

STONESOFT

ANNUAL REPORT

2003

STONESOFT

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STONESOFT

CORPORATE PROFILE

Stonesoft Corporation is a worldwide company focused on enterprise-level network protection and business continuity assurance. Its StoneGate™ security platform unifies firewall, VPN, and IPS to deliver defense agility combined with high availability for business-critical applications.

Enterprises that require advanced network security and always-on business connectivity can choose StoneGate for the lowest up-front costs, 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, go to www.stonesoft.com.

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YEAR IN BRIEF

- In January Stonesoft announced StoneGate firewall/VPN solution for IBM eServer zSeries Mainframe computers.
- During the first half of the year Stonesoft carried out co-operation negotiations with the personnel that lead to dismissal of 50 employees. As a result of the co-operation negotiations and other measures that were taken in order to adjust operations and the cost level to correspond better with the level of business, the operating costs decreased at the quarterly level by EUR 2.0 million.
- In September Stonesoft announced a new firewall/VPN appliance product family that enables the delivery of StoneGate to a wider range of customers.
- In September StoneGate's version 2.0.5. was granted a Common Criteria Evaluation Assurance Level 4+ (EAL4+) certificate. The Common Criteria certificate is an ISO certificate recognized in 16 countries.
- In November Stonesoft announced the addition of a new intrusion detection and prevention system to the StoneGate product family (StoneGate IPS - Intrusion Detection and Analysis with Active Response).
- In December a patent was granted in the USA for the Multi-Link technology developed by Stonesoft.
- The company's cash position and equity ratio remained strong.

KEY FIGURES

Thousand euros

	2003	2002
Net Sales	23 197	30 173
Net Sales Change	-23 %	-48 %
Operating Profit / Loss Before Goodwill		
Depreciations (EBITA)	-13 861	-22 708
% of Net Sales	-60 %	-75 %
ROE, %	-35 %	-44 %
ROI, %	-33 %	-42 %
Equity Ratio, %	90 %	90 %
Net Gearing	-0.78	-0.81
Total Assets	43 291	59 916
R & D Costs	6 541	7 436
% of Net Sales	28 %	25 %
Number of Employees at the End of the Year	264	336
Earnings per Share (euro)	-0.26	-0.49
Equity per Share (euro)	0.61	0.87

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CEO'S REVIEW

For Stonesoft, the year 2003 was a time of refocusing and changes on the road towards profitability. During the year we refined our strategy and selected growing market segments corresponding to our own core competence. We will continue to focus on these market segments also in 2004.

We announced many new solutions during the year, expanding the StoneGate product family. In November, we announced that a new intrusion detection and prevention system would be added to the StoneGate product family. This marks StoneGate's evolution from a firewall/VPN solution to the StoneGate Security Platform, combining firewall, VPN, intrusion detection and their management.

In September a new firewall/VPN appliance product family was announced (StoneGate Security Appliances), enabling the delivery of StoneGate to a wider range of customers.

We also conquered a totally new area of network security, when StoneGate deliveries to IBM zSeries Mainframe computers began during the first quarter. Our co-operation with IBM started promisingly, and we delivered numerous solutions to customers already in 2003. A similar co-operation project was commenced with IBM, relating to the iSeries servers, in January 2004.

Our StoneGate technology gained recognition again this year for its high quality. In December a patent was granted in the USA for the Multi-Link technology developed by Stonesoft. After a long process, StoneGate version 2.0.5. was granted a Common Criteria Evaluation Assurance Level 4+ (EAL4+) certificate in September. The Common Criteria certificate is an ISO certificate recognized in 16 countries. We also won the Best Buy award again from SC Magazine in May.

During the summer we carried out co-operation negotiations with the personnel in order to adjust operations and the cost level to correspond better with the level of business. As a result, we were forced to make 50 employees redundant. These measures were carried out without endangering the company's core operations. Our commitment to research and development was maintained at nearly the same level as before, and our international sales network even expanded by the end of the year.



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The year was challenging and, despite positive developments, we were unable to achieve profitability during 2003. Nevertheless, the sales of our primary product, StoneGate, grew by 24% compared to the previous year. Thus, the sales of StoneGate compensated to a significant extent for the drop in total sales caused by declining sales of the StoneBeat product family. We also obtained many new public customer references during the year, which helped sales work.

OUTLOOK

Tight competition will continue in the network security markets, but we believe that, due to the improving prospects for StoneGate sales, the quarterly operating results before amortization of goodwill (EBITA) should start turning positive towards the end of 2004.

