

The Venture Capital Analyst

TRACKING INNOVATION AND THE MONEY BEHIND IT » JUNE 2003 | VOLUME VII | ISSUE 6

VENTURE PROFILE

Essex Woodlands Takes a Centrist Approach

CHICAGO FIRM'S STRATEGY ENCOMPASSES BOTH COASTS—AND A LOT OF SPACE IN BETWEEN

Not all blockbuster pharmaceutical investments take place on the East or West Coast. Essex Woodlands Health Ventures, the largest health care-only firm in the Midwest, has realized some big wins in the nation's heartland, including Richwood Pharmaceuticals, a Florence, Ky., acquirer of drugs for treating pain. The company, which Essex Woodlands seeded in 1992, was sold to Shire Pharmaceuticals five years later for \$192 million.

General Partner Martin Sutter says that Essex Woodlands' Chicago headquarters present a natural access point to companies in unlikely locations, such as Kentucky or Oklahoma. "West Coast and East Coast guys aren't going to do deals in those areas," Mr. Sutter said.

But Essex Woodlands, which has \$500 million under management and plans later this year to launch a fund with a target in the same neighborhood as the \$280 million partnership it is now investing, doesn't restrict itself to the central states. Through its last two funds, the first of which closed in 1998, Essex Woodlands has backed 16 companies on the East Coast and 10 on the West Coast, where it maintains an office in Irvine, Calif. The Midwest accounted for 12 deals.

"We're not afraid to get on a plane to track down a good deal," said General Partner Immanuel Thangaraj, who works out of the Chicago office. Mr. Sutter, meanwhile, heads an

office in The Woodlands, Texas, a suburb of Houston.

To help source deals, Essex Woodlands has established ties with professionals with experience in research, medicine, industry and even serving on regulatory boards. These "adjunct partners," who are on retainer, include Dr. Phyllis Gardner, a Stanford University professor who is the former head of research at Alza Corp.; Dr. Gilbert R. Gonzales, a neurologist from Sloan Ketting and the Mayo Clinic and a voting member of the FDA; Dr. Eric J. Topol, chairman of cardiology at the Cleveland Clinic; and Dr. Frank E. Young, head of the FDA during the Reagan Administration and now a member of the executive committee of the World Health Organization.

Dr. Young came to know Mr. Sutter through their mutual membership on the board of **EluSys Therapeutics**, a Pinebrook, N.J., monoclonal antibody company. Essex Woodlands led EluSys' \$9.5 million first round in April 1999 and also took part in a \$17 million second round in February 2001.

One thing that appealed to Dr. Young about working with Essex Woodlands is that its adjunct partners are "essentially fully integrated" into the firm's investment program, with their suggestions on potential deals sought out and welcomed. Dr. Young said the relatively modest size of the firm's funds also attracted him.

More Emphasis on Mid-Stage Deals

With its last two funds, Essex Woodlands has operated as a larger firm might, with investments ranging from early-stage deals to private placements in publicly held companies. This latter category accounted for roughly one-third of the firm's \$137 million 1998 fund. Twenty-nine percent of the fund was committed to early-stage companies.

With its current fund, which closed in 2001, Essex Woodlands has placed more emphasis on mid-stage "growth" investments (36 percent of committed capital) and later-stage deals (27 percent.) Early-stage companies have drawn just 19 percent of the capital, with 18 percent going to publicly held companies.

Essex Woodlands' most successful investment in a publicly traded company came in 2000 when it participated in a \$40 million private placement for **Cell Therapeutics**, Seattle. "Literally, in a year and a half we returned half the committed capital of the fund, and we still own half our stock," Mr. Sutter said. He said that Essex Woodlands also secured a nice return on its investment in publicly held Bradley Pharmaceuticals but declined to disclose the terms.

At a Glance

Essex Woodlands Health Ventures

MAIN OFFICE

190 South LaSalle St., Suite 2800, Chicago, Ill. 60603
Phone: 312-444-6040 | Fax: 312-444-6034

BRANCH OFFICES

Waterway Plaza Two, 10001 Woodloch Forest Drive, Suite 175
The Woodlands, Texas 77380
Phone: 281-364-1555 | Fax: 281-364-9755

19000 McArthur Blvd., Suite 500, Irvine, Calif. 92612
Phone: 949-261-8390 | Fax: 949-261-8391

KEY PERSONNEL

James Currie | **Immanuel Thangaraj** | Managing Directors,
Chicago

Martin Sutter | Managing Director, *The Woodlands, Texas*

Dr. Douglas Eplett | Managing Director, *Irvine, Calif.*

VENTURE PROFILE

While Essex Woodlands has had success investing on the public market, it didn't manage to take any of its privately held biopharmaceutical companies public during the IPO boom in 2000 and 2001. As Mr. Thangaraj points out, most of the startups that went public in that period were genomics or platform companies, rather than pharmaceutical companies. And the pharmaceutical companies that did go public have not, as a class, performed well; many venture investors still hold depressed shares.

