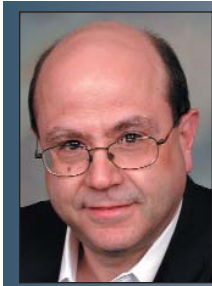


## OPNET: Can Bootstrapping Set The Stage for a Successful Future?

*This is the seventh column in a series. In each I examine one company on the Sustained Success Honor Roll (see page 12) to discover what strategies lead it to long-term success.*

"The Butterfly Effect," a concept within Chaos theory, uses the example *can a butterfly's wings flapping in Brazil cause a tornado in Texas?* to make a point of how a seemingly innocuous initial random event can potentially cause devastating effects later. In a similar manner, but towards good purpose, can a decision made in 1986



### EXECUTIVE STRATEGY

Insight from Brian Turchin

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to bootstrap OPNET's business, lead OPNET to ten straight years of profitable growth nine years later? We shall see.

Marc Cohen is Chairman and CEO of OPNET, a network and application performance management software company, while Alain Cohen, Marc's brother, is its president and CTO. Together, they have compiled a remarkable record of ten straight years of profitable growth; that is,

they grew and were profitable each year from 1995 to 2004.

And in the last four years, one of the most dismal periods ever for our industry, they have achieved some outstanding results:

- They tripled their revenue from \$19.2 million to \$56.5 million.
- They successfully scaled their business. While their revenue tripled, their number of employees only doubled, going from 155 employees in 2000 and 307 in 2004.
- They had a very healthy net income, averaging 8.8 percent of revenue per year.

- And, at the end of their 2004 fiscal year, ending March 31, they had \$81.5 million in cash and short term investments with no debt.

All in all, this is a very enviable achievement. How did they succeed?

### Staying Focused and Having Faith in Our Original Product Vision

In the early 1980s, while an MIT undergraduate student, Alain completed a thesis project that modeled the performance of a computer network. At the time, he reasoned that with the coming proliferation of computing devices and the networking necessary to connect them, there would be a need for such software. His observation was prescient: it was only in 1981 that IBM validated the microcomputer as a tool for business by launching its own micro-computer, the IBM/PC; and it was only in 1983 that Novell released NetWare, one of the first software products that allowed the IBM/PCs to operate in a network.

So, in 1986, when Alain graduated from MIT at the ripe old age of nineteen, he and his brother used \$25,000 to start MIL 3 with network modeling software as its first product. (Prior to going public, in 2000, the company name, MIL 3, was changed to OPNET Technologies.)

But being prescient doesn't necessarily translate into a saleable business product. As we know, the software industry is littered with failed companies started by brilliant engineers. They were enthralled with their technology only to find out, to their dismay, that they had a solution for a business problem that didn't exist.

In 1987, Alain and Marc sold the first copy of their modeler software to MITRE, who still is today a customer-providing some early market validation. But the concept of network modeling software was a very new one in a very nascent market. The business grew slowly, taking ten long years before it reached \$4.9 million in revenue. So when Marc said that he and Alain "picked a product area we believed in and stayed focused on it," he meant it.

Furthermore, they stayed focused on Alain's initial notion in

#### OPNET Financials

year	revenue (mil)		net income (mil)	
2004	\$56.5	22%	\$5.8	10%
2003	\$46.4	4%	\$2.7	6%
2002	\$44.6	36%	\$4.4	10%
2001	\$32.8	71%	\$2.8	9%
2000	\$19.2	60%	\$ .6	3%
1999	\$12.0	1%	\$ .2	2%
1998	\$11.9	38%	\$1.8	15%
1997	\$8.6	43%	\$1.5	17%
1996	\$6.0	22%	\$ .9	15%
1995	\$4.9		\$1.0	20%

(Source: OPNET's SEC filings)

two other ways. First, they stayed focused on solving new and difficult problems as Alain did at MIT. Alain said, "We don't want to reinvent the wheel. We are not going to do what is being done by ten other large vendors who are fighting for market share...So we look into our market space and find the thing that isn't being addressed well by others that customers will want."

And second, they took their core competence, deep knowledge of network modeling, and extended it into new areas. For example, Marc said, "Every company has a network consisting of routers, switches and firewalls. How do you audit the configurations of all those devices? By hand, which is done once a year, if you are lucky, and by that time it is invalid. Or you can completely automate that process, gathering the data, and then, having the data, use advanced analysis to understand if you have routing problems, security problems or performance problems."

Today, the result is, as Alain said, "No single player has the same vision as we have." And according to Marc, their consistent focus has created "hundreds of staff years of intellectual property that is proprietary to us and our secret weapon in this space."

