

SECURENET, INC.: SERIES A ROUND

First there is a mountain, then there is no mountain, then there is.

—Zen proverb

In the fall of 2000, Richard Goodson reflected on his experiences over the past six months since his company had merged with another Internet startup to form SecureNet, Inc. Goodson became CEO of the combined company and was in the process of seeking additional financing. To date, Goodson had been unsuccessful in attracting venture capital funding and had instead focused his efforts on local investors. In July 2000, he raised \$250,000 in seed capital followed, in September 2000, by a bridge loan of \$250,000 from Trio LLC, a group of angel investors. The bridge loan was straight debt and repayment was contingent upon completion of a Series A round of financing, which was necessary to keep SecureNet afloat until several deals with key customers closed. In October 2000, Goodson received an offer from the same angel group to purchase \$1.4 million in Series A convertible preferred stock. While Goodson welcomed the offer, he was uncertain whether the terms of the proposed agreement and the amount offered met his company's growing needs. First, Cyrus Maston, who headed Trio LLC, did not possess a great deal of experience in venture investing. With a successful seed round behind him, Goodson considered whether it might be a good time to revisit some venture capitalists and attempt to bring in a more experienced investor. Second, with only \$1.4 million coming from the Series A round, SecureNet would again need to find additional funds to build its sales force and revenues. Thus, two key issues needed to be resolved before Goodson could make a decision on Trio's offer: whether \$1.4 million was enough for nearly 40% of the firm's equity and how the proposed contract terms would play out in the likely event of subsequent funding.

Company

Following his graduation from business school, Goodson went to work for a large financial institution in its investment-banking-technology group. While an investment banker, he

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worked on several successful initial public offerings for Internet companies. Goodson soon left the world of investment banking to pursue his dream of starting and running his own company. He founded GroupWorks, Inc., a provider of Internet groupware, with a small team focused on providing calendar and messaging solutions through a Web-based service.

In June 2000, GroupWorks announced a merger with Fortress, Inc. Fortress, founded in Charlottesville, Virginia, created solutions for the growing information-security market. Its first product was a server-based application that stood between an email server and the Internet to transparently manage encryption and decryption without user intervention. Goodson became the CEO of the combined firm, which he renamed SecureNet, Inc.

International Data Corporation (IDC) estimated that the worldwide market for information-security services was approximately \$6.7 billion. By the end of 2005, IDC expected the market to more than triple to \$21 billion. Fortress's products alleviated the difficulty of securing e-commerce transactions and reduced the costs of implementing those solutions using preconfigured network appliances.¹

The merger also stood to benefit from the increased attention placed on digital signatures. On June 30, 2000, President Bill Clinton signed the Electronic Signatures in Global and National Commerce Act, which made digitally signed contracts as binding as those using pen and paper. Goodson saw this as an opportunity for SecureNet to leverage Fortress's technology: "This legislation will help replace reams of paper and sanction the use of the Internet as a legal tool for conducting business." Even with federal legislative support, digital signatures faced an uphill adoption battle that SecureNet intended to take advantage of: "We will make it easy for the everyday user to participate, and place management of the public key infrastructure at the ISP [Internet Service Provider] level of the Net." SecureNet's product could be easily extended to create digital signatures as well as to secure e-commerce, thereby creating additional revenues from its current product line.²

In addition to the recently signed legislation, two other federal laws placed pressure on specific industries to upgrade the level of security around data used in e-commerce transactions. The Gramm-Leach-Bliley Act required financial institutions to protect sensitive financial information. SecureNet's Email Security System™ not only met the security requirements of the Act but also secured delivery of statements, prospectuses, trade confirmations, and account statements that could save financial institutions considerable expense. In addition, the Health Insurance Portability and Accountability Act (HIPAA) required the health-care sector to encrypt personally identifiable medical information transmitted over the Internet.

¹ A "network appliance" was a device that had both the hardware and software component and was configured to perform a specific task with minimal intervention.

² In July 2000, SecureNet received national press attention when it announced that it would open-source and freely distribute a version of its secure e-mail server software under the name Antivore™. The announcement was in response to increasing public debate surrounding an FBI project that allowed monitoring of email traffic from an ISP without the knowledge of the sender or recipient of the email. Antivore™ placed a major obstacle in front of the FBI's ability to eavesdrop on e-mail.

Background on Encryption

Increasingly, companies found it necessary to send personal, proprietary, or confidential information over the Internet.³ As this information traversed the Internet between parties, it was typically routed through open and unsecured networks, crossing several public and private routers and servers. While the information was traveling between parties, copies could be made and the contents read or modified. Additionally, because of this open and unsecured design, it was possible to forge information so that it appeared to originate from trusted parties. In 1991, Phil Zimmermann wrote Pretty Good Privacy (PGP), a desktop encryption program, to prevent the tampering or forging of e-mails, and offered it as freeware to the Internet community.⁴ PGP quickly became the most widely used encryption software in the world and launched an entire industry providing encryption software to ensure privacy and security for Internet communication.

PGP was built around a relatively new way of encrypting information called “public key” (PK) cryptography. Prior to PK cryptography, most encryption was based on symmetrical or secret key cryptography, where a single key was used to encrypt, or lock, the message, rendering it unreadable. To decrypt, or unlock, the information in the now unreadable message, the same key had to be applied. The security of the message was dependent on keeping the key a secret. Once the key was known, anyone who intercepted the message could read it. **Exhibit 1a** diagrams the symmetrical-key-encryption process.

PK cryptography introduced a more complex but more secure method for encrypting messages. In PK cryptography, a pair of keys—the public and private keys—were used to encrypt and decrypt messages. When the public key of a pair was used to lock a message, only the private key of the same pair could unlock it, and vice versa (i.e., what the private key locked, only the public key could unlock, as shown in **Exhibit 1b**). Typically, the public key was freely shared, and therefore, to send someone an encrypted message, only the public key was needed.

