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IBM buyout ends summer of takeover rumors for ISS

ISS' operations will remain in Atlanta, where IBM already has 7,000 employees.

By PHILIPPA MAISTER, Staff Reporter

THE ANNOUNCEMENT that IBM will buy Atlanta-based Internet Security Systems, Inc. culminated six weeks in which a buyout was rumored—and ISS' stock price rose from a 52-week low of \$17.63 to \$27.62 at the end of trading Wednesday.

The deal values ISS at \$28 per share, or \$1.3 billion for a company that was once operated out of the founder's grandmother's house.

"ISS was an obvious takeover target," said Avondale Partners analyst Sean Jackson.

He said ISS was attractive because it has some size—it had \$330 million in revenue last year, unusually large for the industry—and because of its client base includes large companies such as, according to the company, 17 of the world's largest banks.

"It goes after the largest corporations, so it makes sense for IBM to go after it," he said. "We are seeing more and more that Internet security is being embedded in the existing technology infrastructure.

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Follow these links to SEC documents related to the IBM-ISS deal:

- [ISS latest quarterly report \(Aug. 4, 2006\)](#)
- [Agreement and plan of merger between IBM and ISS \(Aug. 23, 2006\)](#)

Richard Stice, an equity analyst at Standard & Poor's who specializes in computer hardware companies, said a lot of IBM's clients "are focusing more on the security area, and that's probably why IBM went ahead with the transaction. On a revenue basis, the deal is relatively small, but it gives IBM more viability in attracting new clients and retaining existing ones."

Stice noted that there has been a spurt of acquisitions of computer security companies in recent months.

The deal marks the summer's second big tie-up between a major business-infrastructure provider and a security company, after EMC Corp.'s \$2.1 billion acquisition of authentication specialist RSA Security Inc., announced in July.

Kilpatrick Stockton, led by David Eaton and David Stockton, acted as securities counsel to ISS, working with Weil Gotshal & Manges' Boston office. IBM was represented by Scott Barshay and George Schoen of the New York's Cravath, Swaine & Moore.

ISS' story is the stuff of legend. Company founder Christopher W. Klaus developed the Internet Scanner software on which ISS was built as a high school student, and launched it as freeware while a student at Georgia Tech in 1994. Klaus formed a company that sprouted from his apartment's living room, then joined

Georgia Tech. In 1994, Klaus formed a company that operated from his grandmother's home, then joined up with Thomas E. Noonan, another Tech student who is now the company's CEO, to develop the software further.

Two years after its founding, the two were able to attract \$3.6 million in venture capital financing.

Mustaque Ahamad, director of the Georgia Tech Information Security Center, knows both Klaus and Noonan. He said one of ISS' special strengths is its X-Force Research program, which monitors the

Internet to detect viruses and illegal activities before they strike. In addition, he said ISS' managed security services which monitors and observes clients' networks provides an alert system before an attack occurs.

"ISS is a great group of people and I hope IBM will let them keep doing what they do," Ahamad said.

"Clients increasingly recognize that security must become a network-integrated business process rather than a reactive response to individual threats," Noonan said in a statement. "These on-demand capabilities, together with our managed security services, appliances and software will further bolster IBM's leading security services and products as we take this innovation out to a larger, global stage."

A spokesperson for IBM said ISS will remain in Atlanta and all its management and employees will be offered positions at IBM, which already has 7,000 employees in the metro area. She said ISS has 700 employees in Atlanta and 1,300 worldwide. ISS' website said it has 35 offices in 20 countries worldwide.

ISS will become a wholly owned

subsidiary of IBM and will be merged into its Global Services' Security organization as a business unit. Its security operations centers in Tokyo, Brussels, Brisbane and Detroit will be added to IBM's existing global network.

Armonk, N.Y.-based IBM has now picked up three public companies this month. Two weeks ago, it sealed a \$1.6 billion pact for document-management software provider FileNet Corp. On Aug. 3 IBM agreed to spend \$740 million for MRO Software Inc., which helps industrial companies track physical assets.

Those deals were part of a long-running effort to use acquisitions to fill holes in IBM's software portfolio, easily the company's most profitable segment. ISS is a bit different because of its potential impact on the company's flagging services division.

Val Rahmani, general manager of the IBM infrastructure services group, told ISS staff on Wednesday staff that their contribution would dramatically upgrade IBM's security portfolio and accelerate its growth in high-potential segments. IBM, in turn, can help ISS' sales force gain access to a broader base of customers, especially large enterprises and government agencies, and has the ability to create solutions to help ISS grow rapidly, Rahmani said.

The Associated Press contributed to this report. Staff Reporter Philippa Maister can be reached at pmaister@alm.com.