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INSTITUTIONAL RESEARCH
Technology
INITIATION REPORT

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VirnetX Holding Corporation (NYSE/VHC)

BUY **Secure in Growth & Appreciation**

VirnetX holds patents and technology for secure real-time communications

Investment Highlights

1) VirnetX' declaration of 23 patents and 28 applications essential to 4G and Long Term Evolution (LTE) wireless security standards this morning is expected to provide a boost to the Company's already busy licensing program. The speedy 4G/LTE standard is expected to be the next generation for wireless communications and see a major transition from 3G over the next several years as enterprise end-users and consumers seek wider bandwidth and faster speeds to access increasing amounts of data. VirnetX' declaration will open up secure computing licensing opportunities from makers of chips, servers, smartphones, laptops, netbooks and other devices gearing up for the 4G market, especially among growing concerns from corporations, consumer groups and government agencies related to internet security issues.

2) VirnetX is set to launch its first Beta test site for its GABRIEL Connection Technology in coming months, which will be the cornerstone for an eventual product line encompassing software development kits, a secure domain name registry, and related directory services. In addition to the 4G/LTE declaration made today, the Company is also actively negotiating with household-name partners including leading global wireless OEMs, service providers, enterprise system integrators, government system integrators, and identity & authentication service companies.

3) Not to be overlooked by investors, **the March 2010 court date for the Company's patent litigation against Microsoft (relating to operating systems generating over $50 billion in annual sales)** is rapidly approaching. After two years of hard work, including adding a third patent to the original two named and signing on a leading patent litigation firm with a track record of winning claims against Microsoft in the same US District Court, the Company is looking to ride the momentum from its July Markman claim construction ruling to obtain a positive outcome in this expected-to-be-brief trial.

Current Price	**$3.29**
Price Target	**$6.00**

Estimates	F2008A	F2009E	F2010E
Revenues($000s)	$134	$1,014	$4,000
EPS	($0.35)	($0.31)	($0.27)

Stock Data	
52-Week Range	$0.89-$5.00
Shares Outstanding (mil.)	40.6
Market Capitalization (mil.)	$133.5
Enterprise Value (mil.)	$129.6
Debt to Capital (6/09)	N/A
Book Value/Share (6/09)	N/A
Price/Book	N/A x
Average Trading Volume (10-Day)	100,000
Insider Ownership	38.2%
Institutional Ownership	6.0%
Short interest	450,000
Dividend / Yield	$0.00/0.0%

Price target and ratings changes over the past 3 yrs:
Initiated - December 2, 2009 - Buy -Price Target $6.00

Conclusion

VirnetX has received a flurry of positive news this year, including a favorable ruling on its years-old Microsoft litigation as well as new allowances that strengthen its other patent holdings, with potentially more positive announcements to follow in 2009-2010 as Company management begins to execute on its long-term partnership strategy. Still, VirnetX's shares have underperformed others in its industry (see Table 1.) and we believe these shares have further appreciation potential. Thus, we are initiating coverage on VHC with a BUY rating and an 18-24 month price target of $6.00, still below highs of just last year.

History/Capitalization

VirnetX was incorporated as VirnetX, Inc. in August 2005 in the state of Delaware. In November 2006, VirnetX acquired a number of patents from SAIC and many of its key executives began employment on a full-time basis. In July 2007, VirnetX began publicly trading on the American Stock Exchange through a reverse merger with PASW, Inc., which at that time had limited operations. Later in 2007, the Company changed its complete name to VirnetX Holding Corporation. VirnetX has its headquarters in Scotts Valley, California.

The Company has funded its operations since inception through a number of private and public offerings, including in December 2007, January 2009 and September 2009.

