

# NASHVILLE VENTURE CAPITAL REPORT 2001-2011



Presented by

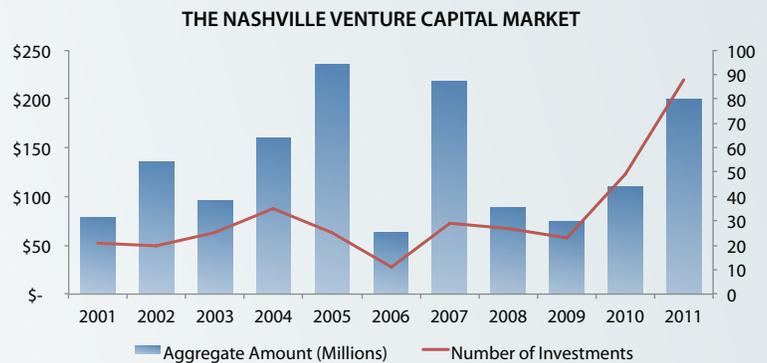


NASHVILLE  
HEALTH CARE  
COUNCIL

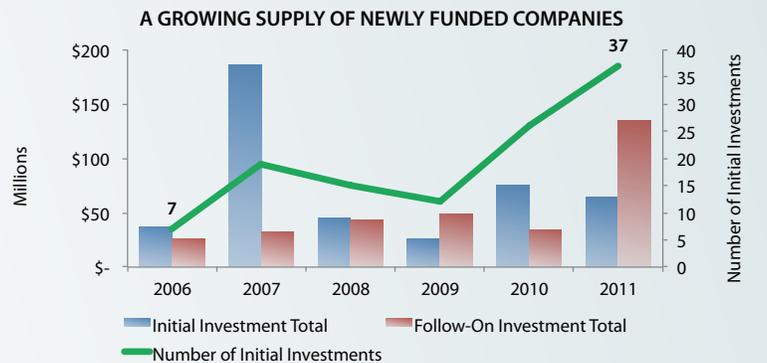
# Executive Summary

Welcome to the first-of-its-kind Nashville Venture Capital Report. This report provides a detailed look at the growth of the venture capital industry in Nashville from 2001 through 2011, with a special focus on venture capital investment in Nashville's health care industry. Overall, the data provides credence to those who cite Nashville as a growing venture capital hub and one of the leading health care markets in the United States. Some of the key findings are outlined below.

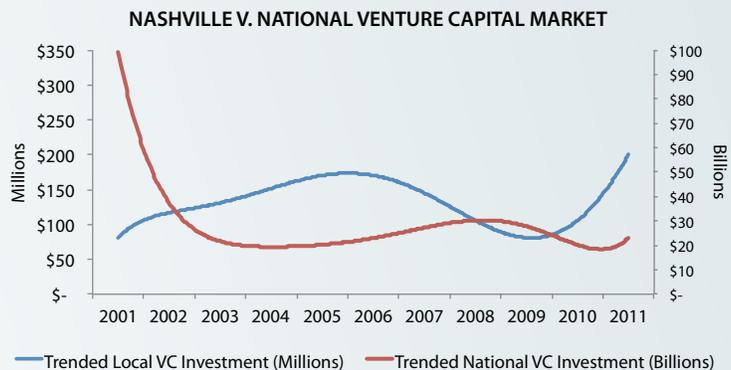
- Since 2001, more than \$1.4 billion venture capital dollars have been invested in 215 different Nashville-based companies.
- More than \$950 million was invested in health care companies during the period; this amount is roughly 65 percent of Nashville's total venture capital investment dollars.



- In Nashville, exciting new companies are being founded faster now than at any time in the past decade. In 2011 alone, 37 companies received their first venture capital investment, suggesting an attractive environment for early-stage growth capital (Series A and B rounds) in the next five years.



- Nashville's public and private sectors have collaborated to develop and nurture a thriving entrepreneurial ecosystem over the past decade, one result of which is reflected in the number of new companies being founded. To sustain and expand upon this foundation will require a continued effort from all stakeholders and a new focus on early-stage growth capital.



# WELCOME TO THE NASHVILLE VENTURE CAPITAL REPORT

On behalf of Nashville Capital Network and the Nashville Health Care Council, we are proud to present this first-of-its-kind Nashville Venture Capital Report. The primary goal of the report is to provide the venture capital and health care communities, in Nashville and nationally, with a comprehensive resource that offers valuable insight into Nashville's venture capital activity over the past decade.

Nashville has long been known for its role in building the country music industry, but the city's entrepreneurial spirit encompasses much more than entertainment. Nashville is widely considered to be one of the nation's leading health care markets. From its beginnings with the founding of Hospital Corporation of America in 1968, the city's health care industry has grown to include 250 diverse health care companies creating more than 200,000 jobs in the community and creating a \$30 billion annual economic benefit to the area. The willingness of the city's health care industry to engage with start-ups has played an invaluable role in encouraging entrepreneurs to build businesses in Nashville. The data contained in this report suggests that the confluence of entrepreneurship and health care in Nashville is at an all-time high. Moreover, venture capital investing in Nashville has weathered the tough economic climate of recent years better than the industry on a national level.

