

# Annual Report 2004



**STONESOFT**  
Real World Business Security™

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## CORPORATE PROFILE

**Stonesoft Corporation (HEX: SFT1V) is an innovative provider of integrated network security and business continuity.**

Its StoneGate™ Security Platform unifies firewall, VPN and IPS, blending network security and end-to-end availability into a unified and centrally managed system for distributed enterprises here security, uptime, and ease of use are essential. StoneGate incorporates the award-winning load-balancing technology of StoneBeat®.

Enterprises that require advanced network security and always-on business connectivity can choose StoneGate for low TCO, best price-to-performance ratio, and highest ROI of any high-end firewall, VPN and IPS solution.

Founded in 1990, Stonesoft Corporation has international headquarters in Helsinki, Finland; Americas headquarters in Atlanta, Georgia; and Asia Pacific regional headquarters in Singapore.



For more information, please go to [www.stonesoft.com](http://www.stonesoft.com)

## YEAR IN BRIEF

- Development of the StoneGate IPS (Intrusion Detection and Analysis with Active Response) product was completed in May.
- In the same month, Stonesoft published a new management system, the StoneGateManagement Center 3.0. The StoneGate Management Center 3.0 integrates the StoneGate product family - firewall, VPN and the new IPS - into a seamless, easy-to-manage comprehensive network security solution, the StoneGate Security Platform. This solution provides data networks with Multi-Layer protection. Multi-Layer network security that incorporates a firewall, VPN and IPS protects not only the outer part of the organization's network but also the Intranet. The StoneGate Security Platform integrates the most important network security components, network management and high availability.
- In early August, Stonesoft's Board of Directors appointed Ilkka Hiidenheimo, 44, the company's founder and Chief Technical Officer, as Stonesoft's new CEO. The previous CEO Jorma Turunen resigned. At the same time, Mikael Nyberg, 44, M.Sc. (Eng.) was appointed the company's Chief Financial Officer and member of the Management Team.
- In August, the company commenced measures to adapt its costs and organization to better match the current level of business, with a view to achieving business profitability more rapidly. These measures created cost savings of approximately EUR 0,8 million on the global level per quarter.
- The company re-evaluated its strategy during the final quarter, completed the announced cost saving program and commenced measures, in line with its strategy, aimed at increasing sales.

### KEY FIGURES

	<i>thousand euros</i>	<b>2004</b>	<b>2003</b>
Net sales, k EUR		22 490	23 197
Net sales change-%		-3	-23
Operating profit/loss before goodwill amortization (EBITA), k EUR		-9 016	-13 861
% of net sales		-40	-60
ROE - %		-52	-35
ROI - %		-33	-33
Equity ratio-%		81	90
Net gearing		-1,06	-0,78
Total assets, k EUR		29 781	43 291
R&D costs, k EUR		5 086	6 541
% of net sales		23	28
Number of employees at the end of the year		237	264
Earnings per share, EUR		-0,25	-0,26
Equity per share, EUR		0,36	0,61

## CEO'S REVIEW

**Last years have been very challenging to Stonesoft. Our revenue decline has continued many years. However during year 2004 global revenue decrease discontinued.**

Due to the unsatisfactory business results during the first half of the year we re-directed our strategy, including organizational setup and go-to-market model. These changes are the most remarkable in our company's history. As a result we have already seen positive signs in several areas. For example, for the first time in three year's period we exceeded our sales targets in Q4. Another achievement is that we reached about 100 percent growth in StoneGate sales when comparing the sales of Q1 2004 to the sales in Q4 2004. These

changes have not affected our high commitment to research and development, which were maintained at the same level as before.

### NEW STRATEGIC DIRECTIONS

Past years have shown that Stonesoft is capable to provide state of the art technologies to meet the evolving needs of our enterprise customers. This has been proven with numerous awards, customer references and by the development of StoneGate solutions. However there has been room for improvement in the business implementation, in the sales resource allocation, marketing, and regional focus.

It is obviously clear, that beyond the mandatory savings and optimizing the operations to achieve the required cost savings, we had to do a fundamental change in the business implementation, in order to scale up with the sales growth. The company management redefined the company strategy to provide a clear regional investment focus, market positioning and go-to-market model. These investments were mainly made to the major markets: USA and in EMEA to UK and Germany to ensure our positions in these key markets. We further leveraged our existing positions in Italy, Spain and in BeNeLux region. In smaller markets we redirected our operations to the channel partners.

We decided to continue our positioning in large enterprises and in selected mid-market verticals, which have high requirements for business continuity, high transaction value or other requirement for in-depth network security. We redefined our go-to-market model and channel strategy to ensure efficient approach to the target markets. We implemented a high touch sales model, to be supported with selected channel partners, providing implementation and support services to the customers. The new channel strategy is based on long-term commitment to the channel partners with a clear Stonesoft value proposition, providing a fair possibility to have a competitive business with our solutions.

We reorganized and centralized our marketing functions globally to enable marketing and demand creation in the selected customer segments as well as joint marketing with the partners.

These substantial changes in the business strategies have been extremely demanding for the organization. However we have succeeded in implementing the change in the Sales and Marketing functions. This means that we can now focus to concrete actions in our key markets. We still have a demanding change process ahead of us, with which we are seeking sales growth, knowing that our solutions and services are on the leading edge of network security. We understand that we need to keep listening to our customers and their challenges in order to develop solutions meeting their requirements, in order to differentiate from our competitors and to maintain highest level of customer satisfaction.

## OUR PRODUCT VISION

**The year 2004 was clearly a breakthrough year in many areas.**

We saw more and more advanced hackers and criminals using network as their tool. How is this related to our work and strategy?

Starting from year 1994 we have been working with network security to ensure business continuity to our customers, when they were using 1st and 2nd generation tools from different network security vendors. Already since 1999 we have been developing more advanced security products to markets, including our knowledge about high-availability, clustering and business continuity. During these years we came out with StoneGate FW/VPN with multiple patented features and most advanced management.

In year 2000 we started our StoneGate IPS project. We were looking for higher granularity in detection, support for higher bandwidth and more efficient detection methods overall. As a result of a challenging product development project we launched in May 2004, a new intrusion detection and prevention system. This marks StoneGate's evolution from a firewall/VPN solution to the StoneGate Security Platform, combining firewall, VPN, intrusion detection and their centralized management.

Our major breakaway was the release of StoneGate Management Center 3.0, which provides optimized and unified management for our StoneGate FW/VPN and IPS products. Feedback from our customers has been very positive and has shown, that our vision and product roadmap really has met our customers' requirements.

Our vision about defense in-depth, with one unified management, is the future to those parts of network security, which are affected by the network architecture changes.

## THANK YOU

I would like to thank our personnel for the positive developments achieved over the year, and for the fighting spirit they have shown in the difficult situation our company has faced. Our financial result improved, and we have announced many new security solutions, which give reason for optimism concerning the future.



I would also like to thank all our customers and partners for the past year.

  
Ilkka Hidenheimo, Chief Executive Officer

## STONESOFT'S VISION AND PHILOSOPHY

### VISION

**Security solutions are key components in effective e-business.**

Stonesoft has an exceptional ability to combine its security, high availability, and clustering expertise enabling Stonesoft to go beyond the traditional approach to security solutions. Stonesoft offers secure business continuity to customers and strives to be recognized as

the forerunner in enterprise security and continuity, today and for the future

### PHILOSOPHY

Stonesoft believes in and understands simple, real life solutions to complex problems, promoting economic value for customers through vision driven development. Stonesoft's solutions are designed for real customers with real problems. Our products offer performance in real life conditions, not just fancy numbers from a laboratory test under controlled conditions. Stonesoft works to solve problems faced in the field, from the branch office, to the data center.

Stonesoft solutions simplify complexity in network security. In network security, added complexity decreases security. With simple solutions, you can improve security, lower the amount of work, and therefore increase productivity. Reductions in network security complexity also reduce management complexity and total cost of ownership. Not every solution has an easy answer, but Stonesoft works to provide the simplest answer possible for any given problem.

Stonesoft's solutions are not useful if they are not affordable. Affordability goes beyond the up-front investment costs but includes the total cost of ownership. Simple solutions tend to reduce costs by lowering investments in new hardware or software, and by increasing employee productivity.

Stonesoft develops those solutions with a vision in mind. The development is driven by a passion to do things in an innovative, responsive way, without boundaries. Stonesoft looks beyond the existing hardware and software limitations, to what solutions should be in the future. Stonesoft develops products while always questioning the contribution to the vision of solutions that build networks that are secure, available, manageable, and scalable.

# STONESOFT'S AREA OF OPERATION

## NETWORK SECURITY

**The network security of an organization is built to reach the highest level of confidentiality, availability and integrity of the information to ensure business continuity.**

Network security planning starts by identifying all business critical information assets the company has. The inventory of these assets then defines the level of resources and investments the company needs to invest into network security.

To achieve the defined level of security, aligned with the company business practises, the company needs to build a security policy and strategy, including security professionals and technologies.

### Network Security Technologies

Successful network security policy and strategy requires an in-depth understanding and wide utilization of different security technologies. The available technologies range from firewalls, VPN and Intrusion Detection and Prevention (IDS/IPS) systems to encryption, authentication, authorization, Public Key Infrastructure (PKI), anti-virus and content scanning solutions.

Anti-virus and content scanning solutions are the most commonly known network security areas, due the fact that viruses are harmful and cause damages to information systems equally in home use and in corporate use. Anti-virus software is used to stop viruses and worms from infiltrating corporate networks, workstations and servers as well as personal computers at home.

