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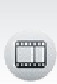

Marching to a new drummer Series: AFTER THE BUBBLE BURST

KRIS HUNDLEY, JEFF HARRINGTON - February 12, 2001

The fun is gone. And survivors of the tech market's tumble are realizing that behind the dot-com dreams, it's really a business.

Suddenly those staid and predictable old economy companies don't look so bad.

The dot-coms that were supposed to represent the future of business have been decimated since the stock market's Internet bubble burst last spring.

Nationally, more than 130 dot-coms closed last year, forcing thousands of Web experts to turn in their perks for invites to pink- slip parties. Webmergers.com, a San Francisco research company, said late last year that dot-coms were failing at a rate of one a day.

For many of the dot-coms that survived, the fun is gone. Their executives and employees are on a grim march to profitability, hoping to reach that elusive goal before funding runs out.

Web designers and other enterprises that thrived serving the dot- coms are sharing their pain, as are the venture capitalists who fueled hundreds of risky start-ups.

"Maybe we were all thinking that this will never go away," said Kevin Hourigan, chief executive of the Web design and consulting company Hydrogen Media."Perhaps we never looked at the big picture to realize it was all still just a business."

This conclusion of the two-part special report, After the Bubble Burst, looks at some of the businesses, and people, struggling to succeed in a new and challenging climate.

TechHealth Inc.

A dot-com refuses to give up

Steven MacDonald pops up from his desk at the far end of a rabbit- warren of empty cubicles and leads a visitor into a conference room full of boxes waiting to be unpacked.

TechHealth Inc., the Tampa Internet company where MacDonald is chief executive, has moved for the third time in its 16-month existence. Unlike its last move, which was made as the once fast- growing company was busting at the seams, TechHealth has just downsized. And from the looks of the new space, where 18 remaining employees seem lost in a sea of empty desks and unused phones, there still could be some downsizing to go.

Like many dot-coms, TechHealth arrived on the scene with high hopes, only to have those hopes dashed with the tech crash last spring. And like many of those that haven't perished, TechHealth is ailing. After snapping up $5-million in funding in December 1999 on little more than an interesting idea - connecting the disabled, care providers and payers via the Web - the company's hopes for a second cash infusion evaporated in August.

In November, MacDonald pulled the plug on the company's consumer Web site, AccessLife.com, and cut 33 employees. But the top executives of TechHealth don't quite fit the stereotype of dot-com entrepreneurs playing fast and loose with other people's money.

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MacDonald, co-founder and chief marketing officer Chuck O'Neill and president Tom Sweet agreed to go without salaries and pour all their efforts into signing up health insurers for TechHealth's electronic patient-management system.

"We had to decide whether we were going to close our doors or stick it out," said MacDonald, who cashed out his 401(k) and sold his truck to raise cash for the company. "We had multimillion-dollar customers willing to try our product. We were too close to let it go."

Said O'Neill, who recently adopted a second child but sold his stock portfolio to stay afloat, "I looked at the money I had in the bank and said, 'I've got enough to hang on till midyear and I'm going to go for it.' "

Today, nine worker's compensation companies are involved in a pilot program using TechHealth's software to manage several hundred disabled patients. Case managers can log onto the company's site, call up a patient's file, order physical therapy, approve a hospital bed rental or check on the patient's last home health visit.

TechHealth, which has contracts with thousands of health professionals and medical equipment providers, gets a cut of any transaction. An insurer, for instance, might pay TechHealth $100 for a wheelchair; TechHealth might pay the supplier $90.

But TechHealth is far from self-sustaining, and MacDonald declines to reveal current revenues. Though angel investors, many of them original backers of TechHealth, are coming through with nearly $1- million to keep the company running through the product's testing stage, the top executives don't expect to take salaries until later this year. Profitability isn't expected until year-end or the first quarter of 2002.

And that's only if customers, now testing TechHealth's program with small sample groups of patients, enthusiastically embrace the system and rapidly ramp up their involvement. And if TechHealth can beat out competitors.

Funny thing is, TechHealth has learned that too much technology is scary to overworked case managers, who are loath to learn one more work-saving system. So the high-tech company had to introduce a low- tech approach: a simple telephone call center where customers can access TechHealth's technology through a human being. "Customers weren't interested in our 'value-added' services," MacDonald said.

