

## Big Government Meets Small Companies: Security Startups Eye Federal Contracts

**A**t a time when business spending on new technology remains flat, venture capitalists see some promise in an unlikely source: the federal government. The creation of the Department of Homeland Security, which consolidates functions previously spread among 22 separate agencies, is the most obvious signal of the government's increased interest in new technologies. But there are other signs as well, such as a showcase of 75 startups sponsored in October by the Laguna Hills, Calif., firm Tech Coast Angels.

"We had 25 representatives from federal defense agencies fly out from the beltway to meet with these companies," said John Morris, president of Tech Coast Angels. A number of the young companies have since established agreements with government agencies, Mr. Morris said.

Small companies have always struggled in seeking an audience of government buyers. The only way most have been able to attract business, especially at the federal level, is to ride in on the coattails of IT suppliers and systems integrators that have large sales staffs to deal directly with the government.

But as the Tech Coast Angels convention suggests, even that may be changing, as employing new technology takes on fresh urgency. Among the startups making inroads with the government is Voyager Systems, a San Diego developer of software that it sells bundled in personal digital assistants. The software enables law enforcement officers to query and augment a database during field investigations.

Voyager, which sells to state and local groups as well as to agencies within the Homeland Security Department, in October drew a \$7.5 million first round from backers that included Shepherd Ventures and GKM Venture Partners, both also of San Diego.

Tom Siegel, a general partner with Shepherd Ventures, said he expects Voyager to become profitable by the middle of the year. The company got a boost recently through a contract with Nextel, which will begin using its sales agents serving the public sector to sell Voyager's products. Previously, Voyager had to make all of its sales with its small own staff.

### One-Stop Selling?

Mr. Siegel is among those who say that by consolidating numerous agencies within a single organization, the Homeland Security department is likely to make business easier for startups. At least in theory, one person should have responsibility for buying technology for the various agencies, including the Federal Bureau of Investigation and the Central Intelligence Agency, that are now part of the department.

The department has yet to spell out regulations for procurement. But several VCs interviewed for this story suggest that the consolidation of agencies could mean big contracts for the companies fortunate enough to obtain them.

Startups designed to expedite communications appear to be in especially good position. Part of the department's mission is to improve information sharing among agencies—the FBI and CIA were widely criticized for the perceived failure to do so prior to the September 2001 terrorist attacks. The department this *year* plans to spend \$722 million on technologies used to help such agencies share their information and intelligence planning a \$25 million venture fund that will be run by one or more private venture capital firms.

One apparent change in venture-backed security companies that sell to the government is that those drawing capital these days tend to be closer to becoming profitable than their predecessors were.

VentureOne data shows that none of the companies in this category that were funded in 1997 through 2000 was profitable. In 2001, just one such company showed a profit. But three among those funded in the first nine months of 2002 did so, and numerous companies that received backing over the past two years may become profitable in 2003.

Voyager Systems is in this category. So is IPMobileNet, an Irvine, Calif., spin-out of Siemens AG. IPMobileNet develops mobile radios with global positioning systems that converge wireless voice and data communications with the Internet. This allows customers, including law enforcement agencies, to exchange more information. Police officers, for example, can take a picture while on the road and instantly transmit it to headquarters.

The company, backed by Kline Hawkes, Los Angeles, and FA Technology Ventures, Boston, among others, raised an \$11 million first round in 2001.

Startups that have executives who came from federal agencies can sometimes do a lot with little capital. An example is Sensor Systems, a Sterling, Va., company whose CEO, Steve Huff, is a former CIA analyst. Kline Hawkes was Sensor Systems' only investor, putting \$3 million in a first-round for the startup in 1997. "When we invested in them, they had a government book of business," said Managing Partner Frank Kline.

Sensor Systems develops image manipulation software for geographic and military intelligence applications. Demand for the product surged in the fall of 2001, amid the U.S.-led campaign to dislodge the Taliban from Afghanistan, and Sensor Systems saw its revenue for the year double to \$12 million. With the demand for military surveillance remaining high, the company expected to double its revenue in 2002 as well.

E Team, a Canoga Park, Calif., company backed by Tech Coast Angels, develops software that government agencies use to manage emergencies. Through an extraordinary coincidence, E Team was scheduled to deliver a software order for the city of New York on Sept. 17, 2001. As it turned out, E Team had the software up and running on Sept. 12, the day after the World Trade Center attack.

The software enables agencies to communicate with one another. Otherwise, "the only way to communicate is to talk through a cell phone, and [heads of different agencies] rarely have each other's phone numbers," Mr. Morris, the Tech Coast Angels president, said.

Tech Coast Angels invested \$3 million in E Team in 2000; an undisclosed software company made an investment last year. E Team sells its software through an arrangement with IBM Corp. and SAIC, a San Diego technology outsourcing company.

*By Tom Davey*

*Tom. Davey@AlternativeInvestor.Info*