Authentication, authorization and Public Key Infrastructure (PKI) solutions are used to ensure reliable user identification in networks. Encryption tools enable encryption of critical data and hence ensure confidentiality by protecting from unauthorized usage.

Firewalls function as gatekeepers between networks, for example between the corporate network and the Internet. Firewalls control all data traffic, which goes through them and blocks unwanted traffic with defined rule base.

Virtual Private Network (VPN) solutions enable secure communication over the Internet by establishing secure and confidential connections between remote offices, business partners and remote users. Intrusion detection and prevention systems (IDS/IPS) are the core elements in fulfilling the corporate security policy and strategy. Intrusion detection systems monitor the network traffic and alert the network administrator, whenever malicious or inappropriate network traffic is detected. This makes it possible to respond to the possible attacks before serious damage has taken place. IPS functionality can also automatically block some of the attacks.

Management is the most fundamental component in network security. This becomes even more important as new technology layers are added to ensure corporate security strategy and policy.



**Stonesofts StoneGate™ Security Platform unifies firewall, VPN and IPS, blending network security and end-to-end availability into a unified and centrally managed system**

**Stonesoft StoneGate™ Security Platform**

for distributed enterprises where security, uptime, and ease of use are essential. StoneGate incorporates the award-winning load-balancing technology of StoneBeat®. Enterprises that require advanced network security and continuous business connectivity can choose StoneGate for low TCO, best price-to-performance ratio, and highest ROI of any high-end firewall, VPN and IPS solution.

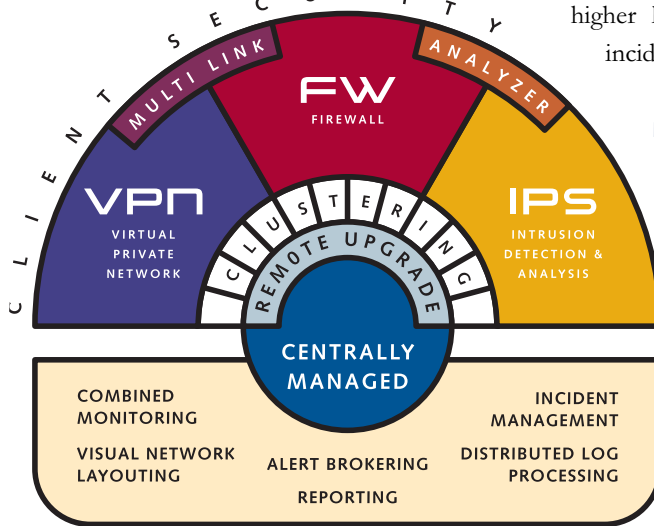
Stonesoft StoneGate Security Platform is uniquely positioned in the network security area. This positioning is reached with the innovative technology solutions, which enable Unified Management, In-Depth Security, End-to-End Availability and Security solutions for IBM eServers (iSeries, zSeries and xSeries) with a wide range of deployment options.

**Unified Management**

The StoneGate Management Center (SMC) provides an innovative approach for role-based administration through a unified management system. Forming the heart of the StoneGate platform for security and continuity, the SMC delivers unified tools for security enforcement with security management functionality, surveillance, with live and on-demand monitoring, as well as full control with systems and data management.

Unified management enables lower administration costs in every day routines, especially in multi-site environments. Unification of security, networking and end-to-end availability reduces complexity, increases

security and service availability. Unified Security solution gives higher level security and is more efficient in security incident management



**In-Depth Security**

StoneGate provides unified In-Depth security with layered architecture and correlated incident detection and response between firewall and IPS to reduce response times and errors. In-Depth security is reached by utilizing Stonesoft’s StoneGate High Availability Firewall, Multi-Link VPN and IPS solutions.

**End-to-End Availability**

Internet uptime and performance, gateway and Web server load balancing enhances

business continuity by utilising Stonesoft’s ISP Multi-homing with Multi-Link Technology, Gateway and IPS Sensor Clustering and Load Balancing and Server Load Balancing solutions.

**Broad range of deployment options**

Today the enterprise networks are diverse and complex. Stonesoft StoneGate’s Broad hardware support gives flexibility to deploy StoneGate in the best way to meet the corporate objectives. StoneGate Appliances do offer drop-in solutions for a range of installations, from small remote offices to large central locations. StoneGate for Intel offer broad range of industry standard hardware to provide maximum flexibility. StoneGate Firewall/VPN is also available for IBM eServer Platforms (IBM iSeries, zSeries and xSeries) to enable server consolidation and to bring security closer to business critical applications.

# CORPORATE GOVERNANCE

## GENERAL MEETING

**Stonesoft Corporation complies with the Corporate Governance Recommendation for listed companies issued by Helsinki Stock Exchange (HEX) Plc, the Central Chamber of Commerce of Finland and the Confederation of Finnish Industry and Employers.**

The General Meeting is the highest decision-making body of Stonesoft Corporation. The General Meeting decides upon matters such as amendments to the Articles of Association, the acceptance of the financial statements, the distribution of profits and the election and fees of Board members and auditors. The Annual General Meeting must be held no later than the end of June each year.

## BOARD OF DIRECTORS

### Duties and responsibilities of the Board

- The Board is responsible for supervising the management and proper organization of the Group in accordance with legislation, the Articles of Association and the instructions issued by General Meetings.
- The Board decides upon matters of major importance to the operations of the company. These include the acceptance of the main strategies, the approval of action plans, major capital expenditures and divestitures of assets.
- The Board appoints and dismisses the company's CEO and decides on his/her service terms.

The Board meets regularly at least 8 times a year and additionally when necessary. The Board met 16 times in 2004. The average attendance of the directors at the Board meetings was 97 percent.

### Election of the Board

The Board of Stonesoft Corporation comprises no fewer than three and no more than six members. The Annual General Meeting elects the members of the Board for a term of one year at a time. The Board elects a Chairman from among its members. The Board currently comprises four members, one of whom is employed by the company. Having four board members is considered to be suitable for a company of this size.

### Composition

Stonesoft Corporation's Board of Directors comprises the following. For more information about Board members, see pages 14-15.

#### Alexis Sozonoff (b. 1938)

Member of the Board since 2001  
Chairman of the Board since 2003

#### Ilkka Hiidenheimo (b. 1960), CEO, Stonesoft Oyj

Chairman of the Board between 1990-1998  
Member of the Board since 1990

#### Pertti Ervi (b. 1957)

Member of the Board since 2004

#### Jyrki Ritvala (b. 1943)

Member of the Board since 2004

### **independence**

The Board evaluated the independence of its members. It was noted that Ilkka Hiidenheimo as the CEO and the biggest shareholder of the company is not independent and that Pertti Ervi is providing consultancy services to the company to the extent that he is not considered independent. The other members were considered to be independent with the following remarks; the Chairman of the Board, Alexis Sozonoff, has option rights that has been granted to him earlier and have no major financial value at the moment.

### **Board Committees**

The Board of Directors decided not to establish any Board committees due to the size of the Board of Directors and the size of the company.

### **Fees, share ownership and options of the Board**

The fees paid to members of the Board in 2004 are as follows: the Chairman's fee is EUR 4,000 per month and a member's fee is EUR 2,000 per month.

### **Board and Management holdings 31.12.2004**

Name	Shares	Option plan 1999	Option plan 2000	Option plan 2001
Christen Tobias	1 000	12 000	0	24 000
Ervi Pertti	5 000	0	0	0
Hiidenheimo Ilkka	10 417 400	0	0	0
Laine Saara	3 500	15 000	5 000	12 000
Nyberg Mikael	0	0	0	0
Panula Erkki	0	0	0	0
Ritvala Jyrki	0	0	0	0
Sozonoff Alexis	0	20 100	20 100	24 000

### **CHIEF EXECUTIVE OFFICER**

The Board appoints and discharges the CEO of the company. The CEO is in charge of the day-to-day management of the Group in accordance with the Companies' Act and the instructions and orders given by the Board. The CEO may undertake acts which, considering the scope and nature of the operations of the company, are unusual or extensive, only with the authorization of the Board. The Group's Executive Management assists the CEO in his duties.

January 1, 2004 - August 2, 2004 the President and CEO of Stonesoft Corporation was Mr. Jorma Turunen. Starting August 3, 2004, the President and CEO of Stonesoft Corporation is Mr. Ilkka Hiidenheimo (44), the founder of the company.

### **The CEO's compensation**

Stonesoft's President and CEO Ilkka Hiidenheimo has decided not to receive any compensation for his duties until the company is profitable. There is no specific retirement age set forth for the CEO. The CEO's pension is the same Finland's Employee Pension Act (TEL) that is compulsory to all Stonesoft employees. Contract of employment for the CEO provides for notice of six months prior to termination with compensation being six months salary and a further optional six months fixed salary in case the company terminates the contract without essential breach of contract by the CEO. Both the pension right and the right for compensation in case of termination of contract are only theoretical as long as the CEO is not receiving any compensation.

## **EXECUTIVE MANAGEMENT**

The company's Executive Management assists the CEO. The Executive Management comprises the following since August 3, 2004:

**Ilkka Hiidenheimo**, Chief Executive Officer

**Tobias Christen**, Chief Technical Officer

**Saara Laine**, Senior Vice President and General Counsel, Legal/ Business Support and Human Resources

**Mikael Nyberg**, Chief Financial Officer

**Erkki Panula**, Executive Vice President, EMEA Sales and Global Marketing

The CEO and the Board of Directors decide salaries and other compensation to the members of Executive Management. The Board decides on granting stock option rights to the Executive Management members. For more information about Executive Management, see pages 16-17.

