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From acorns to oak trees

The core players in this sector have a pretty tight stranglehold on the market. We asked the entrepreneurial and investment community of Europe not only where the best opportunities lie, but more tellingly, how to develop a business in this tough market. *Pages 2-4*

Security spin-off targets E7.5m

For the latest financing news on the business application software sector in Europe turn to *pages 4-7*



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From acorns to oak trees – the patient way to challenge the software giants

No-one is denying that the core players in the business application software sector have a pretty tight stranglehold on the market right now. They, and we are talking Oracle, SAP, IBM, PeopleSoft, Microsoft and Siebel for the main part here, are not likely to be seriously challenged by any new entrants any time soon. However there are still a number of areas where startups can slip in and take a decent slice of the pie. The key question for the entrepreneurial and investment community of Europe is not simply identifying those opportunities, but more tellingly, finding out how to develop their business in a tough market.

Slipping under the net

"All new entrants must accept that the ERP players are the backbone of the industry," Sebastien de Lafond of London-based venture capital firm **Add Partners** told Technology Finance, "if they want to be successful they have to either come up with a solution that none of the other ERP vendors is offering (preferably before they've even dedicated any resources to it), or work with them on something." De Lafond is optimistic that new players will emerge to threaten the core players but suggests it may take from 4-6 years for them to reach that position. Ferdinand Porak of **Vision Capital**, which focuses on investing in companies preparing for Trans-Atlantic growth, believes that as vendors are now forced to focus on their core businesses, major gaps are opening up for innovative new solutions from startups. "If its not being addressed by the big players it's definitely a good opportunity," said Porak.

Oracle's Peter Perregaard, not surprisingly sees the startups' role as a little more limited. "A number of startups have developed excellent products but they can't expect to compete with the major players," he said. "We can sum up what's happening in the business application software industry by saying that there is huge consolidation going on and this puts a lot of pressure on startups and how they develop." Oracle claims that buying up smaller companies is not a part of its strategy, as it is focused on developing areas in-house.

However, Oracle is not closing the door to startups. Far from it, the software giant rather sees the startup role as a little more symbiotic than the investors do. Perregaard explained: "Startups need to ask themselves what they are good at that can complement what the larger players are doing... and they should be looking to develop software products that fit with their platforms."

Perregaard went on to give CFC Skandihealth, a locally focussed Scandinavian healthcare application provider, as an example of how this relationship can work well. In this model new firms focus on where they add value and patiently build businesses to meet this target. Such niche localised focus is particularly sought after in healthcare and governmental software products because there are so many legal requirements peculiar to any one area. Perregaard said that rather than attempt to build an entire system, startups should look to do something with a narrower focus "such as building a locally specific accounting engine."

It is debatable whether investors and entrepreneurs worth their salt are likely to find such a lack of ambition too enticing though. Michele Appendino, managing director of Milan headquartered VC **Net Partners**, agrees with Oracle that the "bread and butter" is not there for startups entering the business application software sector, but he is more optimistic about potential. "There is more room for players offering a multifunction or enabler solution that helps companies better exploit the business process itself."

Evolutionary, Specialist and Modest

Software startups in today's market need a very different business model to the one they might have drawn up two years ago. The days of rapid growth timetables have long gone and any new solution needs to be able to prove an existing need before developers can realistically begin expanding on that niche.

Porak stressed the importance of startups being "evolutionary rather than revolutionary" in today's market. He recommended building the business model and the technology one layer after another rather than building it all at once. He also said that the technology should be based on an existing layer to be truly attractive. Furthermore commercialisation of the business should be developed layer on layer, by forming partnerships and revenue sharing agreements, rather than through a direct sales launch.

