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Where are the next giants?

A fragmented local industry tends to see quick acquisitions before startups mature

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Far from the existential angst gripping the Route 128 beltway — on idyllic Martha's Vineyard, in fact — Clark Yennie is honing what he thinks is the next big idea in software.

Yennie's Covestone Corp. is developing a simplified relational database, but things are a bit more complex. Yennie would displace the databases of IBM Corp. and Oracle Corp. in Corporate America. He has a few more years of development to go before being market-ready. And, oh yeah — his database will require companies to install new programs or overhaul existing ones.

Don't knock a fellow for thinking big.

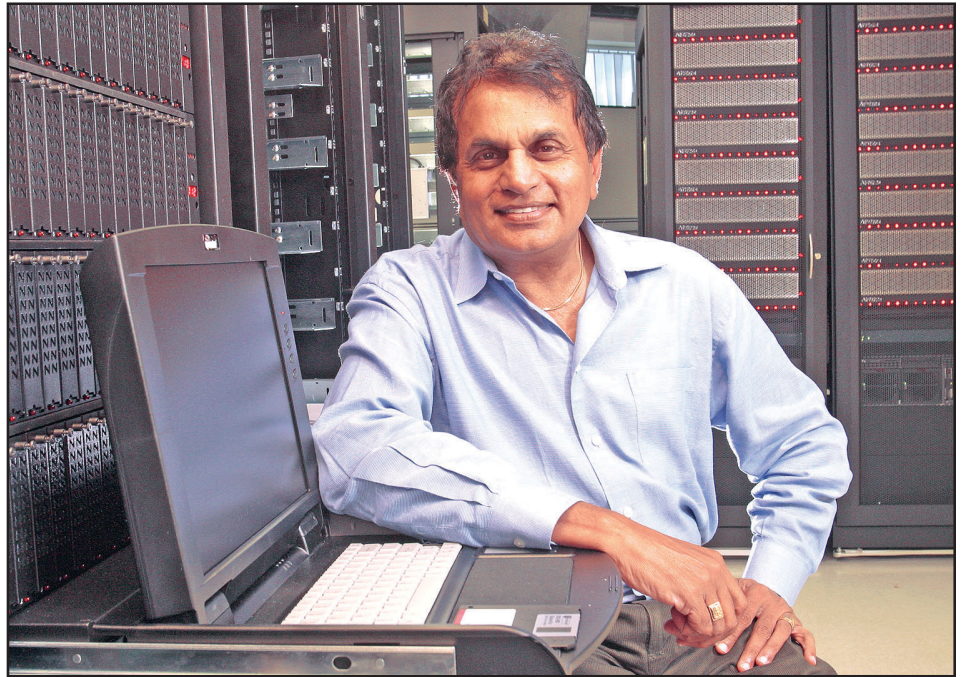
The last Massachusetts software company to deliver big on big ideas was Lotus Development, acquired in 1995 by IBM for \$3.5 billion. The state that spawned task-oriented software powerhouses like Lotus and Cullinane Corp. has produced few runaway enterprise software successes since.

Not for lack of trying — between 1995 and October of 2005, venture capitalists sank \$10.5 billion into the Massachusetts software sector, according to the National Venture Capital Association.

Few firms have emerged from that crop to match the success of Jit Saxena's Netezza Corp. in Framingham, or Cambridge's DataPower Technologies Inc., acquired last week by IBM.

Local entrepreneurs have long complained that their East Coast investors spook too easily. If the Massachusetts software sector is a pumpkin patch, critics indicate, then too often venture capitalists yank companies up by the roots for a quick sale instead of allowing them to blossom to the prize-winning proportions of a Lotus or Ascential Software, bought this year by IBM Corp. (NYSE: IBM) for \$1.1 billion.