## **AUDIT & INTERNAL CONTROL**

### **Auditors**

Auditors task is to conduct annual statutory audit in order to examine whether the financial statements present fairly the financial position, results of operations and cash flows of the company in conformity with generally accepted accounting principles in Finland, and that company's internal control functions are in place and support company's activities.

At the Annual general meeting the shareholders appoint one audit firm of public accountants certified by the Central Chamber of Commerce, to operate as company's Auditor, as stated in Articles of Association. Auditor is appointed for the task on temporary basis.

Furthermore the Charter of the board adds that; (i) the board members shall discuss the auditor's report once a year in a meeting held during the first quarter and (ii) one of the Company's auditors should be present in the board meeting, where the auditors report is discussed.

The auditor of Stonesoft is currently Ernst & Young Oy. The auditor fees were EUR 32.678 in year 2004

### **Internal control**

Internal control function at Stonesoft is incorporated into the daily activities of finance & controlling and legal departments. Its aim is to supervise and reinforce the adherence of company's policies and set processes and safeguard company's assets.

### **Risk Management**

Board of Directors is responsible of ensuring that Stonesoft's overall risk management and related policies are in place. Co-ordination of risk management policy is the responsibility of the Chief Financial Officer (CFO). Policy and function aim at ensuring the attainment of company's business objectives and the continuation of its operations.

The Chief Financial Officer as the co-ordinator of corporate risk management creates corporate level risk management principles, develops risk management tools and establishes global insurance policies. Business units must adhere the corporate level policies and proactively contribute to the development of corporate risk management. Risk management function concentrates on (i) evaluation and management of operational risks (ii) management of financial risk and (iii) management and safeguard of critical business related information and assets.

### **Operational risks**

Stonesoft constantly develops its sales processes and related control systems. The product sales and related services sales are made mainly through a global channel partners, using standardized Stonesoft agreements. The sales operations are supported by the company's internal legal unit seeking to reduce the risks related to the global business operations through continuous management and development of contracts. The company also uses insurances to cover the operational risks.

### **Financial risks**

Stonesoft does not provide financing, other than generally accepted terms of payment, to its customers. The company invoices mainly in Euros, US dollar being the other invoicing currency. The company's costs occur mostly in Euros. Exchange rate fluctuations can affect the company's financial results. The company uses matching as a main tool for offsetting the exchange rate risks.

The task of Stonesoft's Corporate Treasury is to manage financial risks in accordance with the Treasury Policy approved by Stonesoft's Board of Directors. The main principles of the policy are; (i) to ensure the short-term liquidity of the Company, (ii) to guarantee efficient circulation and short-term investments of the operational cash flows and (iii) to follow prudent and transparent investment policy for the cash reserves, aiming at guaranteeing competitive return on selected risk level. The company's reserves are all invested on interest bearing low risk instruments.

The company's operations and related costs are continuously controlled. As a result of its small size the company does not have a separate internal audit organization or a separate audit committee.

### **Management and safeguard of critical business related information and assets**

Stonesoft manages and safeguards its critical business information by stringent internal policies and processes. The company constantly reviews and updates its network infrastructure and guarantees safety of its business critical information. Company's has made plans to ensure business continuity during the unexpected.

### **INSIDERS**

The Stonesoft Group has complied with the Guidelines of the Helsinki Exchanges for Insiders since July 25 2003, which are complemented by the company's own insider regulations.

Under the Finnish Securities Market Act, the permanent insiders of Stonesoft based on their positions are the members of the Board of Directors, the CEO and the auditors. Under Stonesoft's own insider regulations the following are also regarded as permanent insiders: the members of the company's Executive Management, Regional Directors and Marketing Director, attorneys, controllers, the Chief Accountant, the Invoicing Manager and the assistants of executive management, legal affairs and the financial department.

The company's own insider regulations regulate trading with the company's shares as follows. Permanent insiders must schedule their trading to ensure that no trading is done one (1) month before publication of the company's financial statements release or the publication of an interim review (the so-called closed window).

In addition, the Board has given the following recommendation to all Stonesoft employees, according to which

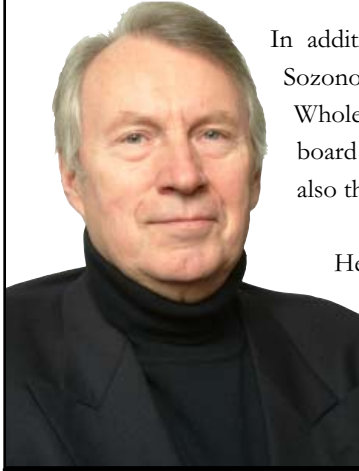
- (1)** Stonesoft's shares and/or other securities should be acquired only as long-term investments; and
- (2)** Acquisitions and disposals of Stonesoft's shares and other securities should be scheduled for times when the markets have as detailed and accurate information as possible on factors affecting the value of the company's securities (e.g. after the disclosure of results).

## STONESOFT'S BOARD OF DIRECTORS

### **ALEXIS SOZONOFF**

Chairman of the Board since 2003  
Member of the Board since 2001

Alexis Sozonoff (born 1938) was Vice President of Customer Advocacy for Hewlett-Packard Company until his retirement in early 2002. He joined HP in 1967 and served in several management positions during 1967-1981 and 1994-2002. During 1981-1993, he was Vice President of International Operations for Harris Information Systems.



In addition to acting as Chairman of the Board for Stonesoft Corporation, Sozonoff currently serves as Chairman of Hewlett Packard Finland, European Wholesale Group (EWG) in Switzerland, and Global Beach, UK. He sits on the board of F-Secure, VimpelCom, Russia's 2nd largest wireless carrier and he is also the Vice Chairman of the Geneva-based Sir Peter Ustinov Foundation.

He holds a bachelor's degree in economics from the University of Tennessee in Knoxville and a degree from the Nijenrode University in Breukelen, Netherlands. He also graduated from the Wharton Advanced Management Program in 1995.

### **ILKKA HIIDENHEIMO**

Member of the Board since 1990  
Chairman of the Board 1990-1998

Ilkka Hiidenheimo (born 1960) is the founder of Stonesoft Corporation and he has worked at Stonesoft since the foundation in 1990. He works as the CEO of Stonesoft Corporation since August 2004 and before his appointment to CEO he worked as Chief Technology Officer.



Before Stonesoft he has worked from 1989 to 1990 as consultant at Oracle Finland Oy and served as system designer and product manager at Tekla Oy during the period 1985 to 1989.

He is a member of the Board of Directors also in Teos Oy and Hiidenkivi Investment Oy.

**PERTTI ERVI**  
Member of the Board since 2004

Pertti Ervi (born 1957) is an independent consultant and investor. Ervi has worked over 20 years in IT-distribution. He co-founded Computer 2000 Finland Oy (currently Tech Data Finland Oy) and served as a Managing Director for the company until 1995. He was then invited as Co-President for Computer 2000 AG international headquarters in Munich, Germany. He has worked closely at international management level with major IT-vendors like Cisco, IBM, Intel, HP and Microsoft.

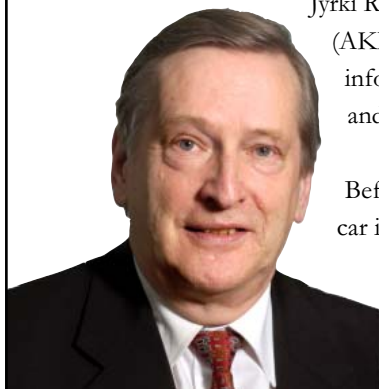


He is Chairman of the Boards of F-Secure Oyj, Mentorium Venture Connections Oy, Forte Netservices Oy, Intstream Oy and Stockway Oy.

He holds B.Sc./Electronics degree from Tekniska L aroverket in Helsinki.

**JYRKI RITVALA**  
Member of the Board since 2004

Jyrki Ritvala (born 1943) works as Director General in Ajoneuvohallintokeskus (AKE), a Finnish Vehicle Administration, an administration, service and information centre operating under the aegis of the Ministry of Transport and Communications.



Before joining Ajoneuvohallintokeskus, he has made a long career in the car industry in Finland, in Sisu-Auto Oy.

Jyrki Ritvala has a Master of Law degree.

## STONESOFT'S EXECUTIVE MANAGEMENT

### **ILKKA HIIDENHEIMO**

Founder and CEO

Ilkka Hiidenheimo (born 1960) is the founder of Stonesoft Corporation and he has worked at Stonesoft since the foundation in 1990. He worked as the CEO of Stonesoft Corp. since August 2004 and before his appointment to CEO he worked as Chief Technology Officer.



Before Stonesoft he has worked from 1989 to 1990 as consultant at Oracle Finland Oy and served as system designer and product manager at Tekla Oy during the period 1985 to 1989. His areas of responsibility at Stonesoft are Business Development, Investor Relations, Americas region, Apac region.

He is a member of the Board of Directors of Stonesoft Corporation and he has also served as chairman of the board from 1990 to 1998. He is a member of the Board of Directors also in Teos Oy and Hiidenkivi Investment Oy.

### **SAARA LAINE**

Senior Vice President & General counsel, Legal/Business Support and Human Resources



Saara Laine (born 1954) has served as Director of Legal Affairs of Stonesoft Corp. since the beginning of 2000. Previously she was employed by Castrén & Snellman Attorneys at Law (1998-2000) and prior to this, she served as lawyer, director of legal affairs, member of the Executive Board and Board of Directors of IBM Oy in Finland and IBM's EMEA headquarters in Paris, France (1990-1998).

She has a Master of Law degree. Her responsibilities at Stonesoft are legal/business support and human resources.