Over the past ten years the cyclical nature of the software market has meant that companies must regularly shift between being generalist and specialist in the focus of their product lines. De Lafond is adamant that now is the time for specialisation as generalisation is no way to tackle developing in a troubled market. "You have to be vertical and you have to integrate this logic into the software," he said. To do this de Lafond said it is integral that a startup gets right inside the industry and deeply understand their logic. "You need to know everything from how they put together their balance sheets to how they manage their customers and how they develop their supply chains. Only then can you come up with an underlying architecture that is relevant." De Lafond believes that from this there will also be the potential to grow big as companies can start off by specialising deeply but at the same time make an architecture open enough to ensure expansion can be extended to other industries.

Another factor which affects all startups is customer perception. Unfortunately the business application software sector in the last four years has seen enterprises make huge investments in ERP supply chain management and eCRM solutions with pretty awful results. To overcome the scepticism rife among large customers, the dynamic for selling software today has to change. De Lafond says "Firstly you have to tell your customer that your solution will take advantage of existing infrastructure. They need to know that they did not waste all of their money. Secondly you need to prove the short term value of your software and this requires a relatively modest and targeted approach to start with." Porak agreed: "Any solution must also have an immediately demonstrable bottom line impact, ideally with an immediate ROI, for it to be of interest to a large client."

Hot areas for specialisation: Finance

Specialisation may be essential for software developers in the current market but it does open up considerable risks in choosing which horse to back. The dominant markets for business application software are traditionally the telecoms and financial services sectors. Not surprisingly the financial services sector is seen as the market with the most potential. Porak said: "the massive regulatory changes that have swept the financial sector alongside a number of exciting technological developments make it particularly attractive." Porak went on to suggest that the difficult conditions of the past two years have also meant that innovations have not been picked up so readily. Consequently, there is plenty of space for a marked leap in the impact of new solutions. Porak picked out **Atempo.com**, **Neteconomy** and London-based **Reech Capital** as particularly exciting European startups in this sector, all of which are in talks to raise further finance.

Human Capital Management

Sebastien de Lafond is predicting big things for the human capital management space. "Human resources are the number one assets of any business," explained de Lafond, "but software solutions to tap into this resource have not yet been fully realised because the technology needs to have full internet and infrastructure integration across the entire company." Such infrastructure has only been realised in the past two to three years so the best solutions are yet to be put into practice. Advanced human resource products are not yet provided by most ERP vendors. Even Tom Siebel, the CRM champion himself, has been quoted saying the Employee Relationship Management space would be larger than the eCRM space. PeopleSoft is thought to be showing particular interest in this space too.

De Lafond picked out **Temposoft**, an Add Partners portfolio company, as a particularly exciting European startup in this space. Temposoft gives enterprises the full view and control of human resources throughout the

entire organisation. It is already selling to Fortune 500 companies, such as Carrefour and Sainsburys, in E1m pieces and has set a target of E15m of revenues this year. The firm claims to have generated E4m in Q2 of this year predominantly in the US, which is no mean feat in the software industry right now. Temposoft has raised a total of E14m in two rounds and counts Add Partners, Atlas and CDC as investors. The firm has no plans to raise more cash this year but is aiming to be ready for a NASDAQ listing within 12 to 24 months.

Business processes

Michele Appendino of Net Partners believes that software tackling the business process sector provides a high number of opportunities at the moment, particularly when targeting SMEs in Europe. "Given the level of recession now, it's clear that companies have reduced their IT budgets and need to bring in software that improves current infrastructure or reduces costs," he said. Appendino highlighted Radiance Technologies, a US firm which Net Partners has invested in, as providing a good example of a company making the most of this space. Radiance deals in digital delivery logistics. Its software is used for example to improve product design and after sales processes for automotive or aerospace companies which have massive amounts of data to transfer.

Surviving without an exit

Most interviewees agreed that no startup should expect to achieve any form of exit within the next three years. They should rather assume capital raised is to take them through a fairly long path. However, that is not to say the interviewees did not expect significant consolidation in the sector in the long run. Oracle's Peter Perregaard believes this will lead to there being very few global players working alongside a high number of local players which utilise their platforms. The venture capitalists are more optimistic for the prospects of the emerging players and believe there is room for one or two new entrants to build the foundations over the next three to four years that enable them to emerge as the new giants of the industry.

