

IT Security Sector Monthly Report

May 14, 2003

UPDATA CAPITAL

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Recently Announced Network & Security Services Deal:



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Market Update

Trading: Share Prices Rebound into Positive Territory – Quarterly earnings announcements and macro-events lifted IT security stocks and the NASDAQ. Updata's index of 35 public IT security firms is ahead 4% year-to-date since the start of 2003, after being down 10% in early April. The sub-index of 12 leading security companies representing 91% of industry market capitalization rose 8% on average YTD, less than the NASDAQ's 11% rise due to big individual declines by such stalwarts as ISS and NET (see right chart). This reflects the market's close attention to financial performance. Updata's security index currently trades at 66% of its 52-week high, compared to 88% for NASDAQ.

Updata's security index trades at mean Enterprise Value/CY 2003E Revenue and EBIT multiples of 2.8x and 16.3x respectively (2.3x and 13.2x median). The industry's average CY 2003E P/E of 32.7x is in line with an estimated 33x for infrastructure software overall. The average 2003 P/E-to-Growth ratio for the universe is 1.6x. Five companies trade at 2003 revenue multiples greater than 4.0x – all except one are currently profitable. In comparison, only half of the all the security companies are profitable.

M&A: Activity Continues to Build – At least a dozen security deals valued at more than \$440 million have been announced YTD through April 2003, ahead of last year's trend. Half of the total deal value represents Network Associates' leap into intrusion prevention through back-to-back purchases of Intruvert and Entercept in April, which we discuss in a recent note. Although mean valuation multiples remain exceedingly high, big variations on a deal-to-deal basis make reliance on overall averages potentially misleading.

We believe there is a significant backlog of deal discussions underway that should

Bellwether Security Share Price Changes YTD

	1/2/2003	5/13/2003	% Change
CHECK POINT	\$14.05	\$16.87	20%
GEMPLUS	\$2.20	\$2.42	10%
IDENTIX	\$5.21	\$5.29	2%
INTERNET SECURITY	\$19.92	\$15.37	-23%
MACROVISION	\$15.77	\$18.93	20%
NETSCREEN	\$17.68	\$21.98	24%
NETWORK ASSOCIATES	\$16.90	\$12.64	-25%
RSA SECURITY	\$6.64	\$10.04	51%
SYMANTEC	\$42.68	\$46.06	8%
TREND MICRO	\$17.00	\$14.92	-12%
VERISIGN	\$8.48	\$12.60	49%
WEBSense	\$21.62	\$15.90	-26%
Average			8%
Median			9%
NASDAQ	1,385	1,540	11%

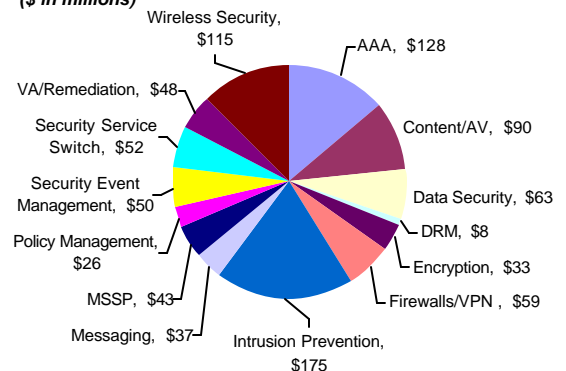
result in continued M&A volume growth through the remainder of this year and well into 2004. A list of M&A activity year-to-date is provided on page 3.

Private Investment: Solid Pace Continues

– At least 27 security companies announced new funding totaling \$235 million from January through early May. In the past 12 months, Updata has tracked more than 100 security investments totaling \$950 million, including 27 A rounds. By comparison, overall software venture investment totaled \$4.3 billion in 2002, according to the PwC/MoneyTree Survey. A list of recent security investments is provided on page 3.

