

IT Security Sector Report

April 2, 2004

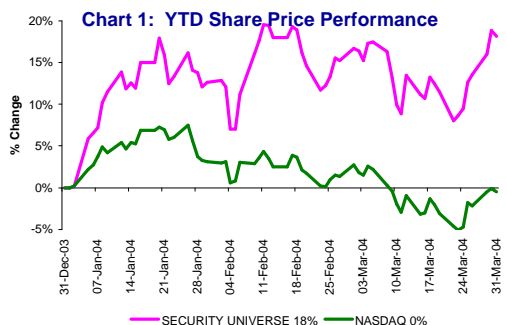
UPDATA CAPITAL

Persistent Vulnerabilities Push Security Stocks Higher

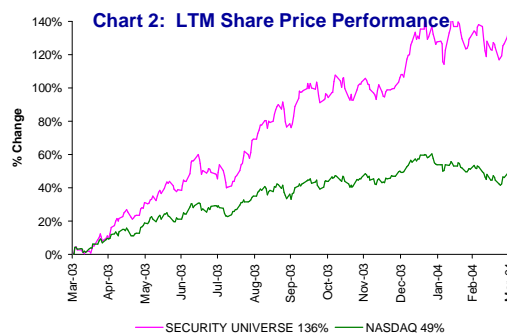
The first quarter of 2004 was the worst on record in terms of damage caused by computer viruses and worms such as MyDoom and Netsky. Estimates of lost productivity and clean-up costs run in the billions of dollars. Not surprisingly, antivirus vendors have been reporting record sales growth. Similarly, the worsening spam epidemic has been a boon for antispam vendors: venture funds have invested \$220 million in the space since last summer, and Brightmail filed to go public last month. In January, eight federal agencies – including the Department of Homeland Security – flunked network security audits, prompting calls for more government IT security initiatives. And businesses report that looming HIPAA (4/05) and Sarbanes-Oxley (9/04) deadlines are driving higher security spending.

These and other security issues have driven sector share prices up in Q1 despite a broader tech sector price pullback. Last quarter, Udata's Security Index gained 18%, versus a 0% change in the NASDAQ (**Chart 1, right**). Security stocks trade at a mean 2004e P/E multiple of 38.5x, ahead of the S&P 500's forward P/E of 20.0x. Security trading data is shown on **Table 5, Page 4**.

While the Security Index has risen an impressive 136% over the past 12 months, versus 49% for NASDAQ (**Chart 2, right**), trading multiples of sector leaders remain in line with those of other major software vendors (**Table 1, below**), and still appear reasonable by historical standards.



Security Universe Tickers:
ALDN, ACTI, BVEV, CGFW, CHKP, DMRC, ENTU, GEMP, HIFN, IDNX, ISSX, INTZ, MVSN, NET, NETE, NSCN, NTIQ, RNBO, RSAS, SFNT, SCUR, SNWL, SYMC, TPTI, TMIC, TMWD, VDSI, VISG, WGRD, WBSN, ZIXI



Within the security sector, share prices of smaller vendors as a group continue to outperform larger sector leaders, as they generally have over the past two years. These disproportionate gains partly reflect higher average growth rates among smaller vendors. However, small and microcap stocks empirically have higher volatilities so are more apt to decline further than their larger peers in a bear market.

Table 1: Leading Vendor Comparisons

(\$ in millions)	Major Enterprise Software Vendors					Major Security Software Vendors				
	BEAS	EMC	MERQ	MSFT	ORCL	CHKP	ISSX	RSAS	SYMC	WBSN
EV/LTM Revenues	4.4x	4.8x	8.2x	6.4x	5.6x	9.1x	2.3x	3.5x	8.0x	5.6x
EV/LTM EBITDA	26.3x	26.0x	30.8x	12.0x	13.8x	15.1x	14.7x	31.4x	22.0x	17.0x
2004e P/E	34.5x	40.0x	41.9x	20.4x	23.0x	21.2x	25.2x	37.3x	32.6x	30.9x
5-yr Est. Growth	15%	17%	21%	11%	11%	11%	16%	17%	17%	24%
PE/Growth	2.3x	2.4x	2.0x	1.8x	2.2x	1.9x	1.6x	2.2x	1.9x	1.3x
Cash/Share as % of Price	28%	9%	18%	20%	13%	20%	27%	18%	16%	27%
% Price Change LTM	20%	75%	43%	-1%	6%	51%	51%	172%	134%	151%
% Price Change YTD	3%	3%	-9%	-9%	-9%	35%	-12%	29%	33%	5%
Q-over-Q Rev Growth	12%	25%	29%	19%	9%	5%	6%	16%	31%	30%

