
**IT Security Sector
Monthly Report**

October 2002

Public Security Market Overview	3
Security Trading Data	4
Market Observations	5
Security M&A Activity YTD	6
Security Investment Activity April – October	7
Deal Focus: NetIQ Buys PentaSafe	8

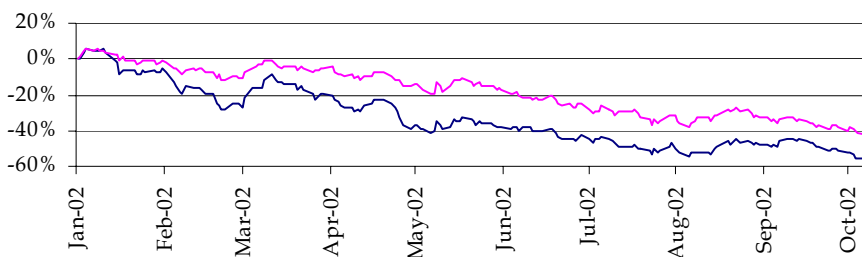
Udata Capital, Inc. Disclaimer

The information and opinions in this report were prepared by Udata Capital, Inc. ("Udata"). The information herein is believed by Udata to be reliable and has been obtained from and based upon public sources believed to be reliable, but Udata makes no representation as to the accuracy or completeness of such information. Udata may provide, may have provided or may seek to provide M&A advisory services to one or more companies mentioned herein. In addition, employees of Udata may have purchased or may purchase securities in one or more companies mentioned in this report. Opinions, estimates and analyses in this report constitute the current judgment of the author as of the date of this report. They do not necessarily reflect the opinions of Udata and are subject to change without notice. Udata has no obligation to update, modify or amend this report or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, estimate, forecast or analysis set forth herein, changes or subsequently becomes inaccurate. This report is provided for informational purposes only. It is not to be construed as an offer to buy or sell or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy in any jurisdiction.

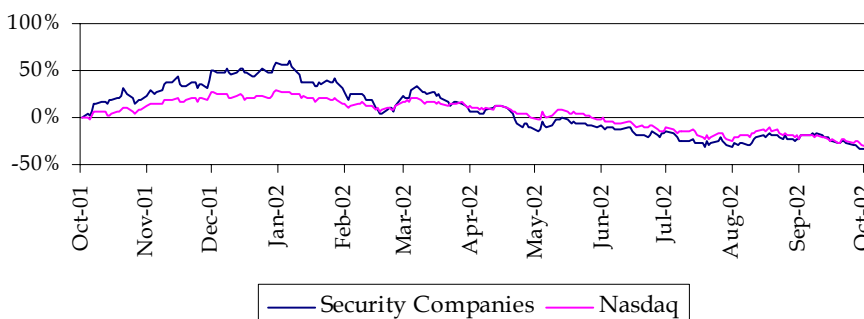
Public Security Market Overview (at 10/11)

- Price Performance:** The average share price of Udata's IT security index declined 55% year-to-date, and 34% over the last 12 months. This compares to NASDAQ's YTD 39% and LTM 29% declines. The Udata index trades at 33% of its 52-week high, down from 44% at the start of 2002. NASDAQ is presently at 59% of its 52-week high. The last several weeks have seen significant price declines in sympathy with the broader technology market, driven most directly by concerns over expected weak quarterly results.
- Trading Multiples:** Udata's security index trades at mean Enterprise Value/Calendar Year 2002E Revenue and EBIT multiples of 2.4x and 19.3x respectively (1.3x and 13.6x median), down about 10% from early September's multiples and 50% from the start of 2002. Twelve of 36 companies trade at 2002E revenue multiples of less than 1.0x, including four with negative enterprise values (market valuations less than cash value). Five companies have market capitalizations greater than \$1 billion: Check Point, Network Associates, Symantec, Trend Micro and VeriSign.
- 3Q 2002 Results:** Next month's security report will detail September's quarterly announcements. As of this writing: Network Associates pre-announced revenues and EPS exceeding estimates; Rainbow pre-announced EPS in line with expectations; Check Point pre-announced lower than expected revenues but EPS in line with expectations; and Hifn, SonicWALL and Valicert pre-announced they would under-perform revenue and EPS quarterly guidance.