Finding a recipient’s public key required that it be made available through some type of accessible infrastructure, such as a Web site or a corporate e-mail directory. Software companies created suites of applications, collectively known as Public Key Infrastructure (PKI) software that facilitated the creation, storage, management, and use of public keys.

Industry Overview

The world of e-commerce security vendors could be divided into two main groups: traditional PKI software vendors and secure service providers (SSPs). Each of these approaches made compromises to give customers e-mail security.

³ Much of the information for this section comes from Bruce Schneier’s *Applied Cryptography* (New York: John Wiley & Sons, 1996).

⁴ http://www.openpgp.org/about_openpgp/history.shtml (accessed 4 April 2004).

PKI software vendors

Entrust, RSA Security, and Baltimore Technologies were companies that sold suites of applications and server software. The PKI implementations were usually used by the information-technology groups of governmental or corporate organizations. These implementations usually required a mix of server hardware and software, desktop software, and recoding of some applications to obtain the full benefit of the entire PKI. Over time, most PKI vendors had moved away from proprietary implementations and adopted standards based on X.509 and S/MIME technologies.⁵

Secure service providers

Such secure service providers (SSPs) as Verisign, Hushmail.com, ZixIt, and Certifiedmail.com managed the PKI and allowed users to access services for a monthly fee. The benefits of this outsource model were that the service providers implemented, managed, and maintained the infrastructure, and the users were able to be up and running quickly. Problems arose when service providers based their platforms on proprietary systems or required both parties involved in a conversation to use their technology. In addition, some service providers required the installation of software on the client machine, which increased the complexity of implementation. One final concern was that, because the SSP provided and managed the infrastructure, the end-user company had to trust the SSP to provide high-quality service and protect its confidentiality.

SecureNet Products

SecureNet's initial software products focused on easy set-up and direct exchange between end users and the Internet. The network appliance model offered lower implementation costs compared with full-featured PKI implementations. Moreover, because the network appliance was run by the company, it provided a transparent infrastructure that decreased concerns about confidentiality.

⁵ The X.509 standard was part of the larger X.500 series of standards. X.500 defined a structure for storing, querying, and managing large electronic directories. Because some of the entities in that directory might use cryptography, the X.509 standard was created to define how cryptographic information would be managed, associated with an end entity, and trusted. The trust model promoted by X.509 was strictly hierarchical. The trust of one party derived from the trustworthiness of that party's position in a hierarchy. X.509 did not, however, define standards for processes like encrypting e-mail or other transactions. Secure Multipurpose Internet Mail Extensions (S/MIME) was a similar secure messaging standard to OpenPGP. Instead of being a stand-alone solution, S/MIME was more tightly integrated into mail-message formatting. In practical terms, this standard was conceptually the same as PGP, including identical security levels, but the implementations differed slightly. Both were valid and maintained standards.

SecureNet targeted companies that faced the greatest need to increase security in their e-commerce transactions. The financial industry was attractive because of its propensity to be an early adopter of technology, the impact of the Gramm-Leach-Bliley Act, and the high costs of a breach of security. The health-care industry faced similar pressures from the HIPAA federal regulations. Additionally, the health-care industry comprised more than one million institutions, each a potential customer of SecureNet. Unlike the financial industry, the health-care industry had generally been reluctant to adopt new technology, but with the increasing pressures to reduce costs and improve service, many health-care providers had begun to explore the use of e-commerce and the electronic transmission of information.

SecureBase

SecureNet's first product, SecureBase™, was an e-mail gateway that handled encryption and decryption of messages originating at a corporate e-mail server. SecureBase handled messages in a transparent manner so that the sender of an e-mail never had to find the recipient's public key and could receive e-mail after it had been decrypted. Compared with competing PKI products, SecureBase had the advantages of requiring no installation on end users' desktop computers and no change in the way email was sent or received.

SecureFind

SecureNet's second product, SecureFind™, was defined as a "PKI backbone." SecureFind reduced the complexity of one user's finding another user's public key if they did not share the same SecureBase server. With SecureFind, any two users of SecureBase could send each other secure email by just typing in the other user's email address. By resolving one of the major roadblocks in the adoption of PK technology, SecureNet could build a network of PK repositories. SecureNet realized that SecureFind could be modified to work with other PKIs or SSPs, allowing them the same benefits of SecureBase. At some point, vendors could be included in SecureBase, allowing easier access to suppliers. SecureNet had trademark and patent protection for its Email Security System, Secure Mail Gateway, and SecureFind.

With a new technology that was yet unproven, SecureNet faced sales cycles of three to six months. Sales typically included a working installation of the SecureBase product and technical support. SecureNet products were often evaluated against those of such competitors as Entrust, Verisign, and RSA Systems. Customers remarked on the advanced nature of the product, its technical capabilities, and ease of use. Below are representative customer comments:

The SecureNet system has been a real pleasure to work with, thanks to the ease of installation and the simplicity of its use. Our attorneys can now send and receive encrypted messages from any office PC and from their home PC by dialing into the firm's network.

—Law office

The SecureNet's SecureBase gives us an easy-to-use, easy-to-manage, and practical security strategy for our most valuable customers. We chose SecureNet for their plug-and-play email and document-security offering—a premium service we can put into action immediately.

—Internet service provider

Financing History

Once the merger was completed, Goodson presented SecureNet's business plan to several Northern Virginia venture-capital firms. Looking back at the experience, Goodson recalled: "I must have called 25 firms and they all said the same things. The VCs claimed that my management team was young and had no entrepreneurial experience (see **Exhibit 2**). They were also turned off by our location."