In five sections, this report: (1) provides background on the essential elements for an entrepreneurial ecosystem;

(2) examines civic and governmental efforts to construct an entrepreneurial infrastructure; (3) takes a retrospective look at venture capital investing by industry; (4) presents evidence of early success and potential opportunities in venture capital investing; and (5) offers a glimpse at the next set of challenges for the entrepreneurial community in Nashville.

As the report highlights, from 2001 to 2011, venture capital firms have invested more than \$1.4 billion in 215 Nashville-based companies. Our community has the key ingredients in place to build on this success, and with this study we hope to highlight those areas of strength and also to point out opportunities for further improvement. Furthermore, we hope that this report will illustrate the important roles that venture capital and health care play in helping to make Nashville an elite city for entrepreneurship.

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**Sid Chambless**, *Executive Director, Nashville Capital Network*  
**Caroline Young**, *President, Nashville Health Care Council*

**At the outset, we extend our sincere thanks to the many firms and organizations that contributed information and made this report possible.**

- Chrysalis Ventures
- Claritas Capital
- Clayton Associates
- Council Capital
- Eastside Partners
- First Avenue Partners
- Harbert Management Corporation
- HCP & Company
- The Heritage Group
- Mainland Morgan & Company
- MB Venture Partners
- New Enterprise Associates
- Noro-Moseley Partners
- Pitchbook
- PricewaterhouseCoopers/National Venture Capital Association Moneytree™ Report based on data from Thomson Reuters
- River Cities Capital Funds
- Salix Ventures
- Welsh Carson Anderson & Stowe

# A **HOTBED** FOR VENTURE CAPITAL



## **Health Care**

Nashville is often referred to as the health care industry capital of the country, serving as home to more than 250 health care companies. The industry cluster includes such leaders as HCA, Healthways, Vanguard Health Systems, AmSurg, and Community Health Systems. Additionally, more than 300 health care focused professional service firms (e.g., accounting, architecture, banking, and legal) in Nashville provide deep health care expertise. Sixteen publicly traded health care companies are located in Nashville, with combined employment of nearly 400,000. In 2011, HCA's return to Wall Street marked the largest-ever U.S. private equity-backed public offering. Annually, the city's health care industry creates a local economic benefit of \$30 billion and sustains more than 200,000 jobs. On a global scale, Nashville's health care industry generates more than \$70 billion in revenue each year.

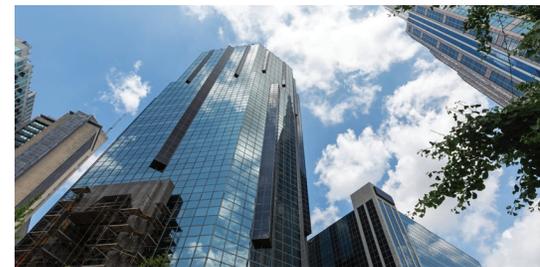
## **Education/Research & Development**

Metro Nashville's 21 accredited four-year and post-graduate institutions are an integral part of the economic and cultural identity of the area. Nashville is also home to a strong R&D community and has developed into a thriving cultural hub due to its growing, diverse population. The city's universities have served as a magnet for top minds and offer many programs specifically devoted to training young entrepreneurs. Local universities have also begun funding start-up focused grants, an example being the recently announced \$25,000 Sohr Grants available to student entrepreneurs attending Vanderbilt's Owen Graduate School of Management. Furthermore, the ground-breaking research performed at the universities has resulted in start-up ventures led by students, professors, researchers, and physicians alike. Efforts such as these recently earned Nashville a place at #4 on Forbes' List of "Top Ten Brain Magnets."



## **Local Economy**

According to the latest information from the Bureau of Labor Statistics, Nashville was the fifth fastest growing metropolitan area based on job growth in populations of over one million residents. This positions the city closely behind notable venture capital hubs



Austin and San Jose, which ranked numbers one and two respectively. Furthermore, the city has a reputation for being an ideal business location and is home to several large corporate headquarters, including Nissan North America, LP Building Products and Dollar General. Nashville also offers employees a high quality of life and lower cost of living than national averages, all of which has garnered the city numerous accolades from major publications :

- #3 Boomtown in America, *Forbes Magazine*
- Top Ten, Best Places For Business And Careers, *Forbes Magazine*
- #1 Fastest Two-year Job Growth, *Kiplinger*
- Health Care Industry cited as "Hub" for Entrepreneurs, *Wall St. Journal*

# BUILDING AN ENTREPRENEURIAL INFRASTRUCTURE

## Business Climate

The Nashville business community has worked diligently to develop, promote and sustain a vibrant environment for entrepreneurship. To this end, groups like the Nashville Health Care Council and Nashville Technology Council seek to promote their respective industries and facilitate initiatives for improving or maintaining the strength of the local economy. Sustaining a strong economy also requires ensuring that resources are available to the next generation of successful businesses. Jumpstart Foundry, Bullpen Ventures, and the Nashville Entrepreneur Center seek to provide guidance, seed capital, and other resources to concept-stage businesses. Additionally, organizations like Nashville Capital Network (NCN) strive to accelerate the development of early stage companies by nurturing entrepreneurs and connecting them with knowledgeable, experienced investors.

