
IT Security Sector
Monthly Report

November 2002

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Public Security Market Overview

- **Strong Share Price Performance:** Udata's index of 34 pure-play public IT security firms jumped 37% in value since the beginning of September, and 28% over the past four weeks ended November 22, in a climb reminiscent of late last year. The NASDAQ index rose 16% and 13% respectively during these periods. The Udata security index currently trades at 46% of its 52-week high, up from 44% at the start of 2002. NASDAQ is presently at 71% of its 52-week high. Security share price increases reflect a combination of: reported improvements in financial performance; growing evidence of an increase in enterprise and government security spending in 2003; and several recent high profile acquisitions.
- **Trading Multiples:** Udata's security index trades at mean Enterprise Value/Calendar Year 2003E Revenue and EBIT multiples of 2.8x and 23.2x respectively (2.1x and 18.7x median). The average PEG ratio for the universe is 1.7x. Nine of 34 companies trade at Enterprise Value/2003E revenue multiples of less than 1.0x. Six companies trade at 2003 revenue multiples of greater than 5.0x. The ten companies with the largest market capitalization represent 87% of the universe's total market capitalization of \$22.3 billion.
- **3Q 2002 Results:** Average third quarter revenues grew 5.4% sequentially over the second quarter of 2002, and 38.9% over the prior year third quarter (2.9% and 10.8% median growth respectively). Eighteen of 34 security companies reported sequential quarterly growth, and 22 reported year-over-year quarterly revenue growth. Twenty of 27 companies for which EPS projections are available are projecting positive net income in 2003. In the third quarter, companies with positive operating income reported average and median EBIT margins of 18.9% and 14.7%.
- **Consolidation Continues:** At least seven IT security acquisitions were announced from October through mid-November, including two public-to-public deals: the acquisition of Cylink by Safenet, and of InterTrust by Philips and Sony. Acquirors have spent over \$2.2 billion year-to-date acquiring pure-play security companies (page 6). The average Purchase Price/Trailing Revenue multiple among deals for which data is available is 13.9x (9.2x median).
- **Investment Activity Heats Up:** At least 16 investments in IT security companies, including six A round investments, were announced from October through mid-November. These investments totaled more than \$120 million. Udata records at least 46 security investments since June totaling almost \$400 million (page 7). Security investments are on pace to reach close to \$1 billion in 2002, roughly flat with 2001.

Security Trading Data (at 11/22)

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	LTM	LTM	CY2003
ACTIVCARD SA	8.80	61.2%	364.7	120.9	3.3x	2.1x	NM	183.3x
BINDVIEW DEVELOPMENT	1.29	42.2%	65.9	27.6	0.4x	NA	NM	NA
CERTICOM	0.75	29.1%	23.8	17.3	1.4x	0.8x	NM	12.5x
CHECK POINT	17.46	35.3%	4,273.1	3,032.3	6.9x	6.9x	11.3x	17.5x
CYBERGUARD	4.15	94.3%	79.6	72.5	2.7x	NA	NM	17.7x
DIGIMARC	15.95	74.0%	278.5	225.5	3.2x	2.2x	NM	66.5x
DIVERSINET	0.55	29.7%	14.5	9.6	18.5x	NA	NM	NA
ENTRUST TECHNOLOGIES	3.64	27.4%	236.8	94.2	0.9x	0.9x	NM	NM
GEMPLUS	2.07	30.0%	1,255.9	912.1	1.2x	NA	NM	29.6x
HI/FN	6.19	30.2%	65.0	10.3	0.5x	0.5x	NM	NM
IDENTIX	6.66	42.3%	564.8	518.9	4.5x	5.6x	NM	NM
INTERNET SECURITY	24.17	58.3%	1,169.7	991.2	4.2x	3.5x	37.2x	38.0x
INTRUSION	0.65	30.2%	13.4	0.3	0.0x	NA	NM	NM
MACROVISION	20.15	49.5%	1,001.9	827.1	10.3x	7.8x	23.5x	27.0x
NETEGRITY	3.49	16.3%	119.3	41.5	0.6x	0.6x	NM	NM
NETSCREEN	16.39	58.6%	1,193.1	946.5	6.8x	4.5x	81.4x	43.1x
NETWORK ASSOCIATES	18.04	59.1%	2,694.2	2,245.9	2.3x	2.2x	20.4x	24.8x
NETWORK-1	0.18	8.1%	1.4	NM	NM	NA	NM	NA
RAINBOW TECHNOLOGIES	8.93	69.8%	235.1	193.4	1.4x	1.4x	NM	31.0x
RSA SECURITY	6.75	34.4%	382.7	367.6	1.6x	1.5x	30.4x	51.1x
SAFENET	25.10	115.9%	195.5	167.6	6.0x	3.9x	NM	41.8x
SECURE COMPUTING	8.07	32.4%	234.6	215.2	3.4x	2.8x	NM	43.4x
SONICWALL	3.60	16.4%	242.2	8.2	0.1x	0.1x	NM	59.0x
SYMANTEC	45.81	106.3%	6,626.5	6,057.0	4.9x	4.0x	17.6x	26.9x
TIPPING POINT	10.89	80.7%	44.2	9.8	NA	NA	NM	NA
TREND MICRO	20.01	64.7%	2,649.3	2,278.2	7.0x	5.3x	18.8x	32.6x
VALICERT	0.33	10.4%	8.5	4.3	0.3x	0.3x	NM	NM
VASCO DATA SECURITY	1.25	35.7%	35.5	40.9	1.9x	1.8x	NM	NM
VERISIGN	10.59	19.8%	2,509.4	2,182.3	2.1x	1.9x	12.9x	17.8x
VIISAGE	4.35	29.0%	88.0	92.7	3.0x	NA	NM	NA
V-ONE	0.25	12.6%	6.5	6.8	1.5x	NA	NM	NA
WATCHGUARD	6.39	49.2%	206.7	115.6	1.8x	1.2x	72.2x	64.5x
WEBSENSE	24.71	70.6%	526.8	398.4	7.3x	4.5x	39.8x	37.7x
ZIXIT	3.89	39.2%	70.5	65.7	55.7x	NA	NM	NA