Areas of security investment are summarized in the Updata chart below:

April 2002 – 2003 Venture Investments by Security Sector (\$ in millions)



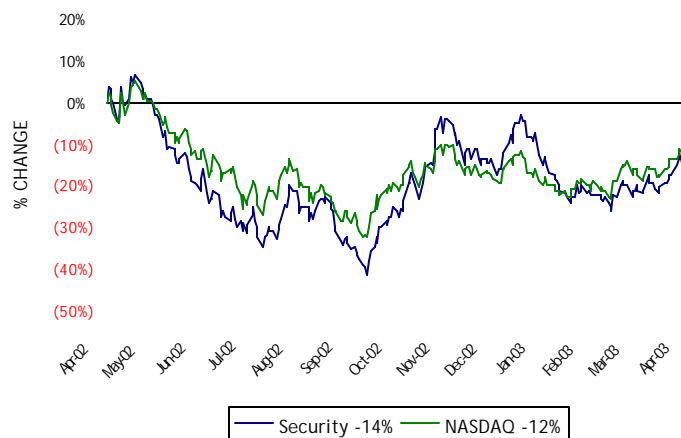
Industry Observations

RSA Conference Tea Leaves – Veteran RSA conference attendees have observed a higher than usual proportion of people on the exhibit floor who are seemingly new to the security industry. These initiates have asked good questions at vendor booths and boosted attendance at educational sessions. Their presence is read by some as a sign that security is going mainstream as more businesses are seeking for the first time to buy products or to partner. On a separate note, some analysts have tried to glean vendor prospects by measuring booth traffic volumes. History shows weak correlation between booth traffic and marketplace success. Booth traffic correlates better with current industry sector interest (e.g. intrusion prevention), as well as with exhibit size, placement and flashiness.

Suites, Appliances or Switches? – Battle lines are being drawn over of the industry's future dominant product paradigm. Many believe that all-in-one integrated ASIC-based appliances with purpose-built hardware platforms will dominate due to their higher throughput, tight integration and lower overall cost. Examples of this approach are Cisco, Netscreen and, recently, Network Associates (through Intruvert). The alternative approach utilizes software installed on commodity boxes. This enables flexible integration of best-of-breed products, while still offering solid price-performance ratios. It also allows for broader distribution channels. This approach is typified by the Check Point/Nokia and Symantec/Sun appliances. Most recently, the blade- or hardware card-based Security Switch solution is being heralded by some as the future of enterprise security. Up-and-coming companies like 14 South Networks (host-based) and Crossbeam (network-based) combine the throughput of the ASIC vendors with the flexibility of the software-in-box approach. These companies enable multiple third party applications to be plugged into specially-designed hardware designed for high security and throughput. In all likelihood, all three paradigms will co-exist for some time as each will be attractive to different customers for different reasons. For that reason, look for major security players to eventually offer all three approaches.

Standards Proliferate – Four recently announced initiatives highlight continuing efforts to simplify security for both vendors and users. We will revisit these initiatives later this year to report on their progress: (1) the Information Systems Security Association outlined Generally Accepted Information Security Principles – enterprise security guidelines analogous to GAAP – that the group expects to finalize by year's-end. A growing number of vendors support the effort, which will incorporate other standards such as Common Criteria. (2) Computer Associates recently announced an Open Security Exchange initiative to develop technical specifications and best practices that will allow security products to work better with physical security solutions. Initial partners are Gemplus, HID, Tyco Fire & Security Software, and Pinkerton Consulting. (3) Five private application security companies – Citadel, GuardedNet, Teros, NetContinuum and SPI Dynamics – have initiated the Application Vulnerability Description Language project to uniformly communicate “find, fix, block, report” information generated by vulnerability assessment, remediation and patch management, application security and security information management vendors. (4) TechNet, a network of senior IT executives, is joining with the Big 4 accountancies to develop a security baseline that business managers can use to evaluate their company's security preparedness.

