
**IT Security Sector
Monthly Report**

December 2002

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Security Market Overview

- **Volatility Continues in a Down Year; Profitability Drives Share Price Performance:** In December, Udata's share price Index of 34 pure-play public IT Security companies declined 11%, following a 28% jump in November. As of 12/27, the Index ended 2002 42% down, versus a 31% NASDAQ decline. Trailing (last 12 month) profitability most strongly predicted security share price performance. Security companies registering positive 2002 EPS trade an average of 54% of their 52-week highs, while unprofitable firms trade at 37% of highs. Although higher revenues naturally tend to correlate with profitability, company size in terms of market capitalization has not been a predictor of price performance - in fact security companies with higher market caps on average performed slightly worse than smaller ones in 2002.
- **Trading Multiples Remain Subdued:** Udata's security index presently trades at mean Enterprise Value/Calendar Year 2003E Revenue and EBIT multiples of 2.3x and 16.7x respectively (1.7x and 16.2x median). The average 2003 P/E-to-Growth ratio for the universe is 2.0x (1.2x median). Seven companies trade at 2003 revenue multiples greater than 4.0x; all are profitable except one (Identix). The ten companies with the largest market capitalization represent 87% of the universe's total market capitalization of \$24.8 billion (versus 89% same time last year). At the end of 2001, mean and median Enterprise Value/Calendar Year 2002E Revenue and EBIT multiples were 5.0x and 41.0x respectively (3.4x and 33.7x median).
- **M&A Activity Accelerates in 2002; Likely to Continue:** Two acquisitions (by NetIQ and Diversinet) announced in December capped a year of at least 32 major IT security deals valued at \$2.1 billion, about twice the value of IT security M&A activity in 2001 and half that of 2000. In 2002, the average Deal Value/Last 12 Month Revenues multiple was 13.2x, versus 9.4x in 2001. Note that these multiples include only data where deal values and revenues were reported or could be estimated. Values may not also fully reflect balance sheets acquired and payments characterized as compensation. Four publicly traded security companies were acquired in 2002: Cylink, Intertrust, McAfee and Visionics. Highest multiple deal of the year: Symantec's acquisition of SecurityFocus for an estimated 30.0x trailing revenues. Largest deal of the year: Network Associates' acquisition of the quarter of McAfee it did not own for approximately \$625 million. See page 6 for further details.
- **Security Investment Activity Remains Strong:** In December, at least 6 investments in private IT security companies were announced at an excess of \$36 million. Udata records 73 security investments totaling more than \$680 million from Q2 - Q4 2002, including 22 A round investments. The most popular investment areas in 2002 were related to wireless and mobile security, vulnerability assessment, and intrusion detection and prevention. See page 7 for further details.

Security Trading Data (at 12/27)

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	CY2003	LTM	CY2003
ACTIVCARD SA	8.55	87.7%	354.3	110.5	3.0x	1.9x	NM	178.1x
BINDVIEW DEVELOPMENT	1.32	43.1%	67.4	29.1	0.4x	NA	NM	NA
CERTICOM	0.50	21.3%	15.8	9.3	0.8x	0.4x	NM	8.3x
CHECK POINT	13.27	26.8%	3,247.7	2,006.9	4.6x	4.6x	7.5x	13.3x
CYBERGUARD	6.05	89.8%	116.0	109.0	4.0x	NA	NM	100.8x
DIGIMARC	12.30	57.1%	214.8	161.8	2.3x	1.6x	NM	51.3x
DIVERSINET	0.30	18.1%	8.0	3.2	6.1x	NA	NM	NA
ENTRUST TECHNOLOGIES	3.40	25.6%	221.4	78.8	0.7x	0.7x	NM	NM
GEMPLUS	2.03	36.9%	1,231.4	887.7	1.2x	NA	NM	29.0x
HI/FN	5.40	26.3%	56.7	2.0	0.1x	0.1x	NM	NM
IDENTIX	5.40	34.3%	457.9	412.1	3.6x	4.5x	NM	NM
INTERNET SECURITY	18.55	44.7%	897.7	719.2	3.0x	2.6x	27.0x	265.0x
INTRUSION	0.38	17.7%	7.8	NM	NM	NA	NM	NM
MACROVISION	15.55	40.9%	773.1	598.4	7.4x	5.6x	17.0x	51.8x
NETEGRITY	2.95	13.8%	100.8	23.0	0.3x	0.3x	NM	NM
NETSCREEN	17.20	61.5%	1,252.1	1,005.5	7.3x	4.8x	86.5x	45.3x
NETWORK ASSOCIATES	16.26	53.3%	2,428.3	1,980.1	2.0x	1.9x	18.0x	22.4x
NETWORK-1	0.15	6.7%	1.2	NM	NM	NA	NM	NA
RAINBOW TECHNOLOGIES	7.33	57.3%	193.0	151.3	1.1x	1.1x	20.1x	25.5x
RSA SECURITY	5.99	30.6%	339.6	324.5	1.4x	1.3x	26.8x	45.4x
SAFENET	24.60	84.5%	191.6	163.8	5.8x	3.8x	NM	41.0x
SECURE COMPUTING	6.50	26.5%	189.0	169.6	2.7x	2.2x	NM	34.9x
SONICWALL	3.52	16.0%	236.9	2.9	0.0x	0.0x	NM	57.7x
SYMANTEC	41.86	90.6%	7,052.9	6,483.5	5.2x	4.3x	18.9x	24.6x
TIPPING POINT	10.09	70.8%	40.9	6.6	NA	NA	NM	NA
TREND MICRO	16.85	54.5%	2,230.9	1,859.8	5.7x	4.3x	15.4x	27.4x
VALICERT	0.32	10.0%	8.2	4.0	0.3x	0.3x	NM	NM
VASCO DATA SECURITY	0.93	26.8%	26.4	31.8	1.5x	1.4x	NM	NM
VERISIGN	8.42	15.8%	1,995.2	1,668.2	1.6x	1.5x	9.8x	14.2x
VIISAGE	4.75	31.7%	96.1	100.8	3.3x	NA	NM	NA
V-ONE	0.17	8.6%	4.4	4.7	1.0x	NA	NM	NA
WATCHGUARD	6.31	48.6%	204.1	113.0	1.7x	1.2x	NM	63.7x
WEBSENSE	22.60	64.6%	481.8	353.4	6.4x	4.0x	35.3x	34.5x
ZIXIT	4.68	71.1%	84.9	80.1	67.9x	NA	NM	NA

