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Securing profits: Venture capitalists betting online security will be big money-maker

Premium content from Boston Business Journal by Kyle Alspach, VC Editor

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As threats from corporate data breaches and IP theft escalate, venture capitalist **Alex Laats** is on the hunt for the next wave of cybersecurity technologies. And he's pretty sure that, like with the current wave, many will be found in Massachusetts.

"The social networking darlings are not here," said Laats, a general partner at Commonwealth Capital Ventures in Waltham. "But I think that we have more hard-core technology, including cybersecurity, than you're going to find anywhere else in the country or the world."

Laats is not alone among VCs — or acquisitive corporations — looking to the Bay State for advances in IT security.

Venture capital going into the sector declined after 2008, but this year appears back on its way up. VC for IT security firms was \$293 million in the first nine months of the year, compared to \$298 million for all of 2010, according to Dow Jones VentureSource.

Meanwhile, IBM acquired venture-backed network security software firm Q1 Labs Inc. of Waltham this month for undisclosed terms. And three other Massachusetts-based IT security firms report robust sales growth over the past year — Verdasys Inc. of Waltham, Rapid7 LLC of Boston and Bit9 Inc. of Waltham.

All three companies were founded about a decade ago but didn't catch fire until the past two years.

In the case of Verdasys, a restructuring a year ago resulted in layoffs of 35 employees, bringing the firm to a head count of 100. But the company's revenue growth, from nearly \$30 million in 2010 to potentially double that this year, has led the firm to hire 50 people since then, said CEO **Jim Ricotta**. Now, an initial public offering is likely for Verdasys within 12 to 18 months, he said.

"We're profitable and cash flow positive, and we don't have to raise any more money" from VCs, said Ricotta of his company, which has raised about \$40 million in financing from backers including Fairhaven Capital Partners of Cambridge and GE Asset Management. Customers include General Electric, DuPont, Siemens and the Department of Justice, Ricotta said.

Commonwealth Capital Ventures, meanwhile, is invested in Boxborough network security firm Crossbeam Systems Inc., while a previous Commonwealth portfolio company in security, Ounce Labs of Waltham, sold to IBM in 2009.

Security software is becoming a higher priority for the enterprise as more data is moved into the new terrain of the cloud, and as data breaches become increasingly sophisticated (and highly publicized). Among the recent cases: The breach at Hopkinton-based EMC Corp.'s RSA unit in March, which the company said was part of an attempted broader attack on defense giant Lockheed Martin Corp.

Laats says there is still plenty of room for new companies in IT security — something the judges of the Boston-based MassChallenge startup competition would seem to agree with. Tinfoil Security, which offers automated web security technology, was among the three winners of the \$100,000 top prize at the competition this week. And security tech startup Circumventive was among the "final 26" startup finalists in the 2011 competition, which began with 733 entries.

One reason for VC confidence in the space is that it's one area the government appears committed to, at a time when other areas, particularly in defense, are facing cuts, Laats said.

Government funding can be a crucial ingredient when it comes to cybersecurity technology development; the technologies often start in universities and are funded by the government's Small Business Innovation Research grants.

But many don't make it out of the universities — and that's where Laats said he and Commonwealth Capital are now looking. Commonwealth recently funded two Cambridge firms that are seeking to commercialize IT security technologies spun out of the Massachusetts Institute of Technology, though neither is being disclosed for now, Laats said.

"Our approach is to go out and find these companies that are doing really exciting research, and not sitting back and waiting for them to find us," he said.

Laats, who joined Commonwealth in 2010, said he's building on experience from his time as a division president at BBN Technologies in Cambridge — known for developing the Arpanet system, a precursor to the Internet, along with the first e-mail and Internet router technologies.

At BBN, ultimately acquired by Waltham-based Raytheon Co. in 2009 for \$350 million, Laats worked to commercialize technologies including the Boomerang shooter detection system, which has been used by the U.S. Army.

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