On the surface, the software sector does not appear to be fallow. Software companies employ 102,400 people in Massachusetts today, according to 2004 research by Mass High Tech and the Massachusetts Technology Leadership Council, not including another 22,400 people who work in the software divisions of traditional hardware companies like storage computer vendor EMC Corp. (NYSE: EMC). The numbers are down 4



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Jit Saxena, CEO of Netezza in Framingham, sits at the crossroads of Massachusetts' storage, application and data integration sector.

percent from a decade ago, when MTLC tallied 130,000 software industry workers here.

Roughly 800 companies in Massachusetts today focus primarily on selling "off-the-shelf" software, with Utah transplant Novell Inc. (Nasdaq: NOVL) perhaps the best known with headquarters here. Another 1,100 firms sell an even mix of products and services, and 900 more do mostly custom-development services, with Boston outsourcer Keane Inc. (NYSE: KEA) the most prominent.

But digging deeper into the MTLC data reveals that fewer than 300 enterprise software application companies exist today meeting the criteria of being independent, Massachusetts-based entities established in the last decade with at least 20 employees.

Of that number, only a small handful are public companies, and just two dominate a significant sector in the industry today — Akamai Technologies Inc. and Nuance Communications Inc., both founded a decade ago. After 10 years in business, Akamai's and Nuance's revenue is about equal to what Lotus achieved in just its third year.

The two companies have something else in common: Their core products are not your garden-variety enterprise application. Akamai (Nasdaq:

AKAM) is almost more a network services company — its software runs on computer servers in corporate data centers around the world, delivering Web content. Nuance (Nasdaq: SSFT), until this month was known as ScanSoft, focuses on selling tools to create speech-recognition systems. Neither company is a household name.

"When you say 'ScanSoft,' the reaction is 'what is that again?'" says Kevin Roche, vice chairman of Getronics NV, a Dutch firm with its U.S. headquarters in Billerica that numbers among the 30 largest IT firms in the world.

Some think Massachusetts' dry spell is more a reflection of the software industry as a whole — that no broad enterprise software category remains for a new company to make synonymous with its name, the way Siebel Systems Inc. burst out of the gate in 1993 with customer relationship management (CRM) software. Siebel (Nasdaq: SEBL) is being acquired by Oracle for nearly \$6 billion.

"It is fairly rare that you see new enterprise software companies today," says Robert Weiler, who was Lotus' sales chief at the time of the IBM sale. "The only enterprise software companies growing are the ones that target specific verticals."

Weiler's current company in Waltham fits that

SOFTWARE: Data integration offers fertile ground for innovation

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mold. He is chief executive of Phase Forward Inc., founded in 1997 with an application to help pharmaceutical companies shepherd drug candidates through clinical trials. Phase Forward (Nasdaq: PFWD) has close to 400 employees today, and became one of the few software companies nationwide to complete an initial public offering of stock in 2004. Other software startups have since followed the money to the biopharma-ceutical industry.

In the shadows of Lotus' 1995 payday, money flowed freest to the sphere of enterprise Web collaboration, including e-learning. Investors have turned 2005 into a yard sale, unable to match the success of WebEx Communications Inc. (Nasdaq: WEBX), a California company launched in 1995 that dominates the Web conferencing market today.

The rush for the exits started with Groove Networks, founded in 1997 by Lotus Notes mastermind Ray Ozzie with software for Notes-style collaborations. Groove became the best-funded Massachusetts enterprise software company of the past decade, raising a reported \$155 million in funding, about half of that amount from Microsoft Corp. Microsoft (Nasdaq: MSFT) bought out the rest of the Beverly company last spring for \$120 million, and is integrating Groove's collaboration capabilities into other Microsoft products.

In September WebEx reeled in Burlington's Intranets.com for \$45 million. The Woburn company that ran Intranets.com's conferencing services, Netspoke, had already been bought out in July for \$23 million by an Atlanta company.

E-learning firm Centra Software Inc. (Nasdaq: CTRA) managed to fetch just \$60 million in its sale, announced Oct. 6, to Saba Software Inc. of Redwood Shores, Calif. A week later, Centra's Class of 1995 peer WebCT Inc., which raised \$125 million in financing, accepted a buyout offer from Blackboard Inc. (Nasdaq: BBBB) of Washington, D.C., valued at \$154 million.