* Numbers in italics not included in calculations

	Mean	Median
Enterprise Value as a Multiple of Revenues	3.5x	2.8x
Enterprise Value as a Multiple of EBIT	23.6x	20.4x
Price / Earnings	52.4x	56.0x

Industry Observations

- **Demand Growth Higher among Smaller Businesses:** A study recently released by Access Markets International projects 31% annual growth in demand for security solutions through 2007 by small to mid-sized U.S. businesses (SMBs). Demand drivers include: increasing use of the Web and network technologies by smaller companies, and increasing broadband access. Security companies positioned to benefit from growth in the SMB market include providers of outsourced/ASP solutions, packaged solutions and appliances.
- **Large Vendors Highlight Focus on Public Education Markets:** In recent weeks, vendors including Symantec, Network Associates, SonicWALL and Secure Computing have touted growing revenues from sales to public school districts. For example, SonicWALL noted that unit sales of its Education Editions security line doubled in Q3 2002 over the prior year quarter, and Secure Computing announced that it sold its web filtering software pre-installed on Cisco's content engine to several school districts to help schools meet the requirements of the Children's Internet Protection Act.
- **Government Security Vulnerabilities Persist:** The General Accounting Office recently reported to Congress that it found "pervasive" security weaknesses in federal technology systems at the 24 largest departments and agencies. Of particular concern were weak protections against insiders attempting to sabotage systems or trying to steal information. The GAO also noted an improvement in security auditing, which it predicted would likely increase the number of faults discovered even as overall security improves.
- **Government Looms Large over Vendor Strategy:** Expected increases in government security spending in connection with homeland security initiatives are impacting vendor strategies in many respects. For example, SafeNet noted Cylink's strong government customer base as a factor driving its recently announced acquisition. ActivCard filed a form S-4 in late September to reincorporate its domicile from France to the U.S., and stated that increasing business with the U.S. Department of Defense was one reason for the change.
- **Security Demand Set to Grow – May Exceed Analyst Expectations:** A November Gartner Group survey of 846 companies points to increasing security spending in 2003, against a backdrop of flat corporate technology budgets. This prediction of security demand growth is affirmed by most other industry analysts. IDC for example has projected overall annualized demand growth in the range of 20%. Spending may actually exceed such projections for several reasons. First, surveys do not fully account for new customer growth; for example, an increase in new business and government customers from Africa and the Middle East, which has already begun to take place. Second, as security awareness grows so will the recognition of network vulnerability, which may boost spending further. Third, industry analysts have sometimes been criticized for over-optimism in the past and therefore may now in some cases be overly conservative in their assessments. Time will tell.

Security M&A Activity YTD

Ann't Date	Seller	Buyer	Deal Value (\$ MM)	Est. LTM Rev (\$ MM)	Mult of LTM Rev	Description
Nov-02	InterTrust	Philips and Sony	\$328	\$12	28.0 x	Digital content protection
Nov-02	Intel Network Systems	SimpleAccess (Shiva)	NA	NA	NA	VPN technologies
Nov-02	Midbar	Macrovision	NA	NA	NA	Digital copy protection
Oct-02	Cylink	SafeNet	\$29	\$34	0.9 x	Encryption solutions
Oct-02	Psionic	Cisco Systems	\$12	NA	NA	Behavioral IDS technology
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	\$625	\$74	8.4 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	\$259	\$30	8.6 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 June - mid-November

Date of Round	Company	Sector	Amount Raised (\$MM)	Round
Nov-02	MagiQ Technologies	Quantum Cryptography	\$6.9	A
Nov-02	FaceTime	Instant Messaging Security	NA	E
Nov-02	Bluefire	Wireless Device Security	\$6.0	B
Nov-02	GuardedNet	Threat Information Management	\$9.0	A
Oct-02	Lurhq	Managed Security Services	\$2.0	NA
Oct-02	Authentica	Secure Messaging	\$4.0	B
Oct-02	DataDomain	Stored Data Security	\$9.3	A
Oct-02	InkSure	Anti-counterfeiting Technology	\$6.7	A
Oct-02	Lumidigm	Biometrics Management	\$5.0	A
Oct-02	Cobion	Content Protection	\$5.9	A
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	Permeo 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

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