Goodson's initial attempts to attract venture capital were unsuccessful, so he focused his efforts on local investors. In July 2000, SecureNet completed a \$250,000 seed round, selling 100,000 shares of common stock at \$2.50 a share to a group of local investors. The seed round represented 14.1% of SecureNet's equity. Two months later, SecureNet followed this round of financing with a \$250,000 bridge loan, led by Trio LLC. The bridge loan required repayment of \$500,000 upon completion of a Series A round within six months. See **Exhibit 3** for the Pre-Series A capitalization table.

The bridge loan and the proposed \$1.4 million Series A round of financing came from Cyrus Maston, a central Virginia angel investor who headed Trio. Maston, a lawyer by training, left his practice in 1997 to manage his father's estate, worth some \$200 million, and became an active investor in venture capital and real estate. Prior to that, he had been a successful executive in his own right in the mining and energy industries. To date, he had not achieved a great deal of success in his venture investments, as several of his portfolio companies were in liquidation or reorganization. Despite the disappointing results, Maston remained keen on SecureNet.

In October 2000, Trio proposed a \$1.4 million Series A round. Under the proposed terms, Trio would receive convertible preferred stock at \$4.38 a share. The total number of shares to be issued in the round assumed that, in lieu of repayment, the entire bridge loan of \$500,000 would convert into Series A shares at \$4.38 a share. (**Exhibit 4** contains the proposed Series A term sheet.) Although \$1.4 million was a considerable step up in funding, Goodson was concerned about the adequacy of the funding in light of his firm's current high-resource demands. Goodson described SecureNet's use of cash at the time:

For the most part, the money was spent on operating expenses. We were burning through about \$75,000 a month just to make payroll and pay the rent. Add in product-development costs, legal fees, and technology-related expenses, and you've got a burn rate approaching \$150,000 a month.⁶

⁶ Funds were needed solely for operating expenses. There was no need for additional capital expenditures.

Exhibits 5, 6, and 7 show the historical income statement, balance sheet, and financial projections of SecureNet, respectively.

Market Conditions

Market conditions were mixed in the fall of 2000. The NASDAQ had reached record highs in late 1999 and early 2000, but beginning in March, the market began a slide that continued through the fall. Despite this decline, the IPO market continued to flourish. The year 2000 was on track, in terms of the number and dollar amount of IPOs, to finish only slightly below 1999, the best year in history. More important for SecureNet, venture-capital firms were investing at a record pace, especially in the information-technology area. The number of information-technology deals had grown from 2,584, in 1998, to a projected 6,725, in 2000. Reflecting the strong interest in the area, the average amount invested per deal more than doubled, from \$5.7 million, in 1998, to \$13.9 million, in 2000. Following Y2K and several well-publicized Web-site attacks, companies were increasingly concerned about computer and Internet security. Goodson believed these conditions favored SecureNet, and with his initial funding successfully completed, the opportunity might now exist to reapproach some of the venture capitalists who had turned him down earlier. **Exhibit 8** provides a summary of the prevailing current market conditions. **Exhibit 9** provides market multiples for several of SecureNet's competitors.

The Decision

Although revenues had yet to materialize, SecureNet was close to landing several key customers. One prospect was a top financial firm, and another was a large health care company. As of October 2000, SecureNet had enough cash on hand to last several months—but no more than that. Trio's offer had the advantage of immediate availability, but the valuation for the company seemed low in relation to other early-round investments. Although Goodson was confident in the strength of SecureNet's technology, he was less certain about the company's ability to market its products and grow quickly before major competition entered the industry. For this reason, he felt further guidance and expertise in the form of an experienced venture capitalist might be beneficial, assuming he could find one such investor willing to invest. If Goodson brought in an investor other than Trio, however, the company would be forced to find additional financing before March 2001 in order to meet the commitments under the bridge loan.⁷ If Goodson went ahead with Trio's offer of \$1.4 million for the Series A, in all likelihood SecureNet would need additional funding relatively soon thereafter. Venture capitalists understood the need for flexibility in dealing with early-stage companies. Goodson was less certain that Trio, with its limited background in venture capital, would be of similar mind. In any event, Goodson would have to examine the details of the Series A term sheet carefully in order to understand how additional funding might affect the firm's future ability to operate. Not being a lawyer, he did not relish the task ahead.

⁷ That is, the company would forgo its option under the proposed terms of the Series A to convert the bridge loan, and would instead remain subject to the \$500,000 repayment provision of the loan.

