



Interim Report
for Effnet Group AB (publ)
January-September 2000



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- Net sales totalled KSEK 4,029 (1,182).
- A net result, including financials, for the period of KSEK –83 026 (–34,382) was reported.
- The company has contracts currently valued at MSEK 100 to 150. The company has MSEK 312 in cash and bank balances.
- During the third quarter, Effnet sharpened its focus on a technology/software licensing business model. The reason for this focus is the rapidly growing market for network equipment based on standard components, as well as proprietary high-end solutions. Effnet's technology perfectly matches the technology trend for Internet Protocol (IP) networking and IT security/data protection. The company plans to provide its router/firewall hardware solutions to third parties such as Ingram Micro Sverige AB.
- The company recruited a VP sales, marketing & business development in North America and a VP sales & marketing in EMEA.
- In September, Effnet's wholly owned subsidiary Wkit Security AB closed its first major deal, marking the successful entry into the highly concentrated CD-ROM production market (the annual worldwide market is estimated at 8.9 billion disks). The Danish CD-ROM manufacturer SDC DanDisc signed a contract to license the SecureIT copy protection software for its production of CD-ROM media. SDC DanDisc is the largest manufacturer of audio-visual media in Northern Europe, with half a million CDs per day production capacity. This licensing agreement is estimated to generate MSEK 50 over a five-year period.

Effnet provides core technologies for Internet Protocol (IP) networking and IT security/data protection. The company develops, markets sells and distributes these network technologies designed to resolve bottlenecks and improve security in communications via the Internet, thereby creating maximum benefit to the customer. Effnet operates in four locations: Stockholm, Luleå, Häverud and Silicon Valley (Mountain View, California). Shares in Effnet Group AB are quoted on the "New Market" List of the Stockholm Stock Exchange.

To find out more about Effnet, please visit our Web site at: <http://www.effnet.com/>

The Evolving Electronic Marketplace

The year 2000 started with a nervous Y2K obsession and proceeded to a roller-coaster ride on the stock market. The same stocks that a few months ago were the darlings of the investment community, are now being criticised for lack of profitability.

Though some semiconductor and systems companies just posted less than expected results, the outlook for the next few years is encouraging: according to the Electronics Industries Association of Japan, the global semiconductor market is expected to rise in value by 20 percent in calendar 2001 from a year earlier to \$250 billion. This is encouraging news to the silicon component manufacturers, the buyers of the IP processing technology that is Effnet's core competence.

With the silicon component manufacturers pressed to reduce costs and time to market, they can no longer afford the time or overhead of themselves creating the many IP packet-processing features their customers specify. They must look elsewhere to acquire this expertise. And when they look, they see Effnet.

Effnet in the Internet Economy

Effnet brings to market network products, technologies and services that resolve bottlenecks and enhance security in Internet communications. The goal is to become a *leading provider of core technologies* for the Internet infrastructure.

Effnet offers patented and award winning technologies. During the last quarter, Effnet has started aligning operations to support the new business strategy, and is pursuing extensive discussions with technology and software licensing prospects.

Effnet has identified four initial areas for its IP networking technology:

1. The network processor market (estimated at \$2.8 billion in 2004).
2. The rest of the total programmable communications processor market (estimated at \$16 billion in 2004).
3. The mobile communication market, with Ericsson, Motorola, Nokia, Samsung, Siemens and others.
4. The router and firewall markets, conservatively estimated at \$14 billion in 2004.

The EffnetEdge™ Toolkit

Effnet offers its technology in the form of the EffnetEdge™ Toolkit modules and the firewall/router stack. For example, earlier this year, the Company signed its first round of licensing agreements with leading independent network processor and communication chip vendors in North America and Europe.

Three steps are normally involved in a licensing agreement.

1. Effnet's technology is *reviewed* at the design stage of each customer's next generation product. After approval Effnet receives a licensing fee.
2. Effnet's technology is *integrated* with the customer's product as the design enters final stages and the product is built.
3. Once the customer's product is launched and sales are made, Effnet receives a percentage of every sale, generally in the 5 to 15 percent range. This creates an ongoing, building *royalty* stream of income for Effnet over the life of that product.

Before the customer adopts the Effnet technology into its products a thorough analysis is made by the customer to ensure the end user need for the technology.

New Markets

The recent development of the Effnet technology, e.g. the IP Header Compression, will extend the customer base comprising broadband and mobile Internet customers.

The Company's subsidiary, Wkit, continues to sell data security products and services to customers whose products or networks require extreme security. One example is the recently closed licensing deal with SDC DanDisc.

Combining the reach and superiority of Wkit with Effnet's focus on IP packet processing speed and security, is clearly expressed in Effnet's keywords *Speed, Security, Innovation*.

Sales

Effnet's net sales during the period totalled KSEK 4,029 (1,182), which is an increase of KSEK 2,847 compared with the same period last year. Effnet's third quarter sales amounted to KSEK 313 (593).

Financial Result

The Group's result after financial items was a deficit of KSEK -83,026 (-34,382). The result for the third quarter was a deficit of -33,840 (-12,355).

Sales and marketing expenses have increased by KSEK 522 compared to the second quarter 2000. Selling and marketing expenses amounted to KSEK 32,304 (13,314).