LTM = last 12 months; EV = enterprise value

Inside This Issue

	Page
Persistent Vulnerabilities Push Security Stocks Higher	1
Venture Investment Surges	2
M&A Activity Strength Continues	2
Recent M&A Transactions	3
Public Company Trading Data	4
Selected Sector Market and Concentration Data	4

Recently Announced Udata Capital Deal

Managed Security Services



Udata Capital, Inc.
www.odata.com

New Jersey Office:

125 Half Mile Road
Suite 201
Reston, VA 20191
(732) 945-1000

Virginia Office:

2100 Reston Parkway
Suite 430
Reston, VA 20191
(703) 736-0020

For more
Information contact:
Don More
Senior Vice President
dmore@odata.com

Venture Investment Surges

Sharp increases in IT security venture activity have accompanied the rise in share prices (**Chart 3, below**). Update records 29 U.S. security investments (including seven A stage deals) in Q1 totaling \$391 million, with 60% of announced deal volume occurring in March (**Table 2, below**). This represents 102% and 141% investment volume growth over the previous and prior-year quarters, respectively. Average investment size also grew, from \$10.3 million per investment in Q4 2003 to \$13.5 million in Q1 2004. While investments covered all areas of security, antispam, intrusion prevention and authentication garnered the most dollars in the quarter.

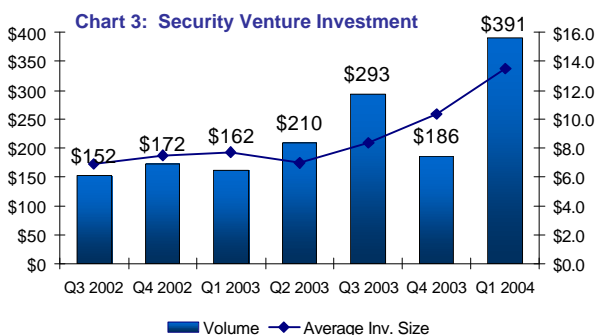


Table 2: Q1 2004 Security Venture Investment

Invest. Date	Company	Description	Amount (\$MM)	Round
Mar-04	CloudShield	Deep-packet inspection	\$20.0	C
Mar-04	Labcal	Authentication systems	\$1.8	A
Mar-04	Security	Policy-based security mgmt	\$15.0	C
Mar-04	Upek	Fingerprint biometrics	\$20.0	A
Mar-04	GeoTrust	Digital certifs.; managed PKI	\$3.7	E
Mar-04	nCircle	Vulnerability management	\$15.0	D
Mar-04	Ciphertrust	Message security; anti-spam	\$42.0	B
Mar-04	SecurePipe	Managed security services	\$3.2	C
Mar-04	Fortinet	Network security appliances	\$50.0	E
Mar-04	Quary Technols.	Security service routers	\$18.0	D
Mar-04	Layer N	High speed encryption chips	\$20.0	B
Mar-04	Infoblox	Network identity appliances	\$21.0	B
Mar-04	FaceTime	IM security	\$6.5	F
Feb-04	Layer 7 Technols.	Web services security	\$1.0	A2
Feb-04	Tablus	Outbound data security	\$7.0	A2
Feb-04	Corestreet	Identity management	\$8.4	B
Feb-04	Preventsys	Network security auditing	\$3.0	B
Feb-04	Authentica	DRM	\$8.0	C
Feb-04	Ounce Labs	Application security	\$6.0	A
Feb-04	Discretix	Flash card security	\$9.5	B
Feb-04	iPolicy Networks	Carrier security appliance	\$26.0	A
Feb-04	OmniTrust	DRM; document security	\$6.0	B
Jan-04	Sourcefire	Intrusion detection/prevention	\$15.0	C
Jan-04	ServGate	Anti-spam	\$18.0	E
Jan-04	Protego	Security event management	\$6.3	A2
Jan-04	Thor	Provisioning software	\$15.0	B
Jan-04	Sana (Company 51)	Intrusion detection, prevention	\$10.0	C
Jan-04	SealedMedia	Document security systems	\$8.0	E
Jan-04	ArrayNetworks	SSL VPN Appliances	\$7.5	C
			\$390.9	

M&A Activity Strength Continues

At least 10 IT security M&A transactions were announced in Q1 2004, including the Juniper Networks-Netscreen merger valued at \$3.6 billion, the largest security acquisition ever. Since January 2003, at least 57 security deals were announced, valued at an aggregate \$5.8 billion. Areas experiencing the most consolidation include identity management, managed security services and consulting, SSL VPN and intrusion detection/prevention (**Table 3, below**).