MacDonald, a 33-year-old whose dark hair is tinged with gray, is candid about other mistakes made. Too much time and money - about $2- million - was spent on the consumer Web site, which was seen as a brand-builder and PR tool rather than a big moneymaker.

"I still think a consumer site is great," he said of AccessLife.com, which won several awards during its brief life. "But we didn't have the time or luxury to support it."

And forget about promises that more money is on its way.

"Never take people at their word," he said. "We had lots of people promising money but it never came through."

Despite the brutal year he's endured - getting jilted by investors, dismissing loyal employees, devoting every waking minute to a concept that may or may not survive - MacDonald remains determined.

"We're going to get there," he said. "We've made it through the hardest part."

Hydrogen Media

Now, there's no time for nonsense

Kevin Hourigan has tried to take the hijinks out of Hydrogen Media.

Sure, the Web design/development and Internet consulting company still has funky decor and blue neon lights greeting visitors to its 34,000-square-foot office off Ulmerton Road in St. Petersburg. There's still a disco ball and a pool table in the lower-level cubicle area that techies nicknamed the Hydrogen Pit.

But now workers are supposed to shoot pool or play video games only at lunch or after work. And what about those playful Nerf games that were encouraged by Hourigan's predecessor?

"There is one Nerf gun I saw downstairs the other day, but I think it's shooting blanks only," said Hourigan, a straight-laced type who took over as Hydrogen's chief executive in October.

Like other Web-related companies, Hydrogen Media is no longer trying to be the hippest place around in an effort to woo programmers and Web artists. Since the dot-com boom has gone bust, it's just trying to survive.

Silicon Valley and other tech centers may be feeling more pain from the new economy's first big downturn. But the Tampa Bay area boasts its share of Web hosting and development companies struggling to reinvent themselves.

Consider the troubles of St. Petersburg's NetPerformance, formed by the merger of a Web development and sales company (U.S. Technologies of Tampa) and a Web hosting company (Digital Chainsaw of St. Petersburg). From a high of more than 80 employees, NetPerformance has about 40 employees left after two rounds of cutbacks in the past couple of months. It dropped the Web development and support side of the business to focus on Web site hosting.

In Clearwater, Internet consultant and applications company K.Tek Systems likewise has regrouped. It is down to nine employees from a high of 20 during the Web frenzy of 1998-99. Huge profits of a couple of years ago gave way to a lackluster second half of 2000 as companies shied away from pouring money into Web ventures.

K.Tek may have shielded itself from a harsher fate through founder and chief executive Kim During's strategy of growing cautiously.

"We're organically grown. We never turned to venture capital," During said. "I thought I was doing something wrong when every company was exploding in size. . . . Now I'm thinking we were right after all." K.Tek is at break-even and should turn a profit again by year-end, she projects.

Then there's Hydrogen Media.

In early 2000, it was celebrating another year in which it tripled revenues. Co-founder and chief executive Scott Gostyla was overseeing a staff of nearly 160 and entertaining thoughts of going public.

The market's tech meltdown last spring abruptly shelved talk of an IPO and prompted Hydrogen to shift strategies dramatically. Hydrogen's board ousted Gostyla in October, replacing him with chief operating officer Hourigan.

In January, the company closed its Los Angeles office, firing 35 people, including 14 staffers in St. Petersburg who supported the California operation.

With 90 remaining employees, Hydrogen shuns being pigeonholed as a Web design company.

It's a software development company, pitching Internet applications. It's a consulting company that helps test concepts and strategies for Web-centered ideas. And, to a lesser degree, it's a Web hosting company.

Executives of Outback Steakhouse, which have a minority stake in Hydrogen, declined to discuss how much influence they exerted on the make-over.

Hourigan, 34, was part of the original core when Hydrogen Media began in 1996. He left to start a computer hardware reseller, Intol Computers, which he subsequently sold to a Dutch company. When he returned to Hydrogen in March 1999, the company was expanding at a breakneck pace, and recruiting in-demand tech workers was a top concern.

That's been replaced by performance.

"This is still a fun place to work but it isn't a free-for-all," Hourigan said. "We have employee procedures like a regular business."

Hyde Park Capital Partners

Investors demand real results

In March, when the Nasdaq was at 5,200, John H. Hill and his partner, John McDonald, planned to raise a $100-million Internet fund and become venture capitalists.

