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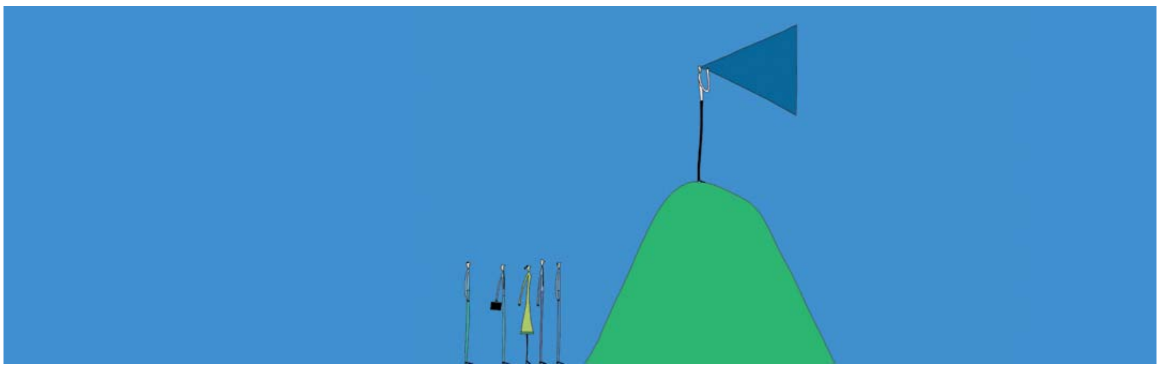
Ideas and Resources – Entrepreneur Interview

John Craton



Cramer Systems Ltd

Introducing Cramer Systems Ltd

It is a well kept secret that some of the leading companies arrived at the top without taking early venture capital funding. Today's market may call on companies to be more prudent in how they apply capital to generate returns.

In the second in a series of discussions with entrepreneurs whose capital-efficient businesses are recognized "return leaders," Kennet Partners Managing Director Javier Rojas sat down with Jon Craton, founder of Cramer Systems, to discuss how the company was able to achieve an exit value of $425 million or 47 times the amount of external funding used.

In the beginning

When Jon Craton was working at a software developer in the late 1980s and early 1990s, his main focus was on creating custom-developed applications for the telecommunications industry. As deregulation of the telecom market gained steam, Jon and Don Gibson, a co-worker at the Bath, U.K. software house, recognized that all telcos were facing a similar problem: no centralized platform that would enable them to manage their network assets as they expanded and optimized operations.

In this problem, they saw opportunity. In 1996, Jon and Don took a GBP £200,000 [$150,000 U.S.] angel investment from two of their former colleagues to establish a business aimed at developing software to simplify and automate provisioning of services for telcos. For the first year, the business – Cramer Systems – focused primarily on securing consulting revenue to generate cash-flow and turn the company cash-flow positive as quickly as possible.

Strong demand for consulting services gave the company the confidence it needed to begin pursuing its bigger goal: developing the telco platform and transitioning to a product-based business. They hired an engineering team and spent less than $150,000 developing a prototype in Visual Basic. Within six months, Cramer secured its first three customers: one in Italy, one in Switzerland and one in the U.K.

Fast forward about 10 years – and having grown to a $100 million company serving dozens of major carriers around the world – Cramer pursued its ultimate exit strategy. The company was purchased in 2006 by Amdocs for $425 million in cash and other consideration. Jon accomplished this by spending only $9 million in capital. In this interview, he explains how Cramer Systems was able to achieve this remarkable return on investment.

Q&A

Name: Jon Craton

Title: CEO and Founder

Company: Cramer Systems

Headquarters: London

Date Founded: 1996

Employees: 320

Venture Capital Raised/Used: $9 million

Exit: Purchased by Amdocs for $425 million

Exit Value to Capital Used: 47x

Company Description: Cramer Systems was a leading operations support systems (OSS) provider to the telecommunications industry.

Why was consulting an important first step in building Cramer Systems?

We were fortunate that we were able to engage with a number of consulting customers that shared our vision of the problem our proposed product offering was intended to address. Consulting enabled us to develop the product in large part through their engagements. Our early customers bought into our vision and had confidence in us as an experienced team that understood the problem and could deliver on the promise of the product.

When did you take your first venture funding?

In mid-1998 – about two years after founding the company – we achieved close to a $4 million run rate and decided to raise $1.5 million. We believed that the venture capital path would bring vigor and discipline to the business and introduce a culture early on that would prepare us well for an IPO. We believed this was a sound decision – for example, we rapidly developed a culture of quarterly-focused behavior across the whole company. We selected Kennet and they did a great job in helping us grow the business.

It was unusual for VCs to get into a company with such a small investment and we were encouraged to take more at this stage. But we kept it at that level because we thought that with another nine to 12 months of research and development, we'd have secured further customer validation and would be in a much better position to raise more money.

Did your second round come within that timeframe?

Yes. In 1999, we got a second round, a $25 million investment from a second investment firm. We wanted to raise this money for international expansion because we saw that our product would play well in the Americas, as well.

This second round also was to establish financial credibility with some of our big customers. Increasingly, customers were placing our application at the heart of major business transformation programs, taking advantage of its capabilities to re-engineer and optimize processes and organizational structures. We believe they would not have committed to purchasing our product if we didn't have the big bank balance and financial staying power to support them for many years to come.