Executing the Triple Merger

Essex Woodlands has shown a knack for positioning companies during periods when the IPO window is closed. In 1995, Mr. Sutter helped facilitate the merger of Essex Woodlands-backed Triplex Pharmaceutical Corp. with Argus Pharmaceuticals Inc. and Oncologix Inc. The merged companies, which assumed the name Aronex, went public in 1997. (Aronex was acquired by Antigenics in 2001.)

In 1999, when biotech companies were unable to go public, Mr. Sutter represented Essex Woodlands' interest in Reprogenesis as it merged with Ontogeny and publicly traded Creative Biomolecules. The resulting regenerative medicine company, called Curis, boasted a deep pipeline of products and technology and was hailed as a model for consolidating specialized biotech companies into a full-fledged business.

The merged company has fallen far short of many expectations. Part of that might be tied to the overall decline in the market, but disappointing news about two of Curis' later-stage products, including OP-1, a treatment for long-bone fractures, drove down its stock price to below \$5 a share by early last year; the stock once had traded above \$20.

Dr. Doros Platika, the CEO of Ontogeny who helped orchestrate the merger and led the new company until 2001, said that, in retrospect, investors in Ontogeny and Reprogenesis might have been better off if the two companies went public independently once the IPO window re-opened in 2000. But Dr. Platika added that with three years of cash and encouraging recent developments, it's too early to write off the company.

Curis, which cut staff during a restructuring late last year, has entered into several agreements with larger companies to share development costs of treatments for kidney disease, stroke, diabetes and other diseases. Partners include Ortho Biotech Products, Amylin Pharmaceuticals, ES Cell International, Elan Corp., and Micromet AG.

According to Mr. Sutter, Curis has both the intellectual property and business model necessary for success. "Although some of the front-end products didn't pan out as we had hoped, the more exciting technology was the early-stage technology that is now benefiting from major partnerships," Mr. Sutter said.

Mr. Sutter also insisted that his firm will continue unorthodox means of pursuing exits. Typical venture capitalists, he suggested, "run their train to the end of the tracks, and if there is a bridge there, fine. If not, they'll go over the end of the cliff."

Essex Woodlands, meanwhile, maintains a special relationship with Roger Griggs, the founder of Richwood Pharmaceuticals, the Kentucky company Essex Woodlands seeded back in 1992.

Following the company's sale in 1997, Essex Woodlands backed Mr. Griggs' investment vehicle, **Union Springs LLC**. "I didn't go out and canvas the world for investors," Mr. Griggs said. "There were only a couple of people I wanted around the table and Essex Woodlands is one [of them]."

Through Union Springs, Essex Woodlands helped Mr. Griggs start three niche pharmaceutical businesses: **Integrity Pharmaceuticals**, a Fishers, Ind., company selling drugs for women; **PediaMed Pharmaceuticals**, a marketer of children's medicine; and **Xanodyne Pharmacal Inc.**, which distributes psychotherapeutic treatments. Both PediaMed and Xanodyne are based in Florence, Ky.

Mr. Griggs said that he and James Currie, the Essex Woodlands general partner who worked on Richwood, have built a strong relationship over the years. Essex Woodlands is a co-investor in all three of the niche pharmaceutical businesses.

Mr. Griggs plans to announce the creation of a new company this fall, one that will identify drugs believed to be especially effective among certain ethnic groups and then market the drugs to those groups.

Investment Snapshot*

Companies Backed	58
Companies Taken Public	12
Companies Acquired/Merged	4
Companies Private	35
Companies Out of Business	7

Breakdown by Sector

Biopharmaceuticals	18
Medical Devices	12
Health Care Services	12
Other	11
Medical Software	5

Breakdown by Rounds

(Initial Investment Only)	
First Round	21
Second Round	15
Later Stage	22

Minimum Investment \$1.5 million

Maximum Investment \$10 million

Number of Investments in 2003 2

*Data for Essex Woodland Funds III, IV and V

Source: Essex Woodlands Health Ventures