Believing in your product and having a sharp focus is one reason why they are successful. There are two others.

### Building an Intimate Direct Connection Between Your Employees And Your Customers

Here's a story. It's the mid-90s and it's 2 a.m. Todd Kaloudis, who is still at work, is startled by the phone ringing. Who could be calling? Turns out it was Marc Cohen. Kaloudis had just been using OPNET's network modeling software and had run into a problem. So he sent OPNET an e-mail describing the problem.

Cohen happened to be up, saw the e-mail, and called him to help resolve the problem. (Later on, in 1999, based on this experience and others, Kaloudis joined OPNET. He is now the V. P. of Business Development and Marketing.)

When was the last time a software company CEO called you to resolve a problem with his company's software, much less at 2 a.m.? Sometimes a small action is very telling. Cohen's action reflects an intense and committed attitude to satisfying a customer.

Alain and Marc have built such an attitude into their business. How? Here are two examples.

First, like many other software companies, OPNET runs an annual customer conference, OPNETWORK. In 2004 it attracted more than 1,500 attendees from 39 different countries. Like many other software companies their goals in holding the event are the same: direct contact and feedback from customers, including feedback on new products. But, OPNET goes one step further. Since 1997, when they held their first annual technology conference, they have almost their entire staff, now more than 300 employees, participate in the week-long event. Why the whole staff? Marc said simply, "There is a huge benefit for our staff to get to know the customer. No better way." In this manner, employees have a direct experience with customers.

And second, they do something unusual to connect their software engineers directly to customers. Most software companies have a separate group of technicians who answer technical customer calls. To gain exposure to customers and to understand their issues, some companies will have software engineers work for a short time in their call center. But, at OPNET, according to Alain, they go one step further. Software engineers, even senior ones, devote 10 percent to 20 percent of their time to tech support.

Alain started this practice because he "realized how much I get out of talking to customers." Further, he said, "most engineers if given the choice of not handling tech support calls will not give it up."

How do these direct connections help OPNET? Alain said, "We have a very loyal base of customers...and this is an overused word, but in our case, it is a partnership with the customer that cuts both ways...They play their role which is to give us information and then we use that to advance the product..." And he concluded, "That is absolutely the most important ingredient in our success."

And it certainly helps financially as 80 percent of OPNET's revenue is from existing customers.

### Being Conservative

Marc cited "being conservative" as one the reasons for OPNET's success. How does this play out in running OPNET?

- **Don't Spend More Than You Make** - First and foremost it means as Marc said, "...we don't spend more than we make." He continued, "That philosophy was critical for us. If we had spent big, going unprofitable, we wouldn't have survived."

#### 2004 Sustained Success Honor Roll

Out of a total of 573 public software companies—all those on the US exchanges, including ADRs—there are only 15 companies who made this year's 2004 Sustained Success Honor Roll. Each of these companies has the remarkable distinction of achieving profitable growth in each of the past five years, or longer; that is, in each of these years they both grew their revenue and were profitable.

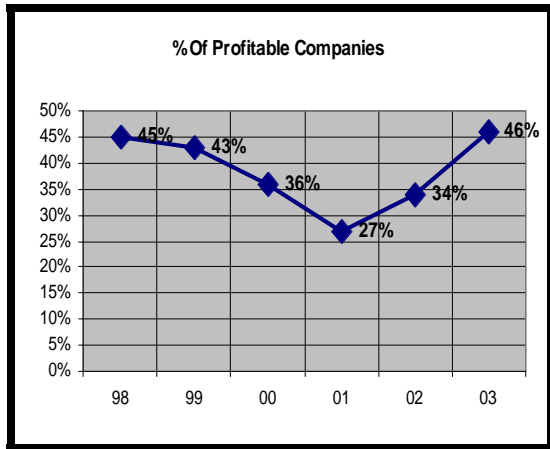
Company	2003 Revenue (in millions)	Consecutive Years of Profitable Growth	Column Written in Software Business
Microsoft	\$32,187.0	23	
Kronos	\$397.4	16	Sep/Nov 2003
Manhattan Associates	\$196.8	14	Nov/Dec 2003
Business Objects	\$560.8	11	May/June 2003
THQ, Inc	\$584.5	9	
Cognizant	\$368.2	9	
OPNET	\$46.4	9	Nov/Dec 2004
Mercury Interactive	\$506.5	8	July/Aug 2003
ANSYS	\$113.5	8	Mar/Apr 2004
Trend Micro	\$437.0	7	Sep/Oct 2004
EPIQ Systems	\$67.9	6	
Infosys	\$753.8	6	
SRA International	\$450.4	6	
Open Text	\$177.7	5	
Quality Systems	\$54.8	5	