* Numbers in italics not included in calculations

Mean	2.8x	2.3x	19.5x	16.7x	56.3x	32.3x
Median	2.2x	1.7x	18.0x	16.2x	51.8x	29.0x

Industry Forecasts for 2003

- **Competition from non-U.S. Security Vendors to Increase:** Internet use and resulting security challenges are proliferating fastest outside the U.S., driving entry of non-U.S. companies into the security market. While domestically focused, many entrants will rapidly begin competing for customers globally. In Japan for example, Hitachi launched access management and antivirus software earlier this month. Mitsui and Toshiba announced in November a new service to guard against computer breaches. Fujitsu opened a large managed security service center in October. Itochu recently invested in a subsidiary that will offer vulnerability assessment and security training services. In India, expect growing competition from software vendors and from outsourcing firms that have begun leveraging their network knowledge and lower costs to offer managed security services.
- **Public Security Markets to Shake Out:** Expect up to a dozen pure-play public IT security firms in the U.S. and a half-dozen in Europe and Asia to disappear in 2003. Most will be acquired and there will be at least one billion-dollar acquisition. Other vendors will go private or substantially change direction. For example, Diversinet recently announced acquisition of an IT services firm focusing on CRM and ERP integration that is several times larger than Diversinet revenues-wise. Many private security companies will also be acquired or simply pull the plug. Drivers for the impending shake out: relatively low public security valuations; too many companies most of which are unprofitable; growing competition; and less interest among investors and customers in small companies focusing on niche segments. Beneficiaries of the trend and likely acquirors will be larger, profitable and cash-rich companies including Cisco, Microsoft and Symantec.
- **Home Security Market Demand Set to Explode:** Growth of telecommuting, broadband and wireless access, as well as consumer concerns over fraud, spam, pornography and viruses will propel home security spending in 2003. Large security vendors have begun moving more aggressively into this market. For example, Check Point-owned Sofaware recently announced an upgraded security appliance offering for the home, and Symantec has drawn 30 million people to its Security Check testing site for personal computers. VeriSign is launching an identity verification service to help companies guard consumers against identity theft on the Web.
- **Security Process Focus Changes:** Studies point to process rather than technology as security's weakest link. Most breaches can be prevented by screening and training employees, developing and monitoring workplace security policies, and keeping abreast of patch updates. In a cautious technology spending environment, firms offering security policy development and management solutions, security information and patch management applications, and employee security education stand to do well in 2003.

Security M&A Activity 2002

Ann't Date	Seller	Buyer	Deal Value (\$ MM)	Est. LTM Rev (\$ MM)	Mult of LTM Rev	Description
Dec-02	DSS Software	Diversinet	NA	\$12	NA	Systems integration services
Dec-02	Marshall Software	NetIQ	\$23	\$3	7.0 x	Antispam, content security
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	Recourse 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 - December

Date of Round	Company	Sector	Amount Raised (\$MM)	Round
Dec-02	Resilience	Security Appliances (runs Check Point)	NA	B
Dec-02	ArcSight	Threat Information Management	NA	C
Dec-02	Credant Technologies	Mobile Device Security Management	\$14.0	B
Dec-02	eEye Digital Security	Intrusion Prevention, Vulnerability Assessment	\$9.0	C
Dec-02	Liquid Machines	Policy-based Information Security	\$4.6	A
Dec-02	Cyota	Online Credit Card Authentication	\$8.0	C
Nov-02	Sygate	Policy-based Endpoint Security	\$17.5	D
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