

# THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

## ZixIt Corporation (ZIXI)



**JOHN A. RYAN** joined ZixIt Corporation as President and Chief Executive Officer and was elected Director and Chairman of our Board in November 2001. From January 1997 through January 2001, he served as President, Chief Executive Officer, and Director of Entrust, Inc., a company for which he led the private place-

ment in 1996 and took public in August 1998. Prior to that, Mr. Ryan held a number of senior management positions in general management, marketing and sales, and finance with Nortel Networks, with his most recent position being Vice President and General Manager of Nortel's global multimedia and Internet projects unit. Before joining Nortel, Mr. Ryan worked for Deloitte Touche LLP and was awarded his Canadian Chartered Accountant designation in 1981. He has also served as an Advisory Board member to Scopus Technologies. Prior to joining ZixIt, Mr. Ryan formed ARM Technologies, a privately held Internet consulting and services company that he founded in February 2001. He also currently serves as a director of Tilion Inc., a privately held Massachusetts-based company that focuses on "in-the-Net" analytics services based on XML for supply chain transactions, and RIPTECH Inc., a privately held, managed security services company based in Washington, DC. He is an advisory board member to Mobelium, a privately held Internet wireless services company based in California, and is on the Board of Trustees for the Hart eCenter at Southern Methodist University

### SECTOR – SECURITY SOFTWARE & SERVICES

**(PAW601) TWST:** Could we start out with a history and overview of ZixIt Corporation?

**Mr. Ryan:** ZixIt is a services company that specializes in what we call secure e-messaging, which basically provides corporations with the ability to send to anyone securely, and insures that the information the company is trying to transmit to that user is sent to them with what we would call our best method of delivery, allowing the sending company not to worry about whether or not it's received securely. We insure the message goes by the safest route possible, depending on the client's circumstances. So we really specialize in external communications for corporations, and we have incredible capacity in bandwidth to handle the external messaging requirements for companies around the world.

**TWST:** Who is the customer?

**Mr. Ryan:** Customers are typically Fortune 1000 enterprises, although certain industries where privacy has a high degree of importance, like the legal profession, are very focused on our type of solution. The markets we're most focused on today are the healthcare and financial services markets, which are especially driven by recent legislation that's been enacted in Congress — the Gramm-Leach-Bliley Act known as GLBA; and in health care the HIPPA Act (Health Insurance Portability and Accountability Act of 1996) — that very specifically identifies how healthcare information can and cannot be transmitted over the Internet and imposes a lot of stiff fines and penalties in the event that companies don't take it seriously. Obviously, these acts are driving companies to assess their e-mail and other communications systems to see how they need to adjust them so that they can comply with the law. In the case of HIPPA, the new regulations are going into effect in April 2003; GLBA, which is really financial services privacy legislation, specifies what financial information about you they can and cannot transmit on the Internet and is enacted already.

**TWST:** How big is this market?

**Mr. Ryan:** At this stage, this subsection of security — it's really secure content management that would be the category that this market falls under — secure content management is a relatively big market, \$1 billion plus. Now, the portion that would really be called "secure e-messaging" is a relatively new, emergent market. And the part that is, let's say, "secure e-messaging services," which is what our business provides, is just at its early stages, just starting to develop. But many forecasters see it in the \$100-\$500 million range, growing at approximately 40% per year, over the next five years. The distinction is that we don't sell products; we rent a service.

**TWST: Is the new legislation going to be the prime driver?**

**Mr. Ryan:** There are two drivers. The legislation certainly is a mandatory requirement for companies to examine and be sure they comply, and in certain market segments, like health care, it will be one of the primary drivers.

I think the real, long-term driver, though, is really cost savings. Companies can save a fortune by avoiding many of the superfluous mailings they do. To give you an example in the financial services industry, every time a trade is made they send out a confirmation of your transactions, resulting in \$0.40 for the postage and envelope and an average cost \$1-\$1.10 per mailing for something that most people would much rather get by e-mail as long as it was securely sent. So it really offers companies a tremendous opportunity to save costs. In health care, you find very similar examples: every time you have a claim now, I know I tend to get a lot of slips in the mail that basically say they settled the claim with the doctor and here are the results of the claim — and it's not like there's a check inside that envelope! So there are excellent opportunities for people to reduce the costs they're currently incurring to meet the legislative requirements on what they have to send to their customers. Secure e-mail with a receipt system that would insure that the company knew you received the document securely and opened it would give them the equivalent of mailing that envelope out, and yet afford them that tremendous opportunity to save money.

A third factor is that it's just good stewardship to insure that when you communicate with your customers, if there's any risk of important information being in that e-mail, that it is secured and that you have the knowledge the customer has received it. That way, corporations can really live up to the good stewardship they should.

It's really those three factors combined that I believe will create a very exciting and high-growth market.