Exhibit 1a

SECURENET, INC.: SERIES A ROUND
Symmetrical or Secret Key Encryption Diagram

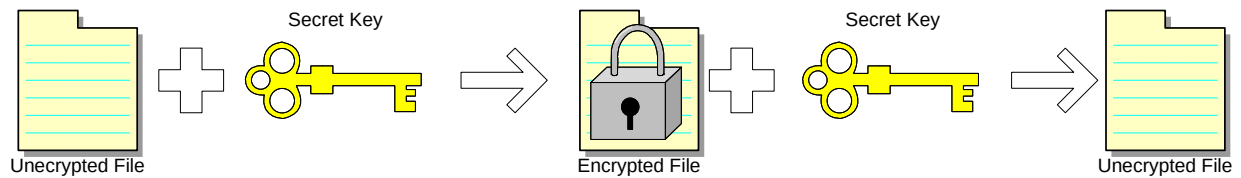


Exhibit 1b

Symmetrical or Secret Key Encryption Diagram

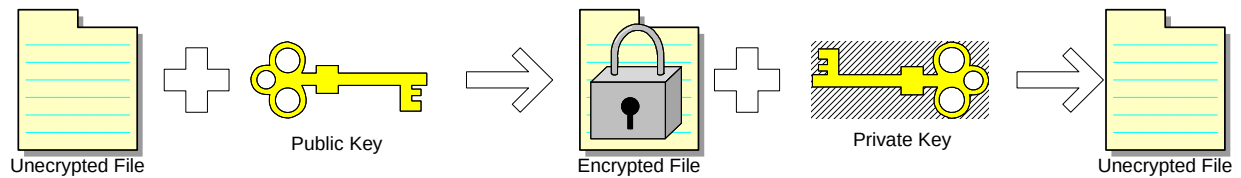


Exhibit 2

SECURENET, INC.: SERIES A ROUND

Management Biographies

Richard Goodson, President

Richard Goodson was the founder and Chief Executive Officer of GroupWorks, Inc., an Internet groupware provider. Prior to founding GroupWorks, he was employed by Bear, Stearns & Co. Inc. in their investment banking technology group. While at Bear Stearns, he advised several Internet-related companies through successful initial public offerings. Mr. Goodson graduated with merit with a BS in Mechanical Engineering from the U.S. Naval Academy at Annapolis, where he competed as a varsity wrestler and qualified as a paratrooper. Upon graduation, Mr. Goodson served as an intelligence officer in the United States Marine Corps. In 1998, he received an MBA from the Darden School at the University of Virginia.

Timothy Rose, National Sales Director

Tim Rose manages SecureNet's sales and marketing initiatives. He has held sales and sales leadership positions at Burton Group, formerly Net Reference, as well as SafeNet, Netrix and Network Equipment Technologies. Mr. Rose brings to SecureNet experience in federal, commercial, international, and original equipment manufacturing (OEM) sales as well as a strong technical and marketing background. Mr. Rose holds a BA from Oberlin College in neuroscience with a minor in computer science, and an MA from George Washington University in Telecommunications. He is a member of Sales & Marketing International and has spoken at numerous international conferences.

William Sherman, CTO

Bill Sherman has 22 years of experience in the computer industry, including computer operations, application design and development, systems programming, systems engineering, consulting and project management. He worked for IBM Global Services, where he served as Senior Consultant to the National Lotus Notes Practice in the U.S. and as Senior Information Systems Architect for IBM UK in Portsmouth, England. He graduated with a BS from Duke University in 1977.

Exhibit 3

SECURENET, INC.: SERIES A ROUND

Capitalization Table

Pre-Series A Capitalization					
Investors	Common Shares	Granted Options¹	Fully Diluted Shares	Percentages held of:	
				Common Shares	Fully Diluted
Founders Shares	53,039	129,121	182,160	10.2%	25.6%
Richard Goodson	157,602	6,125	163,727	30.4%	23.0%
Seed Investors	100,000		100,000	19.3%	14.1%
Other Investors	208,048	57,016	265,064	40.1%	37.3%
Total Shares & Options	518,689	192,262	710,951	100.0%	100.0%

¹ Does not include 258,736 options not yet granted from the authorized pool of 450,998 options.

Exhibit 4

SECURENET, INC.: SERIES A ROUND

Term Sheet

TERM SHEET FOR POTENTIAL INVESTMENT IN
SECURENET, INC.

Confidential

This term sheet summarizes the principal terms with respect to a potential private placement of equity securities of SecureNet, Inc. (the "Company") by a group of investors led by Trio, LLC. This term sheet is intended solely as a basis for further discussion, is not intended to be, and does not constitute a legally binding obligation. No other legally binding obligations will be created, implied, or inferred until a document in final form entitled "Stock Purchase Agreement," is executed and delivered by all parties. Without limiting the generality of the foregoing, it is the parties intent that, until that event, no agreement shall exist among them and there shall be no obligations whatsoever based on such things as parole evidence, extended negotiations, "handshakes," oral understandings, or courses of conduct (including reliance and changes of position). The Company and the investors are discussing a private placement of shares of Preferred Stock on the following terms:

Amount of Investment: \$1.4 million

Type of Security: Shares of the Company's Series A Preferred Stock ("Preferred"), convertible into shares of the Company's Common Stock ("Common").

Price Per Share: \$4.38 (the "Original Purchase Price").

**Rights, Preferences,
Privileges &
Restrictions
of Preferred Stock:**

- (1) Dividend Provisions: The holders of the Preferred will not be entitled to receive dividends except in the sole discretion of the Board whenever funds are legally available and when, as and if declared by the Board.
- (2) Liquidation Preference: In the event of any liquidation, dissolution or winding up of the Company, the holders of Preferred will be entitled to receive in preference to the holders of Common an amount (the "Liquidation Preference") equal to the Original Purchase Price plus any declared and unpaid dividends. After the payment of the Liquidation Preference to the holders of Preferred, the remaining assets shall be distributed ratably to the holders of Common and Preferred (on an as-if-converted basis). At the option of the holders of Preferred, the effectuation by the Company or third party acquirers of a transaction or series of transactions in which more than 50% of the voting power of the Company is disposed of to a single person or group of affiliated persons or the consolidation or merger of the Company with or into any other corporation or corporations or the sale of all or substantially all of its assets shall be deemed to be a liquidation, dissolution or winding up for purposes of the liquidation preference.
- (3) Conversion: A holder of Preferred will have the right to convert Preferred, at the option of the holder, at any time, into shares of Common. The total number of shares of Common into which Preferred may be converted initially will be determined by dividing the Original Purchase Price by the conversion price. The initial conversion price will be the Original Purchase Price. The conversion price will be adjusted to reflect stock dividends, stock splits and similar events and as provided in paragraph (5) below.
- (4) Automatic Conversion: In the event of: (i) a firm commitment underwritten public offering of

shares of the Company at a total offering of not less than \$20 million at a price per share not less than three (3) times the Original Purchase Price (a “Qualifying IPO” or “QPO”); or (ii) the consent of the holders of at least a majority of the then outstanding shares of Preferred, the Preferred will be automatically converted into Common, at the then applicable conversion price.