### **TOBIAS CHRISTEN**

CTO



Tobias Christen (born 1967), Ph.D., serves as Chief Technology Officer. He joined Stonesoft in 1999. Before his appointment as CTO he has served Stonesoft as Senior Vice President of Product Management and R&D Manager. Before joining Stonesoft, he worked for 3 years in the IT research lab of the Swiss Bank Corporation (now UBS). From 1992-1997 he worked in an interdisciplinary research group at Novartis, Basel, Switzerland.

He graduated in computer science at the Swiss Federal Institute of Technology in Zürich, Switzerland in 1992. He received his Ph.D. in computer science from the same institution. His areas of responsibility at Stonesoft are technology, research and development, customer support and quality control.



**MIKAEL NYBERG**  
CFO



Mikael Nyberg (born 1960) serves as Chief Financial Officer since August 2004. Before joining Stonesoft he worked seven years for the global IT distributor Tech Data Corporation. Years 1997-2001 he held various positions in Tech Data Finland and in 2001-2003 he served as Managing Director, Back Office in Tech Data International in Switzerland. Years 1985-1997 he worked in various positions in Esso Corporation.

He has Master of Science, Business Administration and Master of Science, Engineering degrees. His areas of responsibility in Stonesoft are Finance, IT and Order Services.

**ERKKI PANULA**  
Executive Vice President, Global Marketing and Channels, EMEA Sales



Erkki Panula (born 1961) serves as Executive Vice President for global marketing, channels and alliances. He is also responsible for the sales at EMEA territory.

Before joining Stonesoft he worked three years at Tech Data International Sarl in Switzerland as Managing Director of Cisco Business for EMEA. During 1999-2001 he worked as Executive Search and Management Audit Senior Consultant at IIC Partners in Helsinki. During 1990-1999 he has been working for Tech Data/Computer 2000 for various Business Management and Managing Director positions in Finland, Baltic countries and Russia.

He holds B.Sc./Electronics degree from Tekniska Läroverket in Helsinki.

# REPORT BY THE BOARD OF DIRECTORS 2004

Financial year January 1, 2004- December 2004

**NET SALES AND PROFIT** (previous year's figures in parenthesis)

## The 2004 financial year

Stonesoft Corporation's net sales in January-December were EUR 22.5 million (EUR 23.2 million). Compared with the previous year's corresponding period, there was a decrease of EUR 0.7 million, or 3%. The earnings before interest, taxes & amortization for the year under review was EUR -9.0 million (EUR -13.9 million). The geographical distribution of net sales was as follows: Europe, Middle East and Africa 74% (72%), North and South America 19% (20%) and Asia-Pacific 7% (8%).

The company's operating result was up EUR 4.6 million compared to the previous year. The loss for the year after taxes was EUR 14.5 million. The previous year's loss was EUR 14.8 million. During the year, the company wrote off EUR 4.3 million imputed tax receivable from the balance sheet.

## Finance and investments

At the end of the year under review, the Corporation's total assets were EUR 29.8 million (EUR 43.3 million). The equity ratio was 81% (90%) and gearing (the ratio of net debt to shareholders' equity) was -1.06 (-0.78). Consolidated liquid assets at the end of the year totaled EUR 22.0 million (27.4). Investments in fixed assets totaled EUR 0.26 million (0.20).

## DEVELOPMENT OF BUSINESS OPERATIONS

### Markets and competitive environment

Network security markets are expected to grow steadily in the coming years. The growth of both the firewall/VPN markets and the IDS/IPS markets is expected to continue at an annual rate of about 20% in 2004-2006 (Sources: IDC, Datamonitor).

### Main business events in 2004

- Development of the StoneGate IPS (Intrusion Detection and Analysis with Active Response) product was completed in May.
- In the same month, Stonesoft published a new management system, the StoneGate Management Center 3.0. The StoneGate Management Center 3.0 integrates the StoneGate product family - firewall, VPN and the new IPS - into a seamless, easy-to-manage comprehensive network security solution, the StoneGate Security Platform. This solution provides data networks with multi-layer protection. Multi-layer network security that incorporates a firewall, VPN and IPS protects not only the outer part of the organization's network but also the Intranet. The StoneGate Security Platform integrates the most important network security components, network management and high availability.
- In early August, Stonesoft's Board of Directors appointed Ilkka Hiidenheimo, 44, the company's founder and Chief Technical Officer, as Stonesoft's new CEO. The previous CEO Jorma Turunen resigned. At the same time, Mikael Nyberg, 44, M.Sc. (Eng.) was appointed the company's Chief Financial Officer and member of the Management Team.
- In August, the company commenced measures to adapt its costs and organization to better match the current level of business, with a view to achieving business profitability more rapidly. These measures created cost savings of approximately EUR 0,8 million on the global level per quarter.
- The company re-evaluated its strategy during the final quarter, completed the announced cost saving program and commenced measures, in line with its strategy, aimed at increasing sales.

## REVIEW OF MAJOR RESEARCH AND DEVELOPMENT ACTIVITIES

Stonesoft focuses on innovative research and development and the protection of its inventions. In the financial year, the company's R&D focused on developing both new and existing high availability network security solutions.

The company's investments in research and development in 2004 totalled EUR 5.1 million (6.5). Research and development employed 63 (66) persons at the end of the financial year. In line with the Corporation's accounting principles, R&D expenditure is booked as an expense at the moment it occurs.

## ADOPTION OF IFRS

Stonesoft Corporation will adopt IFRS-compliant reporting in 2005. The first interim report prepared according to the IFRS (International Financial Reporting Standards) will be published for the first quarter of 2005. The process of transferring to the preparation of consolidated financial statements in compliance with the IFRS is proceeding according to plan.

The opening balance sheet of the year 2004 and the Income Statements and Balance Sheets of the first three quarters are ready. Accordingly, the year 2005 quarterly results can include comparison with the year 2004 results. Most significant changes to Stonesoft are as follows:

- amortization of goodwill will no longer be done but goodwill will be tested for its value
- finance leases are transferred to the balance sheet and costs booked as depreciation instead of as rents
- larger development projects must, in the future, be activated in the balance sheet
- stock option programs must be booked as costs imputed tax
- receivables will be booked on the balance based on the company's capability to utilize them

The overall impact of the IFRS rules is estimated to be small to Stonesoft. Stonesoft will report geographical areas (EMEA, Americas and APAC) as primary segments.

## SHARE CAPITAL AND OPTION PROGRAMS

### Authorizations currently in force

The Annual General Meeting of 10 March 2004 decided to grant a new authorization to the company's Board of Directors to decide on increasing the company's share capital in the following way:

rights offering; and/or  
granting options; and/or  
issuing convertible bonds.

### The terms and conditions of the authorization are:

The share capital of the company may be increased in one or several lots in such a way that the shares issued in the rights offering and/or the shares issued on the basis of the issued options and/or the shares issued in exchange for convertible bonds can altogether increase the share capital of the company by a maximum of EUR 229,000.00 so that a maximum of 11,450,000 shares with a counter book value of EUR 0.02 each, can be subscribed for in the said rights offering and/or share issue on the basis of the issued options and/or the shares issued in exchange for convertible bonds. Options may only be granted on condition that the shares issued on the basis of these rights can only increase the company's share capital by a maximum of EUR 30,000.00. Options can only be granted in conjunction with acquisitions or mergers.

The Board of Directors of the company has the right to decide on who is entitled to subscribe for new shares, options or convertible bonds. The new shares and/or options and/or convertible bonds can, in accordance with Chapter 4 Section 6 of the Companies Act (No 734/1978 with its amendments), be subscribed for with contribution in kind or otherwise under specific terms and conditions.

The new shares issued in the rights offering and/or the shares issued on the basis of the issued options and/or the shares issued in exchange for convertible bonds can be offered for subscription by making an exception to the pre-emptive subscription rights of shareholders referred to in Chapter 4 section 2 of the Companies Act (No 734/1978 with its amendments) if the exception can be justified on grounds that are financially significant to the company, such as acquisitions, implementation of co-operation arrangements or an increase in the number of financing options, or as a part of an incentive scheme for the company's management and/or other members of the personnel.

The Board of Directors of the company is entitled to decide on the basis of determining the subscription price of the new shares issued in the rights offering and/or the shares issued on the basis of the issued options and/or the shares issued in exchange for convertible bonds, as well as on the subscription price itself which may not, however, be less than the counter book value of the share.

The Board of Directors of the company is entitled, within the limits set by the Companies Act (No 734/1978), to decide on all the other issues and conditions related to the rights offering and/or issue of options and/or the issuing of convertible bonds, such as on the interest payable on the convertible bonds.

The authorization will be in force until the following Annual General Meeting of Shareholders, but not, however, for more than one year from the date of this resolution of the Annual General Meeting of Shareholders.

#### **Option programs**

Stonesoft Corporation's Extraordinary General Meeting of 24 November 2004 accepted the Board's proposal for a new Stonesoft option program, offering up to 1,500,000 options to Stonesoft Group companies' boards, other management and personnel. Some of the options are issued to subsidiaries fully owned either directly or through its other subsidiaries by Stonesoft Corporation.

Each option entitles its owner to subscribe for one Stonesoft share with a counter book value of EUR 0.02. A maximum of 1,500,000 shares may be subscribed for in the option program, meaning that the company's share capital may increase through these share subscriptions by up to EUR 30,000.

The options are divided into four different types, depending on the terms and conditions of the option program. The share subscription period begins, depending on the type of option, on 1 January 2006 at the earliest, and ends with all options on 31 December 2010. The share subscription price when using options is EUR 0.56.