We have built a center with tremendous capacity. We already have room in our center to store over 120 million plus e-mail addresses for people. We can basically process over 2.3 million transactions per hour, which, I think, would handle virtually all of the world's extranet communications today.

**TWST: Who are you competing with in this space?**

**Mr. Ryan:** As a pure-play service we are the only company that really participates as a service in the market. There are several companies out there that have partial product solutions that would encompass a portion of the service we provide, but nobody, really, is in the space with the full turnkey solution that we have. Therefore, the secure e-messaging market is filled with lots of product companies, probably 30 plus different little companies, none of which really offer a service to their clients backed up with a \$50 million investment in a world-class data center with the kind of capacity that we offer. I think that puts us in a very unique position to meet the demands of certain market segments that will only be able to be successful in the event they have a services offering, as they were never really able to put in a product offering successfully in their industry.

To expand on that a little bit, taking health care as an example, every person in health care typically deals with at least seven other organizations outside of their own company and, therefore, it's a very networked community of hospitals and physicians and pharmacies and pharmaceutical companies connected to insurance companies and prescription benefit managers, all providing these services for the Fortune 10,000. Therefore, it's a very integrated supply chain of services. It would be impossible for that market to have any particular company put in a product solution and then try to put their demands on all the other trading partners, because they could end up as an insurance company that works with 10,000 different Fortune 10,000

companies and they could end up having to set up and maintain 10,000 different solutions. What health care really needs is an industry-wide solution that everybody can rely on so that they can, one, implement security, and, two, have consistent security across all communications. That affords what I think is a tremendous opportunity for ZixIt Corporation.

**TWST: How is that going to happen?**

**Mr. Ryan:** Fortunately, on one level there are some very serious legislative deadlines that basically demand all communications over the Internet must meet the HIPPA regulations. And what we have done to help insure that people understand them is, we have partnered with Preston Gates, a law firm out of Seattle, and with PricewaterhouseCoopers to devise HIPPA-specific and GLBA-specific lexicons that would allow companies to automatically scan all their e-mail and encrypt the messages that fail to meet the lexicon standards. They could automatically encrypt those messages and send them off to their trading partners securely. The company is now conducting audits for customers with ZixAuditor™, a unique assessment tool we've developed to help them understand the nature of the risk that they are currently experiencing. Then we provide for them a very easy solution to help them mitigate that risk. From our perspective, it's really a mixture of one, education using ZixAuditor to help give them the actual results on how well they are doing to comply with current legislation; and, two, giving them the solution that will allow them to remediate and meet the legislative requirements. Three, we've also introduced ZixAuditor as an ongoing compliance service that allows customers to verify that they are, on an ongoing basis, complying with the legislation. That way, they can set the bar at what we would call "best practices" and demonstrate to anybody down the road that they've taken all the prudent and best-behavior approaches to insure that they've complied with the legislation.

We think, as we educate the market and people recognize that they can get this solution very cost-effectively, that we can implement it in less than a day and that we can turn it on for their entire user population. That affords customers a very easy-to-deploy, easy-to-use and affordable solution. We anticipate that we'll enjoy success with that approach.

**TWST: Given the potential in this market, what's to prevent competition from coming in and challenging you?**

**Mr. Ryan:** We'll always have lots of competition here in America — which is great, because it obviously puts an extra bounce in our step. I think one of the big challenges our competitors will have is how to replicate and build an infrastructure such as we have with an investment of over \$50 million. Two, we've really used a very unique approach of going to market by encompassing a professional service combination — our solution set with ZixAuditor — plus our services that add on to it the best method of delivery and a number of other differentiated features that the competition has yet to really encompass in their products.

Then third and last, I think we have a very unique understanding of the vertical markets we're going after. All in all, we have the ability to truly educate and deliver, in the manner our customers are used to, our solutions — generally in a day. None of our competition has the ability to deliver as quickly as we do. That's because we've been working on this for quite some time — almost four years now — and have really honed the solution set to be easily deployable and easy to use.

**TWST: As we look out over the next 18 or 24 months, what should investors expect from you?**

**Mr. Ryan:** I think investors should expect that we start to sign up major institutions and really start to see acceleration of major deployments.

Then I hope that they'll also see, as our plans are to deliver it, the ability to win across an entire and complete market segment, like health care or like insurance or financial services, with the fourth target market being supply chains. All of these markets are really very conducive to a services model where they can all rely on one universal solution set. And I believe that's where ZixIt is most uniquely positioned. Therefore, our investors should see us gaining momentum in all of those and then, of course, accelerating our revenue and then targeting profitability down the road.