Products/Markets

VirnetX' patented GABRIEL Connection Technology combines industry standard encryption protocols with the Company's patented techniques for automated domain system (DNS) lookup mechanisms. In addition to GABRIEL, which will enable users to create secure domain names, the Company intends to establish the exclusive domain name registry in the US and other key international markets. VirnetX's patented GABRIEL Connection Technology provides the only seamless, automated security platform which provides secure communications by next-generation Internet-based applications. The key benefits and features of the GABRIEL technology include:

1) Seamless and automatic appearance to the user - After a one-time registration, users connect securely using a simple format, with no cryptographic or password information required;

2) Secure data communications – Users create secure networks with trusted sources and communicate over a secure channel;

3) Control of data at all times – Users can secure and customize their unified communication and collaboration applications with policy-based access and secure presence information;

4) Authenticated users – Users know that they are communicating with other trusted users that have secure domain names; and

5) Application-agnostic technology – This technology provides security at the IP layer of a network by using patented DNS lookup mechanisms to make connections between secure domain names.

There are four primary end-markets for VirnetX's secure real-time communications technology: IP Telephony, Mobility, Fixed Mobile Convergence, and Unified Communications. In addition, a new potential application is rapidly developing and may soon offer opportunities for the Company: Cloud Computing arising out of 4G technological advances. The primary markets, current participants, and market potential are as follows:

IP Telephony

IP (Internet Protocol) telephony includes technologies that use packet-switched connections to exchange voice, fax, and other forms of information traditionally carried over the circuit-switched connections of the public switched telephone network, or PSTN. The adoption of IP telephony, most notably Voice over Internet Protocol (VoIP) gateways and hosted services, has helped many businesses significantly lower network operating costs by using a common network for voice and data. IP telephony-enabled mobile features have been particularly important as the corporate workforce becomes increasingly dispersed. Related security infrastructure for IP telephony, however, has lagged behind the growth of this technology, leaving these new networks and services vulnerable to a number of threats and annoyances. What's more, use of new IP telephony networks has increasingly been extended beyond the boundaries of an organization's private network, increasing security threats.

The market for IP telephony products and services, including PBX systems and IP phones, VoIP gateway equipment, VoIP hosted services and IMS equipment for service providers was estimated at over $24 billion annually, and is forecast to continue to grow at a 20%+ annual rate over the next several years. Key providers in the IP telephony market include Alcatel-Lucent, Avaya, NEC, Skype (formerly part of eBay) and Cisco Systems.

Fixed-Mobile Convergence

Fixed-mobile convergence occurs when wireline and wireless telephones work together with Internet Protocol to deliver services, including voice, video and/or data uniformly across multiple access networks. These networks include WiMAX, WiFi, cellular and fixed. This market has grown extremely fast over just the past few years, as consumers increasingly need to be connected and have real-time access to media streams, blogs and breaking news, according to the industry group Fixed-Mobile Convergence Alliance (FMCA), an alliance of leading operators representing over 850 million customers worldwide. Typical forms of media-rich, real-time communications include e-commerce, social networking, and online dating. Mobile devices like dual mode (cellular/WiFi) phones are key to the growth of this market along with related service providers in both enterprise and consumer markets.

The annual market for fixed-mobile convergence services and products, including dual-mode cellular/WiFi phones, related network controllers, and multi-access convergence gateways is estimated at $31 billion, and is forecast to grow at 35% annually over the next several years. Key players in this market are Alcatel-Lucent, Ericsson, Motorola, Nokia and Samsung.

IP Mobility

Smartphones, multi-functional devices that handle a wide variety of complex functions including Internet access, e-mail access, calendars and scheduling, data processing, and contact management, have grown in use over the past several years as these devices have become more powerful and as new providers have entered the market. Originally the domain of business-oriented providers such as Research in Motion's Blackberry product line, new phones have expanded the market, especially Apple Computer's iPhone, but also new offerings from more conventional phone manufacturers including Samsung, Motorola, LG, Nokia and Sony Ericsson. In addition to consumer use, business use of smartphones has increased as well, as mobile workers seek similar functionality inside or outside the home office. However, this increased mobility also presents increased security risk, for example, from rogue users who may be able to enter the corporate enterprise network through wireless access points. Providing authenticated access to corporate wireless networks and enterprise applications through the wireless domain represents a significant market opportunity for VirnetX or a potential partner on a "zero-click" or "single-click" basis, without the need for end-users to enter encryption codes.