YTD Security Sector Price Performance



LTM Security Sector Price Performance



Security Trading Data (at 10/11)

Company	Market Value			Enterprise Value as a Multiple of		Equity Multiples		
	Current Price	% of 52 Week Hi	Market Cap	Enterprise Value	Revenues	EBIT	Price / Earnings	
	\$		\$	\$	LTM	CY 2002	LTM	CY 2002
ACTIVCARD SA	6.70	46.6%	276.6	32.1	1.0x	0.8x	NM	NM
BINDVIEW DEVELOPMENT	0.82	26.8%	42.4	NM	NM	NM	NM	NM
CERTICOM	0.65	15.9%	20.6	13.7	1.1x	1.1x	NM	NM
CHECK POINT	14.92	30.2%	3,783.1	2,600.7	5.7x	6.0x	9.2x	10.0x
CYBERGUARD	3.20	72.7%	60.4	55.3	2.4x	NA	NM	NA
CYLINK	0.41	10.9%	13.5	3.0	0.1x	0.1x	NM	NM
DIGIMARC	11.21	52.0%	193.9	141.7	3.1x	1.7x	NM	NM
DIVERSINET	0.25	13.5%	7.0	2.9	4.7x	NA	NM	NA
ENTRUST TECHNOLOGIES	3.12	23.5%	202.1	55.8	0.5x	0.5x	NM	NM
GEMPLUS	1.23	17.8%	746.1	384.4	0.5x	0.4x	NM	NM
HI/FN	4.13	20.1%	43.3	NM	NM	NM	NM	NM
IDENTIX	4.52	28.7%	379.2	324.4	3.1x	3.1x	NM	NM
INTERNET SECURITY	15.85	38.2%	775.5	601.5	2.6x	2.5x	31.5x	19.9x
INTERTRUST	2.99	90.1%	287.8	161.5	33.5x	NA	NM	NA
INTRUSION	0.39	18.1%	8.1	NM	NM	NA	NM	NM
MACROVISION	12.02	29.5%	617.1	439.1	5.5x	4.5x	11.5x	12.2x
MCAFFEE.COM	17.54	41.1%	858.0	746.3	10.1x	8.7x	36.1x	33.9x
NETEGITY	1.67	7.8%	56.8	NM	NM	NM	NM	NM
NETSCREEN	12.41	44.4%	885.0	649.5	5.2x	4.6x	156.7x	59.0x
NETWORK ASSOCIATES	11.89	39.0%	1,750.5	1,212.9	1.3x	1.3x	13.3x	13.6x
NETWORK-1	0.42	17.4%	3.2	NM	NM	NA	NM	NA
RAINBOW TECHNOLOGIES	3.49	27.3%	92.4	55.0	0.4x	0.4x	NM	27.5x
RSA SECURITY	2.93	14.9%	165.6	171.0	0.7x	0.8x	NM	NM
SAFENET	14.57	67.3%	115.6	89.6	4.5x	2.8x	NM	37.3x
SECURE COMPUTING	3.08	12.4%	90.3	72.0	1.2x	1.1x	NM	NM
SONICWALL	2.30	10.5%	154.4	NM	NM	NM	NM	NM
SYMANTEC	34.40	79.8%	4,990.3	4,062.9	3.5x	3.4x	13.1x	13.4x
TIPPING POINT	9.93	73.6%	40.3	5.9	NA	NA	NM	NA
TREND MICRO	24.25	78.4%	3,191.1	2,859.8	8.8x	8.2x	44.2x	25.9x
VALICERT	0.37	11.3%	9.5	0.7	0.0x	0.1x	NM	NM
VASCO DATA SECURITY	1.15	32.9%	32.5	36.2	1.7x	1.2x	NM	NM
VERISIGN	5.35	10.0%	1,264.9	1,043.3	0.9x	0.8x	4.9x	5.8x
VIISAGE	3.81	22.7%	76.0	76.6	2.7x	NA	NM	NA
V-ONE	0.18	9.1%	4.4	7.3	1.6x	NA	NM	NA
WATCHGUARD	3.60	27.7%	115.5	22.8	0.4x	0.3x	NM	NM
WEBSENSE	12.91	36.9%	268.2	148.4	3.1x	2.4x	19.8x	12.4x

