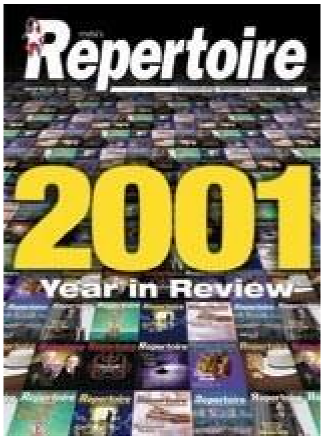
ONE DOT-COM'S STORY



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In the spring of 1999, Zack Rinat, John Ellithorpe and myself were spending a lot of time in a small 700sq.-ft. office in Palo Alto, CA, in search of the ''next big thing.'' Zack had just sold NetDynamics, an Internet software company, to Sun Microsystems for $170 million several months earlier, and John had been one of the key product architects at NetDynamics. I had come off a foray into business academics at Stanford and decided it was time to get back to ''the real world.''

After experimenting with the worlds of collaboration and scheduling and exploring countless other opportunities, from ''fun auctions'' through kids' online networks and streaming video depositories, we locked in on the business-to-business concept (B2B). Specifically, we came to understand that online B2B marketplaces would transform the world of business procurement and collaboration as we know it.

Several dozen such marketplaces were up and running at the time, including the undisputed industry pioneer, Chemdex, as well as such now familiar names as eSteel and PaperExchange and, of course, Neoforma, Medibuy and Cimtek in the medical space. Zack, John and I, with help from Zack's executive assistant, Diana Schindler, spent most of that summer analyzing existing marketplace plays, learning the requisite technologies and exploring a variety of potential industries we were considering entering.

In retrospect, we must have been quite naïve. Zack and John had mostly technology industry experience, Diana spent many years in education, and I had spent several years in retail as an executive, first with Edison Brothers Stores and later with the May Company. But we were all foreign to the industries we were now approaching. However, this naiveté would give us the 'out-of-the-box' advantage that would eventually lead to quick and early success.

'Largest and Most Inefficient'

By late summer we had zeroed in on the health care industry, ''the largest and most inefficient of industries,'' as we were to proclaim in countless future presentations. The three major players at the time, Neoforma, Medibuy and Cimtek, were all well known in the industry and had good brand recognition. Neoforma and Medibuy were considered the ''800 pound gorillas.'' Each had already been through four rounds of venture capital financing, each had raised over $150 million, and each was about to file to go public. But all three companies lacked one essential ingredient, paramount to the success of any business venture – customers.

Our fledgling team spent many sleepless nights trying to understand how companies that were built up by well-regarded industry executives, sported countless MBAs and intelligent people on their executive teams and boards of directors, and were backed by some of the best-known venture capitalists on the planet, could not kick start their electronic marketplaces.

As we continued to ponder this issue, starting to wonder if there was an opportunity to establish a successful eMarketplace in the health care industry at all, we came across Brett Fielder, who at the time was running Pharmco's St. Louis based operation. Brett was an industry veteran, with deep and widespread connections and a familiarity with and grasp of technology we had rarely come across. Several weeks later, we asked Brett to join the company, at the time called Medicea, as a co-founder and director of business development. To our great joy, he did.

With Brett's help, and following time spent at HIDA '99 in Chicago interviewing more than 40 manufacturers and distributors, we were able to identify the three main reasons early marketplace pioneers in the industry were failing.

The 'Great Disintermediator'

First, the assumption underlying all early B2B plays was that of disintermediation.

Disintermediation was not unique to the health care industry. The world over, almost everyone thought that Net-based plays would replace existing intermediaries, thereby improving the efficiency of supply chains and reducing costs. In some circles the Internet was referred to as ''the great disintermediator.'' Although not many dared voice this trend as it applied to the health care industry, it seemed clear to us that the creators of most of the health care B2B marketplaces wanted to put distributors out of business, replace them with eMarketplaces, close transactions online and use 3rd party logistics providers to deliver the goods.

The Veranto team never thought this approach had a future in health care. We recognized that distributors in health care deliver tremendous value-add to the supply chain, above and beyond logistics. They provide sales, marketing and training, storeroom and inventory management, and product packaging and assortment. More critically, they take financial risk upon themselves, buying inventory upfront and taking responsibility for collecting receivables from their provider-customers. At Veranto, we believed distributors would be critical to the success of any electronic marketplace. That's why distributors took center-stage in our B2B approach to the industry.