The market for IP mobility, primarily smartphones and mobile standalone data cards, is currently estimated at $44 billion annually and is forecast to grow at 9% per year over the next several years.

Unified Communications

Unified communications encompasses organizing the array of communication methodologies. The basic components comprising unified communications include directories for storing addresses, message storage, and secure presence of a user's status for each node of communication such as available, away, busy, etc. Compared to the markets above, Unified Communications is fairly small, with approximately $400 million in revenue in 2006, and is forecasted to grow 17% annually over the coming years. Key providers include Alcatel-Lucent, Avaya, NEC, and Cisco Systems. However, this application has not yet reached its full potential due to a lack of transparent and seamless security, creating hesitation on the part of users due to the lack of credentials verification by a neutral third party. VirnetX's technology and products can help address these concerns and help grow the Unified Communications market more rapidly than in the past.

Cloud Computing

A fifth, and most recent, potential market for VirnetX's secure private networks is Cloud Computing, defined as the use of the internet by enterprises for off-loading software and hardware (primarily storage) needs, thus saving the costs of purchasing frequent software upgrades and additional storage capacity as businesses grow. Generally speaking, cloud computing providers fall into three categories: software-as-a-service providers; infrastructure-as-a-service vendors that offer Web-based access to storage and computing power; and platform-as-a-service vendors that give developers the tools to build and host Web applications. Major cloud computing vendors include IBM, Amazon and Google.

However, with the growth in the use of cloud computing have come potential risks for corporate users. Ephraim Schwartz writes in a July 2008 *Infoworld* article entitled "The dangers of cloud computing":

"The idea of cloud computing -- designed around an architecture whose natural state is a shared pool outside the enterprise -- has gained momentum in recent months as a way to reduce cost and improve Information Technology (IT) flexibility. But the use of cloud computing also carries with it security risks, including perils related to compliance, availability, and data integrity.

Yet many companies don't think through those risks upfront. And where the decision is made to put some services and applications in the cloud, the business must ask how that risk should be managed. But in the meantime, until security models and standards emerge for cloud computing architecture, most of the risk and blame if something goes wrong will fall directly on the shoulders of (the Corporation's department of) IT -- and not on the cloud computing service providers. ...

Ultimately, the consumer of the services is responsible for maintaining the confidentiality, integrity, and availability of data."

The current **competitive landscape** for the Company's product lines can be segmented into three groups:

1) SIP Firewalls – Firms such as Borderware, Ingate and Cantata Technology provide application layer gateways that manage and protect the flow and quality of VoIP and other SIP-related communications. The drawbacks of these products include a failure to provide end-to-end security;

2) Session Border Controllers (SBC) – A number of firms, such as Acme Packet, AudioCodes, DiTech Networks, Nextpoint and China-based Huawei sell these devices which are used in networks to exert control over the signaling and media streams involved in VoIP calls. The limitations on these systems is such that every data packet must be decrypted and analyzed, thereby preventing end-to-end encryption; and

3) Proprietary or Homegrown Security Solutions – Large communication vendors have developed security systems that have been integrated directly into their product offerings. The problem with these solutions is that they create corporate networks that are isolated and that restrict enterprises, and also that they lack security functioning between domains.

Recent Results

VirnetX reported their third quarter financial results in an early November filing of their 10Q with the SEC. In the quarter, the Company generated over $20,600 in revenues, solely from the single license agreement through a Japanese subsidiary, down from $23,900 in the same period one year ago. Research and development expenses stayed relatively constant year-over-year, at $215,000 for the quarter, primarily driven by a like number of in-house employees and engineering activities. Selling, general & administrative expenses decreased by $340,000 to $2.4 million during the third quarter, due primarily to reduced outside legal fees caused by a lull in the court calendar as the Microsoft patent infringement litigation awaits trial next spring. Altogether, VirnetX lost ($2.6 million) or ($0.07) per share in Q3/2009, versus a loss of ($2.9 million) or ($0.08) per share in Q3/2008.