## Government Efforts

Tennessee has established a favorable climate for entrepreneurs with the help of the State of Tennessee, including the Department of Economic and Community Development and the Tennessee General Assembly, which has engaged in a focused effort to provide early stage companies with access to capital. In 2009, the State of Tennessee established the TNInvestco Program. The program consisted of \$200 million in tax credits, which were sold to institutional investors and generated \$140 million in investable proceeds. These proceeds are currently being invested by ten venture capital funds with broad experience in developing innovative new companies capable of having a significant economic impact in their given industries. Leveraging the momentum of the TNInvestco Program, the administration of Governor Bill Haslam has established the INCITE program, a \$30 million Co-Investment Fund designed to stimulate the growth and development of innovative small businesses in Tennessee by matching private capital with state funds for qualified investments. Tennessee is also home to nine regional accelerator programs, which help concept-stage entrepreneurs refine their business pitch and develop traction before seeking venture capital investment. Overall, state government has established a strong track record of fostering entrepreneurship that crosses party aisles, which as the data indicates, has begun to make a real impact on the number of promising start-up companies in Nashville.

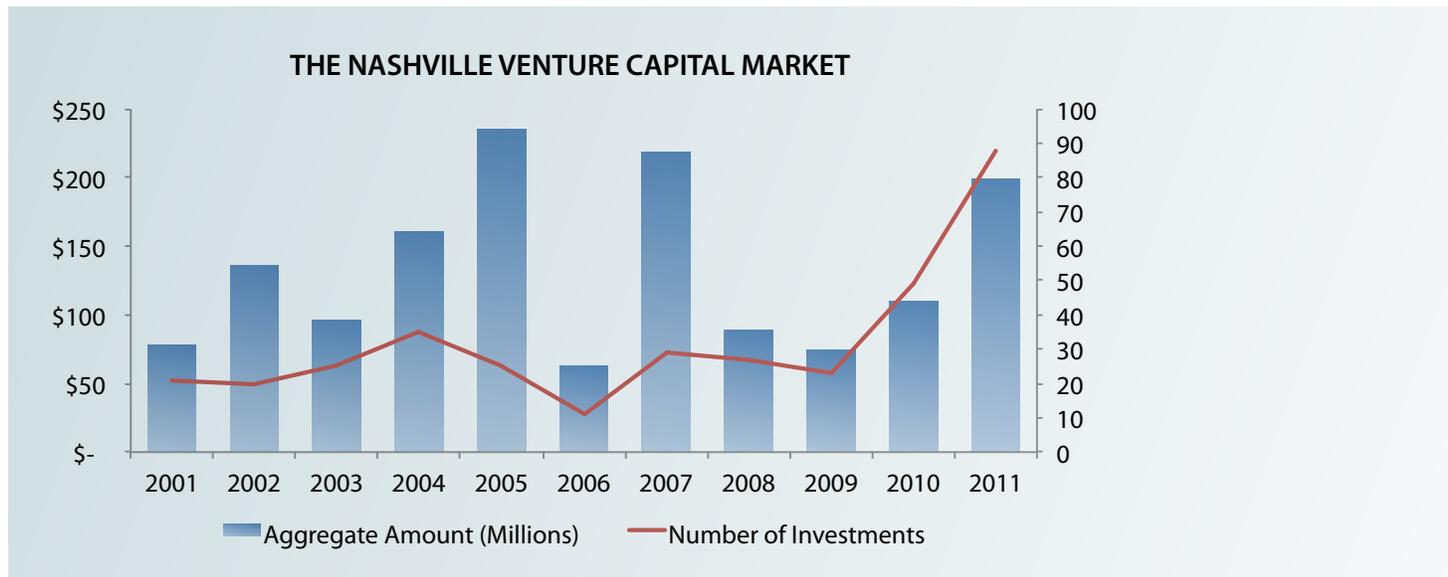


# A DEEPER LOOK AT THE VENTURE CAPITAL INDUSTRY

*Since the beginning of 2010, the number of funded companies and the total investment amounts have trended strongly upward, . . .*

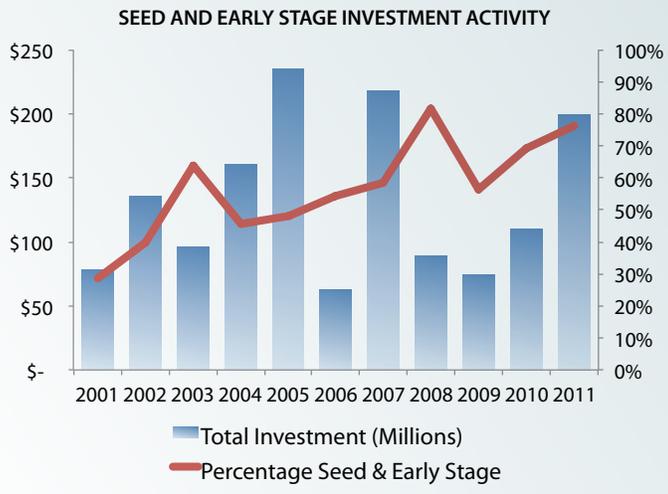
In collecting the data for this report, NCN and the Council surveyed a number of venture capital groups about their investments in companies located in the Nashville MSA. Participating venture capital groups provided the company names, financing amounts, industry sectors, number of unique financing events and the life-stages of their Nashville investments from 2001-2011. Pitchbook and the Moneytree™ Report were also consulted and NCN's internal database was analyzed to complete the dataset. In order to limit the focus to venture capital, the following were excluded: leveraged buyouts, dividend recapitalizations, mezzanine debt offerings, distressed investments, and equity investments in larger or more established companies deemed to be mature. With these exclusions, Nashville-based companies that had accepted growth capital in return for an equity stake were isolated and analyzed. The process presented an accurate depiction of venture capital in Nashville and represents the most complete data set ever compiled on the city's venture capital activity. All contributors proved to be invaluable resources and willing participants in collecting the necessary data.