SPECIALIST OR GENERALIST?

Although investors and corporates are quoted in our main article advising startups to specialise in the current market, Phillippe Herbert, managing director VC Partech International has a different view.

He believes that smaller companies in this sector have to look to offer a broader range of services in their software. "Salesforce.com, for example, has an enormous task ahead in trying to beat Siebel in the eCRM space. We encourage our companies to find areas that are a conjunction of several topics so that you can not just solve CRM but other issues such as finance and production as well," said Herbert. Herbert believes focusing too deeply on one issue is dangerous in the current climate. "This is because industrial companies are not prepared to risk innovation right now," he said.

Business Application Software News

Security spin-off targets E7.5m

Seclutions AG, a security software company based in Switzerland that was spun off from IT services company Ergon Informatik AG, is seeking E7.5m in a first round of financing. CEO Roland Heer told Technology Finance the round is aimed at accelerating international expansion in the UK and elsewhere.

Seclutions was spun off in April 2002. Zug-based investment banking boutique *e-Firm* advised Ergon on carving out the unit, and is now helping with the current round. E-Firm was set up and is run by ex-Fantastic Corp founder Peter Ohnemus.

The goal is to conclude the current round in 2002. The lead investor is expected to be an international VC firm, with room for one or two VCs in more junior roles.

A seed round raised earlier in the year was used to finance expansion in the Swiss marketplace.

Ergon is a significant majority shareholder prior to the current round, but expects to be a minority shareholder afterwards. The company is believed to take a "pragmatic" view of a potential exit. Seclutions' technology is expected to generate interest from large software vendors in the information security industry and among application developers.

Ergon is a 18-year old customer-specific software developer for mission critical Unix applications. It employs 70 staff and is very profitable. Seclutions is the first activity to be spun off.

The rationale was that Ergon found itself repeatedly asked to solve the same problem: providing a secure entry server to protect web applications that had to be accessible 24/7. The next step was to realise that this security solution is generic rather than customer-specific. While there are many network security solutions available in the market from firewall vendors, there are few application level security products, which created the opening for Seclutions, said Heer.

The corporate culture required to produce and market a standard product is distinct, and strongly suggested a spin-off. Ergon will use Seclutions' product as its security platform, to be incorporated in solutions for its customers.

The tagline for Seclutions' product is "high security made simple". The company claims the simplest application security server can be installed from a CD and configured in an hour or two, something that used to take a team several days. A key pitch to customers is cost savings.

In terms of competition, US-based Sanctum Inc offers application level filtering. However, Heer stresses that Seclutions also authenticates users.

B-BUSINESS BACKS CEDRON

Amsterdam-based *Cedron BV*, a provider of product information management solutions, bagged E10m in new funding in a private placement led by b-business partners. Other investors included DVC Deutsche Venture Capital and Innotech. This is the third new investment b-business partners has made in the last five months.

Founded in 1999, Cedron already claims a strong customer base including blue chip corporations such as ABB, Pioneer, Compaq, Manutan and Minolta-QMS. The new funding will be used to strengthen the sales and marketing organisation in Europe and the USA.

b-business has now invested a total of E82m into eleven portfolio companies in six European countries.

b-business, which has 13 industrial shareholders, has made it known that it is particularly interested in investing in corporate spin-off opportunities. (See Technology Finance archives for full article.)

ATEMPO.COM NEGOTIATES VC ROUND

Business application software provider **Atempo.com** (formerly Quadratec) of Paris, is in talks with investors and expects to secure around US\$6-7m in the next month or two. Atempo has just hired a new CEO to spearhead an aggressive move into the US market.

The company, which works in the high-capacity memory backup market, already has a significant number of France's blue chips – including France Telecom and Alcatel – as customers for its flagship product Time Navigator. Atempo's solutions are for on-line backup, archiving and restoration of files, databases and application software for Unix, NT, VMS, NetWare, Windows and OS/2. One investor in the company said that the business was particularly exciting because it addresses recovery issues so innovatively.