Second, the health care industry in the United States alone includes upwards of 300,000 providers, about 24,000 manufacturers and approximately 1,200 distributors. Existing B2B marketplaces planned to bring thousands and thousands of players up online, one by one. That was a daunting task. In the pharmaceutical business, successful companies employ thousands of sales reps to go knock on every provider's door. We thought there had to be a better way.

Third, our competitors were faced with the classic ''chicken-and-egg'' problem that plagued every eMarketplace on the Web. To create a liquid market, one needs to attract both buyers and sellers. But lacking buyers, online markets were uninteresting to sellers - and vice versa.

Although the solution to the marketplace conundrum was staring everyone in the face, it took a bunch of outsiders to pick up on it: Bring distributors up online! By the fall of 1999, Cimtek had been working with distributors for more than a year, but from our vantage point, it seemed that the distributors were being pitted against each other in an online marketplace. Those distributors had little choice but to compete on price. Hardly an attractive proposition.

Private Marketplaces for Distributors

Brett and I thought the obvious solution would be to build private marketplaces for each distributor we could sign on, and to structure the marketplaces in a way that would allow optimal cost savings for the distributors. By doing so, we would have addressed each of the issues which the existing B2B marketplaces failed to address properly:

- First, our private marketplace strategy would avoid disintermediation. Instead, we sought to strengthen distributors' position in the medical supply chain.

- Second, we didn't need to knock on hundreds of thousands of doors. Instead, we would sell our Internet solution to distributors, who in turn would seek to bring all of their existing customers and suppliers online.

- And third, by tackling the center of the transaction rather than the edges, we would never have a chicken-and-egg problem. We would immediately have liquidity in the marketplace, with providers, distributors and manufacturers migrating their existing businesses to the Web.

By November 1999 we had secured a verbal agreement from Midwest Medical Supply in St. Louis, MO, to come on-board as our first, 'lighthouse' customer. In December, sensing that we had hit on something truly unique and bound to be successful, we spun out a pure technology company - Model N - which focused on developing the technological infrastructure necessary to create, operate and maintain private Web-based marketplaces. In parallel, we incorporated Medicea as 'Model V1,' and received our seed investment from Zack Rinat, who remained as chairman but who also became CEO of Model N. By January 2000 we had signed a contract with Gary Reeve at Midwest Medical, and in late February Nimrod Goor joined us as CEO, allowing me to focus on marketing and prepare the company for an early-summer launch.

In March 2000 a beta version of our system was up and running. We conducted our first end-to-end transaction, with Sue Anthony, central supplies manager for Parkside Meadows Retirement Community in St. Charles, MO. Here's how it worked:

1. Ms. Anthony placed the order online.

2. The order traveled from Parkside Meadows to our servers in San Jose, CA, and then to Midwest Medical's ERP system in St. Louis, where it triggered the ''pick, pack and ship'' process.

3. Midwest's system then generated an invoice for Ms. Anthony's order.

4. She received notification and was immediately able to go online to view her invoice.

This was the first time a Web-based end-to-end transaction had taken place in the health care industry, and we had done it!

In April we signed a deal with Bill McLaughlin at IMCO to create private eMarketplaces for IMCO's 120 distributor members. In retrospect, our presence and presentation at IMCO's annual conference days later was the high point of Veranto's short history.

In May we changed our name to Veranto, and in June we launched the company - and went live with Veranto 1.0, running Midwest Medical's private eMarketplace. By the end of the summer of 2000 we were clearing transactions at a rate that was to exceed the combined total of all other eMarketplaces in existence at the time - if we could keep the pace up. IMCO distributors were signing up for implementations left and right, and the future could not have looked better-.except that this was also the beginning of our downturn.

The Decline

Three major factors brought about Veranto's decline.

When we spun out Model N in the winter of 1999, we were all operating as one cohesive team. But Model N was to grow much faster than Veranto. In June 2000, Model N raised a first round of $30 million from Accel Partners and KKR (Kohlberg Kravis and Roberts, the legendary leveraged buyout firm), as well as from such notable persona as Eric Schmidt, then CEO of Novell, and Marc Andreesen, founder of Netscape and CEO of Loudcloud. Jim Breyer - in the view of many the No. 1 venture capitalist in the Valley, if not the world - joined Model N's Board of Directors. Model N began the build-up of a new management team, and set a course to sign up Fortune 500-type customers. While they were absolutely committed to supporting Veranto's technological needs, our timelines and priorities began to diverge.