Cash burn during the quarter was approximately $1.5 million, a decrease from approximately $3 million in each of the first two quarters of this fiscal year and from quarterly levels near $3 million in fiscal 2008 also.

Balance Sheet and Operating Cash Flow

VirnetX maintained $4.0 million in cash and equivalents at September 30th, offset by $120,000 in short- and long-term obligations, primarily related to operating lease obligations. The cash on hand at September included the net proceeds of approximately $5.4 million from a recent private placement. In addition, the September 2009 private placement included a short-term Series III warrant which could raise an additional $6 million during the 60-day period following effectiveness of the registration statement. We estimate that the Company will maintain its current quarterly cash burn rate of approximately $1.5 - $2.0 million, at least through the current quarter, although operating cash use could increase next year as the Microsoft patent infringement court date approaches (March 2010) or with the signing of new licensing agreements which might require ramped-up R&D and engineering work. At current levels of cash burn, barring additional funding or stepped-up R&D spending, we estimate that VirnetX has approximately 6 months of operating cash burn on hand, although exercise of the Series III short-term warrants and/or the signing of new licensing deals could extend this period for a number of quarters.

Outlook/Growth Drivers

VirnetX's most immediate growth driver is expected to be an upcoming declaration of secure patents for the 3G protocol into the new 4G, targeted for the end of this year. This declaration, key for the increasing use of cloud computing, as well as the success of earlier patent licensing activities are anticipated to lead to one or more licensing agreements, including upfront license fees and ongoing sales royalties, beginning as early as the end of this year but also possibly in 2010. Initial licensing agreements are expected to revolve around the Company's GABRIEL Software Development Kits. Also upcoming in 2010 is the start of the Microsoft litigation trial, which could have positive financial implications on VirnetX, if successful, or could reduce ongoing legal expenses even if not. Finally, VirnetX is targeting initial license fees and ongoing sales royalties from a Secure Domain Name Registry the Company hopes to establish in 2010 or 2011, along with ongoing revenues from a Master Registry and Conversion Service business model to be set up in accordance with the registry.

For our projections, we are assuming one partnership agreement to be completed by the end of the year, perhaps with a small initial fee only, with 1-2 more similar partnerships established next year. We are also anticipating that ongoing royalty payments may begin to accrue to VirnetX in 2010, most likely the latter part of the year. For 2011, we are projecting that additional license agreements will be signed, but that recurring service and royalty revenue will begin to play a more prominent role in the income statement. We are not assuming any additional revenues from the ongoing Microsoft litigation, scheduled to come to trial early next year.

We have also assumed moderate but steady increases in R&D and general and administrative expenses the next two years, although the start of revenue production for VirnetX is forecast to lead to decreased loss from operations through 2011.

Management

Kendall Larsen is CEO, President and Chairman of the Company and has held the same positions since inception in August 2005. Prior to 2005, Mr. Larsen focused on activities related to the formation of VirnetX. Mr. Larsen has also held positions as a Limited Partner at Osprey Ventures, as a Senior Vice President of the Security Products Division of Phoenix Technologies, and senior executive positions at technology firms including RSA Security, Xerox, Rolm/IBM, Novell, General Magic and Ramp Networks. Mr. Larsen holds a BS degree in Economics from the University of Utah.

Edmund Munger has been Chief Technology Officer and a Director since 2006. Prior to joining the Company, Mr. Munger held various positions with SAIC and the FBI. Mr. Munger is named as a co-inventor on most of the patents in the VirnetX patent portfolio. Mr. Munger holds an MS degree in engineering from MIT and a BS degree from the US Naval Academy.

Bob Short has been the Chief Scientist for VirnetX since 2006. Prior to joining the Company, Dr. Short held various positions at SAIC, and also has held positions at ARCO and Sperry. Dr. Short is named as co-inventor on most of the patents in the VirnetX patent portfolio. Dr. Short holds a Ph. D. degree in Electrical Engineering from Purdue University along with Master's and Bachelor's Degrees from Virginia Tech.