During 2004 no subscriptions were made on the basis of the option programs for key personnel of the company.

At the end of the financial year on 31 December 2004, Stonesoft's share capital entered in the Trade Register totaled EUR 1,146,054.64. The number of shares was 57,302,732 and the counter book value of each share was EUR 0.02. The share capital remained unchanged.

#### **DEVELOPMENT OF SHARE PRICES AND TURNOVER**

On 2 January 2004, Stonesoft's shares were valued at EUR 0.68. At the end of the year, the share price was EUR 0.58. The highest share price was EUR 1.07 and the lowest EUR 0.51. During the year, the total turnover of Stonesoft shares amounted to EUR 22 million. Stonesoft's share price decreased by 15 % during 2004. Over the same period, the Helsinki Stock Exchange HEX index increased by 3,25 %, while the telecom & electronics sector index decreased by 12,21 %. Based on the share price on 30 December 2004, Stonesoft's market capitalization was EUR 33.2 million.

## **PROPOSAL BY THE BOARD OF DIRECTORS FOR DISTRIBUTION OF PROFIT**

The parent company's operating loss before amortization of goodwill (EBITA) was EUR 9.0 million and the loss for the fiscal year after taxes was EUR 14.5 million. At the end of the period, neither the Corporation nor the parent company had any distributable equity in its shareholders' equity. The Board of Directors proposes that the parent pay no dividend for 2004 and that the loss for the fiscal year be debited to the retained earnings account.

## **PERSONNEL**

At the end of the 2004 financial year, Stonesoft's personnel numbered 237 (264). During the 2004 financial year, the company carried out a substantial structural reform in the organization, enabling an increase in the efficiency of administration and a significant increase in the number of people engaged in sales duties in the key markets specified in Stonesoft's strategy.

## **THE COMPANY'S BOARD OF DIRECTORS AND EXECUTIVE MANAGEMENT**

In the 2004 financial year, Jorma Turunen was the CEO of the company between 1 January 2004 and 2 August 2004, and Ilkka Hiidenheimo was the CEO of the company between 3 August 2004 - 31 December 2004. The Chairman of the company's Board of Directors was Alexis Sozonoff and other members were Ilkka Hiidenheimo Hannu Turunen, John C. Yates and Kai Karttunen until 10 March 2004. Alexis Sozonoff continued as the Chairman of the Board of Directors and Ilkka Hiidenheimo as a Board Member after the Annual General Meeting in 10 March 2004. Pertti Ervi and Jyrki Ritvala were elected to the Board of Directors as new Board Members.

As of 3 August 2004, the members of the company's Management Team were Ilkka Hiidenheimo, Mikael Nyberg, Erkki Panula, Saara Laine and Tobias Christen.

## **MAJOR EVENTS AFTER THE FINANCIAL YEAR**

In February 2005, Stonesoft published the StoneGate firewall and VPN solution for IBM i5-servers published in September 2004.

## **FUTURE OUTLOOK**

The company started to take measures at the end of the year to strengthen the sales in selected geographical and product focus areas in accordance with the strategy. The addition in resources is expected to bring additional sales with 3 - 9 month's delay because of the length of the sales cycles in the enterprise segment. However, the recruitment and salary costs will increase the cost level already starting from the first quarter.

The company believes that, as a consequence of these changes, its core business, product sales, will grow significantly faster than the estimated average growth of 20 % in the network security market forecasted by the most distinguished research institutes. The company believes that this growth will help it to reach profitability.

Due to normal seasonality effects, sales in the first quarter is expected to be sequentially lower than in the last quarter of 2004. The company expects however, that the year-on-year growth from 2004 will be clearly positive. According to the current plans of the company EBITA will be positive as of the last quarter of the year.

# STONESOFT GROUP INCOME STATEMENTS AND BALANCE SHEET 2004

## GROUP INCOME STATEMENT

	<i>note</i>	<i>1.1. - 31.12.2004</i>	<i>1.1. - 31.12.2003</i>
<i>thousand euros</i>			
<b>Net sales</b>	<b>1</b>	<b>22 490</b>	<b>23 197</b>
Other operating income	2	545	840
Materials and services	3	-1 859	-1 780
Personnel costs	4	-17 214	-20 147
Depreciations and reduction in value	5	-2 510	-2 713
Other operating expenses		-11 674	-14 464
<b>Operating profit/loss</b>		<b>-10 221</b>	<b>-15 067</b>
Financial income and expenses	6	304	817
<b>Profit / loss before extraordinary items</b>		<b>-9 918</b>	<b>-14 250</b>
Extraordinary items +/-	7	0	35
<b>Profit / loss before appropriations and taxes</b>		<b>-9 918</b>	<b>-14 214</b>
Direct taxes	8	-4 602	-573
<b>PROFIT / LOSS FOR FINANCIAL YEAR</b>		<b>-14 519</b>	<b>-14 787</b>

## GROUP CASHFLOW STATEMENT

	<i>thousand euros</i>	<i>2004</i>	<i>2003</i>
<b>Cash flow from operating activities</b>			
Operating profit / loss		-10 221	-15 067
Adjustments to operating profit / loss		2 400	2 842
Finance income and expenses		304	817
Change in net working capital		2 503	-1 036
Extraordinary items		0	35
Taxes paid		-292	-415
<b>Total</b>		<b>-5 306</b>	<b>-12 823</b>
<b>Cash flow from investing activities</b>			
Investments to intangible and tangible assets		-259	-197
Investments to (-) / sales of (+) other shares		-3	-3
<b>Total</b>		<b>-262</b>	<b>-200</b>
<b>Cash flow form financing activities</b>			
Change in long-term receivables		0	-2
Other		88	48
<b>Total</b>		<b>88</b>	<b>46</b>
<b>Change in cash and cash equivalent</b>		<b>-5 480</b>	<b>-12 977</b>
Cash and cash equivalent at the beginning of the period		27 441	40 418
Cash and cash equivalent at the end of the period		21 961	27 441

## GROUP BALANCE SHEET

<b>ASSETS</b>	<i>thousand euros</i>	<i>note</i>	<i>31.12.2004</i>	<i>31.12.2003</i>
<b>Non-current assets</b>				
Intangible assets		9	587	1 038
Consolidated goodwill		9	301	1 507
Tangible assets		10	673	1 267
Investments		11	9	6
<b>Non-current assets total</b>			<b>1 570</b>	<b>3 818</b>
<b>Current assets</b>				
Inventories			188	91
Long-term receivables			38	60
Short-term receivables		12	6 023	11 880
Investments		13	20 590	24 126
Cash in hand and at banks			1 372	3 315
<b>Current assets total</b>			<b>28 211</b>	<b>39 472</b>
<b>TOTAL</b>			<b>29 781</b>	<b>43 291</b>
<b>EQUITY AND LIABILITIES</b>				
<b>Shareholders' equity</b>				
Share capital		14	1 146	1 146
Other restricted capital		14	75 560	75 743
Retained earnings / loss		14	-41 497	-26 981
Profit / loss for the financial year		14	-14 519	-14 787
<b>Shareholders' equity total</b>			<b>20 690</b>	<b>35 121</b>
<b>Provisions</b>			<b>49</b>	<b>159</b>
<b>Liabilities</b>				
Short-term liabilities		15	9 043	8 011
<b>Liabilities total</b>			<b>9 043</b>	<b>8 011</b>
<b>TOTAL</b>			<b>29 781</b>	<b>43 291</b>

## PARENT COMPANY INCOME STATEMENT

	<i>note</i>	1.1.-1.12.2004	1.1.-31.12.2003
<b>Net sales</b>	<i>thousand euros</i> 1	<b>15 530</b>	<b>16 510</b>
Other operating income	2	1 340	1 271
Materials and services	3	-1 856	-1 624
Personnel costs	4	-6 925	-7 672
Depreciations and reduction in value	5	-795	-868
Other operating expenses		-16 868	-23 010
<b>Operating profit / loss</b>		<b>-9 574</b>	<b>-15 393</b>
Financial income and expenses	6	-874	852
<b>Profit / loss before extraordinary items</b>		<b>-10 447</b>	<b>-14 541</b>
Extraordinary items +/-	7	947	150
<b>Profit / loss before appropriations and taxes</b>		<b>-9 500</b>	<b>-14 390</b>
Direct taxes	8	0	-42
<b>PROFIT / LOSS FOR FINANCIAL YEAR</b>		<b>-9 500</b>	<b>-14 432</b>

## PARENT COMPANY CASHFLOW STATEMENT

	<i>thousand euros</i>	2004	2003
<b>Cash from operating activities</b>			
Operating profit / loss		-9 574	-15 393
Adjustments to operating profit / loss		781	934
Financial income and expenses		301	852
Change in net working capital		4 152	2 313
Taxes paid		0	-42
<b>Total</b>		<b>-4 340</b>	<b>-11 335</b>
<b>Cash flow from investing activities</b>			
Investments to intangible and tangible assets		-129	-279
Investments to (-) / sales of (+) shares in subsidiaries		-110	-46
<b>Total</b>		<b>-239</b>	<b>-325</b>
<b>Cash flow from financing activities</b>			
<b>Total</b>		<b>0</b>	<b>0</b>
<b>Change in cash and cash equivalents</b>		<b>-4 579</b>	<b>-11 660</b>
Cash and cash equivalents at the beginning of the period		25 804	37 465
Cash and cash equivalents at the end of the period		21 226	25 804