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 announced many new security solutions, which give reason for optimism concerning the future.

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

Jorma Turunen
Chief Executive Officer

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STONESOFT'S AREA OF OPERATION

NETWORK SECURITY IS A WIDE AREA– WHERE DOES STONESOFT OPERATE?

The network security of an organisation is built from many different operations and aspects that aim at securing the confidentiality, availability and integrity of the information. A good starting point for planning network security is to evaluate the information assets in the company and to determine the level of resources the company is willing to invest in security. Network security involves the company's security policy and strategy, the security professionals and the technologies that enable network security.

NETWORK SECURITY TECHNOLOGIES

Different security technologies are an integral part of network security. Nowadays there are several security technologies in the field. Organisations that want to protect their corporate network need to understand the role of different technologies. There are anti-virus and content-scanning solutions, encryption, authentication, authorization and public key infrastructure (PKI) solutions, along with firewalls, VPN and intrusion detection and prevention systems (IDS/IPS).

Anti-virus software and content scanning are the most commonly known areas of network security for most people, since viruses are harmful for computer users both at work and at home. Anti-virus software is used to stop viruses and worms from infiltrating corporate networks and individual computers.

The purpose of authentication, authorization and public key infrastructure (PKI) solutions is to ensure reliable user identification in networks. With encryption tools, important data can be encrypted and thus protected from unauthorized usage.

Firewalls function as a gatekeeper between two networks, for example between the corporate network and the Internet. Firewalls control all traffic going through them and block the unwanted traffic.

A VPN (Virtual Private Network) enables secure communication over the Internet. VPN-technology protects the data that needs encryption. A VPN can be used to secure the connections of remote workers or the traffic between remote offices.

Intrusion detection and intrusion prevention systems (IDS/IPS) monitor the network traffic and the security in different network segments. Hostile and otherwise unwanted traffic can penetrate corporate networks from both the internal network and the Internet. IDS/IPS gives an alarm when suspicious traffic is found in the network, making it possible to respond to attacks before major damage has been done. IDS/IPS can also automatically block some attacks.

An important aspect of network security technologies is their management. This becomes even more challenging when more technology layers are added.

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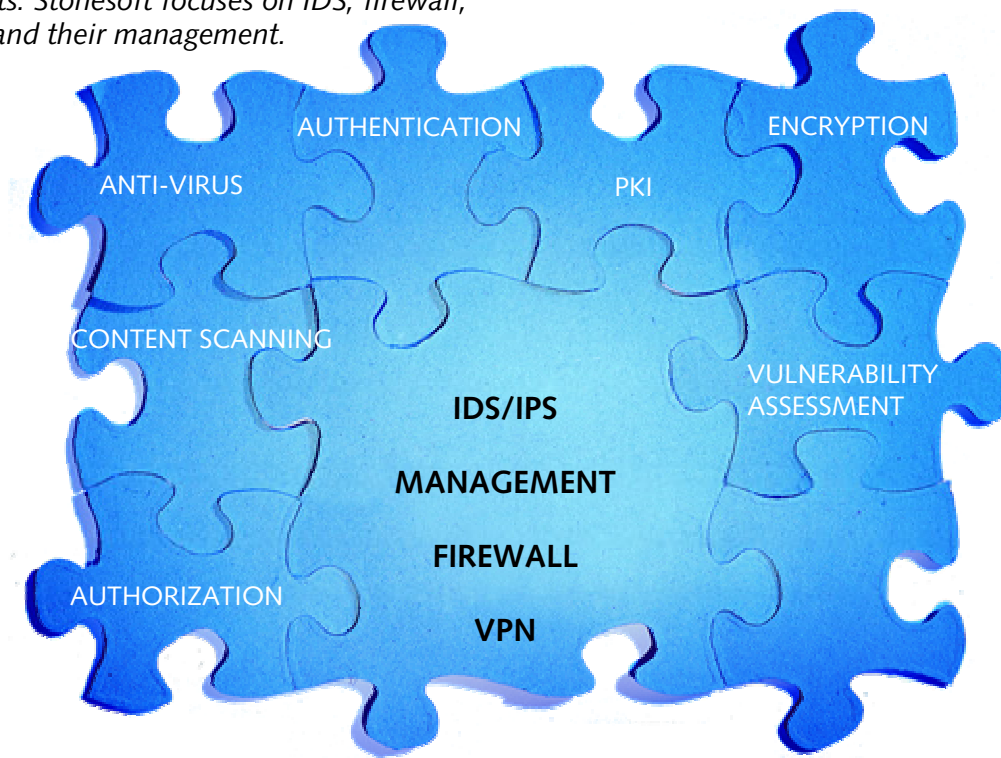
STONESOFT TECHNOLOGIES

Stonesoft has traditionally produced firewall and VPN solutions. In 2004 Stonesoft will launch intrusion detection and intrusion prevention as a part of the StoneGate architecture.