Ferdinand Porak of Vision Capital, which is an investor in **Atempo.com**, believes the company is particularly impressive because unlike its competitors it addresses recovery issues as well as offering back up solutions. Current backers include Vision Capital, Vertex and Bank of America. (www.atempo.com)

FINANCIAL SERVICES COMPANY SEEKS FUNDS

Profitable private company **NetEconomy**, a money laundering and fraud detection company based in the Netherlands, is considering raising its first round of venture funding. NetEconomy has achieved profitability by growing organically, a rare achievement in the software industry these days.

NetEconomy has broadened its specialisation in telco customers to also target the financial sector. NetEconomy's USP is that it offers real monitoring and detection, which offers the possibility that the client can act on fraudulent behaviour immediately cutting losses instantly. (www.neteconomy.com)

M&A OPPORTUNITIES IN ERP RIFE?

One London-based investment banker described the business application software market as Europe's most fertile M&A ground. "Expect a lot of activity in the mid-tier markets in ERP in Europe over the next six months, as so many players have drastic funding requirements." The recent acquisitions by Microsoft (advised by Goldman Sachs) of Navision and SAP's acquisition of Israel based TopManage has also put further pressure on the SME market for ERP forcing the midrange players to take consolidation more seriously.

There are a lot of companies in the ERP sector that are being linked to deals: e-business software supplier Intershop has taken on *ING Barings* for a trade sale (see Germany section), IT security player Baltimore Technology (advised by *JP Morgan*) has just offloaded another division, selling its encryption software unit to Irish security firm AEP (see main story). Baltimore has stated that despite offers it now intends to work the rest of the business through to break even next year before considering more exit options. ERP software supplier AbaXX (advised by *JP Morgan*) has been looking at M&A opportunities for some time as has software developer Izodia (advised by Lehman Brothers).

The business and application software sector experienced one of the largest IT M&A deals in Europe this year as Microsoft snapped up Danish ERP and eCRM software group Navision A/S for US\$1.3bn in cash and shares. *Goldman Sachs* provided Microsoft with financial advice, and *Gorrissen Federspiel Kierkegaard* and *Preston Gates & Ellis* provided legal counsel. *Schroder Salomon Smith Barney* and *Nordea Securities* provided financial advice for Navision and its law firm was *Kromann Reumert*.

REECH EXTENDS ARMS FOR FRESH CAPITAL

London-based **Reech Capital**, another profitable software company which has grown organically, is also considering raising funding of E6-7m to expand its global reach.

Reech provides software solutions for the financial derivatives and risk management sector. It is already rumoured to have built up revenues of over E10m since its inception in 1999 without receiving any VC funding whatsoever. It does not appear to have a pressing need to bring in finance right now and if agreeing valuation with potential new investors is difficult the firm is likely to revert to concentrating on improving its visibility in the marketplace for the time being.

Reech has offices in London, Paris and Frankfurt, and is looking to expand to New York and Tokyo. (www.reech.com)

CREALOGIX PLANS ACQUISITIONS

E-business solutions group CREALOGIX Holding AG of Switzerland plans to expand by acquisition in the coming years in Switzerland and Germany, company sources said. Particular focus is on middleware and backend services. Potential targets could offer customer lists or technology in these areas. It is not known if financial advisers have been appointed, although *Bank Vontobel* led its IPO on the SWX New Market in September 2000.

Most recently the company bought the Swiss operations of Germany's MIT Group, which served to boost Crealogix's e-learning division into the top spot in Switzerland. MIT was set up in 1987, and specialises on content creation for an international clientele. The Swiss operation will have exclusive rights to distribute learning products from the German side, while MIT Germany will cover its home market and expand its international platform business.