- (5) Antidilution Provisions: The conversion price of the Preferred will be subject to adjustment, (i) for stock dividends, stock splits, or similar events, and (ii) to prevent dilution in the event that the Company issues additional shares at a purchase price less than the applicable conversion price. No adjustment to the conversion price will occur for any issuance of additional shares at a purchase price in excess of the current conversion price. The conversion price will be reduced to the price at which such additional shares are sold (full ratchet adjustment). Conversion prices will not be adjusted because of (a) conversion of Preferred, (b) the issuance and sale of, or the grant of options to purchase, up to 450,988 shares of Common pursuant to the Company’s employee stock purchase or option plans, or (c) options or stock issued to equipment lessors and bank lenders.
- (6) Voting Rights: Except with respect to election of directors, a holder of Preferred will have the right to that number of votes equal to the number of shares of Common issuable upon conversion of its Preferred at the time the shares are voted. Election of directors will be as described under “Board Representation” below.
- (7) Protective Provisions: The Preferred shall vote on an as-converted basis, but also has a class vote as provided by law. The consent of the holders of at least a majority of the outstanding Preferred, voting as a single class, will be required for any action which would: (i) amend or repeal any provision of, or add any provision to, the Company’s Articles of Incorporation (the “Articles”) or Bylaws to change the rights of the Preferred, or increase or decrease the number of authorized shares of the Preferred; (ii) create any new series or class or shares having a preference or priority as to dividends or assets superior to or on a parity with that of the Preferred; (iii) create any bonds, notes or other obligations convertible into, exchangeable for or having option rights to purchase shares of stock with any preference or priority as to dividends or assets superior to or on a parity with that of the Preferred; (iv) reclassify any class or series of Common into shares with a preference or priority as to dividends or assets superior to or on a parity with that of the Preferred; (v) apply any of its assets to the redemption or acquisition of any shares of Common, except from employees, advisors, officers, directors, consultants and service providers of the Company on terms approved by the Board; (vi) agree to a merger, sale or consolidation of the Company with another entity or the effectuation of any transaction or series of related transactions in which more than 50% of the voting power of the Company is disposed; or (vii) other protective provisions to be set forth in the Articles.

Redemption: At the election of the holders of a majority of the Preferred, the Company shall redeem the Preferred in three (3) equal annual installments commencing six (6) years from the date of purchase by paying in cash an amount equal to the Original Purchase Price plus any declared but unpaid dividends. To the extent that the Company may not at any such date legally redeem such Preferred, such redemption will take place as soon as legally permitted.

Information Rights: The investors shall receive standard information rights including annual audited and quarterly unaudited financial statements. The investors shall receive standard inspection and visitation rights.

Registration Rights: (1) Registration Rights Agreement: The registration rights provisions between the Company and any past purchasers of the Company’s stock shall be merged with the registration rights of the investors in this transaction to be set forth in an Investors Rights Agreement (the “Rights Agreement”).

- (2) Demand Rights on Forms other than Form S-3: If, at any time after the earlier of the effective date of the registration statement for a QPO and the date three (3) years from the purchase of the Preferred (but not within 180 days of the effective date of a registration), investors request that the Company file a Registration Statement for at least 40% of the Common issued or issuable upon conversion of the Preferred, the Company will use its reasonably diligent efforts to cause such shares to be registered. The Company will not be obligated to affect more than two registrations (other than on Form S-3) under these demand registration right provisions.
- (3) Registrations on Form S-3: Holders of at least 20% of the Preferred (or Common issuable upon conversion of the Preferred) will have the right to require the Company to file an unlimited number of Registration Statements of Common on Form S-3 (or any equivalent successor form) if the anticipated aggregate public offering price to the public would equal at least \$500,000. The Company will not be obligated to affect more than two registrations on Form S-3 per year.
- (4) Piggy-Back Registration: The investors will be entitled to “piggy-back” registration rights on registrations of the Company or on any demand registrations, subject to the right of the Company and its underwriters, in view of market conditions, to reduce or eliminate the number of shares of the investors proposed to be registered.
- (5) Registration Expenses: All registration expenses (exclusive of underwriting discounts and commissions and special counsel fees of a selling shareholder) shall be borne by the Company.
- (6) Transfer of Registration Rights: The registration rights may be transferred to a transferee (other than a competitor of the Company) who acquires at least 20,000 of the shares (as adjusted) held by a holder of Preferred (or Common issued upon conversion of Preferred). Transfer of registration rights to a limited or general partner or a wholly owned subsidiary of any investor will be without restriction as to minimum shareholding.
Future Purchasers of Company Securities: Subsequent purchasers of the Company’s securities may be granted information and registration rights upon consent of the holders of at least 51% of the holders of registration rights.
Other Registration Provisions: Other provisions will be contained in the agreements with respect to registration rights as are customary, including cross-indemnification, the Company’s ability to delay the filing of the demand registration for a period of not more than 180 days, the agreement by purchasers of the Preferred if requested by the underwriter in a public offering not to sell any Company securities they hold for a period of up to 180 days following the effective date of the Registration Statement of such offering, underwriting arrangements and the like. The registration rights will only apply to Common issued upon conversion of Preferred and the Company shall have no obligation to register an offering of Preferred.

Board Representation:

The authorized number of directors of the Company will be seven (7). So long as 25% or more of the Preferred issued in this financing remain outstanding, the Preferred (voting as a class) will elect two (2) directors and the Common (voting as a class) will elect five (5) directors. If at any time, less than 25% of the Preferred remains outstanding, all of the directors will be elected by the Common.