## A Broad Overview of the Nashville Venture Capital Market



The graph above provides a broad summary of the total venture capital invested in Nashville as measured by both dollars and number of investments. The number of venture capital investments in Nashville remained fairly steady from 2001-2009, with every year but 2006 totaling between 20 and 40 investments. However, the amount of capital invested in the years 2005 and 2007 spiked to levels well above the norm for Nashville. Sandwiched between the two spikes, 2006 was unusually low for both the number of companies receiving funding and the total amount invested.

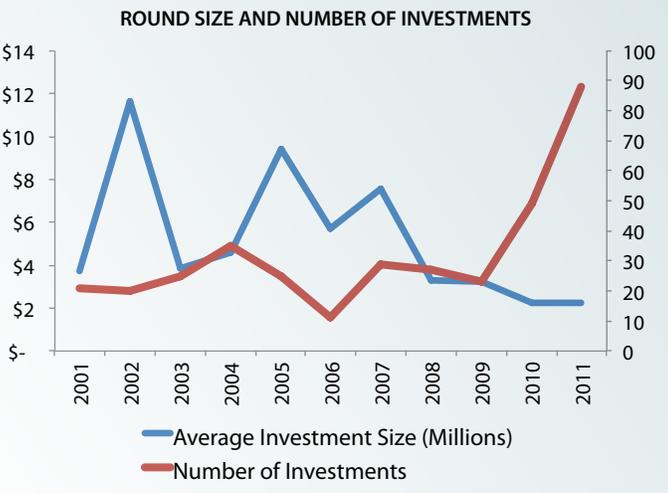
The TNInvestco Program has clearly had a strong impact on the overall venture capital activity in the Nashville market. Since the beginning of 2010, the number of funded companies and the total investment amounts have trended strongly upward, suggesting that the program has been a boon to local entrepreneurs and has positively influenced the local economy. The graphs on the following page detail the amount of early and seed stage investment activity in the Nashville market.



The data clearly indicates that even **despite the downturn in the national economy, beginning in 2010 Nashville experienced a steady rise in the amount of capital invested and the number of individual financing events.** The “Seed and Early Stage Investment Activity” chart (left) illustrates the rise in early stage venture capital activity over the entire ten year period of the study. Beginning in 2001, Nashville’s investments in seed and early stage companies tallied 25 percent of the total venture capital dollars devoted to Nashville-based companies. By 2011, that number had trended steadily upwards, reaching nearly 75 percent of all venture capital dollars.

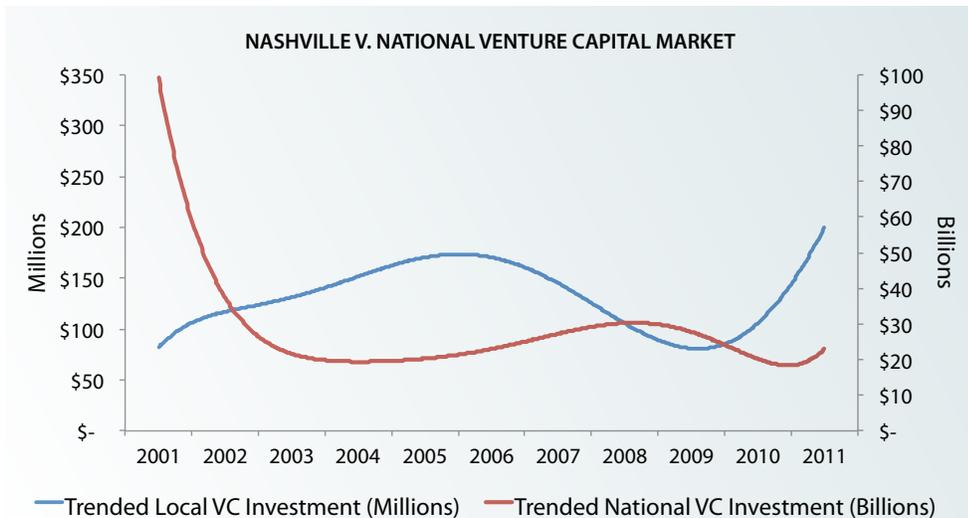
While the TNInvestco Program accelerated this growth, it is clear that seed and early stage activity have been trending upward for the better part of the past ten years, which provides tangible evidence of Nashville’s emerging entrepreneurial culture. This increase also corresponds with an institutionalization of angel investing through groups such as Nashville Capital Network.

The “Round Size and Number of Investments” graph (left) confirms the same trend. More early stage companies have received funding, which has resulted in the average size of venture investments trending downward from the 2002 peak of \$11.6 million to under \$2 million by 2011. This will likely result in a strong supply of concept-proven, young companies seeking growth capital over the next few years, and should continue to fuel Nashville’s momentum in attracting investment from national venture capital firms.