To be fair, few companies have duplicated Lotus' lightning growth. In fact, only two have pulled it off: BEA Systems Inc. and VeriSign Inc., both based in Silicon Valley and both with annual sales topping \$1 billion.

VeriSign (Nasdaq: VRSN) represents one of the great "what-ifs" in Massachusetts software lore. It was spun out of Bedford legend RSA Security Inc. (Nasdaq: RSAS) with Internet software and services. VeriSign has easily outstripped RSA, with 3,200 employees today, while RSA's head count hovers at 1,150.

BEA Systems (Nasdaq: BEAS), which sells a range of software to integrate applications and data online, employs 3,350 people.

Of the remaining dozen largest software companies in the country founded since 1995, five more are in California, including

LOCAL TALENT

Massachusetts data integration and business intelligence companies

Company	Town	Founded	Focus
Ab Initio Software	Lexington	1995	Complex data integration
Applix Inc.	Westborough	1983	Data integration
IBM-Ascential	Westborough	1986	Data integration
Cognos Corp.	Burlington	1981	Business intelligence
IBM-DataPower	Cambridge	1999	XML middleware
Iona Technologies Inc.	Waltham	1997	SOA integration
Netezza Corp.	Framingham	2000	Data warehousing
OatSystems	Waltham	2001	RFID data integration
Progress Software Corp.	Bedford	1981	Data integration

Source: BBJ research

NATIONAL SCENE

Largest U.S. software companies founded since 1995*

Company	HQ	Employees	Revenue**	Focus
VeriSign	Mountain View, Calif.	3,205	\$1.6B	Internet applications
BEA Systems	San Jose, Calif.	3,350	\$1.1B	Internet middleware
Eclipsys	Boca Raton, Fla.	1,985	\$347M	Medical records software
Ariba	Sunnyvale, Calif.	1,685	\$330M	Procurement software
DoubleClick	New York City	1,540	\$302M***	Online advertising
WebEx	Santa Clara, Calif.	1,825	\$278M	Web conferencing
Akamai	Cambridge	765	\$259M	Internet traffic management
S1 Corp.	Atlanta	1,665	\$241M	Customer management
Nuance****	Burlington	1,110	\$217M	Speech recognition
Salesforce.com	San Francisco	765	\$237M	CRM software

* List excludes dot-coms like Google and WebMD ** Based on trailing four fiscal quarters through Oct. 25 *** Based on public estimates **** Renamed from ScanSoft in October

Source: BBJ research

Salesforce.com and WebEx. While Massachusetts is the only state to place two companies in that group, it is a hollow victory. Most executives interviewed for this story echo the sentiments of Foster Hinshaw, who, with Saxena, launched Netezza, one of the most successful startups in Massachusetts since 2000. "We used to do better compared to California. Just taking into account the amount of investment dollars that have gone into local software companies, we should have done better."

With more than 2,000 employees, Westwood-based Medical Information Technology Inc. has inherited Lotus' title as the largest home-grown enterprise software employer in Massachusetts, selling applications and databases that manage patient records.

Meditech also offers evidence that Clark Yennie

may be onto something after all. Like Yennie's Covessoft, Meditech based its applications on its own radical database design. For hospitals, it proved a better answer than the 30-year-old database structures on which IBM and Oracle built their empire.

To Yennie, the rumors of enterprise software's demise have been greatly exaggerated, and he is not limiting his imagination to the island that is the health care industry.

"Industry ... is not really talking about the fact that (companies) are sitting on top of a pile of very old software," Yennie says. "A lot of what we do today can be done in ways which are radically different, and yet we aren't doing it."

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Mini giants: Mass. emerges as data integration leader

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Massachusetts has long been among the first neighborhoods IBM Corp. hits when trick-or-treating for new software, and this October it once again haunted Boston.