Enterprise value/trailing revenue multiples paid in security acquisitions since 2003 averaged 9.8x, with a median of 6.2x (excluding services deals). Multiples ranges have remained relatively stable over time. Note however that individual deal multiples vary widely and that averages/medians exclude deals where values or revenues have not been publicly disclosed.

Security demand growth and persistent market fragmentation will support an active security M&A market for some time to come. Transactions can generally be classified among four types: (1) *Bundle Buys*: As multi-function appliance demand growth outpaces demand for separate products, vendors are rounding out their offerings by adding complementary products that can be combined onto a single platform. (2) *Defense in Depth*: Experts tout the need for combined external perimeter and internal host defenses, and integrated solutions for protecting network and application stack layers. In response, vendors are assembling product sets that meet these needs. (3) *Moving Downmarket*: Enterprise vendors seeking to broaden their addressable markets and capture growth in the consumer and SOHO markets are adding products at lower price points. (4) *Covering the Bases*: To capture a bigger slice of customer security budgets, vendors seek to add products that, while not highly complementary, effectively leverage distribution channels. Recent acquisitions are listed on **Table 4, next page**. Selected sector market and concentration data is shown on **Table 6, page 5**.

Table 3: M&A Transactions by Security Area: 2003 – Q1 2004

Vendor Type	No. of Deals
Identity Mgmt	8
MSSP	6
Consulting	6
SSL VPN	6
Intrusion Detection/Prevention	5
Anti-spam	4
Antivirus	3
Biometrics	3
Appliances	3
Firewall/VPN	3
Anti-piracy/DRM	3
Web Filtering	2
Other	5

Table 4: Recent M&A Transactions

(\$ in millions)

Ann't Date	Seller	Buyer	Deal Value	LTM Rev	Mult of LTM Rev	Description
Mar-04	Riverhead	Cisco	\$39	NA	NA	DDoS; Intrusion Prevention
Mar-04	Corvigo	Tumbleweed	\$39	NA	NA	Anti-spam software
Mar-04	Twingo	Cisco	\$5	NA	NA	SSL VPN technology
Mar-04	DeLean	Identix	\$3	NA	NA	Skin biometric technology
Mar-04	Fortress Solutions	BeTrusted	NA	NA	NA	Security consulting
Feb-04	Ubizen	BeTrusted	\$64	\$50	1.3 x	MSSP; application security
Feb-04	TransDigital Technologies	Viisage	\$50	NA	NA	Identity management (passports)
Feb-04	NetScreen	Juniper Networks	\$3,621	\$310	11.7 x	ASIC Firewall/VPN appliance
Jan-04	Asgard Holdings	SteelCloud	\$3	NA	NA	Network security services
Jan-04	Cobion AG	Internet Security	\$33	\$5	6.6 x	Content filtering; anti-spam
Dec-03	Guardent	VeriSign	\$140	\$24	5.8 x	MSSP
Dec-03	Business Layers	Netegrity	\$43	\$10	4.3 x	Identity provisioning
Dec-03	Zone Labs	Check Point	\$205	\$28	7.3 x	Desktop firewall
Dec-03	SnapGear	CyberGuard	\$16	NA	NA	Linux security; firewall/VPN appliances
Nov-03	Waveset	Sun	\$150	\$15	10.0 x	Identity provisioning
Oct-03	Digital Silicon (Sentaurus)	Demarc Security	NA	NA	NA	Intrusion detection software
Oct-03	Ositit	Blue Coat	\$7	NA	NA	E-mail and Web antivirus appliance
Oct-03	ITM ThreatSmart	Perimeter	NA	NA	NA	MSSP player
Oct-03	Rainbow (merger)	Safenet	\$457	\$136	3.4 x	Tokens, anti-piracy, SSL acceleration
Oct-03	SafeWeb	Symantec	\$26	\$3	10.4 x	SSL VPN appliances
Oct-03	SSH Communs. (oem business)	Safenet	\$14	NA	NA	VPN, content inspection software
Oct-03	Mormar Technology	DynTek	NA	NA	NA	Security Consulting
Oct-03	Neoteris	Netscreen	\$265	\$32	8.3 x	Virtual VPNs
Sep-03	ActiveState	Sophos	\$23	NA	NA	Anti-spam software
Sep-03	TesserEye	SecureWorks	NA	NA	NA	Network monitoring and security
Sep-03	Cinea	Dolby Laboratories	NA	NA	NA	Anti-piracy solutions for digital content
Sep-03	Cogentric	TruSecure	NA	NA	NA	Security risk management software
Sep-03	Elron Software	Zix	\$7	\$8	0.9 x	Web filtering software
Sep-03	Baltimore - OmniRoot	Betrusted	\$3	\$1	3.3 x	SSL solutions
Aug-03	Chrysalis-ITS	Rainbow Technologies	\$20	\$9	2.2 x	Encryption hardware
Aug-03	IMSecure	ZoneLabs	NA	NA	NA	IM client security
Jul-03	Aurora Biometrics	Dicom	\$1	NM	NM	Facial biometrics IP
Jul-03	N2H2	Secure Computing	\$19	\$12	1.6 x	Web filtering software
Jul-03	uRoam	F5	\$25	\$1	25.0 x	SSL VPN
Jul-03	Baltimore - Managed Services	Betrusted	\$2	\$2	1.2 x	Managed security services
Jul-03	Veridicom (assets)	Alpha Virtual	NA	NA	NA	Fingerprint biometrics
Jul-03	Vacman (Vasco asset)	SecureD	\$3	\$2	1.6 x	Single sign-on
Jul-03	SecureNet	Betrusted	\$30	\$25	1.2 x	Managed security services (Australian)
Jul-03	Information Security (TruSecure)	TechTarget	NA	NA	NA	IT Security magazine
Jul-03	Baltimore - SelectAccess	Hewlett Packard	\$14	\$1	11.9 x	Web-based single sign-on