**PARENT COMPANY BALANCE SHEET**

<b>ASSETS</b>	<i>thousand euros</i>	<i>note</i>	<i>31.12.2004</i>	<i>31.12.2003</i>
<b>Non-current assets</b>				
Intangible assets		9	611	1 024
Tangible assets		10	271	524
Investments		11	8 118	9 183
<b>Non-current assets total</b>			<b>9 000</b>	<b>10 731</b>
<b>Current assets</b>				
Inventories			188	82
Short-term receivables		12	5 242	9 210
Investments		13	20 514	24 046
Cash in hand and at banks			712	1 758
<b>Current assets total</b>			<b>26 656</b>	<b>35 096</b>
<b>TOTAL</b>			<b>35 656</b>	<b>45 828</b>
<b>EQUITY AND LIABILITIES</b>				
<b>Shareholders' equity</b>				
Share capital		14	1 146	1 146
Share premium account		14	76 821	76 821
Retained earnings / loss		14	-44 064	-29 631
Profit / loss for the financial year		14	-9 500	-14 432
<b>Shareholders' equity total</b>			<b>24 403</b>	<b>33 903</b>
<b>Provisions</b>			<b>26</b>	<b>43</b>
<b>Liabilities</b>				
Short-term liabilities		15	11 227	11 881
<b>Liabilities total</b>			<b>11 227</b>	<b>11 881</b>
<b>TOTAL</b>			<b>35 656</b>	<b>45 828</b>

## NOTES TO THE FINANCIAL STATEMENTS

### Accounting Principles

The following group companies have been consolidated in the Stonesoft Group financial statements:

Stonesoft Oyj; parent company, Stonesoft Finland Oy, Embe Systems Oy, Embe Systems Inc (USA), Stonesoft International Oy, Stonesoft Inc (USA), Optiwise Inc (USA), Stonesoft France S.A.S (Ranska), Stonesoft AB (Sweden), Stonesoft Networks Ltd (UK), Stonesoft Germany GmbH, Stonesoft Japan K.K, Unirel Sistemi S.r.l (Italy) - merge to Stonesoft Italy Srl on 30.11.2004, Stonesoft Italy Srl, Stonegate AG (Switzerland), Stonesoft Netherlands B.V., BVBA Stonesoft Belgium, Stonesoft Espana S.A. (Spain), Stonesoft Tunis SARL (Tunisia), Stonesoft Australia Pty Ltd, Stonesoft Singapore Pte Ltd, Stonesoft Hong Kong Limited, Stonesoft Canada Inc, Stonesoft LTDA (Brazil).

### Principles of consolidation

The consolidated financial statements were prepared using the acquisition cost method. The difference between the acquisition cost of subsidiaries and the amount of shareholders' equity proportionate to the acquired shareholding has been entered as goodwill. The consolidated goodwill is depreciated in five years. Transactions within the Group as well as internal receivables and payables and internal ownership of the share have been eliminated.

### Group net sales

When calculating the net sales, indirect taxes of sales and adjustment items are deducted from total sales revenues. Revenues and costs for maintenance of software products are divided into the respective contract periods.

### Items in foreign currency

The financial statements have been prepared in euros. Receivables and payables in foreign currency have been converted to euros using average rates of the closing date. Exchange rate differences from accounts receivable have been recorded to sales adjustments and from accounts payable to exchange rate adjustments of purchases. Other exchange rate differences have been entered to exchange rate adjustments in financial income and expenses.

The profit and loss accounts of foreign subsidiaries have been converted using the average exchange rate of the period and the balance sheets have been converted using the exchange rate of the closing date. Translation differences from the shareholders' equity and other restricted capital are included in other restricted capital. Translation differences from retained earnings and profit/loss for the financial year are included in retained earnings.

### Pension expenses

Company's pension arrangements have been made in compliance with local legislation. Pension costs are recorded as expenses for the financial period. The statutory pension liability has been fully covered by annual pension insurance payments.

### Research and development

R&D expenses have been recorded as annual expenditure for the year they incurred.

### Rents

Rental expenses are recorded as expenditure for the financial period they incurred. The rental liabilities (note 16) include future rental payments according to current contract terms.

### Valuation of capital assets

Capital assets have been entered in the balance sheet at acquisition price less scheduled depreciation. The scheduled depreciation has been calculated using the straight line method on the basis of the economic lifespan of the capital asset.

## Depreciation period of capital assets

	Stonesoft Group		Stonesoft Oyj	
	2004	2003	2004	2003
Machinery	3-5	3-5	3-5	3-5
Equipment	5	5	5	5
Other tangible assets	5	5	5	5
Other long-term expense items	5	5	5	5
Consolidated goodwill	5	5	-	-

## Securities included in financial assets

Securities included in financial assets have been valued at the acquisition price or the market price, whichever is lower.

## NOTES TO THE INCOME STATEMENT

	thousand euros	Stonesoft Group		Stonesoft Oyj	
		2004	2003	2004	2003
<b>1a NET SALES by market areas</b>					
Emea		16 663	16 765	10 468	10 946
Americas		4 300	4 605	3 534	3 737
Asia Pacific		1 527	1 827	1 527	1 827
<b>Total</b>		<b>22 490</b>	<b>23 197</b>	<b>15 530</b>	<b>16 510</b>
<b>1b NET SALES by business function</b>					
<b>Software and appliance revenue</b>					
Own licenses and appliances		7 696	7 628	7 662	7 508
Other licenses		130	238	130	197
<b>Software and appliance revenue total</b>		<b>7 826</b>	<b>7 865</b>	<b>7 792</b>	<b>7 705</b>
<b>Service revenue</b>					
Consultation and training		7 244	6 749	407	486
Support, own		6 767	7 393	6 739	7 336
Support, other		461	753	461	669
<b>Service revenue total</b>		<b>14 472</b>	<b>14 896</b>	<b>7 607</b>	<b>8 492</b>
<b>Other revenue</b>					
Hardware		201	584	201	504
Other revenue		-9	-148	-70	-192
<b>Total</b>		<b>22 490</b>	<b>23 197</b>	<b>15 530</b>	<b>16 510</b>
<b>2 OTHER INCOME FROM BUSINESS OPERATIONS</b>					
Government subsidy for R&D activities		0	111	0	111
Sales of fixed assets		7	34	1	0
Rental income		345	591	263	514
Income from personnel canteen		95	95	60	62
Compensation paid by an insurance company		32	0	32	0
Others		66	9	29	5
Group internal administration fee		0	0	955	580
<b>Total</b>		<b>545</b>	<b>840</b>	<b>1 340</b>	<b>1 271</b>

	Stonesoft Group		Stonesoft Oyj		
	<i>thousand euros</i>	2004	2003	2004	2003
<b>3 MATERIALS AND SERVICES</b>					
Materials and goods					
Purchases during the financial period		1 864	1 637	1 875	1 482
Change in stocks		-97	-18	-107	-17
		<b>1 767</b>	<b>1 619</b>	<b>1 768</b>	<b>1 465</b>
External services		91	161	88	159
<b>Total</b>		<b>1 859</b>	<b>1 780</b>	<b>1 856</b>	<b>1 624</b>
<b>4 WAGES, SALARIES AND INDIRECT EMPLOYEE EXPENSES</b>					
Wages and salaries		14 192	16 591	5 706	6 246
Pension expenses		1 734	1 829	890	1 017
Other indirect employee expenses		1 287	1 726	329	409
<b>Total</b>		<b>17 214</b>	<b>20 147</b>	<b>6 925</b>	<b>7 672</b>
Salaries and fees paid to the Board of Directors and CEO		532	354	454	285
Number of personnel, average		258	298	108	127
<b>5 DEPRECIATION</b>					
Goodwill		1 206	1 206	20	18
Tangible assets		798	941	332	371
Intangible assets		506	566	443	478
<b>Total</b>		<b>2 510</b>	<b>2 713</b>	<b>795</b>	<b>868</b>
<b>6 FINANCIAL INCOME AND EXPENSES</b>					
<b>Dividend income</b>					
from Group companies		0	0	0	27
from others		3	2	3	2
<b>Interest and other financial income</b>		<b>1 100</b>	<b>1 123</b>	<b>1 087</b>	<b>1 098</b>
<b>Financial income, total</b>		<b>1 102</b>	<b>1 125</b>	<b>1 090</b>	<b>1 127</b>
Reduction on value of investment		0	0	1 175	0
Interest and other financial expenses		798	308	789	275
<b>Financial income and expenses, total</b>		<b>304</b>	<b>817</b>	<b>-874</b>	<b>852</b>
<b>Financial income and expenses includes</b>					
Exchange rate gains / losses (net)		-712	-135	-714	-114
Gains / losses from securities market		965	605	965	605

	<i>Stonesoft Group</i>		<i>Stonesoft Oyj</i>		
	<i>thousand euros</i>	2004	2003	2004	2003
<b>7 EXTRAORDINARY ITEMS</b>					
<b>Extraordinary income</b>					
Group contribution		0	0	947	848
Payment to receivables written down in previous year		0	37	0	0
<b>Extraordinary items, total</b>		<b>0</b>	<b>37</b>	<b>947</b>	<b>848</b>
<b>Extraordinary expenses</b>					
Closing down the Optiwise business		0	1	0	0
Optiwise Oy, loss due to the merger		0	0	0	697
<b>Extraordinary expenses, total</b>		<b>0</b>	<b>1</b>	<b>0</b>	<b>697</b>
<b>Extraordinary items, total</b>		<b>0</b>	<b>35</b>	<b>947</b>	<b>150</b>
<b>8 INCOME TAXES</b>					
Income taxes on extraordinary items		0	-11	0	0
Income taxes on actual business		-315	-407	0	-42
Change in deferred tax liability / receivables		-4 310	-158	0	0
Taxes from previous financial periods		23	3	0	0
<b>Direct taxes, total</b>		<b>-4 602</b>	<b>-573</b>	<b>0</b>	<b>-42</b>