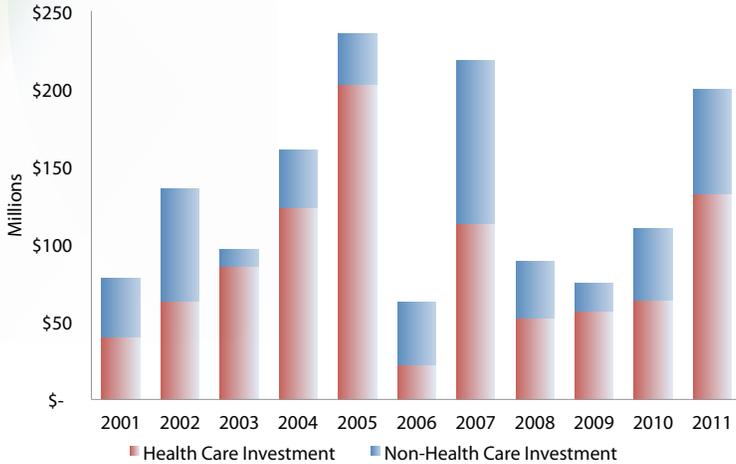
## A Comparison of Nashville with National Venture Capital Trends

Perhaps not historically considered a venture capital hub, data suggests that Nashville is an emerging and dynamic market for venture capital activity. Buoyed by its health care industry, the city has weathered the recent economic downturn better than the industry in aggregate. Nashville has developed and engaged in a focused effort to foster a strong entrepreneurial ecosystem. In turn, venture capital dollars have been attracted to the city.



# Health Care Industry Trends

**HEALTH CARE: A LARGE PORTION OF TOTAL VENTURE DOLLARS**

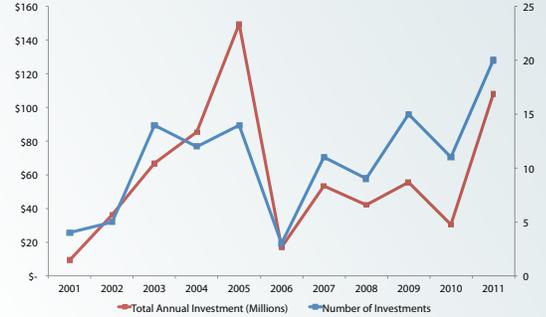


In terms of aggregate dollars invested by venture capital firms in Nashville businesses, the health care industry exceeds all other industries combined. Over the past decade, 65 percent of all Nashville's venture capital funding has been invested in health care companies, which are defined here by the following sub-categories: Health Care Services, Health Care IT, Medical Devices, and Biotech.

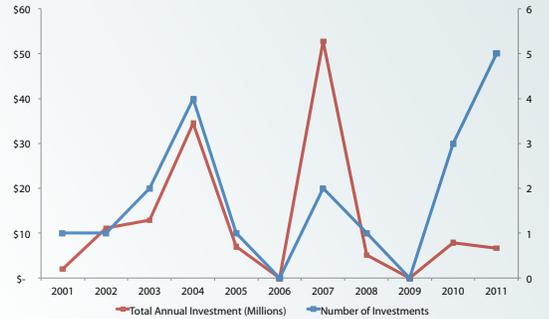
In a typical year, 20 health care companies based in Nashville will receive venture funding totaling between \$75-100 million. In the aggregate, venture capital firms have poured nearly \$1 billion (\$950 million) into Nashville health care ventures from 2001-2011. As the graphs to the right illustrate, each of the sub-sectors of health care has attracted significant amounts of capital, but Health Care Services has received the largest total amount. Looking forward, several other industry sub-categories have begun to gain momentum as well.

While Health Care IT has yet to see a major funding event such as those that caused the peaks in Medical Devices and Biotech in 2005 and 2007, respectively, the industry has attracted a significant amount of capital since 2009. Health Care IT had nearly as many funding events (17) in 2011 as Health Care Services (20) and looks poised to continue its growth. None of the other sub-categories rival Health Care Services in terms of aggregate investment totals: more than \$600 million since 2001. Most importantly, all four health care sub-categories appear relatively strong and the number of investment rounds in each has grown steadily since 2008. The overall strength of the health care industry provides a solid foundation for entrepreneurs seeking to start a health care company in Nashville.