Data is sourced from publicly available information and, in some cases, represents estimates.

Table 5: Public Company Trading Data

(3/24/2004 closing prices)

(\$ in millions except per shares)

Company	Segment	Current Price	% of 52 Week Hi	Market Cap	Enterprise Value	Ent Value / Revenues LTM	CY2004P	CY2004e P/E	5-yr Growth	P/E / Growth
ACTIVCARD SA	Authentication	\$ 6.23	53.7%	\$ 259.7	\$ 24.2	0.6x	0.8x	NM	35%	NM
ALADDIN KNOWLEDGE SYS	Anti-piracy	17.81	98.9%	215.3	195.8	3.6x	3.2x	37.9x	40%	0.9x
BINDVIEW DEVELOPMENT	Vulnerability Assess	3.55	75.4%	165.6	130.4	1.9x	1.6x	NA	NA	NA
CHECK POINT	Firewall/VPN	21.42	89.0%	5,485.8	3,955.7	1.9x	7.8x	21.2x	11%	1.9x
CYBERGUARD	Firewall/VPN	8.99	75.2%	242.1	227.4	6.0x	4.0x	31.5x	28%	1.1x
DIGIMARC	DRM	11.28	65.4%	222.5	149.5	1.7x	1.6x	37.6x	20%	1.9x
ENTRUST TECHNOLOGIES	Authentication	3.90	71.1%	247.3	142.3	1.6x	1.5x	NM	10%	NM
GEMPLUS	Authentication	4.12	73.6%	1,248.6	894.0	0.9x	0.9x	NM	30%	NM
HI/FN	Encryption	11.08	59.1%	122.0	96.3	4.2x	2.0x	NM	25%	NM
IDENTIX	Biometrics	5.07	70.6%	436.8	397.8	4.6x	5.3x	NM	27%	NM
INTERNET SECURITY	Intrusion Prevention	16.12	78.4%	804.1	577.0	2.3x	2.1x	25.2x	16%	1.6x
INTRUSION	Intrusion Prevention	0.77	62.6%	15.9	13.2	2.0x	ND	NA	NA	NA
MACROVISION	DRM	17.49	65.0%	870.0	754.6	5.9x	5.1x	22.4x	23%	1.0x
NETEGRITY	Identity Management	7.35	52.2%	279.3	242.2	3.2x	2.6x	52.5x	21%	2.6x
NETIQ	Vulnerability Assess	12.92	75.7%	727.5	390.9	1.4x	1.5x	NM	18%	NM
NETSCREEN	Firewall/VPN	33.34	88.8%	2,880.2	2,539.7	9.2x	6.3x	51.3x	28%	1.9x
NETWORK ASSOCIATES	Antivirus	16.92	91.5%	2,797.7	2,441.7	2.6x	2.6x	24.5x	14%	1.7x
RSA SECURITY	Authentication	16.05	91.1%	1,012.5	899.9	3.5x	3.1x	37.3x	17%	2.2x
SAFENET	Encryption	37.01	86.2%	501.3	384.5	5.8x	1.8x	29.6x	25%	1.2x
SECURE COMPUTING	Web Filtering, FW	14.44	72.7%	490.9	466.6	6.1x	4.7x	33.6x	23%	1.4x
SONICWALL	Firewall/VPN	8.36	83.2%	567.8	324.3	3.4x	2.6x	76.0x	18%	4.2x
SYMANTEC	Antivirus	43.02	96.4%	15,350.8	13,682.3	8.0x	6.4x	32.6x	17%	1.9x
TIPPINGPOINT	Firewall/VPN	25.78	75.7%	196.9	173.2	NM	11.5x	NM	NA	NM
TREND MICRO	Antivirus	33.11	96.9%	4,337.4	3,926.1	8.7x	ND	35.0x	NA	NA
TUMBLEWEED	Secure Messaging	6.80	79.3%	275.7	250.8	8.2x	4.7x	75.6x	30%	2.5x
VASCO DATA SECURITY	Authentication	2.00	63.9%	62.4	63.8	3.1x	2.2x	NA	NA	NA
VIISAGE	Biometrics	7.27	100.0%	156.4	160.0	4.3x	2.7x	NM	20%	NM
WATCHGUARD	Firewall/VPN	7.27	89.2%	239.2	156.1	1.9x	1.8x	NM	22%	NM
WEBSense	Web Filtering	27.15	82.5%	625.4	458.1	5.6x	4.5x	30.9x	24%	1.3x
ZIXIT	Secure Messaging	12.15	74.6%	291.3	272.5	NM	13.5x	NM	NA	NM