Last spring, IBM spent \$1.1 billion to acquire Ascential Software in Westborough to get its hands on data-integration tools considered by some to be the best in the world. It turns out Big Blue was only getting started. In September it grabbed DWL, an Atlanta company with customer data integration software. And last week, IBM (NYSE: IBM) lumbered back into Massachusetts, spending in excess of \$100 million to acquire DataPower Technologies Inc., a Cambridge Web integration software company.

In the heyday of Lotus Development, acquired by IBM in 1995, companies largely focused on enterprise software applications that crunch numbers; produce documents; analyze cash, resources and projects; and improve the flow of information and materials.

Today, Massachusetts is cultivating expertise in three areas — protecting data that sits in existing applications, instantaneously rooting it out, and firing it off to where it is needed most.

Does the Bay State's expertise in storage, security and data integration make it a fertile garden for budding software companies? Or is Massachusetts' mainstay expertise destined to become a neglected back lot of the software industry, choked with weeds?

If the actions of IBM are any indication, data integration is a flowering sector in the software world today — and Massachusetts has quite the green thumb.

Ironically, the state has the ghosts of the former minicomputer industry in Massachusetts to thank. Companies like Digital Equipment and Data General

employed hordes of software engineers who glued together minicomputer systems and applications — not unlike the data integration capabilities that IBM has been hoarding in 2005.

No company sits more at the crossroads of Massachusetts' software past and future than Netezza Corp. The Framingham company's data-warehouse systems are used by such companies as Amazon.com (Nasdaq: AMZN) to pull huge volumes of information out of digital archives and distribute it to applications.

Having just cleared its fifth year in business and with only 150 employees, Netezza is already rated by industry analysts among the giants of the business intelligence industry with IBM.

If Netezza epitomizes the industry, its CEO personifies it. Few executives have straddled the worlds of storage, data integration and enterprise applications like Jit Saxena, who co-founded the company with Foster Hinshaw. Saxena spent part of his career leading software projects at Data General, which subsequently was acquired by Hopkinton storage computing giant EMC Corp. (NYSE: EMC). He would go on to become CEO of Westborough's Applix Inc. (Nasdaq: APLX), originally an enterprise software company but now focused on selling data-integration software.

"I think of business intelligence as a sort of byproduct of storage," Saxena says. "Clearly we are moving toward a world where everybody wants to know everything, and we are using business intelligence to learn what is likely to happen. Storage has a pretty major role to play in this area, and not just because of EMC being here."

Like the minicomputer companies, EMC has long employed software engineers to stitch its systems together, but the company has more than storage on its minds these days.

Thanks to a series of acquisitions, including two last week, EMC this year

began generating more sales from software and services than from storage computers. It is a similar strategy to the one IBM commenced in 1995 with Lotus, but EMC has given no indication whether it will follow IBM's lead with a push into data integration.

Massachusetts is home or host to a wide range of data integration and analysis software firms. Besides Applix and Ascential, Cognos Inc. (Nasdaq: COGN), Progress Software Corp. (Nasdaq: PRGS) and Harte-Hanks Inc. (NYSE: HHS) have large operations here. DataPower, an MIT spinout, is just one of a number of new data-integration startups to have emerged the past few years. Two more are from MIT researcher Michael Stonebraker: Streambase Inc., is designing software to instantaneously strip information out of databases, and his Vertica Systems Inc. in Andover, like Netezza, is working on a data warehouse system.

The startup bug bit Netezza Corp. founder Foster Hinshaw again — he has left Netezza to create a new company called Dataupia Inc., but is not disclosing his plans.

To industry insiders like Hinshaw, the most exciting software company on the East Coast is the one you have never heard of: Ab Initio Software Corp. The Lexington company was founded in 1995 by Sheryl Handler, who previously ran Thinking Machines, a failed supercomputer company in Cambridge with several prominent alumni. Ab Initio is doing custom data integration in the most intense computing environments in business, government and academia.

It is not the kind of work likely to produce a billion-dollar handout in the guise of an Ascential; but Ab Initio is doing its bit to scare up a bit of respect for the Massachusetts software sector.

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