* Numbers in italics not included in calculations

Mean	2.7x	2.4x	20.4x	19.3x	45.8x	41.1x
Median	2.4x	1.3x	13.3x	13.6x	33.0x	35.2x

Market Observations

- **M&A Activity:** At least three IT security acquisitions have been announced since late September (page 6), including NetIQ's \$255 million purchase of PentaSafe (page 8). Year-to-date, at least 25 security deals have been announced. The average Purchase Price/Trailing Revenue multiple among deals for which data is available is 12.8x (10.3x median).
- **Investment Activity:** At least six investments in IT security companies were announced in the first half of October, and another six in September. Udata records at least 56 security investments since April totaling \$571 million (page 7). Number of investments by type: A - 15; B - 25; C - 8; D/E - 3; Private Placement - 5. Average investment size: \$10.4 million.
- **Public-Private Valuation Disparities:** Notwithstanding low trading values for public IT security companies, reported M&A valuations remain strong. Highly valued targets participate in promising sectors and all possess two or more of these characteristics: market leadership, critical mass, growth and profitability. For such security leaders, there is little pressure to sell and there are typically multiple suitors, driving robust deal multiples. Other companies seeking to sell today tend to find the opposite holds true. Private equity/VC investments made at premiums to public values may be justified to the extent investors believe their company is - or has the potential to become - a security leader.
- **Insiders Remain Greatest Security Threat:** A recent study by PwC, the U.S. Chamber of Commerce and the American Society for Industry Security found that insiders - ex-employees and contractors - remain the biggest security threat, ahead of hackers.
- **Spam and Antivirus Converge:** Spam has become a security issue due its ability to hide viruses and facilitate fraud, as well as its often objectionable content. Most providers of e-mail content scanning solutions, e.g. MessageLabs and Sybari, have partnered with antivirus vendors to offer a bundled solution. Antivirus vendors have recently begun adding spam capabilities to their offerings: McAfee acquired a product called SpamKiller and Symantec's Norton Internet Security 2003 includes a feature called Spam Alert. Expect continuing consolidation of message scanning with antivirus and web filtering firms.
- **Recent Partnership Announcements:** Websense partners with Cisco to integrate its Internet usage management and monitoring functionality with Cisco routers; RSA partners with PeopleSoft to enable customers to securely manage user access and administration; VeriSign partners with Intel to integrate VeriSign certificate solutions into notebook PCs.
- **Government Security Demand to Grow:** The federal government recently issued a draft report describing its strategy to secure cyberspace, and proposes spending \$4.5 billion to secure IT systems in 2003, and \$20 billion in 2004-06. While subject to congressional approval, the proposed budget increases highlight the importance of government channels. Among recent government security deals, Trend Micro and Network Associates each announced five-year, multi-million dollar contracts to provide antivirus solutions to the Department of Defense. At the state level, Viisage Technology received a \$2.4 million contract to expand its facial recognition project with the Pinellas County, FL Sheriff's Office.