William E. Sliney has been Chief Financial Officer of VirnetX since 2007. Prior to joining the Company and its predecessor PASW, Mr. Sliney was CFO of Legacy Software and CEO of Gump's, a retailer based in San Francisco. Mr. Sliney holds an MBA degree from UCLA.

In addition to management team members Mr. Larsen and Mr. Munger, VirnetX's board includes **Scott C. Taylor**, currently Executive Vice President and General Counsel of Symantec; **Michael Angelo**, currently a Senior Architect with NetIQ Corporation and formerly with Microsoft, Hewlett Packard and Compaq Computer; and **Thomas M. O'Brien**, currently Senior Vice President of Reit Management and Research. Advisory Board Members include **John Cronin**, Managing Director of ipCapital Group and formerly head of IBM's "Patent Factory"; **Paul Henderson**, currently Managing Director of Clarify, LLC, and formerly Director of IP acquisition at Hewlett-Packard, and **John F. Slitz**, Chairman of World Series of Golf and formerly with System Research and Development, IBM, Novell and Osprey Ventures.

Intellectual Property

VirnetX has a large patent portfolio, comprising 12 US and 8 international patents, as well as 12 pending applications in the US and 16 overseas. The Company's patent portfolio is focused on securing real-time communications over the internet, as well as related services including the establishment and maintenance of a secure domain name registry. The various terms of the issued US and international patents are not set to expire until 2019 to 2024. The Company's key patents and their description are listed in the table below:

Patent	Description
US 6,502,135	Method for transparently creating a virtual private network in response to a domain name query
US 6,839,759	Method for automatically establishing secure a secure communication link between computers of a virtual private network (VPN) without the user entering any cryptographic information
US 7,188,180	Method of establishing a secure communication link between computers of a virtual private network
US 7,209,479	Third party VPN certification
US 7,418,504	Agile network protocol for secure communications using secure domain names
US 7,490,151	Establishment of a secure communication link based on a domain name service (DNS) request

VirnetX's other US patents include: 6,618,761 – *Agile network protocol for secure communications with assured system availability;* 6,826,616 - *Method of establishing a secure communication link between computers of a virtual private network;* 6,834,310 – *Preventing packet flooding of a computer on a computer network;* 6,907,473 - *Agile network protocol for secure communications with assured system availability;* 7,010,604 - *Agile network protocol for secure communications with assured system availability;* and 7,133,930 - *Agile network protocol for secure communications with assured system availability*.

Most of the Company's patents were originally acquired from SAIC pursuant to several agreements and amendments signed between 2005 and 2008. Pursuant to this acquisition and later amendment, SAIC has a non-exclusive, royalty-free and worldwide license to use and make improvements to these patents outside of the Company's field of use, which generally encompasses secure communications.

In March 2008, VirnetX hired the ipCapital Group to help support the Company's licensing business. The ipCapital Group is led by John Cronin, also a Director of VirnetX, who patented 100 inventions over a 17 year career at IBM where he led the so-named "IBM Patent Factory" group and increased IBM's annual licensing revenue from $30 million in 1992 to more than $1 billion in 1997. As part of this success-based compensation agreement, ipCapital will accelerate the licensing of VirnetX's patent portfolio by providing strategic planning, development, assessment and implementation of the IP licensing program.

In addition to the global OEMs listed above, other potential channel partners include: Global Service Providers such as AT&T, Google, DoCoMo, Verizon and Vodafone; Commercial System Integrators such as CSC, Accenture, HP, IBM and Price Waterhouse Coopers; Government System Integrators such as Booz Allen Hamilton, CACI, Lockheed Martin, SAIC and Northrup Grumman: and authentication service providers such as VeriSign.