Source: Cape Horn Strategies, Inc. Updated 10-12-04

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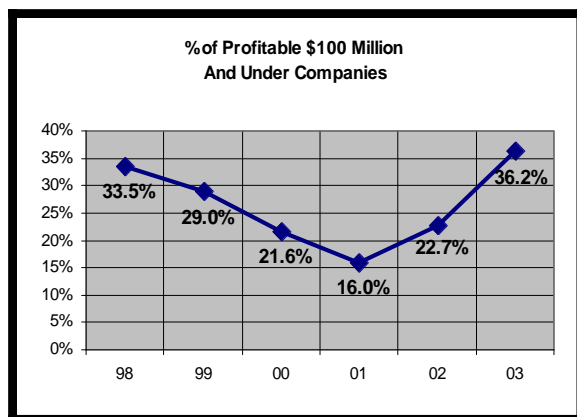
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The idea that you actually collect more money than you pay out is fundamental to business. Yet, it is something that we as an industry have a terrible time understanding. Even in the go-go years of 1998 and 1999, the industry, as represented by public software companies, was unprofitable.



Source: Cape Horn Strategies, Inc.

And it's even worse if you are a company with \$100 million in revenue or less. Looking at just this group, our industry performance is downright miserable. In 2001, only 16 percent of these companies managed to be profitable!



Source: Cape Horn Strategies, Inc.

So when Marc says it is fundamental for him to run a profitable business, this is a major strategy statement. It is one he acted on from his company's start. Even though I show 10 straight years of profitability starting in 1995 -- in and of itself quite a difference from other companies in its category -- according to Marc they have been cash-flow positive since their second year in existence, 1987, when they sold their first product.

• **Manage Your Growth** - Marc said, "Almost from the beginning, since we generated cash, it gave us some flexibility to grow and add people. But I didn't want to hire people too fast. I wanted to control the process. If I added people its true that I might have ended up making more money, but then I might have lost our culture, or at worst, it might have ultimately ended up destroying our company."

• **Don't Bet Your Business on Acquisitions** - We have seen major acquisitions go awry. Compaq bought a very large but trou-

bled Digital Equipment Corporation, which only caused more trouble. Hewlett-Packard bought a troubled Compaq and is still having digestion problems. Marc is not looking to double the size of his company through an acquisition. Marc said, "Because we are conservative, we are not going to bet the company on acquisitions. We are not going to go out and through an acquisition double the size of our business because that action could easily go south."

• **Avoid Outside Hype and Pressure by Knowing Who You Are** - What do you do if you're conservative and you are buffeted by the hype of the Internet frenzy? "...Everyone was telling us you need to grow faster, you need to go into debt. And we decided not to do any of that... It felt unnatural because we couldn't see exactly when we would recover all these expenses if we went into debt. It goes against our grain." To resist the siren call of the Internet frenzy required a strong conviction and focus that said you had confidence in what you were doing and it was the right thing.

• **Seek a Venture Capitalist Firm's Help When You Want to Go Public** - Even though the Cohen brothers steadfastly avoided venture capital funding, they decided they could use the help of the right venture capital firm in another way. Eventually they did want to take their company public. So they wanted an experienced firm who could help them prepare their company for a successful IPO. As Marc said, "You only get one chance to do it right." In 1997, they concluded a deal with Bruce Evans of Summit Partners. OPNET received \$7 million in exchange for 15percent ownership of the business and Evans joined their board.

How did Evans help? "One of the first things Evans said was, as the CEO, I don't have the time to run the sales organization. I need a professional sales executive to come in here and run it for me. So he said he would get a top-notch recruiting firm and interview people," said Marc. With recommendations like this and others, Evans helped OPNET prepare for what one of the strongest IPOs in 2000.

In each of these conservative strategies the Cohen brothers chose an option that lowered their risk while increasing their probability of success.

What of the future? According to Marc, OPNET is now positioned to reach its next revenue target of \$100 million. Let's return to the question that I asked at the outset of this column.

## The Butterfly Effect

Bootstrapping, as Alain and Marc did, is a very unforgiving experience that has a brutal logic about it. No cash; no business. Very simple. Generating and preserving cash, as a result, becomes a bootstrapper's primal instinct.

If you want to be successful, bootstrapping leads to the strategies that the Cohen brothers adopted. To prevent a cash deficiency, run a profitable business. To preserve cash, keep your business focus. To generate cash, build a partnership with your customers so they stay with you, forever.

So did the Cohen brother's bootstrapping decision in 1986 lead OPNET to ten straight years of profitable growth nine years later. You bet.