**	**Avg per financing* ($m)**	**No. of ≥$50m rounds**
2015	4.1	287	12.5	12
2014	4.2	407	10.9	12
2013	4.0	455	9.7	9
2012	3.7	394	9.8	8
2011	4.5	508	9.5	9
2010	4.4	430	11.0	9
2009	3.5	378	10.2	6
2008	3.2	301	11.2	4
**Calculated using only those rounds with disclosed value*				

As the overall total for the year has not changed markedly this can only mean that much less venture investment is going to smaller rounds. The danger is that so few start-ups make it even to the prototyping stage that the supply of innovative medical devices is strangled.

Perhaps the let-up in the pace of M&A activity in the sector will persuade venture investors to back more technologically promising start-ups. It might also free up large medtech companies to invest their own cash reserves via their corporate VC arms.

The alternative is that this trend persists or even worsens. If this happens it will be hard to see where the device industry will be able to find new products, and hence new sources of revenue, in the future.

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