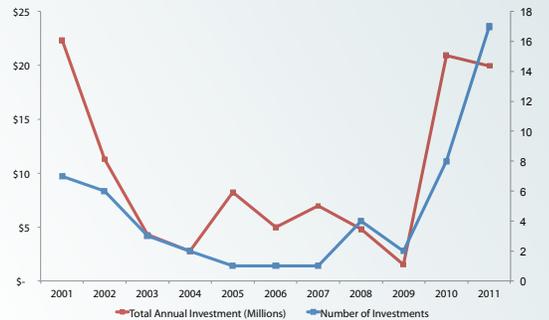
**HEALTH CARE SERVICES**



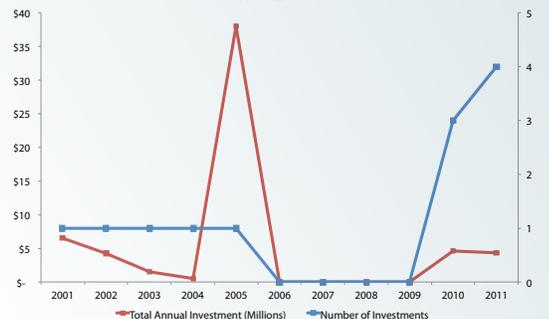
**MEDICAL DEVICES**



**HEALTH CARE INFORMATION TECHNOLOGY**



**BIOTECH**



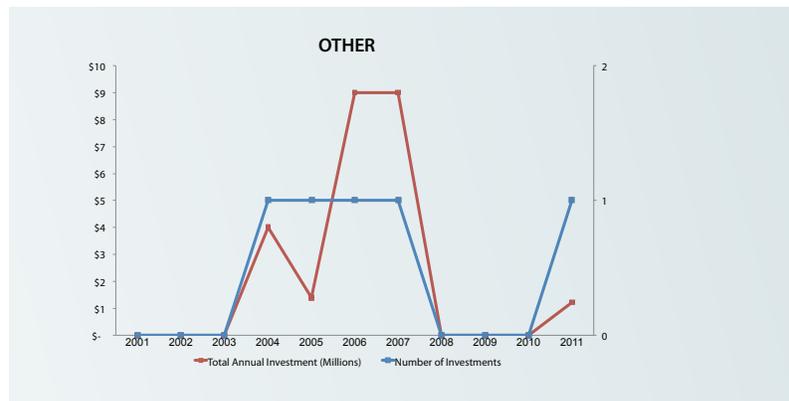
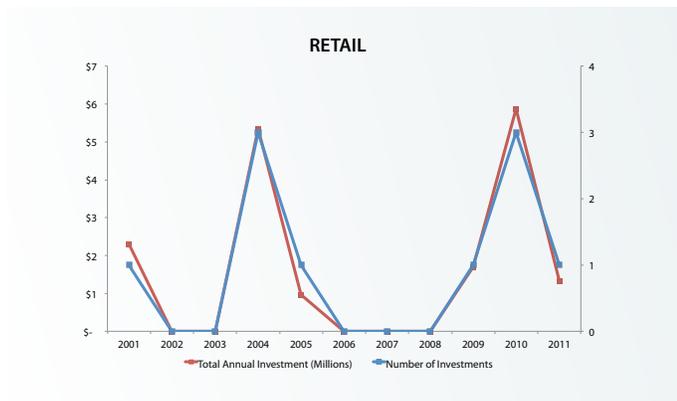
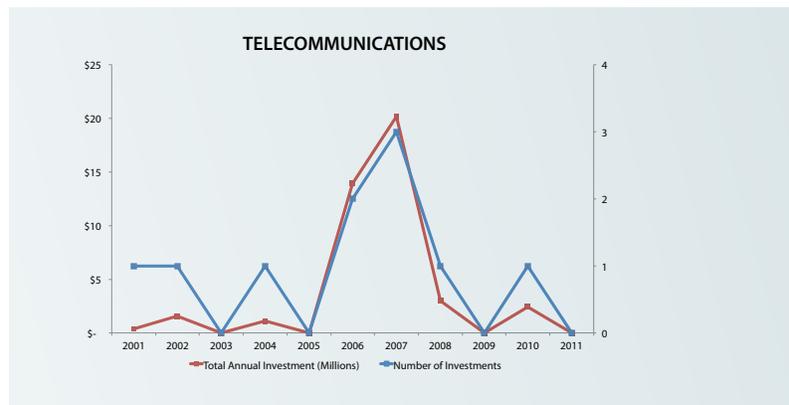
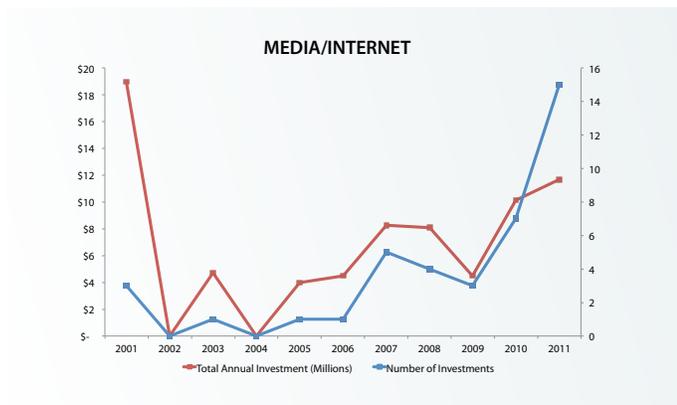
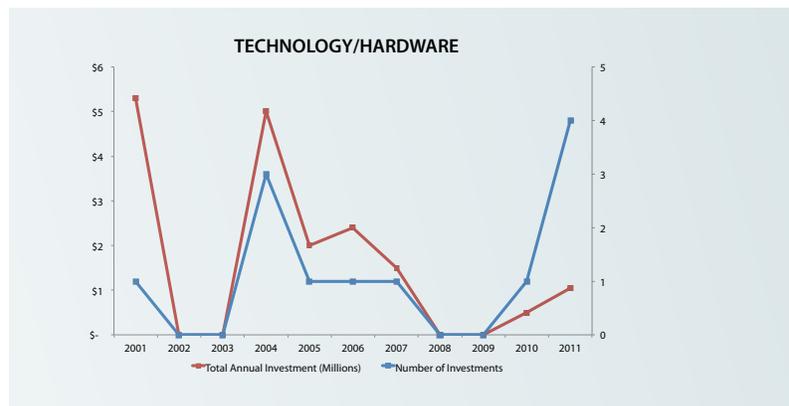
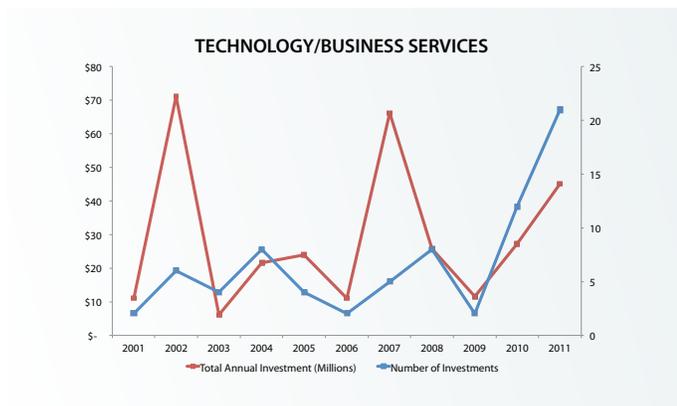
## Non-Health Care Industry Trends