The costs of product and technology development, reported on a current basis, amounted to KSEK 27,694 (16,131). Expenses have increased by KSEK 993 compared to the second quarter 2000.

Administrative expenses amounted to KSEK 31,306, an increase of KSEK 1,780 compared to the second quarter 2000.

Financial Position

Effnet's equity-to-assets ratio at 30 September 2000 was 95.5 % (85.9 %). Liquid assets, including current investments, totalled KSEK 311,959 (36,709).

Capital Expenditure

Capital expenditure during the period totalled KSEK 6,473 (1,133), consisting mainly of computer equipment expenditures.

Personnel

The number of employees at the close of the period totalled 87 (50). The average number of full time employees at the close of the period totalled 76 (39).

Outlook for 2000/2001

The near and intermediate term outlook is best assessed via the major deals under active consideration in our technology licensing business.

- With three licensing deals closed during this year, we still have an additional half dozen deals under active discussion and more in earlier stage discussions. Our goal is that one will materialise as a contract in this fiscal year and that several others will materialise early next year. The total available opportunity in the processor space is estimated at nearly \$12 billion in 2001, growing to \$19 billion for 2004. Effnet's available market can be expected to fall in the \$50 to 150 million range in 2004, considerably less in 2001.

- The IP processing opportunity in mobile communications is clearly huge, but no usable estimates are presently available.
- The firewall and router opportunity that is available to Effnet through its licensing model is estimated at \$25 million in 2001, growing to \$70 million in 2004.
- In the security business, there are several large projects being actively pursued. Our aim is that at least one of these will be placed under contract this fiscal year or the first quarter of next year. The SDC Dandisc contract marks our successful entry into a huge market. Annually, there are some 8.9 billion data disks produced world wide that need copy protection. Our customer and several prospects regard our SecureIT protection scheme as the most secure, easiest to use and most cost effective protection software available. SecureIT is sold according to our new business model: revenues are proportional to the number of disks protected over the lifetime of the licensing contract. With 15 companies controlling 98 percent of the world wide output, the CD production market is highly concentrated. This means that a small company, such as Effnet, can reach and cultivate all the significant prospects with modest investments in sales and support.
- The goal is to be listed on the O-list by 1Q 2001. We expect to have all prerequisites in place for submission to the Stockholm Stock Exchange by 30 November. Among the exchange's requirements is to add individuals with board experience from Swedish public companies. We have decided to meet such requirements with individuals with world class international experience growing high technology companies. We are currently in final negotiations with several such candidates.

Financial Calendar

Final report for fiscal year 2000 will be released 14 February 2000. The financial calendar for fiscal year 2001 will be released 30 November 2000.

The Company's auditor has not audited this interim report.

Stockholm, 2 November 2000

Effnet Group AB (publ)

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Consolidated Profit and Loss Account (Summary) (KSEK '000)	2000 January – September	1999 January - September	1999 January - December
Net sales	4 029	1 182	2 272
Cost of goods sold	- 2 793	- 364	- 714
Gross profit	1 236	818	1 558
Selling expenses	- 32 304	-13 314	- 23 395
Administrative expenses	- 31 306	- 5 958	- 8 944
Research and development costs	- 27 694	- 16 131	- 21 309
Other operating income/expenses	- 8 893	-26	2 285
Operating result	- 98 961	- 34 611	- 49 805
Financial items, net	15 935	229	1 312
Result after financial items	- 83 026	- 34 382	- 48 493
Tax	0	0	93
Minority interest in result for the period	0	0	11
Result for the period	- 83 026	- 34 382	- 48 389

Consolidated Balance Sheet (Summary) (KSEK '000)	2000 30 September	1999 30 September	1999 31 December
Assets			
Intangible fixed assets	178 296	0	0
Tangible fixed assets	9 208	1 538	1 798
Current assets	15 179	4 255	5 414
Cash & bank balances	311 959	36 709	386 979
Total assets	514 642	42 502	394 191
Shareholders' equity & liabilities			
Shareholders' equity	491 245	36 500	385 922
Minority interest	0	0	58
Provisions	95	95	95
Long term liabilities	500	0	0
Current liabilities	22 802	5 907	8 116
Total shareholders' equity & liabilities	514 642	42 502	394 191

Consolidated Cash Flow Statement (KSEK '000)	2000 January – September	1999 January – September	1999 January - December
Cash flow from day-to-day operations	- 71 448	- 33 915	- 48 191
Changes in working capital	- 589	- 1588	2 645
Investments	- 6 473	- 1 133	- 1 170
Financing	3 489	70 127	428 037
Change in liquid assets	-75 021	36 667	381 321

Per-share data (adjusted to reflect new share issues) 2000		1999	1999
Amounts in KKSEK	30 September	30 September	31 December
Number of shares at close of period	54 599 100	46 054 525	52 054 525
Average number of shares	52 652 001	38 994 350	42 096 370
Earnings per share	- 1.58	- 0.88	- 1.15
Earnings per share after full dilution	- 1.42	- 0.84	- 1.08
Shareholders' equity per share	9.33	0.94	9.17
Shareholders' equity per share after full dilution	8.38	0.89	8.58