Microsoft Litigation

On February 15, 2007, VirnetX initiated a lawsuit against Microsoft in the US District Court for the Eastern District of Texas (Tyler), in which the Company alleged that Microsoft infringes on two of the VirnetX's patents related to the creation of virtual private networks, or VPNs. On April 5, 2007, the original complaint was amended to include a third patent. Altogether, 18 claims were made covering eight Microsoft products including major systems software such as Windows Vista, XP, Server 2003 and 2008 and Office Communicator, comprising over $50 billion in sales in the most recent full year, 2008. On February 17, 2009 a Markman hearing on claim construction was conducted by the Tyler District Court and on July 31, 2009, the Court issued a Markman Order in which the Court adopted interpretations that the Company believes are favorable on many of its claim terms that were in dispute in the litigation. Earlier this summer, in June 2009, VirnetX hired McKool Smith, an experienced Texas-based patent litigation firm which had recently won a $200 million patent infringement case against Microsoft (also in the Tyler District Court), to spearhead its litigation effort against Microsoft. Following the July Markman ruling, VirnetX management outlined their ongoing strategy regarding patent litigation in general. The Tyler District Court trial is expected to begin in March 2010.

Stock Valuation/Comparables

We have compiled a six-stock comparison group for VirnetX in Table 1, including both small and large providers of communications equipment and services. Some of the companies in our comparable table are competitors in the internet security space, including SBC providers Acme Packet (Nasdaq/APKT/Not Rated) and AudioCodes (Nasdaq/AUDC/NR), while others in our group are potential partners such as Qualcomm (Nasdaq/QCOM/NR) and VeriSign (Nasdaq/VRSN/NR), and the remaining pair, Broadcom (Nasdaq/BRCM/NR) and InterDigital Communications (Nasdaq/IDCC/NR) simply compete in related markets. On average, the stocks in this comparison group trade at very healthy multiples, 25x this year's estimated earnings, 17x next year's estimated earnings, and nearly 4x this year's estimated revenues, most likely due to the high growth rates (50% estimated for 2010E over 2009E on average) for the group and for the industry as a whole. Because VirnetX is not yet profitable and is not expected to be profitable next year, it is difficult to directly compare and value VirnetX with the larger, more established six-stock group included in our table. However, we can compare how these stocks have traded over the past twelve months as the stock market has recovered, vis-à-vis their earlier 52-week highs. On this basis, VirnetX' shares still have some appreciation to accomplish, despite the recent strength in price, as VHC is trading at approximately 34% below its 52-week high as compared with an average of 12% for the six-stock comparable group. Thus, we are recommending that investors purchase these shares with an 18-24 month price target of $6.00, just slightly above highs from earlier this year and on par with highs from a more optimistic stock market early in 2008. On the other hand, VirnetX shares have responded strongly in their limited history to positive news, and should the Company execute on its patent licensing and/or patent litigation strategies in the near future we can foresee these shares performing a trading break-out over previous highs set in 2008 in the $6 range.

Catalysts/Investor Timeline

1) Declaration of secure patent portfolio for 3G into 4G – End of year 2009
2) GABRIEL Connection Technology Beta testing rollout– End of year 2009
3) Microsoft litigation – Start of trial – March 2010
4) Licensing Agreements – Initial – Q4/2009
5) Licensing Agreements – Ongoing, Upfront fee plus royalties – 2010-11
6) GABRIEL Software Development kits – Initial sales – 2010-11
7) Secure Domain Name Registry – Initial license fees/sales royalties – 2010-11
8) Secure Domain Name – Master Registry and Conversion Service - 2011

Risk Factors

We believe an investment in VirnetX involves the following risks:

- **Lack of profitability –** VirnetX has not generated earnings or positive operating cash flow, or substantial revenues, since its inception in 2005 and since the Company went public in 2007. Furthermore, our projections show that the Company is not expected to be profitable over the next several years as well even while initial revenues begin to accrue. While VirnetX has been successful in raising capital in the past and may be able to raise capital in the future, or alternatively sign licensing agreements including upfront payments, there can be no assurance that the Company will be able to raise additional funding before operating cash flow turns positive.
- **Reliance on partnership agreements —** VirnetX's current strategy is to leverage its strong intellectual property portfolio and seek and sign partnerships with leading participants in the internet and communications industries. To date, VirnetX has not established manufacturing capacity, service departments, or significant sales infrastructure with which to sell products and services directly to telecommunications companies. Should few or no partnerships be executed by the Company in the future, VirnetX would be required to spend considerable capital and energy to establish its own infrastructure to sell directly.
- **Need to defend patents and other intellectual property –** VirnetX is currently involved in patent litigation with Microsoft, and although Company management is optimistic that a recent Markman order bears favorably for VirnetX in this litigation, there can be no assurance that the Company will prevail in this litigation against a much larger company with greater resources. Likewise, VirnetX is relying on the strength of its patents to assist in signing partnerships with other companies, and there can be no assurance that other large players in the industry will not challenge or simply ignore the Company's patents in the future in developing secure networks, particularly if current and future patent litigation is unsuccessful.

VirnetX Holding Corporation
Consolidated Statements of Income
(in $000s, except EPS)

Robert M. Wasserman

FYE December	2006	2007	1Q08 March	2Q08 June	3Q08 Sept	4Q08 Dec	2008	1Q09 March	2Q09 June	3Q09 Sept	4Q09E Dec	2009E	2010E	2011E
Revenues	$0.0	$74.9	$33.3	$50.7	$23.9	$25.8	$133.7	$3.2	$7.2	$3.2	$1,000.0	$1,013.6	$4,000.0	$12,000.0
Expenses														
Research and development	554.2	684.3	177.7	240.1	215.5	212.0	845.3	221.7	220.6	215.2	240.2	897.7	1,000.0	1,200.0
General and administrative	853.5	8,040.9	2,957.9	2,906.8	2,755.6	2,889.7	11,510.0	3,186.7	3,715.0	2,412.1	2,437.1	11,750.9	14,500.0	15,000.0
One-time and other	0.0	0.0	0.0	0.0	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total operating expenses	1,407.7	8,725.2	3,135.6	3,146.9	2,971.1	3,101.7	12,355.3	3,408.4	3,935.6	2,627.3	2,677.3	12,648.6	15,500.0	16,200.0
Loss from operations	(1,407.7)	(8,650.3)	(3,102.3)	(3,096.2)	(2,947.2)	(3,075.9)	(12,221.6)	(3,405.2)	(3,928.3)	(2,624.1)	(1,677.3)	(11,635.0)	(11,500.0)	(4,200.0)
Interest and other income, net	6.3	(41.8)	70.6	47.6	24.3	7.0	149.4	2.2	1.2	1.4	(8.6)	(3.8)	200.0	300.0
Net income (loss)	(1,401.3)	(8,692.2)	(3,031.7)	(3,048.6)	(2,922.9)	(3,069.0)	(12,072.2)	(3,403.0)	(3,927.1)	(2,622.8)	(1,686.0)	(11,638.8)	(11,300.0)	(3,900.0)
Basic and diluted income (loss) per share	($0.08)	($0.36)	($0.09)	($0.09)	($0.08)	($0.09)	($0.35)	($0.09)	($0.11)	($0.07)	($0.04)	($0.31)	($0.27)	($0.09)
Basic and diluted shares outstanding	17,087	24,312	34,810	34,900	34,900	34,890	34,875	37,017	37,370	37,264	40,570	38,055	41,900	42,400
Key ratios:														
Cash Flow/share	($0.07)	($0.32)	($0.07)	($0.07)	($0.06)	($0.07)	($0.32)	($0.07)	($0.09)	($0.05)	($0.02)	($0.23)	($0.19)	$0.01
EBITDA/share	($0.07)	($0.32)	($0.07)	($0.07)	($0.06)	($0.07)	($0.33)	($0.07)	($0.09)	($0.05)	($0.02)	($0.23)	($0.19)	$0.00

Balance Sheets
($000s)

