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Raising Capital in the Digital Health Industry:

Lessons from FCA Venture Partners

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On July 11th, **Grant Blevins** of **FCA Venture Partners**, of Nashville, Tennessee, returned to OBIO via webinar to give his second workshop on digital health, this time focusing on what early stage companies should consider when raising capital (when, why, and how much).

Here is a summary of the key points that I wanted to share with you:

Don't raise too early or you'll spoil your message and leave a sour taste in investors' mouths.

- Before you begin to raise, think about whether you could achieve your goals without additional capital. Is capital absolutely essential for your business to progress?
- Do everything you can to avoid the '*catch 22 of fundraising*' ie. when a start-up goes to market too early and gets trapped because they don't have enough traction to gain investor interest, and don't have enough investor interest to receive funds for traction.
- If possible, build your product first and use early revenues to gain traction and avoid this problem. When you think you are ready to raise, make sure to perform a deep dive on:
    - Product utilization – utilization is ROI for your start-up. Start tracking this as soon as you sign your first customer. Investors will be interested in seeing this data.
    - Market size – what is your initial target market as well as your total addressable market? FCA consider a market less than $200 million insignificant for a digital health investment.
    - Current sales pipeline velocity - how long will it take to get a customer from the top of the sales funnel to close? How long is the sales cycle?

Use value creation milestones to determine when you are ready to raise.

- Certain milestones are good indicators that you may be ready to raise, and have created enough value to attract investor interest.
- At the seed stage, you should have an initial product built with at least one pilot customer using it (it is relatively cheap to build software products these days, so this should be attainable). This is where you will get early utilization data. It is good to diversify at this stage and show you have the potential to access and be successful in multiple markets.

- At series A, investors begin to take interest when you have at least **$30,000 (to $100,000) in MRR**, or ideally $1 million in ARR. Your core product should be being used by multiple customers, with a low customer concentration (up to 5 customers that are not friends/within your network). At this point, you should be able to demonstrate traction in a specific target market with one revenue stream that will champion.
- By the series B stage you should be raising growth capital. By now you should be seeing anywhere from $3-5 million in ARR.
- If you are at the pre-seed stage, avoid approaching VC's. Think about using a convertible note to punt your valuation down the road, or approach strategic angel investors with expertise in your specific market.

When you are ready to raise, make sure you are being realistic about your valuation.

- Overvaluing your company, regardless of what stage you are at or series you are raising, is a quick way to turn off investors.
- In digital health, seed companies are generally valued in the $3-7 million range, series A companies in the $6-15 million range, and B companies in the $15-25 million range. This should be a good indicator of whether your valuation is in the right ballpark.
- Investors also generally like to see ownership criteria that makes economic sense to the founders. Maximizing the ownership retained by the founders ensures they remain engaged and driven.
    - At the seed stage, founders should be retaining around 70% of the company.
    - At the series A stage, ownership should remain at roughly 30%. Anything below 10% at this point is a serious concern and can be a deal breaker.
    - At series B, founders should retain 10-15% of the company.

It is important that you target the right investors.

- Databases like PitchBook and Global Data (both available to OBIO Members) and CB Insights are invaluable resources for building targeted lists of potential investors. You should define each investor's general criteria and make sure they align with your company.
- Look for patterns in investment history and use these to adjust your fundraising strategies accordingly. Also take note of any competitive investments. If an investor has made an investment in a company that could either be a direct or indirect competitor, they are much less likely to make an investment (FCA Venture Partners passes 8 out of 10 times on competitive investments). When pitching, don't be afraid to ask if they have made any competitive investments in the past.

OBIO Members can find a recording of the webinar, as well as summary slides, in the OBIO Member portal (OBIO Webinars and Presentations – Finance).