Events of Noncompliance and Remedies:

- (1) Events of Noncompliance. An Event of Noncompliance will be deemed to have occurred if:
 - (a) The Company fails to make any redemption payment it is obligated to make, breaches any of the covenants or fails to comply with the provisions of the agreements contemplated by this transaction for the benefit of the investors or fails to comply with other provisions in the Articles applicable to the Preferred, which breach or failure remains uncured for ten (10) business days following written notice to the Company or is incapable of being cured.
 - (b) The Company’s representations and warranties are untrue in any material respect as of the closing, and which remains untrue ten (10) business days following written notice thereof

to the Company or which are incapable of being remedied.

- (c) The Company incurs bankruptcy, receivership, acceleration of third party obligations, assignment for benefit of creditors, or unsatisfied judgment.

- (2) Remedies for Events of Noncompliance. Upon the occurrence of the Event of Noncompliance, holders of a majority of the Preferred may demand immediate redemption of all or any part of their Preferred, in which event all holders thereof shall be entitled to receive written notice thereof and to demand immediate redemption of all or any part of their Preferred.
 - (a) Upon the occurrence of an Event of Noncompliance, holders of Preferred shall have the right to elect a majority of the members of the Board. This right will cease as of the regularly scheduled annual stockholders meeting which follows cessation of the Event of Noncompliance.
 - (b) The foregoing remedies are not exclusive, and other available legal remedies may be pursued, including, without limitation, actions for damages, specific performance or injunctive relief (without the necessity of posting a bond or other security).

Use of Proceeds:

The proceeds from the sale of the Preferred will be used for working capital.

Stock Restriction and Vesting:

The founders of the Company and all other holders of Common who are employees of, or consultants to, the Company will execute a Stock Restriction and Vesting Agreement with the Company pursuant to which the Company will have a repurchase option to buy back at cost a portion of the shares of Common held by such person in the event that such shareholder's employment with, or consulting to, the Company is terminated prior to the expiration of 36 months from the date of the purchase of the Preferred or date of first employment or consulting, whichever is later (the "Starting Date"). A portion of the shares will be released from the repurchase option based upon continued employment by the Company as follows: 1/36th will be released from the repurchase option at the end of each month from the Starting Date. In addition, the Company will have a right of first refusal with respect to any employee or consultant's shares proposed to be resold, terminable upon completion of a public offering by the Company.

Reserved Employee Shares:

The Company may reserve up to 450,988 shares of Common (the "Reserved Employee Shares") inclusive of shares presently reserved for issuance upon the exercise of outstanding options for issuance to employees, officers and consultants. The Reserved Employee Shares will be issued from time to time under such arrangements, contracts or plans as are approved by the board of directors. Issuance of shares or options to employees in excess of the Reserved Employee Shares will be subject to the investors' right of first refusal described below. Holders of Reserved Employee Shares will be required to execute Stock Restriction and Vesting Agreements as described above.

Right of First Refusal:

In the event that the Company offers equity securities (other than Reserved Employee Shares, or upon conversion of outstanding Preferred, or upon exercise of outstanding options or warrants, or in connection with an acquisition or in a public offering), each investor who holds at least 20,000 shares (as adjusted) of the Preferred issued in this private placement shall have a right of first refusal to purchase a pro rata percentage of shares in the new offering, based on the holder's percentage ownership interest in the Company. This right will terminate upon a Qualified IPO.

Stockholders Agreement:

- (1) The founders, the investors and the Company shall execute an amended and restated stockholders agreement, which shall provide for the following rights.
- (2) Right of First Refusal. In the event any founder or investor proposes to sell shares of the Company, the Company, then holders of at least 10% of the Preferred ("Principal Stockholders") will have a right of first refusal on such shares, subject to exceptions for family and estate planning transfers.

Co-Sale Rights. In the event any founder or investor proposes to sell shares of the Company which in the aggregate constitute greater than 50% of all Company shares, and the Company and the Principal Stockholders do not purchase such shares pursuant to their right of first refusal (as described in (2), above), then each remaining founder or investor ("Remaining Stockholders") will be entitled to participate in such sale by selling the same percentage of his stock (except for any Reserved Employee Shares) as such founder or investor is selling. This right will terminate upon the earlier to occur of the Company's initial public offering or a sale of the Company.

- (3) Drag-Along Rights. In the event any founder or investor proposes to sell shares of the Company which in the aggregate constitute greater than 50% of all Company shares, and the Company and the Principal Stockholders do not purchase such shares pursuant to their right of first refusal (as described in (2), above), then such founder or investor may require all Remaining Stockholders to sell all shares (except any Reserved Employee Shares) owned by them.

Confidential Information, Non-solicitation, Inventions Assignment:

Each officer, director and key employee of the Company will enter into a Confidential Information, Non-solicitation and Inventions Assignment Agreement in a form reasonably acceptable to the Company and the investors.

The Stock Purchase Agreement:

The purchase of the Preferred, if consummated, will be made pursuant to a Stock Purchase Agreement (with exhibits) drafted by counsel to the investors and acceptable to the Company and the investors. The Stock Purchase Agreement will contain, among other things, representations and warranties of the Company, covenants of the Company, and conditions to the obligations of the investors.

Conditions of Closing:

The closing for the purchase of the Preferred will be conditioned upon:

- (a) Completion of due diligence to the satisfaction of the investors in their sole discretion.
- (b) Execution by the Company of the Stock Purchase Agreement and related agreements satisfactory to the investors in their sole discretion.
- (c) Compliance by the Company with applicable securities laws.
- (d) Opinion of counsel to the Company rendered to the investors in form and substance satisfactory to the investors.
- (e) Key man life insurance having been obtained for the benefit of the Company on Richard Goodson for \$500,000.
- (f) Such other conditions as are customary for transactions of this type.