	12/31/08	9/30/09
Assets:		
Cash and equivalents	$457.2	$4,016.2
Accounts receivable, net	1.2	0.0
Prepaid expenses & other	189.8	90.0
Total current	648.2	4,106.3
Property & equipment, net	32.6	24.0
Intangibles	204.0	168.0
Deferred offering costs	94.3	0.0
TOTAL ASSETS	$979.0	$4,298.3
Liabilities:		
Accounts payable and accrued expenses	$1,669.3	$4,203.9
Current portion of notes & obligations	44.0	40.0
Total current	1,713.3	4,243.9
Long-term obligations	160.0	120.0
Stockholders' equity (deficit)	(894.4)	(65.7)
TOTAL LIAB & EQ	$979.0	$4,298.3

Investor Catalyst Timeline

	4Q09E Dec	2010E	2011E
Patent Portfolio - Declaration of secure patents for 3GPP into 4G	X		
Markman Ruling/Microsoft			
Court date		March	
Licensing Agreements on Patent Portfolio		X	X
GABRIEL Software Development Kits			
Initial License Fees			
Ongoing sales royalties		X	
			X
Secure Domain Name Registry			
Initial License Fees		X	
Ongoing sales royalties			X
Secure Domain Name - Master Registry and Conversion Service			
Initial License Fees			X
Ongoing sales royalties			X

Source: Dawson James Securities, Inc. estimates; Company documents

Table 1. Secure Computing Industry Company Analysis

			Shares	Market Cap	Calendar Year		Revenues	Calendar Year		Price/Revs	Earnings	52-Week		% off	
Company	**Symbol**	**Price**	**(millions)**	**($Millions)**	**EPS '09E**	**EPS '10E**	**2009E**	**P/E '09E**	**P/E '10E**	**2009E**	**Growth**	**High**	**Low**	**Highs**	**Notes**
Acme Packet	APKT	$10.30	58.3	$ 600.5	$0.34	$0.41	$ 140	30.3	25.1	4.29	20.6%	$11.00	$2.83	6.4%	Leading Session Border Controllers (SBC) provider
AudioCodes	AUDC	$2.55	40.2	102.5	0.07	0.17	125	36.4	15.0	0.82	142.9%	$3.06	$0.92	16.7%	Israeli-based provider of SBCs and security gateways
Broadcom	BRCM	$30.18	495.0	14,939.1	1.10	1.54	4,400	27.4	19.6	3.40	40.0%	$31.20	$13.67	3.3%	Communications semiconductors
InterDigital Comm	IDCC	$24.22	43.1	1,043.9	1.75	2.89	300	13.8	8.4	3.48	65.1%	$33.69	$18.41	28.1%	Licenses digital wireless technologies
Qualcomm	QCOM	$45.06	1,670.0	75,250.2	1.90	2.25	10,400	23.7	20.0	7.24	18.4%	$48.72	$29.34	7.5%	IP licenses for wireless products & internet services
VeriSign	VRSN	$22.58	192.4	4,344.4	1.30	1.46	1,030	17.4	15.5	4.22	12.3%	$24.99	$16.89	9.6%	Authentication and Domain name services
Average								24.8	17.3	3.91	49.9%			11.9%	
VirnetX	VHC	$3.29	40.6	133.5	($0.31)	($0.27)	1	N/A	N/A	N/A	N/A	$5.00	$0.89	34.2%	Licenses IP technology for secure networks

Source: Dawson James Securities; Capital IQ

Important Disclosures:

Price Chart:

Price target and ratings changes over the past 3 years:
Initiated – December 2, 2009 – Target $6.00

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	Company Coverage		**Investment Banking**	
Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Speculative Buy	5	29%	5	100%
Strong Buy	0	0%	0	0%
Buy	9	53%	3	33%
Neutral	3	18%	2	67%
Sell	0	0%	0	0%
Sell Short	0	0%	0	0%
Under Review	0	0%	0	0%
Restricted	0	0%	0	0%
Total	17	100%	10	59%

Information about valuation methods and risks can be found in the "STOCK VALUATION" and "RISKS" sections of this report.

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