Bellwether Security Company Share Price Performance – Last 12 Months



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Recent IT Security M&A Activity

Ann't Date	Seller	Buyer	Deal Value (\$ MM)	LTM Rev (\$ MM)*	Mult of LTM Rev	Description
Apr-03	Entercept Security	Network Associates	\$120	\$8	15.0 x	Host-based intrusion prevention
Apr-03	Intruvert	Network Associates	\$100	\$2	50.0 x	Network intrusion prevention
Feb-03	CrossLogix	BEA	NA	NA	NA	Enterprise authorization infrastructure
Feb-03	Raqia Networks	Safenet	\$7	NA	NA	Semiconductors for security
Feb-03	Valicert	Tumbleweed	\$13	\$12	1.0 x	Authentication, secure messaging
Feb-03	Nexland	Symantec	\$22	\$8	2.7 x	Security appliance technology
Feb-03	beTRUSTed (PwC unit)	One Equity Partners	NA	NA	NA	Security consulting
Feb-03	Vigilinx	TruSecure	NA	NA	NA	Security consulting, threat intelligence
Feb-03	Systor Security Solutions	Beta Systems Software	\$1	NA	NA	Secure user rights administration
Jan-03	Deersoft	Network Associates	NA	NA	NA	Anti-spam software
Jan-03	NetOctave	CyberGuard	\$2	NA	NA	SSL accelerators
Jan-03	Okena	Cisco Systems	\$154	\$5	30.8 x	Intrusion prevention management
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

Recent IT Security Private Investments

Date of Round	Company	Sector	Amount Raised (\$MM)	Round
May-03	Teros (fka Stratum8)	Web Application Security	\$12.0	C
May-03	Crossbeam	Security Services Switches	\$18.0	C
May-03	Skybox Security	Vulnerability Assessment	\$6.0	B
Apr-03	SecureLogix	Telecom Firewall	\$4.2	C
Apr-03	Credant Technologies	Mobile Security Software	NA	B
Apr-03	CoreStreet	Authorization, Validation software	\$4.0	A
Apr-03	Neoscale	Data Storage Security	\$12.0	B
Apr-03	PoliVec	Security Policy Automation	\$3.0	C
Apr-03	Intellitactics	Security Event Management	\$6.8	D
Apr-03	NetContinuum	Web Application Security Appliance	\$20.0	C
Mar-03	WholeSecurity	Identity Theft Prevention	\$3.8	A
Mar-03	Neoteris	Secure Application Access	\$17.5	C
Mar-03	SecurePipe	Managed Security Services	\$2.0	B
Mar-03	Surety	Digital Signature Authentication	\$2.0	C
Mar-03	NetSec	Managed Security Services	\$10.0	D
Mar-03	Lancope	Intrusion Detection and Prevention	\$5.0	B
Mar-03	Authentec	Biometric Fingerprint Sensors	\$12.1	C
Feb-03	Pedestal Software	Security Policy Management	\$5.3	A
Feb-03	H5 Technologies	Test-based Content Scanning	\$6.5	B
Feb-03	Sourcefire	Intrusion Detection Software	\$11.0	B
Feb-03	Cryptek	Secure Messaging and Access	\$10.0	B
Feb-03	Gilian Technologies	Web Application Security	\$5.0	C
Jan-03	Guardium	Database Security	\$4.0	A
Jan-03	Q1 Labs	Network Threat Monitoring	\$3.3	A
Jan-03	Courion	Identity Management/Provisioning	\$13.0	C
Jan-03	Crossbeam	Security Applications Platform	\$18.0	C
Jan-03	Counterpane	Managed Security Monitoring	\$20.0	D