Health care is one of several thriving industries in Nashville. Since 2009, more than \$140 million has been invested in sectors other than health care. Technology/Business Services has been a consistently strong performer among industries outside of health care. Several large investments have been made in the space, and since 2009 the investment dollars have again increased significantly.

While Technology/Hardware has been less active than other sectors, it too has made solid gains over the past two years. **One of the biggest risers outside of health care has been the Media/Internet sector**, which was adversely impacted by the tech bubble crash at the turn of the century but has seen a steady and sustained rise in

terms of both investment dollars and number of financings since 2002. Since 2004, there have been 38 Media/Internet investments totaling over \$50 million. The category hit its ten-year high in 2011 with 15 unique investments and over \$11 million invested in the sector.

On the other hand, Telecommunications, Retail, and investments not fitting neatly into one of this report's categories, ("Other"), have not played as large a role in the Nashville venture capital market. There have been some significant one-off investments in each of these industries but they have not sustained the sort of momentum that other sectors have demonstrated.

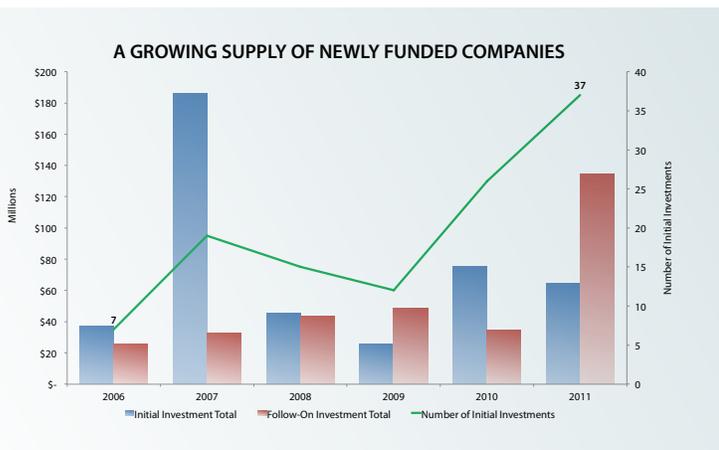


## Successful Exits

This study was designed to track investments rather than exits in the venture capital industry. However, the research did uncover information regarding several notable venture backed exits. A small sampling of IPOs includes: Emdeon, Symbion, BioMimetic Therapeutics, M\*Modal, Acadia Healthcare Company, and HealthSpring. Additionally, the Nashville market experienced a number of notable venture backed mergers and acquisitions: HealthSpring was acquired by Cigna; Spheris was acquired by Medquist (now M\*Modal); Psychiatric Solutions was acquired

by Universal Health Services; Rivals.com was acquired by Yahoo!; StudioNow was acquired by AOL; Passport Health was acquired by Spectrum Equity and Great Hill Partners; and Surgis was acquired by United Surgical Partners International. The research does not include any information regarding the returns associated with these exits, but this limited summary does indicate that Nashville has been home to a number of large acquisitions and initial public offerings over the past decade.