Notes:

EPS Growth rates provided by Zacks.

2004 P/E based on consensus EPS

Mean	4.3x	3.9x	38.5x	23%	1.8x
Median	3.5x	2.7x	33.6x	22%	1.8x

Table 6: Selected Sector Market and Concentration Data

(\$ in millions)	Top 3	2003	Proj. Growth	Penetration	
Segments	Mkt Share	Top 3 Vendors	Spend	CAGR	Rate
Antivirus	74%	Symantec (36%), Network Assoc (24%), Trend (14%)	\$2,581	15%	95%
Firewall/VPN	72%	Check Point (32%), Cisco (31%), Juniper (9%)	\$2,649	18%	88%/77%
Strong Authentication	64%	RSA (35%), VeriSign (21%), Safenet (8%)	\$783	28%	25%
Intrusion Detect/Protect	57%	ISS (25%), Cisco (19%), Symantec (13%)	\$865	16%	44%/24%
Web Filtering	53%	Websense (23%), SurfControl (20%), Secure Comp (10%)	\$364	27%	-
Message Security	33%	Clearswift (15%), Tumbleweed (11%), Brightmail (7%)	\$364	36%	-
MSSP	6%	VeriSign (2%), Symantec (2%), Ubizen (2%)	\$870	24%	-

Sources: IDC 2003 and 2002, Udata.

Udata Capital, Inc. is a leading investment banking firm specializing in mergers and acquisitions for the information technology industry. Since its inception in 1987, Udata has managed over 350 mergers and acquisitions for software, IT services, e-commerce, infrastructure, telecommunications, e-services, and security firms, representing an aggregate value over \$10 billion.

Our clients rely on our deep understanding of technological vision and financial expertise to assure the successful execution of their strategic initiatives.



www.uptata.com

New Jersey Office:

125 Half Mile Road
Suite 201
Red Bank, NJ 07701
(732) 945-1000

Contact

Barry Goldsmith: bgoldsmith@uptata.com
Ira Cohen: icohen@uptata.com
John MacDonald: jmacdonald@uptata.com
Don More: dmore@uptata.com

Virginia Office:

2100 Reston Parkway
Suite 430
Reston, VA 20191
(703) 736-0020

Contact

John Burton: jburton@uptata.com
Joel Kallett: jkallett@uptata.com

© Reproduction of this information without express written permission is prohibited.

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.