In December 2001, Crealogix bought the e-learning company Acadia Communications & Training AG. It established a commercial relationship with Click2learn in April. E-learning is a core activity for Crealogix, alongside multimedia/design, and consultancy. These are geared to assisting medium to large sized corporations use their intranets and internet more profitably. Customers include UBS, Winterthur and Migros. The company employs 30 staff on e-learning.

In 2001/2002 the company made a profit of SFr1.1m on turnover of SFr20.6m.

AEP MAKES ACQUISITION, SECURES CASH

Ireland-based **AEP Systems**, which supplies e-security and acceleration hardware products, has acquired the security hardware division of Baltimore Technologies for £4m and raised another E8m in VC funding. The round is rumoured to have valued AEP at around E35m, compared to a reported E27m valuation five months ago.

The new funding is the second tranche of the AEP's April 2002 round, which has now been increased from E14m to E17m. E9m was drawn down in April and a further E8m was drawn down this month. The new cash was largely from a group of existing investors including b-business partners, ACT Venture Capital, Enterprise Ireland, Island Capital and Allied Irish Bank. AEP CEO Pat Donnellan said that other undisclosed investors had also contributed, including a strategic play which would likely declare its involvement in a months time. Other significant investors include Intel.

The new cash will finance the new acquisition and develop sales and marketing efforts especially in the US and Asia. Donnellan is targeting the middle of next year for AEP to reach profitability. ING Barings and Merrion Corporate Finance advised AEP on the last fundraising, but played no part in these transactions. *LK Shields* provided legal advice for AEP.

AEP has agreed to pay £4m for the Baltimore division. This is made up of £3m in cash including a £300,000

eBUSINESS FIRM MANDATES BANK

Technology Finance has learned that *CSFB* has been mandated to arrange a E35m private placement for an unidentified Berlin based eCRM company.

deferred payment, with the remaining £1m to be paid depending on the division meeting certain milestones up to 2004. *JP Morgan* has been advising Baltimore on its restructuring while legal advice comes from *Lovells*. AEP investor b-business partners declared its intention to back corporate spin-offs in Technology Finance two months ago. This is the first spin-off the VC has made yet.

Donnellan said that AEP might well make more acquisitions in the not too distant future but added that the immediate focus was to integrate these businesses. Baltimore's hardware security division develops high-security cryptographic hardware products targeted at financial institutions and government agencies. It earned profit before tax of £300,000 and had net assets of £2.2m last year.

Baltimore completed a similar divestment earlier this year when it sold its content filtering division to UK software startup Clearswift Corp for £20.5m. Clearswift itself raised £22.2m in a second round of funding from investors including Kennet Capital, to back this deal. (www.aepsystems.com)

MISYS SWOOPS ON EAGLEYE

Banking and healthcare software supplier **Misys** has acquired **Eagleeye Solutions**, a London-based compliance software supplier to the asset management industry.

Misys will pay a total consideration of up to £15m over a three-year period for the acquisition which expands Misys Asset Management Systems' middle- and front-office applications offerings.

Technology Finance reported that Misys was in a good position to make some acquisitions in July. The firm has plenty of firepower left in its debt facility which is thought to be good for about £4-500m with only £150m being used at present. *Dresdner Kleinwort Wasserstein* is Misys' banker and advised Misys on its last purchase – the £75m acquisition of the financial advisory network DBS in August 2001.

Through the Eagleeye acquisition Misys will provide technology that will enable asset managers to check and confirm pre and post trade positions in real-time, preventing possible manual errors and breaches of client mandates, institutional rules and government regulations. Compliance is a particularly hot area at the moment, partly due to the recent high-profile accounting scandals that of the last year. Eagleeye Solutions, which is around three years old, is looking to secure its first customers. Misys also declared its intentions to spin off its independent financial advisory unit two months ago with an IPO in the next two years. The unit is currently thought

to be worth around £400m although Misys stressed that the deal would only take place when equity markets have stabilised. No mandate has been secured for the flotation.