Expenses:

Each party will pay its own fees and expenses incurred in connection with this transaction.

Closing:

The closing of the transaction, if all conditions are met, is expected to occur on or before January 15, 2001.

Exhibit 5

SECURENET, INC.: SERIES A ROUND

Income Statement

	2000			2001 Projections				
	Q3 Act.	Q4 (Est.)	FY (Est.)	Q1	Q2	Q3	Q4	FY
Revenue	\$0.0	\$0.0	\$0.0	\$2.5	\$97.5	\$10.0	\$7.5	\$117.5
Cost of Goods	<u>1.8</u>	<u>19.0</u>	<u>20.8</u>	<u>32.9</u>	<u>19.0</u>	<u>19.4</u>	<u>18.4</u>	<u>89.7</u>
Gross Profit	(1.8)	(19.0)	(20.8)	(30.4)	(78.5)	(9.4)	(10.9)	(27.8)
Product Development	50.5	119.4	169.9	141.1	183.6	192.8	173.2	690.7
S, G & A	<u>111.8</u>	<u>288.4</u>	<u>400.2</u>	<u>263.2</u>	<u>373.4</u>	<u>292.7</u>	<u>270.1</u>	<u>1,199.4</u>
EBITDA	(164.1)	(426.8)	(590.9)	(434.7)	(478.5)	(494.9)	(455.0)	(1,863.1)
Depreciation	<u>2.7</u>	<u>1.1</u>	<u>3.8</u>	<u>1.0</u>	<u>1.0</u>	<u>1.1</u>	<u>1.0</u>	<u>4.1</u>
EBIT	(166.8)	(427.2)	(594)	(435.7)	(479.5)	(496.0)	(456.0)	(1,867.2)
Interest Expense	0.0	0.0	0.0	0.0	0.0	0.8	8.8	9.6
Interest Income	<u>0.0</u>	<u>0.7</u>	<u>0.7</u>	<u>0.5</u>	<u>0.5</u>	<u>0.5</u>	<u>0.0</u>	<u>1.5</u>
Pretax Income	(166.8)	(427.2)	(594.0)	(435.2)	(479.0)	(496.3)	(464.8)	(1,875.3)
Other Expense	0.0	0.2	0.2	0.0	0.3	(0.3)	0.1	0.1
Income Taxes	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
Net Income	(\$166.8)	(\$427.4)	(\$594.2)	(\$435.2)	(\$479.3)	(\$496.0)	(\$464.9)	(\$1,875.4)

Exhibit 6

SECURENET, INC.: SERIES A ROUND

Balance Sheet

	<u>12/31/2000</u> <u>(projected)</u>
<u>ASSETS</u>	
Cash	\$12.4
Accounts Receivable	13.1
Prepaid Expenses	0.0
Other Current Assets	<u>36.4</u>
Total Current Assets	61.9
Property, Plant and Equipment (net)	147.8
Other Long-Term Assets	<u>28.7</u>
Total Assets	\$238.4
<u>LIABILITIES & STOCKHOLDERS' EQUITY</u>	
Accounts Payable	\$77.3
Pre-received Income	0.0
Accrued Expenses	<u>27.8</u>
Total Current Liabilities	105.1
Other Liabilities	9.5
Long Term Debt	<u>507.3</u>
Total Liabilities	621.9
Stockholders' Equity	<u>(383.5)</u>
Total Liabilities & Stockholders' Equity	\$238.4

Exhibit 7

SECURENET, INC.: SERIES A ROUND

Financial Projections

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Revenue	\$117.5	\$3,786.3	\$21,821.3	\$55,630.0	\$84,833.7
<i>% Growth</i>	<i>NM</i>	<i>NM</i>	476%	155%	52%
Cost of Goods	<u>89.7</u>	<u>507.9</u>	<u>1,721.0</u>	<u>2,768.2</u>	<u>3,558.4</u>
Gross Profit	27.8	3,278.4	20,100.3	52,861.8	81,275.3
<i>Gross Profit Margin</i>	24%	87%	92%	95%	96%
Product Development	690.6	920.3	4,228.6	11,770.5	18,819.9
S,G & A	<u>1,200.1</u>	<u>4,592.4</u>	<u>12,889.5</u>	<u>24,077.7</u>	<u>31,082.3</u>
EBITDA	(1862.9)	(2,234.3)	2,982.2	17,013.6	31,373.1
<i>EBITDA Margin</i>	<i>NM</i>	<i>NM</i>	14%	31%	37%
Depreciation	<u>4.2</u>	<u>159.9</u>	<u>2,475.0</u>	<u>6,575.7</u>	<u>10,606.2</u>
EBIT	(1,867.1)	(2,394.2)	507.2	10,437.9	20,766.9
<i>EBIT Margin</i>	<i>NM</i>	<i>NM</i>	2%	19%	24%
Interest Expense	9.6	41.2	0.0	0.0	0.0
Interest Income	<u>1.5</u>	<u>56.1</u>	<u>308.0</u>	<u>223.7</u>	<u>294.4</u>
Pretax Income	<u>(1,875.2)</u>	<u>(2,379.3)</u>	<u>815.2</u>	<u>10,661.6</u>	<u>21,061.3</u>
<i>Pretax Margin</i>	<i>NM</i>	<i>NM</i>	4%	19%	25%
Income Taxes	<u>0.0</u>	<u>0.0</u>	<u>322.0</u>	<u>4,265.0</u>	<u>8,425.0</u>
Net Income	<u>(1,875.2)</u>	<u>(2,379.3)</u>	<u>493.2</u>	<u>6,396.6</u>	<u>12,636.3</u>
<i>Net Income Margin</i>	<i>NM</i>	<i>NM</i>	2%	11%	15%