We put together a business plan based on deploying this capital, and within a number of months our head count grew to 260 people. Then we hit the Internet bust. Within one quarter, we sale our sales funnel shrank significantly.

How did you weather that crisis?

We were faced with a dilemma – we had hired a lot of people, had strong R&D and sales momentum, but demand was not the same. We didn't want to bleed the company through a series of multiple redundancy rounds. Knowing we needed to get the headcount down, we did one redundancy round and went about 10 percent deeper than we initially considered. We had 260 employees at the time and cut 20 percent – or 60 people – and then ran flat for about one year, in terms of revenue with breakeven performance.

Maybe it's because I have a founder/owner mentality, but I couldn't see us burning through cash to keep headcount. To knock out 20 percent of business creates a difficult environment –

particularly since we had just raised money and everyone could see we had plenty of cash. In hindsight this was the right decision. The downturn lasted longer than most people anticipated, and the company that was left after the downsizing was appropriate for market conditions.

What other actions did the company take to position itself for a successful exit strategy?

After about seven years, we decided to bring in a professional CEO, who changed the organizational structure and brought in stronger sales management. During that time the company had a significant uptick in growth, but the CEO resigned after about 1 ½ years. I took over the CEO role for a year while we searched for a new one, and during that time I focused on managing cash flow. We then brought in our second professional CEO, who spent 18 months enhancing revenue, creating a regional structure and led the company through the Amdocs acquisition.

One of the other things I did throughout the history of the company was to lead by example with regard to cost control. Because we were an international company, it would have been easy to fall into traveling first class and taking limos. I wouldn't ask any of our employees to do anything I wouldn't do, including flying in the back of the plane.

On the other hand, I believed that we should never scrimp on the hiring we did. We were fortunate to find an effective headhunter, and that money was well spent. When we found our star talent, we would hire them at any cost because lesser people would end up costing more in the long run.

What advice would you have for founders of bootstrapped businesses who are debating whether to take capital?

The biggest piece of advice would be to make sure your timing is right and that you have a plan on how to deploy that capital. Also it is important to ensure you have a value proposition that is validated by customers. The most effective sales tool we had were delighted customers who were strong advocates for what we were doing. Finally, don't be afraid to reduce headcount in a downturn to get the company to breakeven, even if you have plenty of cash.

About the interviewer

Javier Rojas

Javier Rojas is a managing director at Kennet Partners and leads its US investment activities. He is currently on the board of Daptiv, Adviva, IntelePeer, NetPro Computing, MedeFinance, and Kapow Technologies.

Prior to joining Kennet, he was a managing director of Broadview International and led their West Coast Software and Services practice. Javier specialized in advising high growth, early-stage companies on how to capitalize on emerging technology markets and partnering opportunities.

He invested and/or advised on a number of successful companies and high value exits including Etek, Webex, Looksmart, Blue Mountain Arts, When.com and Rightworks.

Previously, Javier was with Morgan Stanley. Earlier, he founded a software firm that developed products for capital markets interest rate and currency swap traders.

He holds an MBA degree from The Harvard Business School and a BAS degree from Georgetown University.

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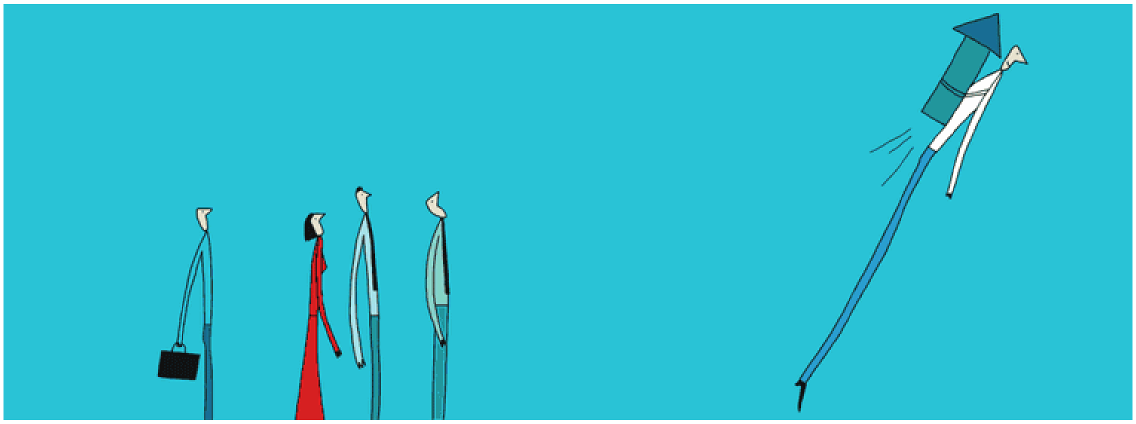
About us

Kennet invests in entrepreneurial technology businesses to help them take the next big jump in growth.



We're an experienced growth equity investor with a long track record of building global market leaders and achieving high-value exits.

Since 1997 we have invested over $270 million in companies in Europe and the US.

As a growth equity investor, Kennet focuses on companies that have proven commercial success and are now ready for the next phase of growth.

The companies we invest in often do not need money to survive.

They have options. But the right investment from the right partner can help them keep ahead of their markets, expand internationally, ramp up their sales forces and lead to greater value for shareholders.

Visit us at www.kennet.com to learn more.

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