In the meantime, our fledgling customers, Midwest Medical, Midland Medical, St. Louis Homecare and others, were actively migrating business to their private marketplaces. However, they began to voice concerns and demands pertaining to the design and operation of the Veranto system. Since we had virtually outsourced all of our technological capabilities to Model N, we were dependent on Model N for execution - and, understandably, we were no longer Model N's sole customer. Our customers refrained from migrating additional accounts to their private marketplaces until their demands were met - and rightly so. But, as a result, the level of transactions pumped through our marketplaces was to remain at end-of-summer levels for several months to come.

The second factor was somewhat related to the first. As Model N's strategy shifted, we decided to pursue the kind of ''big name'' accounts that would grab Model N's attention - Cardinal, McKesson, Owens and Minor, and so forth. In the ensuing months we devoted much of our bandwidth to pursuing these accounts. We became entangled in a head-to-head race with Ariba to land the McKesson eMarketplace contract. We never won any of the big contracts. Worse, we lost steam with many smaller distributors who had been eager to jump on board with us.

The third factor was one that we could have neither predicted nor controlled, namely, the souring of the stock market. The high-tech market had begun its long downward slide in late March 2000. Zack had followed up on his seed investment in Veranto with a first round in late spring, but funds were running low. We would be penniless by the end of 2000 if we did not raise a second round of venture capital from external investors. But as we kept postponing going out and presenting to the VCs, venture capitalists were making fewer and fewer investments - particularly in health care technology, with absolutely nothing being funneled to B2B plays in the industry.

Not a Single Dollar

By mid-November 2000, when we finally did get out in front of investors, conditions were abysmal. While no investments were being made, Veranto revenues had been flat for the past three months, and our customers were still waiting on promised fixes and upgrades. Understandably, they could not support us with the level of enthusiasm that would be needed to land any kind of financing in what turned out to be the bleakest VC market in over a decade. Needless to say, we did not raise a single dollar.

We met with great success at the eHealthcare conference in New York that December. Interest in our platform was at a peak; everyone was writing about us, and analysts began to sing our praises. Yet our bank account was rapidly approaching zero. Later that month Zack was to give us emergency financing amounting to several hundred thousand dollars, in the hope that we would close a multimillion-dollar deal with McKesson by mid-February 2001. Ironically, by January we had released the fifth upgrade to Veranto 1.0, and our customers were thrilled. They began migrating new provider accounts to their private marketplaces immediately. The first two weeks of February were record setting - double our best two-week period ever. But it was too late in the game.

By the first week of February, we came to understand that we probably would not get the McKesson contract. We began to talk more openly with our team, in an effort to prepare them for what was to come. By the second week of February, the inevitable was quite clear. Following the February 15 payroll, we would be left with $60,000, hardly enough to continue running a company with 25 employees. The next few days were almost like one long meeting, with all of us trying to creatively find a way to keep the Veranto flame burning.

Zack made it clear he would not sink any more of his personal funds into the company - he had committed millions of dollars by that time, and not one of us stood to lose more than he already had. The Model N board met and rejected the possibility of Model N taking a position in Veranto. On the evening of February 14, we basically made the decision to close the company - but still prayed for the McKesson decision to come through.

But on the morning of February 15 we learned that McKesson awarded the multimillion-dollar contract to Ariba. The entire Veranto team gathered in the conference room at 5000 Shoreline Court in South San Francisco for what was to be the last time.

Veranto management (myself included!) had failed to set aside the required funds to pay for accrued vacation and severance. In fact, the company owed Model N several hundred thousand dollars on top of the company's debts to employees. Zack wrote a personal check, amounting to many thousands of dollars, to pay for accrued PTO and severance for our 25 employees. Model N took over the assets of Veranto, including the brand, the health care marketplace application, and our customers. And Veranto was to be no more.

Midwest Medical continues to operate its private marketplace as a Model N customer. All other Veranto customers decided to pursue alternative eCommerce strategies. Model N has become extremely successful, landing major deals in the food and services industry as well as with notable manufacturers such as Owens Illinois, the world's largest manufacturer of glass containers. We Verantologists, as we now call ourselves, have gone our own ways. A few stayed on with Model N in various capacities, while most of us went on to pursue the next ''big thing.'' But for all of us, Veranto was a special experience that will always have a special place in our hearts.

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