



GUEST ARTICLE

HEALTH CARE SERVICES SECTOR ACHES FOR ATTENTION



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“Since 2001, five health care service companies that were initially venture-backed achieved maximum market capitalizations of more than \$1 billion after going public.”

The health care services industry has been a rewarding sector for **HLM Venture Partners**, yet one that is underappreciated by many investors. This sector includes companies that are deploying innovative medical technologies to deliver cheaper, faster and better care; companies that are focusing on services that help manage costs; and companies that are providing more consumer-oriented health care.

In contrast to the medical device sector, which venture firms have poured roughly \$2 billion a year into over the past five years, and life sciences startups, which have attracted roughly \$4 billion a year in the same time period, health care services companies have attracted only about \$400 million of venture capital annually since 2001.

Yet since 2001, five health care service companies that were initially venture-backed achieved maximum market capitalizations of more than \$1 billion after going public, and several actually achieved market caps in excess of \$2 billion.

These companies are **Centene** and **Amerigroup**, both of which help states deliver high quality and cost-effective health care to their Medicaid populations; **Cross Country TravCorps**, a health care staffing company; **Odyssey Health Care**, a hospice care company; and **Psychiatric Solutions**, an owner and operator of psychiatric hospitals.

Room for growth

Despite the performance of these companies, there continues to be relatively little growth capital available to the health care services startups, making this underappreciated sector that is potentially very attractive for investors.

Largely because of the demographics of aging Baby Boomers, normal volume growth in health care services is roughly 5% a year. However, provider-based companies that deploy innovative medical technologies can often exceed this pace.

Radiation oncology is a case in point. For years, the linear accelerator technology used to treat cancer advanced at a gradual pace. But in the late 1990s, when a new type of linear accelerator (IMRT) became more widely available, it transformed the entire field. Traditional linear accelerator technology is like a shotgun: With certain types of cancers, there is a risk of collateral damage to surrounding areas. The new IMRT technology is more akin to a rifle: It enables the radiation oncologist to deliver a stronger and more localized beam. Many (but not all) patients who previously received the older type of treatment are now much better off with IMRT, and other cancer patients who previously weren't candidates for radiation at all can now take advantage of this potentially life-saving treatment alternative.

It comes as no surprise that IMRT has generated greater than normal volume growth. However, IMRT is very expensive and requires clinical and technological expertise to deploy and operate. This created an opportunity for **Vantage Oncology** to partner with radiation oncologists and owners of radiation treatment facilities to help deploy this superior treatment technology.

Weight management

We see a similar opportunity in outpatient facilities focused on weight management. It's no secret that America is suffering from a near-epidemic of obesity and that the health consequences of obesity include diabetes and heart failure. Historically, the only sur-

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gical alternative for the morbidly obese was a highly invasive and relatively dangerous inpatient procedure that required a long and costly hospital stay.

More recently, innovative medical technology companies such as **Allergan** and **Satiety** have developed devices that allow for relatively comparable procedures to be performed on an outpatient basis. For many patients, these new devices allow for similar results with fewer risks and a shorter recuperation. It's easy to foresee the emergence of specialty weight management centers offering a full continuum of assistance to people suffering from obesity, including these surgical alternatives, which can result in better care at a lower cost.

The second area where we see a tremendous opportunity falls under the broad category of companies that help control health care costs without compromising the quality of care. Health care is the single largest sector of the U.S. economy, representing approximately 15% of GDP. And with health care costs outpacing the general rate of inflation, we, as a society, must find means to control this spending without impairing quality.

Fortunately, there are excellent companies focusing on this issue. For example, HLM is an investor in **Sanovia**, which helps health plans provide care to patients using high-cost infusion and injectable drugs. Many of these drugs represent remarkable advances in treatment. For example, they can allow someone suffering from rheumatoid arthritis or Crohn's disease to lead a normal life. However, many of these drugs are extremely expensive, costing as much as \$500,000 per patient per year.

Because many biotechnology drugs are still relatively new, they often lack good clinical protocols to ensure that patients in need receive them and, conversely, that resources aren't inappropriately utilized on patients for whom these drugs aren't likely to make a difference. Sanovia offers health plans clinical expertise in the utilization of biotechnology therapies with the goal of optimizing clinical outcomes and saving money at the same time.

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Customer service

Americans are steadily becoming better health care consumers. We're more informed and also more willing to spend our own money to receive care, whether elective or otherwise. You can see this trend in cosmetic procedures such as Botox treatments, elective drugs such as Viagra and health clinics located in drug and grocery stores. One of our portfolio companies, **Cbr Systems**, enables families to store umbilical-cord stem cells for possible use in treating future diseases. We believe that there are great opportunities for companies making Americans better-informed as health care consumers, offering necessary services that are more convenient, and providing elective services that fulfill consumer demand.

One final area where we believe there is a great unmet need is immigrant health care. The demographics of America have been changing rapidly over the past few decades. We have millions of hard-working immigrants who today have poor access to quality care either because they can't navigate their alternatives or because they are impeded by language barriers. While we haven't yet found the perfect investment at HLM, we remain committed to this theme, which rep-

resents both a great investment opportunity and a critical societal need.

Independent of these themes, the companies we like are those with great management teams. Because services companies are operating businesses rather than research and development labs, there is also an enormous premium on the quality of company management. Unlike medical device and life sciences startups, venture-stage health care services companies are typically operating companies from day one. The best opportunities rarely result from proprietary intellectual property or some kind of new mouse trap. Rather, most are evolutionary improvements on existing models. As a result, it's critically important that companies have seasoned management teams in place before raising the capital they'll need for rapid growth.

Management is an area where venture capital firms with extensive networks in health care services can really help portfolio companies. One of the most important things a venture investor can do is help surround good people with other talented managers and then let them do their jobs. Young health care services companies looking for this kind of added value will do well to work with venture partners who have extensive experience in our industry. Not only will this mean valuable input on the board level, but it insures access to a network of industry contacts that can be tapped for management positions within the company.

In summary, we see tremendous opportunity in health care service companies, providing that they are focused on the right areas and are led by great teams.

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Reprinted from *Venture Capital Journal*, November 2007
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