**TWST: What is the business model? When you say a service approach, what does the typical contract look like?**

**Mr. Ryan:** ZixIt basically sells an annual service agreement with its clients. A typical institution could start off as small as 100 to 1,000 users, and that cost could be in the range of a \$10,000-a-year to \$20,000-a-year subscription; if they were to be deployed for over 10,000 users, the annual subscription would be approximately \$125,000 per year, generally with an unlimited number of messages they could send securely. That would be the typical kind of range. As they buy other added services from us, we could easily see them spending from \$200,000-\$300,000 per year with us to take advantage of the offers we have.

**TWST: What are some of the other services that you'll have available?**

**Mr. Ryan:** Today, in addition to the secure e-messaging with best method of delivery and receiving, we have ZixAuditor — our compliance services, which analyzes all inbound and outbound e-mail messages for both HIPPA and GLBA and best practices compliance. You can also buy that service on an annual basis to verify your compliance on an ongoing basis and help tweak and enhance the rules that you use to really be more encompassing for your particular company. We also offer the ability to do broadcast mailings with a product called ZixBlast™, which allows companies to, let's say, automate their entire process for secure statement deliveries or stock transactions or healthcare benefits or other types of communications that they do on a large-scale basis with their customer base. Those are our core offerings today.

We're looking to add several other services as we look toward the future.

**TWST: Does your approach work with all the common e-mail formats?**

**Mr. Ryan:** Yes, it does. In fact, it's really one of the only solutions that works without any client-side software whatsoever, but can also work with integrated client-side software. Our product basically integrates into all of the popular e-mail packages. It works on top of all the standard browsers and allows the company really not to have to worry about downloading software for their customers. Because if, for example, they require a plug-in to their Microsoft Outlook package, we handle all the downloads from here, and any customer issues on download come to ZixIt's Support Center, which alleviates that burden and risk from the company. Fortunately for us, though, client-side software's not a necessity or requirement for our technology to work. Our software figures out how to send e-mail securely by the Best Method of Delivery™ in the most secure fashion possible.

**TWST: Is this being deployed today?**

**Mr. Ryan:** Absolutely.

**TWST: What does the business basically look like at the moment?**

**Mr. Ryan:** For the full suite of products, we delivered it at the end of March, our reception so far has been excellent, not just here in North America but on a global basis. We now have well over 25 systems in service, either sold or under evaluation, across health care and financial ser-

vices and approximately a third of those in the international community from Europe to Korea, Japan and Hong Kong.

**TWST: Have you set a target time to reach profitability?**

**Mr. Ryan:** At this stage we have not given a forward estimate as to when we anticipate profitability. However, it's clear to me that we need to get our business levels to around \$6 million per quarter to achieve that goal, and as I look out into the future, given our cost structure and where we are with our infrastructure, which requires very little in ongoing capital investment, the prospect of achieving that type of goal in the future seems very achievable.

**TWST: How are you approaching the market? Do you have your own dedicated sales force for this?**

**Mr. Ryan:** We're approaching the market in North America with our own direct sales force and inside sales team. So obviously, we have field account executives and also an inside sales force to sell systems to individuals as well as to businesses. We see that evolving over time to a more indirect strategy, but at this early stage of the market we want to maximize the customer feedback that we get to insure that our solution is optimized for the opportunity.

Internationally, we're going with what we call our global operators and our global operator program, and we've signed deals in both Japan and Korea, where we've designated an operator to work with channels within that market to take our solution to the market. And we will be expanding our international global operators in the coming months into other countries, as well.

**TWST: Do you have the management team in place to expand the way you're talking about?**

**Mr. Ryan:** I believe I do. I joined the company December 1, 2001. I had experience with a previous startup in the Internet security space at a company that I took public, Entrust Technologies, and when I joined ZixIt in December I brought in a number of industry experts and other experts who I had worked with in the past. Now we have built, I think, an excellent team that complements the team members who stayed with the company. So right now, we're in great shape.

We've got very strong engineering and development and a great resource, David Robertson, who joined us from Nortel Networks. Our sales side is managed by two people (with whom we basically launched our whole international program and the domestic services program when I was at Entrust). And then we have all the talent that we had when we started! So I think we're in great shape. Our business development strategies expert who joined us, Dan Nutkis, a healthcare expert, has given us a unique approach, enabling us to really stimulate and take advantage of that market segment. Therefore, we have a well-rounded, experienced team here that now has a full portfolio of solutions at a time when the question of how to secure communications to their customers and partners is really at the forefront of companies' minds.

**TWST: I guess pending laws do tend to focus people's attention!**

**Mr. Ryan:** There's no question that HIPPA has brought a great degree of focus on health care and that the financial services community is very serious about GLBA. Therefore, I think our timing is very good.