Security M&A Activity YTD

Ann't Date	Seller	Buyer	Deal Value (\$ MM)	Est. LTM Rev (\$ MM)	Mult of LTM Rev	Description
Oct-02	TTR	Macrovision	NA	NA	NA	Digital copy protection
Oct-02	PentaSafe Security	NetIQ	\$255	\$30	8.5 x	Security policy management
Sep-02	Baltimore Hardware Assets	AEP Systems	\$6	NA	NA	Cryptographic hardware
Aug-02	Traxess	Network Associates	NA	NA	NA	Network forensics
Aug-02	PGP (NET)	PGP Corporation	\$14	NA	NA	Desktop, wireless encryption assets
Aug-02	OneSecure	NetScreen Technologies	\$40	\$2	23.0 x	Intrusion detection/prevention
Aug-02	vCIS	Internet Security	\$20	NA	NA	Behavioral inspection based IDS
Aug-02	Entact Information	ASG Software	\$5	NA	NA	Access management
Jul-02	Response Networks	Open Systems	NA	NA	NA	Service level and event mgmt
Jul-02	McAfee.com (remaining 25%)	Network Associates	\$762	\$74	10.3 x	Online antivirus, PC mgmt software
Jul-02	Riptech	Symantec	\$145	\$15	9.7 x	Managed security services
Jul-02	Recurse Technologies	Symantec	\$135	\$10	13.5 x	Signature & anomaly based IDS
Jul-02	SecurityFocus	Symantec	\$75	\$3	30.0 x	Threat intelligence services
Jul-02	Mountain Wave	Symantec	\$20	\$3	8.0 x	Event data monitoring, correlation
Jun-02	Veritect (Veridien)	Red Siren	NM	NA	NA	Managed security services
May-02	Fipoint	Secure Computing	NA	NA	NA	Authentication management
Apr-02	Karthika Technologies	Kasten Chase	\$8	NA	NA	Data encryption
Mar-02	Biometrica Systems	Viisage	\$2	NA	NA	Facial biometrics
Feb-02	Visionics	Identix	\$284	\$30	9.5 x	Biometrics
Feb-02	Gauntlet (NET)	Secure Computing	NA	NA	NA	Firewall/VPN assets
Feb-02	Telenisus	Forsythe Solutions	NA	NA	NA	Security consulting assets
Feb-02	Rapid Stream	Watchguard Technologies	\$48	NA	NA	ASIC Firewall/VPN appliances
Jan-02	LAU Security Systems	Viisage	\$28 royalty	NM	NM	Facial biometrics
Jan-02	Content Technologies	Clearswift	\$30	NA	NA	E-mail/Web content security
Jan-02	Three Pillars	TruSecure	NA	NA	NA	Managed security services

Security Investment Activity April - October (at 10/11)

Date of Round	Company	Sector	Amount Raised (\$MM)	Round
Oct-02	nCircle	Vulnerability Assessment, Management	\$20.0	C
Oct-02	Vormetric	Stored Data Security	\$10.0	B
Oct-02	Intruvert	Intrusion Prevention Appliance	\$15.5	C
Oct-02	Interlink	Wireless Network Security	\$7.5	B
Oct-02	Tipping Point	Firewall/VPN/Intrusion Detection Appliance	\$10.0	Private Placement
Oct-02	Permo Technology (NEC spin-out)	Application Security, Authorization	\$5.0	B
Sep-02	BigFix	Security Patch Management	\$8.0	B
Sep-02	Cranite	Wireless Network Security	\$12.0	C
Sep-02	AEP Systems Ltd.	Cryptographic Appliances	\$7.9	C2
Sep-02	Zix	Secure Messaging	\$16.0	Private Placement
Sep-02	Columbitech AB	LAN Communication Security	\$2.7	C
Sep-02	Finjan Software	Behavior anti-virus	\$8.5	E
Aug-02	Cigital	Software Vulnerability Management	\$4.0	A
Aug-02	ShieldIP	Digital Rights Management	\$4.2	A
Aug-02	Cenzic	Security QA	\$8.0	A
Aug-02	e-Security	Threat Information Management	\$10.0	B
Aug-02	Vigilos	Security Data Management	\$7.6	A
Aug-02	Arxan	Digital Asset Protection	\$3.0	A
Aug-02	Fortress Technologies	Wireless Security	\$13.0	B
Aug-02	Ecutel	Wireless Security	\$4.5	B
Aug-02	Arbor Networks	Anomaly detection	\$22.0	B
Aug-02	NetMotion Wireless	Wireless security	\$5.0	B
Aug-02	Zero-Knowledge	Privacy software	ND	D
Jul-02	Sonera SmartTrust AB	Wireless security	\$34.0	Partial buyout
Jul-02	V-One	VPN technology	\$1.0	Private Placement
Jul-02	Arrowsight	Surveillance	\$1.5	A
Jul-02	SafeStone Technologies	Access Control	\$4.0	B
Jul-02	Company51	Intrusion Prevention	\$10.0	A
Jul-02	AppGate	VPN	\$2.5	B
Jul-02	Fortinet	Content Protection	\$9.0	B
Jul-02	Priva Technologies	Authentication	\$4.5	A
Jul-02	Thor Technologies	Access Rights Management	\$19.0	B
Jun-02	Sourcefire	Intrusion Detection	\$5.5	A
Jun-02	Lumeta	Network discovery, VA	\$8.0	C
Jun-02	Mazu Networks	DDoS Prevention and Filtration	\$12.0	B
Jun-02	Vocent Solutions	Authentication	\$7.2	B
May-02	Securify	Network Monitoring	\$13.0	B
May-02	Axcelerant	VPN Services	\$9.0	B
May-02	Sophos	Anti-Virus	\$60.0	B
May-02	Zone Labs	Firewall	\$24.5	C
May-02	Riverhead Networks	DDoS Prevention	\$9.0	B
May-02	Recurse Technologies	Vulnerability Assessment	\$11.0	D
Apr-02	Bluesocket	Wireless Security	\$16.0	B
Apr-02	Skybox Security	Vulnerability Assessment	\$5.0	A
Apr-02	Accelerated Encryption Processing	Encryption	\$13.0	B
Apr-02	Guarded Networks	Managed Security Services	\$2.0	A
Apr-02	Cavium Networks	Network Security Processors	\$15.5	B
Apr-02	Cipher Optics	Encryption	\$5.0	A
Apr-02	Imprivata	Authentication	\$13.5	A
Apr-02	NeoScale	Storage Security	\$13.0	A
Apr-02	Diversinet	Wireless PKI	\$3.1	Private Placement
Apr-02	Cyber-Ark	Data encryption	\$12.0	B
Apr-02	JetNet	MSSP	\$1.3	C
Apr-02	ArcSight	Risk Management	\$9.5	B
Apr-02	Lancope	Intrusion Detection	\$5.5	A
Apr-02	NetSec	MSSP	\$7.5	B