## NOTES TO THE BALANCE SHEET

	<i>Stonesoft Group</i>		<i>Stonesoft Oyj</i>		
	<i>thousand euros</i>	2004	2003	2004	2003
<b>9 INTANGIBLE ASSETS</b>					
<b>intangible rights</b>					
Acquisition cost 1.1.		1 714	1 627	1 359	1 278
Additions		35	47	26	97
Reductions		-34	-16	0	-16
Transfers		0	56	0	0
Acquisition cost 31.12.		1 714	1 714	1 385	1 359
Accumulated depreciatoin 1.1.		-1 073	-766	-801	-568
Depreciation for financial period		-270	-305	-214	-249
Accumulated depreciation on reductions and transfers		33	-2	0	16
Accumulated depreciation 31.12.		-1 310	-1 073	-1 015	-801
<b>Balance sheet value 31.12</b>		<b>404</b>	<b>641</b>	<b>370</b>	<b>558</b>

	Stonesoft Group		Stonesoft Oyj		
	<i>thousand euros</i>	2004	2003	2004	2003
<b>Goodwill</b>					
Acquisition cost 1.1.		10 121	10 121	100	0
Additions		0	0	0	100
Acquisition cost 31.12.		10 121	10 121	100	100
Accumulated depreciation 1.1.		-8 614	-7 408	-18	0
Depreciation for financial period		-1 206	-1 206	-20	-18
Accumulated depreciation 31.12.		-9 820	-8 614	-38	-18
<b>Balance sheet value 31.12.</b>		<b>301</b>	<b>1 507</b>	<b>62</b>	<b>82</b>
<b>Other long-term expense items</b>					
Acquisition cost 1.1.		1 285	1 223	1 145	1 145
Additions		24	3	24	0
Transfers		0	60	0	0
Acquisition cost 31.12.		1 309	1 285	1 169	1 145
Accumulated depreciation 1.1.		-889	-609	-760	-531
Depreciation for financial period		-238	-261	-230	-229
Accumulated depreciation on transfers		0	-19	0	0
Accumulated depreciation 31.12.		-1 127	-889	-990	-760
<b>Balance sheet value 31.12.</b>		<b>182</b>	<b>397</b>	<b>179</b>	<b>385</b>
<b>10 TANGIBLE ASSETS</b>					
<b>Machinery and equipment</b>					
Acquisition cost 1.1.		4 815	6 758	665	2 436
Additions		220	163	86	83
Reductions		-332	-2 106	-55	-1 854
Acquisition cost 31.12.		4 703	4 815	696	665
Accumulated depreciation 1.1.		-3 564	-4 720	-148	-1 630
Accumulated depreciation on reductions		314	2 094	49	1 854
Depreciation for financial period		-796	-938	-332	-371
Accumulated depreciation 31.12.		-4 046	-3 564	-431	-148
<b>Balance sheet value 31.12.</b>		<b>658</b>	<b>1 251</b>	<b>265</b>	<b>517</b>
<b>Other tangible assets</b>					
Acquisition cost 1.1.		118	238	7	7
Additions		58	2	57	2
Reductions		-58	-6	-58	-2
Transfers		0	-116	0	0
Acquisition cost 31.12.		118	118	6	7
Accumulated depreciation 1.1.		-102	-137	0	0
Accumulated depreciation on reductions and transfers		0	38	0	0
Depreciation for financial period		-1	-3	0	0
Accumulated depreciation 31.12.		-103	-102	0	0
<b>Balance sheet value 31.12.</b>		<b>15</b>	<b>16</b>	<b>6</b>	<b>7</b>

	Stonesoft Group		Stonesoft Oyj	
	2004	2003	2004	2003
<b>11 INVESTMENTS</b>				
Stocks and shares				
Acquisition cost 1.1.	6	4	8 008	8 045
Additions	3	3	110	46
Reductions	0	0	0	-83
<b>Acquisition cost 31.12.</b>	<b>9</b>	<b>6</b>	<b>8 118</b>	<b>8 008</b>
Capital loans to Group companies				
Balance sheet value 1.1.	0	0	1 175	1 175
Impairment	0	0	-1 175	0
<b>Balance sheet value 31.12.</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1 175</b>

#### GROUP COMPANIES 31.12.2004 - stocks and shares held by the Group

	Group share- holding %	Parent company shareholding %	Book value held by the parent company, thousand euros
Stonesoft Finland Oy, Helsinki	100	100,00	472
Embe Systems Oy, Oulu	100	100,00	6 614
Embe Systems Inc, USA, Dallas	100	0,00	0
Stonesoft International Oy, Helsinki	100	100,00	8
Stonesoft Inc, USA, Atlanta	100	100,00	43
Stonesoft AB, Sweden, Stockholm	100	100,00	11
Stonesoft Networks (UK) Ltd, Surrey	100	100,00	2
Stonesoft France S.A.S., France Sophia Antipolis	100	100,00	40
Stonesoft Germany GmbH, Frankfurt	100	100,00	46
Stonesoft Espana S.A., Madrid	100	100,00	60
Stonesoft Japan K., Tokio	100	100,00	94
Stonesoft Netherlands B.V., Amsterdam	100	100,00	20
Optiwise Inc, Atlanta	100	100,00	17
Stonesoft Italy S.r.l, Milano	100	99,99	231
Stonegate AG, Sveitsi, Zurich	100	100,00	66
Stonesoft Australia Pty Ltd, Sydney	100	100,00	0
Stonesoft Singapore PTE Ltd	100	100,00	0
Stonesoft Hong Kong Ltd	100	100,00	0
Stonesoft LTDA, São Paulo, Brazil	100	100,00	370
BVBA Stonesoft Belgium, Diegem	100	99,00	18
Stonesoft Tunis SARL, Tunis, Tunisia	100	100,00	7
<b>TOTAL</b>			<b>8 118</b>

	Stonesoft Group		Stonesoft Oyj	
	2004	2003	2004	2003
<i>thousand euros</i>				
<b>12 SHORT-TERM RECEIVABLES</b>				
<b>Accounts receivable</b>	<b>5 191</b>	<b>5 905</b>	<b>4 239</b>	<b>4 484</b>
<b>Receivables from Group companies</b>				
Accounts receivables	0	0	0	44
Other receivables	0	0	661	4 105
<b>Prepayments and accrued income</b>				
Periodized interest	0	0	0	95
Rental deposits	49	0	49	53
Other prepayments and accrued income	783	1 384	294	306
<b>Other receivables</b>	<b>0</b>	<b>281</b>	<b>0</b>	<b>123</b>
<b>Deferred tax credits</b>				
Due to periodization difference	395	106	0	106
Due to accumulated losses	16 692	16 323	14 243	16 323
of which booked to tax receivables	0	4 310	0	0
<b>Short term receivables, total</b>	<b>6 023</b>	<b>11 880</b>	<b>5 242</b>	<b>9 210</b>
<b>13 SECURITIES INCLUDED IN FINANCIAL ASSETS</b>				
<b>Investments</b>				
Replacement value	20 815	24 845	20 740	24 765
Book value	20 590	24 126	20 514	24 046
Difference	226	719	226	719
<b>14 SHAREHOLDERS' EQUITY</b>				
<b>Share capital</b>				
Share capital 1.1	1 146	1 146	1 146	1 146
Share capital 31.12	1 146	1 146	1 146	1 146
<b>Other restricted shareholders' equity</b>				
Share premium account 1.1	76 821	76 821	76 821	76 821
Share premium account 31.12	76 821	76 821	76 821	76 821
Translation difference, restricted	-1 261	-1 078	0	0
<b>Other restricted shareholders' equity total</b>	<b>75 560</b>	<b>75 743</b>	<b>76 821</b>	<b>76 821</b>



	Stonesoft Group		Stonesoft Oyj		
	<i>thousand euros</i>	2004	2003	2004	2003
<b>Retained earnings / loss</b>					
Retained earnings / loss 1.1		-41 768	-27 563	-44 064	-29 631
Translation difference, free		271	582	0	0
Retained earnings / loss 31.12		-41 497	-26 981	-44 064	-29 631
<b>Profit / loss for the financial period</b>		<b>-14 519</b>	<b>-14 787</b>	<b>-9 500</b>	<b>-14 432</b>
<b>Shareholders' equity, total</b>		<b>20 690</b>	<b>35 121</b>	<b>24 403</b>	<b>33 903</b>
<b>Calculation on distributable funds</b>					
Retained earnings / loss		-41 497	-26 981	-44 064	-29 631
Profit / loss for the financial period		-14 519	-14 787	-9 500	-14 432
Other reserves					
Translation difference		271	582	0	0
<b>Total</b>		<b>-55 745</b>	<b>-41 186</b>	<b>-53 564</b>	<b>-44 064</b>
<b>15 LIABILITIES</b>					
<b>Short term liabilities</b>					
Advances received		7	115	0	107
Accounts payable		856	965	601	716
<b>Debts to the Group companies</b>					
Other debts		0	0	4 587	5 621
<b>Substantial items included in deferred liabilities</b>					
Matched maintenance cost		4 262	4 187	4 247	4 174
Other deferred liabilities		3 011	1 883	1 497	1 095
<b>Other debts</b>		<b>907</b>	<b>861</b>	<b>295</b>	<b>169</b>
<b>Short term liabilities total</b>		<b>9 043</b>	<b>8 011</b>	<b>11 227</b>	<b>11 881</b>
<b>Liabilities total</b>		<b>9 043</b>	<b>8 011</b>	<b>11 227</b>	<b>11 881</b>
<b>16 PLEDGES</b>					
<b>Leasing liabilities</b>					
Payable in year 2005		652	848	521	702
Payable later		707	896	563	776
<b>Rent liabilities and pledges</b>					
Rental liabilities		7 773	9 180	7 066	8 229
Rental pledges		83	117	56	65
<b>Pledges issued for companies in the same Group</b>		<b>0</b>	<b>0</b>	<b>100</b>	<b>100</b>
<b>Other pledges</b>		<b>46</b>	<b>18</b>	<b>0</b>	<b>0</b>
<b>Pledges total</b>		<b>9 261</b>	<b>11 059</b>	<b>8 306</b>	<b>9 873</b>