**TWST: How would you describe the culture that you found and what's happened to it since you've been there?**

**Mr. Ryan:** I think the culture, since we've come here and really brought in a fresh sales and marketing team and business strategy team and then complemented the engineering team with some very experienced development leadership, has been excellent. We're kind of a unique company in that we're like a startup that happens to have a \$50 million data center with some very good technology and a public market equity status. That combination creates a unique environment — an opportunity for us to really get people charged

up and have the opportunity to see directly the benefit of the work that they're doing reflected in both the feedback and results from our customers, which will obviously be translated into a response from the market. And I think we have a lot of what you'd expect from a startup culture right now — a lot of fun, a lot of hard work and a lot of high energy, complemented by some of the benefits we have as a public company with some seasoned management. So I look at it as the best of both worlds at this juncture. And we're having a lot of fun.

**TWST: How about from a balance sheet point of view? Do you have the resources on hand you need?**

**Mr. Ryan:** I think at this stage we're fine. We have over \$15 million in cash on the March 31<sup>st</sup> balance sheet, and that's good for at least 12 months of liquidity, even without being successful beyond our current plans. But I believe, at the same time, in the event that we need any additional financing that we would have no challenge in getting it. Therefore, I feel very comfortable that the company is in great shape to take advantage of the opportunity and make its customers feel comfortable that they're going to have the long-term position that the customer would like to see them have.

**TWST: It sounds like the growth we've been talking about is internal. Are there any thoughts of acquisitions to fill out the product line?**

**Mr. Ryan:** At this stage, it's crucial that we get lots of success in our focused target markets, and that's where we're putting all our attention and energy. What we would do from there is let our customers guide us in the additional services that they would like to see us provide for them and then use that as the foundation point for any future acquisitions if we were to consider them or any development enhancements that we would target down the road. So customer acquisition and then delivering to the customer what they want in incremental features and services is really the roadmap we're focused on today.

**TWST: How do you feel about the value the market is putting on the company today?**

**Mr. Ryan:** Our market value, on the one hand, is fairly good in that our revenue multiple (because our prior year's revenue is very low) is quite large, given many of our peers in the security space. Now, based on our market potential, we would like to believe that the company has a very unique position and will provide the prospect for an interesting future and, therefore, you could say that we're optimistic when we look to the future about our market cap and where it could go. Those combined, I feel that the market has done a fair job, and now it's up to the company to deliver the goods and execute its strategy. And I have no question that when we do that the market will take care of itself based on the business and the business results.

Therefore, feeling good or bad about the price? It's going to be wherever it's going to be, and that will, hopefully, be based on doing good business and really moving the company forward.

**TWST: Do you think the market understands your position?**

**Mr. Ryan:** I would say no, partially because we don't have the kind of coverage that some companies have. In the past I ran a company that was covered by 18 different sellside analysts. Therefore you had a lot of communication going on to the institutions out there about what the company was up to and what it was doing. We have a way to go to achieve that kind of coverage and institutional ownership, and that's really predicated on ZixIt getting out there and delivering to the kind of customers we're targeting. Then I believe we'll have the kind of support that we need to truly educate the market about our capabilities.

**TWST: When you sit down with investors today, what's the prime question you're being asked?**

**Mr. Ryan:** I think they are most focused on when this market is going to happen. A lot of people had projected the secure messaging or secure e-messaging market to mature earlier, and the question became, why did it not mature earlier in the eyes of many investors — a question we've put a lot of thought into ourselves. When we saw that customers were all concerned about the information that flows out of their corporations, what we basically discovered was that they really had no way to know what was inside of all those e-mails and messages that they were sending out on the Internet or receiving. That realization led to our invention of ZixAuditor to really provide our customers with a tool to assess their inbound and outbound communications and understand, against a standard of good practices, how they were doing. This new tool has enlightened a number of customers and, I believe, will help bring to the forefront more than just a concern about what's flowing in and out of the company. It's a good way for a company to quantify and understand the risk it's taking so that it can make the right investment decisions for the corporation and implement a solution. I think that's why we're very focused on education and then, of course, really delivering a service solution across an industry segment.

I think that's the number one issue on investors' minds: is this market going to take off now and what's going to make it take off? And that happens to be, as well, the number one area of focus for our company's management, that is, providing a stimulant and helping people understand, assess and come to grips with how to cope with this challenge.

**TWST: When you do sit down with investors, what are the two or three summary reasons you give them to take a look at the company today?**

**Mr. Ryan:** I think, first and foremost, I believe we have a very unique solution for this problem. So, obviously, the market itself is the number one reason. We believe we're at the front end of what will be a high-growth market, and that usually spells opportunity. Two is how we're uniquely positioned to help customers solve this problem in a way that's very differentiated from any of our competition. Three is that we have the team and the management group here to execute and deliver.

It's primarily for those three reasons, I believe, that companies or investors should look very hard at our solution and at us as a company for the long term.

**TWST: Thank you. (TM)**

## **JOHN A. RYAN**

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