## VENTURE CAPITAL INVESTMENT: AN OPPORTUNITY

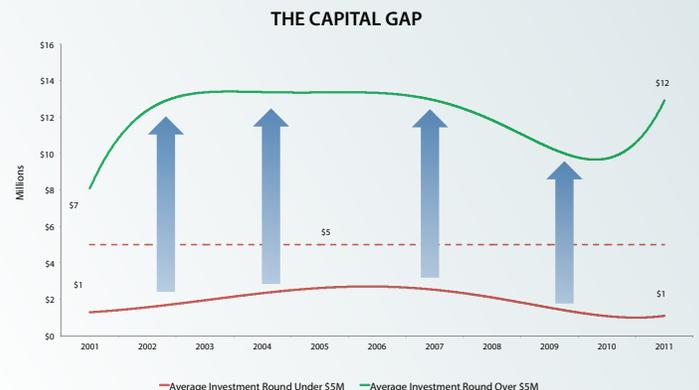


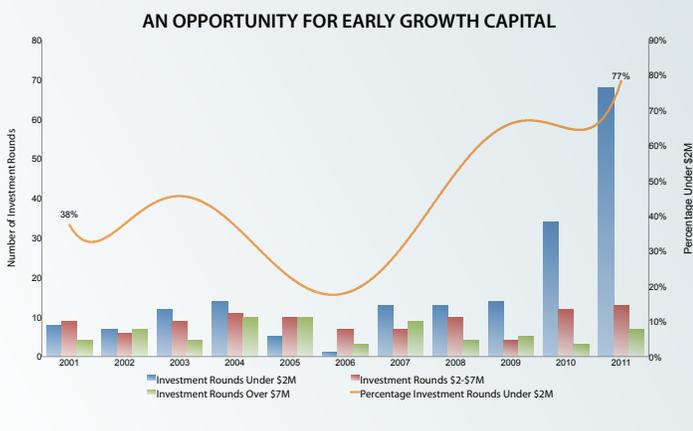
### An Increase in New Venture Financing

In Nashville, exciting new companies are being founded faster now than at any time in the past decade. In 2006, seven companies received venture capital for the first time. By 2011, that number had risen to 37. An "Initial Investment" in the graph above is defined as the first venture capital financing event benefitting a given company. A "Follow-On Investment" is defined as any subsequent venture capital financing event benefitting that company. In 2010, initial investment dollars more than doubled the amount of follow-on activity. As illustrated by the green line in the graph above, the number of companies receiving funding for the first time increased more than three-fold from 2009 to 2011. This is welcome news for entrepreneurs, even as it provides a new challenge for the city and the state to ensure that promising companies have access to growth capital in the coming years.

### A Coming Shortage of Early Stage Growth Capital?

There appears to be a widening gap in Nashville's venture capital market between the capital available to the earliest ventures and the capital available to later stage ventures. This apparent shortage of early-stage growth capital could become a more serious challenge as the number of promising local start-ups continues to escalate. Businesses that receive a seed round or small angel round may have a difficult time generating enough traction to attract or justify a large round of growth equity. This gap, which could put some promising companies at risk of being undercapitalized, presents both a challenge and an opportunity.





The opportunity for early growth capital is illustrated quite clearly when the number of financing rounds is broken down into three categories: under \$2 million, between \$2 and \$7 million, and over \$7 million. In 2001, 38 percent of venture capital rounds in Nashville were under \$2 million. By 2011, that number had climbed to 77 percent. With this influx of early stage investments, **Nashville will soon be home to a large number of young companies with meaningful traction seeking early-stage venture capital to continue their growth.**

## NASHVILLE OVER THE NEXT FIVE YEARS

Moving forward, Nashville government and community partners must work to continue to develop and enhance the necessary entrepreneurial infrastructure to leverage the success of the last decade. Undoubtedly, early stage companies will need continued access to groups like the Nashville Entrepreneur Center and local seed incubators. As these newly-funded companies mature, however, they will seek a different set of resources that the Nashville market should also work to address. With the growing need for information technology expertise, for example, attracting and retaining talented IT personnel and software engineers will be important as companies grow their employee bases. Likewise, additional growth capital will be sought by many newly-funded companies in the coming years. As with any city that has experienced an increase in the number of innovative, young start-ups, Nashville's success has presented it with a welcome set of new challenges and opportunities for further development.

A large part of continuing the city's momentum will be communicating the progress that Nashville has made in establishing itself as a leading market for health care and a growing venture capital hub. If the city works to address new challenges while also maintaining the important investments of the last decade, it will certainly help to ensure that successful entrepreneurs choose Nashville as a place to start and grow their business.



**The focused effort of the local business community and government to build an entrepreneurial infrastructure has created the necessary environment for a thriving venture capital industry, one which appears poised to continue the growth of the last decade.**

The last decade has clearly been an exciting time for both health care and venture capital in the Nashville market. More early stage companies are receiving venture capital funding than ever before in Nashville and the momentum only seems to be increasing. With this abundance of early stage investing, it is likely that many companies have now reached a stage where the potential for substantial growth is upon them. This may indicate a real opportunity for the Nashville market to attract larger rounds of growth capital in the coming years as the city's recently funded start-ups mature and catch the eye of national venture capital firms.



**NASHVILLE CAPITAL NETWORK** accelerates the development of early stage companies by nurturing the most promising entrepreneurs and connecting them with knowledgeable, experienced investors. NCN has cultivated a network of qualified and committed angel investors who have invested more than \$33 million in Tennessee-based companies. Additionally, NCN manages the \$5.2 million NCN Angel Fund and the TNInvestco Tennessee Angel Fund. Nashville Capital Network is on the web at [www.nashvillecapital.com](http://www.nashvillecapital.com).

### NASHVILLE HEALTH CARE COUNCIL

**THE NASHVILLE HEALTH CARE COUNCIL**, founded in 1995 as an initiative of the Nashville Area Chamber of Commerce, is an association of health care industry leaders working together to further establish Nashville's position as the nation's health care industry capital. Worldwide, Nashville's health care industry generates more than \$70 billion in revenue and over 400,000 jobs, and is Nashville's largest and fastest growing employer. Nashville Health Care Council is on the Web at [www.healthcarecouncil.com](http://www.healthcarecouncil.com).

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#### SOURCES:

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