# News Analysis

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# Zen and the art of wellness investing

**Spurred by big exits, VCs earmark more dollars for wellness startups.**

The average venture capitalist and the typical consumer of wellness products have much in common. Each is likely to be a graying Baby Boomer with high disposable income and little tolerance for the inconveniences of growing old. But despite the common wisdom that VCs fund sectors they know best, businesses tied to healthy living historically haven't been big recipients of capital.

That is now starting to change, as VCs realize that Baby Boomers like themselves are big business. They're funding all sorts of nontraditional ventures that tap into health-conscious Boomers' pocketbooks, including a chain of yoga studios, a maker tortilla chips that help reduce cholesterol, and a company focused on brain health.

"We call it life science meets lifestyle," says **William Rosenzweig**, managing director of **Physic Ventures**, a wellness-centered VC fund, and CEO of **Brand New Brands**, a food product incubator. Rosenzweig, who co-founded specialty tea purveyor **Republic of Tea** in the early 1990s, has since become the closest thing the industry has to a poster boy for wellness investing. In the past two years, Brand New Brands has introduced four product lines: a sleep-inducing beverage, a high-fiber shake, chips (the edible variety) that promote heart health, and snack bars that double as digestive aids.

It's difficult to gauge how much venture money is going into wellness, as it crisscrosses traditional investment categories such as medical devices, consumer products, and, in some cases, biotechnology. On a deal-by-deal basis, however, wellness-themed investments crop up with frequency, with a few smaller funds such as Physic, St. Louis-based **Prolog Ventures** and **Sherbrooke Capital Partners**, devoting a big chunk of their portfolio to such deals.

Big funds such as **Highland Capital Partners** and **Oak Investment Partners** are also branching out into the healthy living area. Recent Highland investments include yoga studio chain **Whole Body**, wellness retailer **Pharmaca Integrative Pharmacy**, and yoga clothing maker **Lululemon** (which is in registration for an IPO). Oak, along with **Radar Partners**, participated in a $25 million Series A in June for New **Sun Nutrition Inc**., which makes and distributes healthy beverages and nutritional supplements. (*See table for details.*)

## Health bar

At first glance, starting a wellness business might seem too easy to provide the barriers to entry VCs seek. It's hard to go a block in any upscale California community within a couple hours of Silicon Valley without stumbling on a health food store or yoga studio. And it seems like anyone with a kitchen can throw together some organic delicacy and package it for sale.

*"We call it life science meets lifestyle."*
*William Rosenzweig, Managing Director, Physic Ventures*

However, entrepreneurs quickly find that producing a competitive product is harder than it looks, says **Lynn Graham**, co-founder of Brand New Brands spinout **LightFull Foods**. LightFull is a prime example. Its main product—a 90-calorie shake made with no artificial sweeteners and fortified with fiber and protein—required extensive collaboration with food scientists to develop and time-consuming negotiations with upscale grocery chains **Whole Foods** and **Wegmans** to test market.

Ideally, wellness-related investments should also have an intellectual property component, says **Ilya Nykin**, managing director at Prolog Ventures, which counts about a third of its portfolio companies as being in the wellness space. Patents and licenses were a key driver, he says, behind the firm's decision to invest in two rounds for **Efficas**, which makes a berry-flavored non-prescription medicine to reduce symptoms of asthma and allergies.

Prolog also invested in **Dreamerz Foods**, a San Francisco-based maker of sleep aid drinks that's raised $16.5 million since December. The product, incubated by Rosenzweig, is based on **MIT** neuroscientist **Richard Wurtman**'s pioneering work in the use of the hormone melatonin to treat insomnia.

But not every wellness startup boasts of barriers to entry. Some make a point to promote themselves as small-scale, new age kitchen or workroom startups. Norwalk, Conn.-based food startup **Bear Naked**, tells customers on its website that co-founder and recipe creator **Kelly Flatley** started out baking granola in her parents' kitchen and got into the business full-time with no formal industry experience. The company has raised more than $3 million from private investors since 2004, according to regulatory filings.

Highland-backed Lululemon, meanwhile, states forthrightly in its IPO prospectus that it has no intellectual property rights in the technology, fabrics, or processes underlying its products. Competitors, therefore, "are able to manufacture and sell products with performance characteristics, fabrication techniques and styling similar to our own." To make matters riskier, its technical athletic apparel is sold at a premium to traditional athletic clothing.