ING MANDATED BY INTERSHOP

ING Barings has been mandated to German e-business company *Intershop* to look at all the options available to strengthen the balance sheet. While options for a PIPE deal were thought to be of interest initially, the company, which supplies e-commerce solutions for enterprises, is now thought to be looking for a trade sale.

Intershop was once valued at US\$5bn but its current value is around E100m. A source close to the company stressed that, despite the difficult market conditions being experienced at the moment the firm was still the European leader in its area of ERP transactions. It targets larger enterprise clients with its *Enfinity* software, which manages product catalogues, transaction processing (with support for mobile phones), and application integration tools for direct selling over the internet. The source emphasised the firm's strong brand and product line and explained that the high cash burn rate of the earlier business model had been rectified and the firm was well on the way to becoming a pure software company. New products are said to be seeing a small uptake in demand.

Intershop reported its second quarter financials at the end of July. Sales fell very slightly from E12.2m to E12.1m from the previous quarter, but the firm still claims to be on track to become EBITDA positive in Q4. *Intershop's* net loss narrowed 57% to E5.8m from E13.3m in the previous quarter. (www.intershop.com)

SAGE PAYS CASH FOR CPASOFTWARE

UK accounting and business software maker **Sage Group**, the sole technology firm which still has top 100 status on the London Stock Exchange, acquired US rival **CPASoftware Inc** for US\$14.4m in cash. Sage is eager to strengthen its ties with certified public accountants, which help the company sell its accounting software into small businesses. Sage is advised by *Deutsche Bank* on US acquisitions.

DIGITAL NETWORKS BACKS MESSAGING APPS

Empower Interactive, a provider of application messaging infrastructure software solutions, secured a third round of E8m from Digital Networks, IDG Ventures and existing investors Telesystem Argo Global Capital LLC and Newtonmore Capital Ltd.

The fundraising comes on the back of the announcement of a partnership agreement with Hewlett Packard, and research into the application messaging sector that suggests that as a sector it will account for over 50% of all SMS traffic by 2003.

The investment will be used to support further expansion

in Europe, Asia and the US as well to beef up current marketing and product development efforts.

REEF HITS ROCKS

Despite securing one of Europe's biggest investment rounds of 2002, business application software provider **Reef** was forced to file for bankruptcy this August.

The ambitious Belgium based startup had expanded its applications to offer a more expansive platform for managing e-business. Rumours suggest that early customers had not been happy and that the full amount of the last funding round had not been drawn down.

Reef announced a fundraising round of E30m in February 2002 led by The Carlyle Group. Additional investors included IDG Ventures Europe, Finafund (Europe), 3i, Viventures and SG Cowen. *SG Cowen* was also placement agent for the round. Bryan Garnier advised Reef's previous rounds. (See Technology Finance archives for more details) (www.reef.com)

■ **CreditTrade**, which provides transaction, data and information services to the credit markets, closed a third round raising over US\$8m. Favonius Ventures led the round with existing investor Internet Capital Group (ICG) also contributing

■ **Categoric Software**, a event management applications technology raised over US\$4m in a round led by T-Venture.

■ Business transaction management software company **Choreology Ltd**, bagged a US\$3m investment from Atlas Venture. *Choreology* received US\$2m up front and may draw down a further US\$1m as it meets business milestones.

ORACLE KEEPS WEB SERVICES ON TRACK

Oracle's Larry Ellison recently likened the hype surrounding the web services model to the hot air that filled the internet bubble. However, Peter Perregaard, CEO Oracle Denmark, was quick to stress that Ellison was only warning against seeing web services as the answer to all IT problems. Oracle claims to be doing a lot of work with web services itself although it does not see web services as answering all problems and offering anything like the final solution.

Oracle had said that it wanted to move 50% of its customers on the ASP model by 2005. Perregaard conceded that the pick up for the ASP model has been slower than anticipated

Phillipe Herbert, managing director at Partech International, highlighted web services as one of the areas he is following most closely.