Exhibit 8

SECURENET, INC.: SERIES A ROUND

Market Conditions

All Private Equity Backed IPOs										
Year	IPOs Number	IPOs Amount (\$)	Offer Amount (\$M)		Post Offer Value (\$M)		Age @IPO (yrs)			
			Average	Median	Total	Median	Average	Median		
1995	193	8447.0	43.8	34.1	35,198.5	182.4	117.3	9.1	7.2	
1996	268	11,930.5	44.5	33	57,029.1	212.8	111.9	7.2	5.5	
1997	168	8,031.2	47.8	33.8	35,795.1	213.1	121.1	8.9	5.5	
1998	97	6,757.9	69.7	47.9	36,933.9	380.8	197.7	8.5	4.9	
1999	284	26,142.4	92.1	64	147,022.8	517.7	350.4	6	4.3	
2000	242	24,165.9	99.9	76.5	123,373.8	509.8	257.9	7.8	4.9	
TOTAL	1,252	85,474.9	68.3	47.5	435,353.3	347.7	178.7	7.6	5.2	
Cumulative Fund Performance by Stage of Investment through 2000 Internal Rate of Return (IRR) (%)										
Fund Type	Average	Capital Wtd Average	Maximum	Upper Qtr	Median	Lower Qtr	Minimum			
Early/Seed	32.8	34.4	809.5	39.3	13	0.6	-100			
Seed Stage	15.3	22.5	316	18.5	8.7	1.8	-100			
Early Stage	35.6	35.2	809.5	41.5	14.7	0.4	-60.5			
Balanced	17.7	17.5	398	21.9	9.8	1.6	-98.7			
Later Stage	20.4	13.4	220.5	25.9	10.3	0	-73			
All Venture	24.8	23	809.5	28.3	10.9	0.9	-100			

Exhibit 8 (continued)

Disbursements by Private Equity Funds to Portfolio Companies (\$M)					
Industry	Number of Deals	Average Invested per Deal	Total Invested Amount and Percent		
01/01/1998 to 12/31/1998					
Information Technology	2,584	\$5.7	\$14,586.7	66.6%	
Non-High Technology	989	\$3.7	\$3,684.7	16.8%	
Medical/Health/Life Science	761	\$4.8	\$3,624.1	16.6%	
TOTAL	4,334	\$5.1	\$21,895.4	100.0%	
01/01/1999 to 12/31/1999					
Information Technology	4,482	\$10.3	\$45,966.2	81.6%	
Non-High Technology	655	\$9.1	\$5,936.2	10.5%	
Medical/Health/Life Science	678	\$6.5	\$4,400.5	7.8%	
TOTAL	5,815	\$9.7	\$56,302.8	100.0%	
01/01/2000 to 12/31/2000					
Information Technology	6,725	\$13.9	\$93,455.2	86.1%	
Non-High Technology	914	\$8.3	\$7,614.0	7.0%	
Medical/Health/Life Science	750	\$10.1	\$7,538.2	6.9%	
TOTAL	8,389	\$13.0	\$108,607.4	100.0%	
Benchmark Annualized Returns as of 12/31/2000					
	Index Value	One Year	Three Year	Five Year	Ten Year
PVCI ¹	764.3	−43.8%	16.5%	13.4%	20.8%
S&P 500	1,320.3	−10.1%	11.4%	16.5%	15.1%
NASDAQ	2,470.5	−39.3%	15.6%	18.6%	21.3%
Dow Jones 30	10,786.9	−6.2%	11.3%	16.1%	15.5%

¹ - Warburg Pincus/Venture Economics Post-Venture Capital Index (PVCI)

Source: Thomson Financial.

Exhibit 9

SECURENET, INC.: SERIES A ROUND

Market Multiples for Security Software Firms

(\$Millions)	Sales (\$)	EBITDA	Assets	Market Value Equity (MV)	MV÷ Sales	MV÷BV of Equity (BV)	MV÷ EBITDA	PRICE÷ EPS	BV÷ Sales	Sales÷ Assets	Beta
Company Name											
ENTRUST, INC	126.6	2.9	734.1	1,725.48	13.6	2.6	593.3	14.0	5.3	0.17	3.46
RSA SECURITY	264.0	52.0	589.5	1,728.9	6.6	3.69	33.3	11.9	1.8	0.45	2.36
VERISIGN, INC	305.1	70.5	19,195.2	14,699.3	48.3	0.8	208.5	60.5	0.02	0.02	2.40
NETEGRITY, INC	54.0	(2.2)	138.4	1,639.4	30.5	13.9	(745.2)	2.2	0.39	0.39	3.49
ZIXIT CORP.	0.39	(41.3)	78.7	408.9	1,037.8	5.4	(9.9)	190.7	0.00	0.00	2.06

Entrust provides Internet security solutions and services. The company has a broad set of identification, entitlements, verification, privacy, and security management capabilities.

Netegrity designs, develops, markets, and supports software for controlling user access to electronic commerce applications. The company also offers a full range of professional services to integrate, implement, and support its software product offering.

RSA Security provides electronic security solutions. Its products are designed to help organizations ensure the authenticity of the people, devices, and transactions involved in e-business.

Verisign is a provider of Internet-based trust services including authentication, validation, and payment needed by Web sites, enterprises, e-commerce service providers, and individuals to conduct trusted and secure e-commerce and communications over IP networks.

ZixIT develops and markets products and services that enhance privacy, security, and convenience over the Internet.

Source: Research Insight, Inc.; Dow Jones, Inc.