## STONESOFT GROUP KEY RATIOS

	<i>thousand euros</i>	2004	2003	2002	2001	2000
Net sales, k EUR		22 490	23 197	30 173	57 703	59 568
Net sales change - %		-3	-23	-48	-3	115
Operating profit / loss before goodwill amortization (EBITA), k EUR		-9 016	-13 861	-22 708	-10 417	-1 511
% of net sales		-40	-60	-75	-18	-3
Operating profit / loss after goodwill amortization (EBIT), k EUR		-10 221	-15 067	-25 178	-12 866	-3 623
% of net sales		-45	-65	-83	-22	-6
Profit / loss before extraordinary items and taxes, k EUR		-9 918	-14 250	-24 699	-11 858	-2 822
% of net sales		-44	-61	-82	-21	-5
Profit / loss before taxes, k EUR		-9 918	-14 214	-15 965	-13 094	-6 104
% of net sales		-44	-61	-53	-23	-10
ROE - %		-52	-35	-44	-13	-4
ROI - %		-33	-33	-42	-15	-4
Equity ratio - %		81	90	90	88	87
Net Gearing		-1,06	-0,78	-0,81	-0,68	-0,67
Total assets, k EUR		29 781	43 291	59 916	82 039	93 388
Capital investments, k EUR		259	197	699	727	5 944
% of net sales		1	1	2	1	10
R&D costs, k EUR		5 086	6 541	7 436	9 086	6 270
% of net sales		23	28	25	16	11
<hr/>						
Number of employees (weighted average)		258	298	403	581	450
Number of employees at the end of the year		237	264	336	571	574
<hr/>						
<b>Share specific ratios</b>						
Earnings per share, EUR		-0,25	-0,26	-0,49	-0,15	-0,01
Equity per share, EUR		0,36	0,61	0,87	1,16	1,34
Dividend per share, EUR		0	0	0	0	0
Dividend / profit - %		0	0	0	0	0
Weighted amount of shares (option dilution effect included)		57 302 732	57 302 732	57 302 088	57 643 083	55 499 114
Amount of share at the end of the period		57 302 732	57 302 732	57 302 732	57 301 132	57 267 532

**Calculation of business ratios:**

<b>RETURN ON EQUITY (ROE) % =</b>	$\frac{\text{Result before extraordinary items - taxes} \times 100}{\text{Shareholders' equity} + \text{minority interest}}$
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<b>RETURN ON INVESTMENT (ROI) % =</b>	$\frac{\text{Result before extraordinary items} + \text{interest and other financial expenses} \times 100}{\text{Balance sheet total} - \text{interest free debts}}$
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<b>EQUITY RATIO % =</b>	$\frac{\text{Shareholders' equity} + \text{minority interest} \times 100}{\text{Balance sheet total} - \text{advances received}}$
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<b>NET GEARING =</b>	$\frac{\text{Liabilities at interest} - \text{cash in hand and at banks}}{\text{Shareholders' equity} + \text{minority interest} + \text{voluntary provisions and depreciation differences less deferred tax liability}}$
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<b>EARNINGS PER SHARE, eur =</b>	$\frac{\text{Result before extraordinary items} - \text{taxes} -/+ \text{minority interest}}{\text{Share issue-adjusted shares on date of financial statement}}$
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<b>EQUITY PER SHARE, eur =</b>	$\frac{\text{Shareholders' equity}}{\text{Year-end number of shares adjusted for stock issue}}$
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<b>DIVIDEND PER SHARE, eur =</b>	$\frac{\text{Total dividend}}{\text{Year-end number of shares adjusted for stock issue}}$
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<b>DIVIDEND PER PROFIT % =</b>	$\frac{\text{Dividend per share} \times 100}{\text{Earnings per share}}$
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## INFORMATION ON SHAREHOLDERS

### NUMBER OF SHAREHOLDERS 31.12.2004

	<i>Shareholders</i>		<i>Shares and voting rights</i>	
	<i>Number</i>	<i>%</i>	<i>Number</i>	
1-100	1 939	20,8	155 634	
101 - 1.000	4 656	49,8	2 252 559	
1.001 - 10.000	2 404	25,7	8 041 937	
10.001 - 50.000	261	2,8	5 443 416	
50.001 - 100.000	40	0,4	2 739 155	
100.001 - 1.000.000	39	0,4	13 535 371	
1.000.001 -	6	0,1	25 134 660	
	9345	100,0	57 302 732	

### DISTRIBUTION OF OWNERSHIP BY SECTOR 31.12.2004

	<i>Holdings</i>		<i>Shares and voting rights</i>	
	<i>Number</i>	<i>%</i>	<i>Number</i>	
Companies	464	5,0	5 766 154	
Financial and insurance institutions	16	0,2	3 020 017	
Public-sector organisations	13	0,1	912 400	
Non-profit organisations	27	0,3	778 925	
Households	8 753	93,7	40 895 540	
Foreign and nominee-registered owners	72	0,7	5 929 696	
	9345	100,0	57 302 732	

### MAJOR SHAREHOLDERS 31.12.2004

	<i>Number</i>	<i>%</i>
Hiidenheimo Ilkka	10 417 400	18,2
Turunen Hannu	7 550 000	13,2
Evli Pankki Oyj *	3 236 670	5,7
Nordea Pankki Suomi Oyj *	1 613 990	2,8
Sijoitusrahasto Mandatum Suomi Kasvuosak	1 216 600	2,1
Syrjälä&Co	1 100 000	1,9
Syrjälä Timo	1 000 000	1,7
Westersträhle Karl	878 700	1,5
Kosonen Jukka	800 000	1,4
FIM Forte Sijoitusrahasto	784 600	1,4
Others	28 704 772	50,1
	57 302 732	100,0
*Incl. nominee-registered, total	5 022 170	8,8

### SHARES AND OPTIONS HELD BY THE MEMBERS OF THE BOARD OF DIRECTORS 31.12.2004

	<i>Shares</i>	<i>Options</i>
Ervi Pertti	5 000	0
Hiidenheimo Ilkka	10 417 400	0
Sozonoff Alexis	0	64 200
	10 422 400	64 200

## AUDITORS' REPORT

To the shareholders of Stonesoft Oyj

We have audited the accounting, the financial statements, the consolidated financial statements and the administration of Stonesoft Oyj for the accounting period 1.1.-31.12.2004. The financial statements, which include the report of the Board of Directors, the income statements and the balance sheets and notes to the financial statements of the consolidated closing and of the closing of the parent company, have been prepared by the Board of Directors and the Managing Director. Based on our audit we express an opinion on these financial statements and on the administration.

We have conducted our audit in accordance with Finnish Standards on Auditing. Those standards require, that we perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit included examining on a test basis evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. The purpose of our audit of the administration is to examine that the members of the Board of Directors and the Managing Director have legally complied with the rules of the Companies Act.

In our opinion, the financial statements, showing a loss for the parent company of EUR 9,500,393,66, have been prepared in accordance with the Accounting Act and other rules and regulations governing the preparation of financial statements. The financial statements give a true and fair view, as defined in the Accounting Act, of the consolidated and parent company's results of operations and financial position. The financial statements can be adopted and the members of the Board of Directors and the Managing Director can be discharged from liability for the period examined by us. The proposal by the Board of Directors regarding the handling of the result is in compliance with the Companies Act.

Helsinki, March 7, 2005

Ernst & Young Oy  
Authorized Public Accountant Firm



Pekka Luoma  
Authorized Public Accountant

## LIST OF THE STOCK EXCHANGE RELEASES 2004

31.12.2004	Stonesoft Financial Reports in 2005
21.12.2004	Stonesoft's cost saving program completed. Future investments in growth acceleration.
24.11.2004	Extraordinary General Meeting of shareholders of Stonesoft Corp. decided on a new stock option plan 2004
27.10.2004	The Board of Directors of Stonesoft Corp. is calling an extraordinary general meeting of shareholders on 24.11.2004
22.10.2004	Stonesoft Corporation's Interim Report for January-September 2004
14.9.2004	Adjustment to the effects of Stonesoft's cost saving measures and its future outlook
3.8.2004	Stonesoft to continue adjusting its expenditure and organisation
3.8.2004	Changes in Stonesoft's management
23.7.2004	Stonesoft Corporation's Interim Report for January-June 2004
4.6.2004	Correction to the article in Kauppalehti about Stonesoft on June 1st, 2004
29.4.2004	Stonesoft Corporation's Interim Report for January-March 2004
10.3.2004	Decisions made by the Annual General meeting on 10 March 2004
16.2.2004	Proposals by the Board of Directors of Stonesoft Corp. to the Annual General Meeting of Shareholders
2.2.2004	Stonesoft Corporation's financial statement release January-December 2003



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**STONESOFT**  
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