## Profits in prevention

Risks posed by competitors are counterbalanced by the size of the wellness market. In 2006, U.S. retail sales within the consumer packaged goods health and wellness industry reached $90 billion, up 13% over 2005, according to market research firm **Natural Marketing Institute.** A single hit product can generate the equivalent revenue of a mid-size technology company. Sales of anti-cold supplement Airborne, for example, topped $100 million last year.

*"We're on the cusp of seeing longevity funds start in the Valley."*
*Mary Furlong, Professor of Entrepreneurship, Santa Clara University*

VCs are also attracted by Baby Boomer demographics. Today, the 70-million strong age group represents the nation's wealthiest generation, with an estimated annual spending power of more than $2 trillion, according to market research firm **Mintel International Group**.

Venture capitalists see more opportunities ahead as boomers get older. "We're on the cusp of seeing longevity funds start in the Valley," predicts **Mary Furlong**, professor of entrepreneurship at **Santa Clara University** and a Boomer marketing consultant. The category would encompass such areas as nutritional supplements, health-monitoring devices and "personalized medicine" startups. Target investments would include businesses like **Posit Science**, a San Francisco developer of software programs designed to prevent age-related cognitive decline. Since 2003, the company has raised about $28 million from venture backers including **Draper Fisher Jurvetson**, **Aberdare Ventures**, **State Street Bank** and **VSP Capital**. Posit, still privately held, posted its first profit this year, CEO **Jeffrey Zimman** told attendees at this summer's **Silicon Valley Boomer Venture Summit** in Santa Clara, Calif.

Capturing a piece of boomers' paychecks isn't VCs only motive. Investing in preventative medicine and over-the-counter treatments can also serve as a hedging strategy, says Prolog's Nykin. Wellness investments work particularly well for balancing portfolio risk in life sciences funds, such as Prolog, which have a lengthy cycle from inception to exit.

"When you look at traditional health care investing, we have a tremendous concentration of risks in the product development side," Nykin says. "You might spend tens of millions of dollars before you know if you've got something."

Wellness companies, by contrast, don't go through years of clinical trials before putting a product on the market. Entrepreneurs can hold the product development cycle to as low a year or two. After that, Nykin says: "If you can show traction in the marketplace and build your product to a critical mass, the chance of a successful exit is good."

## Many healthy returns

For consumer product startups in the wellness space, the expected path to exit is through acquisition rather than IPO. That's largely because big food, beverage, and packaged goods companies have proven they'll pay handsomely for startups that meet their desired metrics.

"The food industry is keenly interested in [wellness]. They see it is an area of extremely high growth, and it attracts loyal consumers who are willing to pay more for their products."
Ilya Nykin, Managing Director, Prolog Ventures

Blockbuster acquisitions, such as **Coca Cola**'s $4.1 billion purchase of Vitaminwater maker **Glaceau** this summer, provide further impetus. Envisioning profit potential in a new generation of wellness-focused consumer brands, a few VCs are finding an investment niche funding development of health products with built-in barriers to entry.

Beverages are especially big. This year alone **Coca Cola** paid $4.1 billion for Vitaminwater maker **Glaceau** and $225 million for **FUZE**, a maker of juice and tea drinks backed by private equity firm **Castanea Partners**. Last year, **Peps**i acquired **Izze**, a maker of sparkling fruit juices, for an undisclosed sum.

Energy bar startups have also done well, although they may have reached their zenith early in the decade. **Kraft Foods** spurred the trend back in 2000 with its $200 million acquisition of **Balance Bar**, followed by **Nestle**'s purchase of **PowerBar** and **Abbott**'s $160 million acquisition of the makers of the Zone Perfect Bar.

Corporate venture divisions are also investing in food startups. Dreamerz and **Attune**, which makes energy bars that aid in digestion, raised funding from **Dean Foods** and Nestle, along with standalone venture firms.

Going forward, big food and beverage companies will be making acquisitions of younger companies, predicts LightFull's Graham. Early in the decade, large-cap acquirers typically waited until a company had revenue of $100 million or more. Today they'll buy a company with revenue in the $30 million range, commonly paying somewhere between two and six times sales. Pepsi's acquisition of Izze, for example, occurred when it was posting about $20 million in sales, Graham says.

The tricky part, however, is predicting which premium products consumers will buy. Of course, practically everyone wants healthy, low-calorie foods that taste rich and fattening. But that can't always be delivered.

"I would love ice cream that came with zero calories," concedes Graham. "But a lot of this has to do with the feasibility."

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