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## Tech Sector Summit Preview Network Systems & Applications

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#### Psytechnics receives 3i backing

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## Systems are cool – solutions are hot

While telecom operators have virtually ceased spending on network systems, they are in great need of software and solutions that will allow them to supply premium services, and optimise performance across increasingly heterogeneous technology platforms. The Network Systems & Solutions Summit will include a range of corporates, venture capitalists and startups with different views on these markets and the outlook.

"The two halves of this summit are mirror images" says Jorg Uberla of **Wellington Partners**. "On the systems side, defined as enabling infrastructure, there is an abundance of products but little demand; while in network solutions there are few good products and huge need." Funding by the investment community mirrors this pattern of demand.

Solutions hotspots centre on mobiles and network optimisation/business process efficiency solutions.

"The most interesting software enables delivery of value added services over mobiles," said David Carratt, managing director, **Kennet Venture Partners**. While many are focused on infrastructural software for 2.5G and 3G, there are promising developments in SMS on GSM. The success of premium rate SMS services allowing responses to the Big Brother TV show could be a foretaste of what is to come.

On the business efficiency side, an example from the Kennet portfolio is **Cramer Systems**, which provides a solution to telcos to manage diverse networks with a consistent set of business processes. This generates cost savings and drives more traffic through the network.

### Telecoms glut

"The market environment is difficult for most startups selling network equipment, both central and local access. The crisis in the telecoms sector has led to a huge decline in investment programmes," said Olivier Protard of **Sofinnova Partners**.

The optimism in optical networking and optical switching two to three years ago led to a surge of investment in the sector. Many investors put money into startups which lacked strong differentiators – a result being that there are many well-funded startups chasing too few opportunities, argues the French venture capitalist. This makes it hard even for companies with world class products to stand out.

Most startups in the network systems market sell their products through big equipment vendors; these in turn sell to the service providers; and the whole system is currently "stuck".

### Recovery

On the positive side, the investment cycle will resume at some point, and the favoured technologies will almost certainly be optical. There is general consensus that the metro access market could be first to recover. Unfortunately, individual companies and investors cannot influence the turn in the cycle.

"The level of our investment activity is not a reflection of our willingness to be active," noted Francois Josserand of **Cisco**.

Sofinnova is taking an even more conservative view, and is not counting on a rapid recovery. Protard's two salient criteria for investment are that companies must a) have sustainable technology, and b) not depend on sales growth in 2003. Sofinnova is investing in Europe via Sofinnova Capital IV, a E330m fund raised in 2001.

### Hit bottom on valuations?

Francois Josserand feels the VC market may have reached a turning point: "Six months ago I couldn't see light at the end of the tunnel. Now it looks like valuations on early stage companies have adjusted down as far as they can go without demotivating entrepreneurs." There is less reason to procrastinate on investment decisions as a result.

An exception to lowered valuations is Israel, the Cisco executive observes. There the deal flow in network centric technology is limited, and the quality high, resulting in continuing competition for deals among investors and high valuations.

### Funding for longer

"Reality has set in regarding time scales to exit. Where it was once 18 months to two years, you are now looking at four to five years," said Josserand. As a result corporate and financial investors are allocating more funds to their portfolio companies to get them through this extended period.

The relationship between VCs and investee companies has also shifted. With the closure of capital markets, achieving returns requires concrete financial results rather than the confidence of IPO investors. This places more importance on good management to bring a company to the stage of winning customers. In the boom days, VCs could be relied on to do more of this work, while the capital markets dealt with the returns. The onus is now on companies to do the work themselves, which makes it vital to identify and motivate good managers.

Hence "valuations in the private market are driven by what you need to do to keep management motivated. In many instances private equity deals are being done at a premium to public markets," said Carratt. P/e multiples for listed tech companies have in some instances fallen more sharply than valuations of private entities. Paradoxically, the valuation of a startup may actually

drop when it begins to earn revenues, as the valuation model moves onto a revenue multiple. "One way around this is to commit a larger amount of initial capital, and make it available in tranches over a longer period," said Carratt. There are challenges in structuring the triggers deciding when equity can be drawn down, so as to be fair to both investors and companies.

### Messaging looks promising

In the area of wireless applications a key driver is the realisation that there is money to be made in SMS, said Uberla. "If people are sending 20 billion SMS messages per month, that is not something that will vanish overnight. Entrepreneurs will try to come up with applications," he said. Companies that began life writing WAP applications are repositioning themselves in the SMS space.

Multimedia messaging (MMS) will be a crucial next step. "It is clear now that many mobile operators see MMS running on 2G networks as an indicator of how big the market will be for GPRS and UMTS. If MMS is not a hit, they are likely to delay investment in the next stage. We will have our first peek this Christmas with sales of photo sharing technology, but the real test will be sales in 2003," he said.

Sales of MMS network systems are dominated by **Nokia** and **Ericsson**, the companies that provided SMS gateways. There should be opportunities for small companies to provide platforms to provide MMS services, although selling to major operators is difficult for small vendors. The real opportunity is likely to be creating interesting applications.

Increased interest is reported from the USA in European SMS and MMS technology companies. "They are waking up to the potential of this technology, and want to buy into European expertise," said one financier. European startups may also be finding it easier to tap into finance in North America.

Where are the opportunities in the next two years? "There are niches where even the telcos will have to invest. UMTS may be a nightmare, but the operators need to make changes to their infrastructure to launch new data services and boost ARPUs on existing networks," said Protard. Examples in Sofinnova's portfolio include **Volubill** (whose mobile content charging technology can be bolted onto a telco's existing system which is geared to charging for voice services), and **Esmertec**, which makes software that is embedded on mobile handsets allowing delivery of applications.