Six weeks later, after the Nasdaq had plunged to 3,300, the two former investment bankers with Raymond James and Associates changed their minds and canceled the fund.

Today, with the Nasdaq at about 2,500, Hill and MacDonald have found a different niche: Their Tampa company, Hyde Park Capital Partners LLC, works with struggling new tech companies to find cash or buyers.

"There's a huge amount of opportunity for what we do," Hill said at his company's elegantly appointed offices in the old Mercantile Bank building on Tampa's North Franklin Street. "They always say that fear and greed drive the markets. Nine months ago, it was greed. Now, fear is the bigger factor."

But that doesn't mean Hyde Park Capital's job is easy. Though Hill said plenty of private equity, particularly institutional money, is still going into well-established venture funds, investors' criteria have changed.

Entrepreneurs with nothing more than ideas don't stand a chance, nor do early-stage start-ups. Companies have to have revenues and a target date for becoming profitable.

"There's a lot of window shopping, but investors are afraid to pull the trigger," Hill said. "The hardest part is to find a lead investor."

He should know. Hyde Park has about a half-dozen deals on its plate. None has yet been finalized. And Hyde Park's commissions and fees aren't earned until the deals are signed.

"It takes a long time to close these deals," Hill said. "We've been doing this six months and expect one to close within the next couple months."

Hill, 39, doesn't seem rattled by the wait. He has a bit of a cushion: In February, Hill raised $3.26-million by auctioning his Tarpon Springs mansion and 44 vacant lots to finance Hyde Park Capital, which has six employees.

Hill and McDonald, who worked with Morgan Stanley before joining Raymond James, have seen plenty of business cycles. While managing the technology group in investment banking at Raymond James, Hill headed the company's underwriting in 1996 of the initial public offering of CHS Electronics Inc., a Miami computer reseller. The company had sales of $8.5-billion in 1998; last year, it filed for Chapter 11 protection.

"It was like Icarus," Hill said. "Fast rise, fast fall."

Hill will talk only generally about several of Hyde Park Capital's current efforts. It's trying to sell two private technology companies, one in Naples, the other in Reston, Va. It's also trying to find a buyer for a public company and take another one private through a management buyout.

"I think you'll see a lot more M&A (merger and acquisition) activity as leaders in a space do strategic buyouts," Hill said. "You'll also see financial buyers step in. But a lot of public and private dot-coms simply won't make it because the company isn't even saleable."

Hill is more candid about three clients seeking investors through Hyde Park Capital, which Hill said has ties to some of the biggest venture capital firms in New York and Boston.

He's enthusiastic about efforts to raise $5-million for Gemisis, a Gainesville company that has developed technology for synthetically growing diamonds from diamond crystals. "The jewelry market is huge and then there are the possible applications in electronics," Hill said. "Unfortunately, consumer product plays are really out of favor."

Hyde Park Capital also is seeking first-round financing for MediaBrowser.com Inc., a Largo

software company that produces branded desktop browsers for customers such as Pokemon, NASCAR and Star Wars. (Mike Siewruk, chief executive of MediaBrowser, is a silent partner and individual investor in Hyde Park Capital.) Though MediaBrowser brings in some revenue by licensing its software to the brands, the mother lode was expected to come from sponsored ads, which have yet to materialize.

"They have good contracts, but they have to build up their user base before they sell ads, and that's going to take time," Hill said. "The Internet ad space is also in turmoil."

As a result, Hyde Park Capital has slimmed down its funding goal for MediaBrowser from a maximum of $10-million to the $2-million to $3-million range.

Hill is most enthusiastic about his company's fund-raising efforts on behalf of Decision Management International of Sarasota. The company has $12-million in revenues from its health care consulting business, Hill said. It is trying to raise up to $10-million to finance development of software that will help big pharmaceutical companies comply with FDA regulations, the focus of its traditional consulting business.

"We're getting a great response because it's a later stage company and it's profitable," Hill said.

As Hill tries to snag the interest and investments of venture capital firms, he recognizes that the world has changed dramatically in the past year.

"The little funds are too busy doing triage on their portfolios, and the big funds are looking for deals, but they're not going to be pressured," he said.

The upshot of the tech correction, Hill said, is that existing technology companies lucky enough to have cash flow will grow, but at a slower rate than in the past. And new ideas?

"There are probably a lot of good ideas," he said, "that won't get funded."

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