IN LATER STAGES, THE BAR GETS RAISED

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The first time Authentica Inc. went looking for venture funding, the world was an entirely different place.

It was early 2000; the technology sector was sizzling; and six prominent investors elbowed in to hand the Waltham software maker $18 million in venture capital. The backers privately valued Authentica at $63 million after the cash infusion - even though the company had just $750,000 in annual revenues at the time. A year later, Authentica's value had plunged from those lofty heights. Desperate for cash, the company acquired a competitor, Shym Technology Inc., mainly to get its hands on $7 million in unused venture funds. Authentica slashed costs, kept a lean headcount, and so far has outlived many other start-ups of its era, and some of its financiers. But it hasn't been easy.

Like other later-stage start-ups, five-year-old Authentica has seen the bar for raising money rise dramatically since the late 1990s. VCs are taking far fewer leaps of faith, demanding that companies have customers, revenues, realistic profit forecasts, and unassailable technology. Second and third rounds don't exist for pipedreams, investors say. Even fresh, new start-ups are expected to have far more substance than their flashy peers of the boom years.

"The VCs are still willing to invest in early-stage companies," said Lance Urbas, 50, Authentica's chief executive. "What they're more leery about is the later stage."

That's the case, venture investors concur, even when the technology at stake is hot, and Authentica's content security products are considered just that. With the mainstreaming of the Internet, finance and health care companies must ensure that their e-mail communications with customers are secure, meaning the right people receive them and that only the addressee can access the material. The government, too, is stepping up its Web security in a post-9/11 world. But it's selling products, not simply inventing them, that matters in these sober times.

In its latest fund-raising effort, Authentica had the numbers to show. The company has posted four straight quarters of rising revenues, and sales for the first nine months of 2002 were 50 percent higher than for

all of 2001. Nearly 100 corporate clients have signed up for the software, including the likes of Ford Motor Co., Merck & Co., and Microsoft Corp. Urbas said the company expects to be profitable by the end of next year, and will still have $2 million in the bank.

With those credentials, Authentica was able to raise $4 million last month from its original VCs and those who'd backed its merger partner, Shym. Venture capitalist Michael Tyrrell, whose firm, Venrock Associates, backed Shym and participated in the recent Authentica round, said the combined company has the markings of a survivor.

"Without sales traction these days, any later-stage round is brutal," Tyrrell said. "With sales traction, they're doable. These guys are winning new customers every single quarter."

Venture capitalists agree there are two kinds of deals getting done in a market that saw investments plummet 26 percent to $4.5 billion in the third quarter, the lowest level since early 1998, according to the PricewaterhouseCoopers/Venture Economics/National Venture Capital Association MoneyTree survey, prepared exclusively for The Boston Globe. There are later-stage companies that are successfully selling products that fill a pressing need, and there are robust young start-ups with tangible potential, which are much cheaper to invest in than they would have been three years ago.

Of several recent deals inked at Battery Ventures, all but one company had revenues, at least a few blue-chip clients, thrifty spending plans, and were "close to break-even," said Todd Dagres, a general partner at the Wellesley firm.

The other deal was a communications start-up - a surprise in this nuclear winter for telecommunications - called BroadBus Technologies Inc., that's working on new video-on-demand technology. In that case, Battery was interested in the sector and went searching for a promising company to fund, Dagres said. But the due diligence didn't end there. Boxborough-based BroadBus didn't have customers yet, so Battery executives went out and talked to potential clients to make sure its theory about the technology was on target before leading a $12 million round.

Technology customers, Dagres said, "are only spending money on things that have a very clear and present return on investment." What no VC wants right now, Dagres said, is to be saddled with a portfolio company that needs piles of money to develop a product or just to break even. Battery, he said, is betting on companies that are positioned to endure a rocky 12 months to 24 months and then take off when the economy and stocks recover.

"If we can find a company that's doing well in this terrible market, it's a pretty good indication they're going to do well in a good market," Dagres said.

Some experienced entrepreneurs feel venture firms have taken their caution several steps too far. When Don Shulsinger, 46, launched Sand Video Inc. in January 2001 with Peter Besen, 47, the two MIT graduates from the 1970s figured they were experts in wooing venture funds. They had launched Pixel Magic in 1991, a difficult year for venture and the economy, and LaserData Inc. a decade before that. In each case, they had been in the chip business, working on digital images, and they were able to raise financing from customers. They sold Pixel Magic to Oak Technology of Sunnyvale, Calif., in 1995 for about $11 million.

At Sand Video, where Shulsinger and Besen are working on video-compression chips, the founders bootstrapped the Andover company with their own money and worked for free. Raising money from potential customers, as they had in the past, proved difficult, as money grew tight and high-tech companies shied away from backing start-ups. Finally, Shulsinger said, the executives decided they had to go out and raise money from traditional VCs if they wanted to grow beyond a scant staff of 10. What they found was a far more rigorous process than any they had ever encountered.

"The climate today is just very, very difficult," Shulsinger said. "Where [VCs] may have erred on the side of being overly generous in the late 1990s, it seems that many of the investors have swung to being perhaps overly conservative. They want to know that they have a grand slam in hand before they put out the money."

Venture capitalists love a team with a track record, but star power alone doesn't attract big dollar signs any more. Sand Video had more going for it than the average start-up, with early negotiations underway with several customers and a target market analysts say exceeds $2 billion. It landed a bridge loan in June and finally last month raised $8 million in a first round. Backers included CommonAngels, the local angel investing group; Navigator Technology Ventures of Cambridge; and Baker Capital of New York.

The numbers back up the reports of disillusionment in the early-stage trenches. There were 16 first-round deals done in New England in the third quarter, worth a total of $92.7 million, according to the MoneyTree survey. In the same quarter of 2000, 82 deals worth $664 million were completed. Venture capitalists insist the recent slower pace is far healthier and more sustainable for their business. But along with fewer and smaller investments have come much tougher standards.

Firdaus Bhathena, founder and chief executive of Relicore Inc., recently raised $14 million in a second round for the Burlington provider of software application management systems. Bhathena has been through this drill before, having founded WebLine Communications in 1996 and sold it to Cisco Systems for a massive $325 million in 1999. But things are very different today from those go-go days, he said.

When it comes to raising venture capital, Bhathena said, "The level of scrutiny goes up by orders of magnitude in every area that gets judged." In the late 1990s, he explained, young companies could get by with just a couple of the attributes VCs now demand: serious intellectual property, strong management, and a solid plan. Buzz terms such as "mindshare" and "eyeball value" have vanished.

Paul Levine, the former chief executive of Atria Software and now a partner with Morgenthaler Ventures in Boston, has seen the market's change through the eyes of both an entrepreneur and an investor.

"If, two years ago, you had a fabulous idea of something to sell to the communications industry, you could get funded. Today, that and three-bucks-fifty will buy you a cup of coffee," Levine said.

While venture investing was bound to fall from its nosebleed levels of nearly three years ago, it's deeper in the dumps than many people anticipated, because the stock market and the economy are in such a long slump. The financial environment is setting the tone for how VCs approach young and not-so-young start-ups.

"It used to be that when you put money in an early-stage company, the risks were the team, the technology, and the market," Levine said. By the second round, some of the risk had already been addressed, he said, such as whether the team could get along and the technology could be build. But these days, market risk is often trumping the other factors. "When you go from an early-stage company to that second round," Levine said, "you haven't been able to beat all the market risk out of it yet."

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