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Security Trading Data

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	LTM	
ACTIVCARD SA	9.85	89.5%	400.0	155.0	4.3x	2.8x	NM	1,641.7x
BINDVIEW DEVELOPMENT	1.20	60.0%	57.0	19.3	0.3x	NA	NM	NA
CERTICOM	0.72	72.0%	23.1	20.7	1.7x	2.0x	3.2x	25.7x
CHECK POINT	16.87	80.3%	4,271.4	2,877.2	6.7x	6.6x	11.3x	16.2x
CYBERGUARD	6.26	78.3%	160.0	149.5	4.7x	4.6x	140.7x	56.9x
DIGIMARC	14.31	75.3%	262.6	212.3	2.4x	2.3x	NM	74.1x
ENTRUST TECHNOLOGIES	2.57	51.4%	164.5	40.2	0.4x	0.4x	NM	NM
GEMPLUS	2.42	60.5%	1,465.8	1,052.0	1.2x	NA	NM	34.6x
HI/FN	5.24	47.6%	55.5	9.1	0.2x	NA	0.8x	NM
IDENTIX	5.29	58.8%	451.7	410.8	3.3x	4.5x	NM	NM
INTERNET SECURITY	15.37	56.9%	767.9	551.5	2.3x	2.2x	18.1x	32.0x
INTRUSION	0.50	25.0%	10.3	2.1	0.3x	NA	NM	NA
MACROVISION	18.93	86.0%	922.3	781.5	7.3x	6.9x	8.2x	27.4x
NETEGRITY	6.22	69.1%	213.5	134.0	2.1x	1.9x	NM	NM
NETIQ	14.51	57.8%	818.2	593.2	1.9x	NA	10.5x	22.6x
NETSCREEN	21.98	99.9%	1,853.2	1,561.2	11.7x	6.7x	169.4x	39.5x
NETWORK ASSOCIATES	12.64	55.0%	2,016.7	1,477.8	1.6x	1.6x	10.5x	21.1x
RAINBOW TECHNOLOGIES	9.59	87.2%	266.0	214.1	1.7x	1.5x	NM	23.4x
RSA SECURITY	10.04	91.3%	593.2	555.6	2.3x	2.2x	91.5x	59.4x
SAFENET	27.90	84.5%	268.6	236.9	5.9x	3.9x	38.6x	42.9x
SECURE COMPUTING	6.83	45.5%	206.1	184.5	3.3x	2.4x	NM	41.4x
SONICWALL	4.27	53.4%	288.5	53.5	0.6x	0.5x	NM	115.4x
SURFCONTROL	8.45	100.0%	256.0	259.5	3.8x	2.7x	39.6x	29.2x
SYMANTEC	46.06	94.0%	6,803.1	5,697.4	4.0x	3.4x	16.2x	24.3x
TIPPING POINT	8.89	59.3%	39.4	7.1	NA	NA	NM	NA
TREND MICRO	14.92	48.1%	1,971.1	1,651.9	5.1x	3.8x	19.3x	24.3x
TUMBLEWEED	1.46	58.4%	44.5	17.5	0.8x	0.6x	NM	NM
VALICERT	0.55	55.0%	14.2	12.9	1.1x	1.0x	NM	NM
VASCO DATA SECURITY	1.46	48.7%	41.3	46.7	2.4x	NA	NM	NM
VERISIGN	12.60	96.9%	3,001.4	2,526.3	2.2x	2.3x	13.7x	21.8x
VIISAGE	4.92	61.5%	99.6	105.1	3.3x	NA	NM	NA
V-ONE	0.19	21.8%	4.9	5.2	1.1x	NA	NM	NA
WATCHGUARD	5.05	56.1%	165.3	77.1	0.9x	0.8x	NM	43.5x
WEBSENSE	15.90	49.7%	361.2	210.0	3.2x	2.7x	12.4x	24.1x
ZIXIT	4.90	70.0%	100.8	95.9	169.2x	NA	NM	NA

* Numbers in italics not included in calculations

Mean	2.8x	2.8x	15.6x	16.3x	39.4x	32.7x
Median	2.3x	2.3x	12.4x	13.2x	28.7x	26.6x

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



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