Longer term mobile internet will be an important business. "People tend to think it failed with the disappointment over WAP. It takes 5-7 years for technology to be accepted. But mobile internet will be much more than web pages displayed on mobiles, which was the WAP model," said Protard. SMS messaging is just a foretaste of the scale of this new market.

### More spin-offs

Spin-offs from big companies are likely to be more important in coming months, although some parent companies have been slow to lower their valuation expectations.

"Following the first wave of dotcom entrepreneurs that came and went, there is now a second wave of engineers coming out of large companies, which will grow as the success of some of the spin-offs becomes evident," said Uberla. Examples are radio transmission company **EnOcean**, a spin-off by two **Siemens** engineers, and WLAN technology developer **Garderos**, also a Siemens spin-off. Both were funded by Wellington this spring.

As large corporations continue to squeeze costs in the recession, there could be more opportunities for spin-offs as product areas or divisions get axed. VCs have a role in funding these spin-offs.

The corporate spin-off market will remain important throughout this recession. Big corporations are driven to "return to basics" as a reaction to crisis. This starves new business areas of investment funds and management time, and can lead to promising activities being divested. Protard said: "We are always interested in this area. Volubill was a spin off from Cegetel and SFR. They are telecom operators, and felt that Volubill's software product didn't fit in." The telcos remain minority shareholders.

Routing giant Cisco also sees potential in the spin-out sector. "It is especially interesting if it gives us access to the telco market," Jossierand remarked. He would consider investing with or without financial investors.

### New push on R&D

Cisco business development managing director Francois Jossierand said his company escaped the worst of the downturn through its focus on the enterprise market rather than telcos. "The pendulum has swung to internal R&D. Our strategy is to build on our existing routing and switching platforms to add technology to enter new markets, especially in the telco area," said Jossierand. Targeted areas are security, IP telephony, WLAN connectivity (including voice), and storage. Cisco in August acquired storage area networking (SAN) company **Andiamo Sysems**, in which it had previously invested.

### Network Systems and Applications News

#### Psytechnics receives further 3i backing

**Psytechnics**, the spin-off from British Telecommunications' corporate venturing arm and incubator Brightstar, has bagged £3m in second round funding from 3i and BTextact Technologies.

Psytechnics' patented technology automatically predicts voice quality over telecom networks by measuring the quality of speech being experienced by the user. This enables operators to make use of network capacity more efficient as well as improving customer standards.

3i, backed Psytechnics with £2m first round funding when the firm spun out of Brightstar in 2000. The new cash will be used to ramp up the firm's worldwide presence.

Harry Berry, creative director at Brightstar, earlier this year claimed to have been forced to drastically restructure the corporate venturing arm and incubator due to the lack of venturing activity from VCs in Europe.

#### COMNITEL RAISES E10M

**Comnitel Technologies** of Ireland has raised E10m in a third round which included HgCapital Private Equity, Hamburgische Landesbank and SAIC Venture Capital Corporation. *Goodbody Corporate Finance* provided financial advice.

Comnitel's claims to enable mobile network operators to enhance their revenues through its ServiceAssure solutions which have a customer-centric rather than network-centric approach.

Comnitel has now raised over E30m in VC funding. The new cash will be used for development.

(www.comnitel.com)

#### END2END RAISES DEBT AND EQUITY

Danish mobile application infrastructure provider **End2End Solutions** bagged a bumper funding round of E20m in August from existing and new investors. The new cash is made up of a mixture debt to equity conversion and new equity. It came from Draper Fisher Jurvetson, ePlanet Ventures, DB Capital Venture Partners and Hewlett-Packard. Technology Finance revealed that End2End was looking to raise further finance in January 2002.

End2End has raised E38.7m in previous rounds of equity financing since it was formed in 2000. The funds will be used to further increase the firm's managed service offering with new technologies such as Java, MMS and streaming media as well as to build further relationships with mobile operators and portals across Europe. (www.end2endmobile.com)

■ **Cassium Technologies**, a UK provider of software to develop intranets, extranets, and digital marketplaces, raised US\$1.5m in a first round of funding.

■ Managed security services company **Celeris** of Switzerland closed a SFr5m second round of financing led by Armada Venture Group. Participants were Innoventure Capital AG (Credit Suisse group) and BCAP AG. Celeris was set up and is run by Swiss internet pioneer Martin Altorfer. The company provides managed security services to corporate clients and offers continuous supervision and maintenance of the deployed security infrastructure. It also sells a security management platform called Secopia, which was created by Celeris. This automatically monitors and manages security elements such as firewalls, virus protection gateways, VPNs and intrusion detection systems.

■ **Sysload Software** of France raised E1.5m in a round of financing provided by AXA Private Equity. Sysload Software has built its business over 12 years, providing a unified solution to monitor and diagnose operating systems, database management systems and applications running in Windows, Unix, Linux, NetWare, OS/400, etc. Revenues in 2001 were E3.75m. ([www.sysload.com](http://www.sysload.com))

### COPENHAGEN SITE LEADS EUROPE

Copenhagen won the prize for Europe's best city web site ([www.kobenhavn.dk](http://www.kobenhavn.dk)). The E-City Award ([www.eec-award.com](http://www.eec-award.com)) is based on a benchmarking study, and placed Berlin second, and Stuttgart third overall. A total of 130 city portals from 29 European countries were in the contest. The sites were assessed in various categories – for citizens, businesses and tourists; and for design and best practice. The E-City Award programme was devised by Munich-based consultants Eckart & Partner, the marketing institute of Ludwig-Maximilian-Universität München, and Wiencom (a subsidiary of Vienna Stadtwerke).