Sources: The Deal, IPO.com and other public sources

TOTAL Raised Apr-Oct 2002	\$571.0
----------------------------------	----------------

Deal Focus: NetIQ buys PentaSafe

NetIQ's Oct. 1 agreement to purchase PentaSafe marks the continuing convergence of systems and security management.

Transaction Summary

<u>Buyer/Target</u>	<u>Ann't Date</u>	<u>Offer Value \$mm</u>	<u>Est. Run-rate Revs Multiple</u>	<u>Target Description</u>	<u>Buyer Financial Impact</u>
NetIQ Corp./ PentaSafe Security	10/1	\$192.5 cash + \$62.5 stock (4.3 mm shares)	6.4x	Security policy, privilege and vulnerability management solutions.	Modestly dilutive for 6 - 9 months.

Acquisition Rationale

- PentaSafe's policy, password, vulnerability and intrusion event management solutions complement NetIQ's performance, availability, directory and user management products, enabling the two to capitalize on the convergence of security and systems management.
- The combination helps differentiate NetIQ from larger systems management vendors like BMC and IBM. The ability to offer cross-platform products will also offset an expected decline in NetIQ's Microsoft-related revenues resulting from increased product overlap.
- Other synergies: Both companies' security operations are in Houston and will be combined; PentaSafe's 1,300 customers in similar target markets offer cross-sell potential.
- NetIQ is comfortable doing deals that are large for its size: NetIQ bought WebTrends in 2001 for \$212 million, and merged with Mission Critical in a \$1.4 billion stock swap in 2000.

Implications

- PentaSafe was widely viewed as a viable IPO candidate. NetIQ, which said it will keep all of PentaSafe's products, has in effect taken PentaSafe public while adding greater critical mass than a standalone IPO could. Post-closing, NetIQ will generate almost 40% of its revenues from security products and increasingly compete with other security vendors.
- Expect continued convergence of network and security management sectors through acquisitions (e.g. July merger of Open Systems with Response Networks), and partnership and product announcements (e.g. Network Associates' release last week of Network Performance Orchestrator).
- NetIQ said it would require six to nine months to integrate PentaSafe's organization and technologies, and to align the organization with the broader product set. During this time, competitors will likely take strategic actions to counter perceived threats posed by the combination, accelerating system-security convergence.