HEARD ON THE STREET

Venture Capitalists
Revive Tech-Sector Duds

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Barton Foster calls his introduction to DecisionPoint Software a "near death experience." His job was to see if there was life.

Mr. Foster, a consultant to a venture-capital firm that had invested $10 million in the San Mateo, Calif., start-up company, was given the task a year ago of deciding whether it was worth salvaging. The financial-software company had burned through about $30 million in three years and had dwindled to about 25 employees from twice that number. Battery Ventures, Mr. Foster's client, was trying to decide whether to cut its losses and shut the company down.

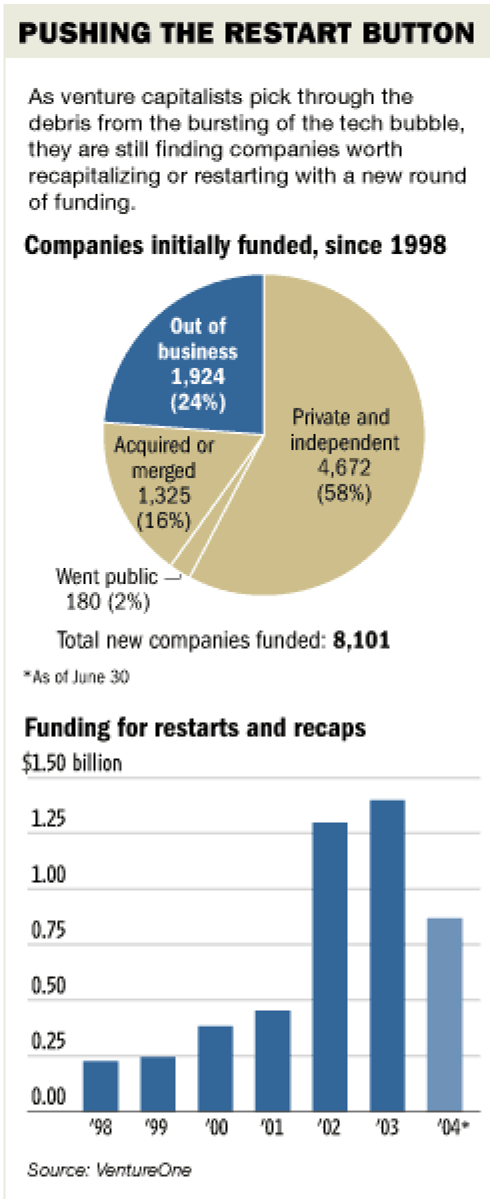
After speaking to several satisfied customers, Mr. Foster says he "saw a real opportunity." He became the struggling company's chief executive and narrowed its focus, targeting chief financial officers and other financial executives who liked DecisionPoint's software because it helped them collect all their data in one place and comply with new corporate-governance requirements in the Sarbanes-Oxley Act.

In June, Battery Ventures, based in San Mateo and Wellesley, Mass., injected an additional $5 million into the company. The work force is up to 70 people, and Mr. Foster says the company is breaking even. "It was a company that everyone else had written off and now is hitting its stride," he says.

It isn't an unusual story these days. While venture capitalists are again starting to target new investments, many also are salvaging the wreckage from their boom-time binge, often with new insider rounds of financing. "When you don't find outside investors, you go around the table and do it to yourself," says Jackie Kimzey, a general partner at Sevin Rosen Funds in Dallas.

Venture capitalists backed 8,101 new companies between the start of 1998 and the first half of this year, according to VentureOne, a Dow Jones & Co. publication that tracks the industry. (Dow Jones also publishes The Wall Street Journal.) Excluding companies that were acquired or went public, 1,924 were shut down by venture capitalists or went out of business, costing investors at least $36.4 billion, according to VentureOne.

Of the 4,672 that still are alive, about half initially were funded at the top of the market in 1999 and 2000. Many now are being recapitalized or relaunched with a new business model as "restarts" as venture capitalists pick through those with the most promising technology -- and least risk -- to see if they can turn a profit. They often can get a larger stake in a company on the cheap.



In the first two quarters this year, $869 million has gone into 79 such investments, of a total $10.4 billion in venture-capital investment in that period. In all of 2003, 141 recapitalizations and restarts pulled in a record $1.4 billion, the VentureOne data show. In 1998, the number reported was 22. It fell to 20 in 1999, then rose to 35 in 2000 before jumping to 50 in 2001. In 2002, the number of recaps and restarts more than doubled to 114, about 80% of them first-time financings.

In many cases, "the company is running out of money," says Mark Sherman, a general partner at Battery Ventures. "A lot of companies funded in 1999 and 2000 pared back to the point where they are alive and there is some question of whether they'll make it or not."

In some cases, the valuations and capital structure of companies funded during the bubble no longer make sense. In others, long-term investors may have lower risk tolerance and can't or don't want to put in more money. In those cases, early venture investors may be willing -- or forced -- to be bought out, even at a reduced price, what is known in the industry as a "washout round."

Some venture capitalists say they are seeing the pace of reinvestments starting to slow down, as they cut their losses and turn their attention to new investments. Last year "was a period of triage," says Mr. Kimzey of Sevin Rosen Funds. "There was not a lot of new investing going on. The companies we thought had promise were in intensive care, and we were trying to keep them in the ballgame."

Still, $475 million flowed into recapitalizations and restarts just in the second quarter this year, the most ever.

Sometimes it is a case of a market finally catching up to a technology. Take GlobeRanger Corp. in Dallas, for example. First funded in 1999, it makes software that permits wireless communication with sensors embedded in various products. The company originally targeted operators of big warehouse chains as its market, but hand-held computers had yet to catch fire. Then **Wal-Mart Stores** Inc. ordered suppliers to use radio-frequency identification tags for tracking and security purposes.

Last year, the company hired a new chief executive and reconfigured its operation, business plan and product to meet that market. The company received an insider-led round of $10 million from an existing syndicate of investors led by Sevin Rosen Funds -- but not before previous investors had losses of about $20 million. The company now is on plan to hit revenue of between $7 million and $10 million next year, says Chief Executive John Koenigs, though it isn't yet profitable.

Kotura Inc., a Monterey Park, Calif., start-up business that makes a silicon optical device used by telecommunications companies, has, in essence, been recapitalized twice. The company was born of a merger between two competing start-up businesses: LightCross Inc. and Arroyo Optics Inc., which itself was previously recapitalized. Together, the two start-ups had raised about $60 million during the past four years. Clifford Higgerson, an investor and general partner with ComVentures, in Palo Alto, Calif., says the companies hit "the nuclear meltdown in the optics business." The telecommunications sector "will be alive in '05. The key is to figure out how to survive until then," he says.

The previous syndicate, in which ComVentures participated, lost most of its earlier investment. In July, ComVentures and Arch Venture Partners pumped $11 million into the newly structured company. "It was the only sensible thing to do," Mr. Higgerson says. In his view, the investment is less risky than starting fresh. "You don't have development risk and there is [now] some indication of demand from the market," he says.

Venture capitalists always juggle old and new companies, he says, but "there still are some leftovers from the last three to four years," and "there is still a meaningful amount" of reinvestment going on.

Indeed, the VentureOne data show money flowing back into consumer and business services start-up businesses, software, electronics and the hard-hit telecommunications sector. This is giving a second, third or even fourth wind to companies such as **eCredit**, a software concern in Dedham, Mass.; OfficeTiger, of New York, which does outsourcing work for law firms, financial and consulting institutions; and Oluma Inc., a fiber-optics maker in Carlsbad, Calif. All three now ship products or provide services.

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