As more network security layers are added, their administration becomes a challenge and centralized management is an increasingly important feature. Stonesoft aims at always making solutions that are easy to manage. Stonesoft solutions are designed to cater for multiple remote users, the components can be placed in several locations, yet the system can be managed from a single location.

High availability is an essential part of all Stonesoft solutions. High availability solutions guarantee the availability, load-balancing and fault tolerance of security technologies. Stonesoft's StoneBeat product line maximizes the effectiveness and availability of the critical network components, such as 3rd party firewalls, anti-virus protection, e-mail/Web content scanning, malicious mobile code protection servers, and intrusion detection network sensors. Clustering and high-availability are also at the heart of the StoneGate firewall, VPN and IPS where they also come at no extra cost.

The network security of an organisation is built from many different operations and aspects. Stonesoft focuses on IDS, firewall, VPN and their management.



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STONESOFT'S VISION AND PHILOSOPHY

VISION

Stonesoft's vision is to be recognized as the forerunner in enterprise security and continuity, today and in the future. 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.

PHILOSOPHY

The Stonesoft philosophy's four aspects underline the values and principles guiding the company's every decision. 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 customers with real problems. The products offer performance in real life environments, 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 centre.

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

At Stonesoft we believe that a solution is not useful if it does not provide economic value to the customer. Affordability goes beyond the up-front investment costs but includes the total cost of ownership.

Product development, at Stonesoft, is driven by a vision to do things in an innovative way. Stonesoft develops products while always questioning the contribution of the solutions towards building networks that are totally secure, highly available, easily manageable, and wholly scalable.

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FOCUS AREAS FOR STONESOFT IN 2004

An intense process of strategy rethinking took place in Stonesoft in 2003. The strategy was refined and sharpened, and as a result of the process Stonesoft defined key strategic focus areas for 2004 that are:

- the expansion of the StoneGate product family through new intrusion detection and prevention systems (StoneGate IPS)
- the further development of the StoneGate Security Appliance family
- the co-operation with IBM

StoneGate will be further developed to serve especially the challenging network security requirements of large enterprises that demand the best possible security, high availability, scalability and maximum performance, combined with simple, centralized management. In 2004 the StoneGate firewall/VPN will expand into the StoneGate Security Platform, consisting of firewall, VPN, intrusion detection and their management.

Stonesoft focused its operations on growing market segments corresponding to its own special expertise, and intensified its cooperation with key partners. Stonesoft's key customer segments include not only large enterprises, but also government organizations, IBM zSeries and iSeries customers, and service providers.

STONEGATE IPS– INTRUSION DETECTION AND ANALYSIS FOR ACTIVE RESPONSE

Stonesoft will launch the new StoneGate IPS (Intrusion Detection and Analysis for Active Response) during the second quarter of 2004.

The growth of the intrusion detection solutions markets is expected to be about 15-20% annually and it is one of the fastest growing segments in network security. Only some 70% of companies deploy IDS in the US, while the corresponding figure in Europe and Asia is 20 - 50%. IDS/IPS solutions are coming more popular since they create an additional layer for the overall network security of companies and enable attacks to be detected and responded to, even in cases when other network security measures such as firewalls or anti-virus systems have been bypassed.

The problem with current IDS/IPS solutions is the excessive flood of data they cause, and inaccuracies. They have produced so many false alarms that it has been difficult to recognise a genuine attack. The StoneGate IPS takes detection accuracy to a higher level, significantly reducing the frequency of false alarms. The StoneGate IPS may also prevent some attacks automatically.

The StoneGate IPS will be available both as software and as an appliance. It can be purchased either as a separate product or as a part of the StoneGate Security Platform which combines firewall, VPN, intrusion detection and their management.

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STONEGATE SECURITY APPLIANCES

Stonesoft launched its new StoneGate Security Appliances at the end of 2003. The demand for appliance-based security solutions is expected to grow rapidly in the coming years at an annual rate of 10-20%.

The demand for appliance-based solutions is growing, because companies are looking for security solutions that are easier to install, use, integrate and manage. StoneGate Security Appliances have the required software pre-installed, making them easy to deploy. Stonesoft takes the full responsibility for software and hardware compatibility and provides all support and maintenance needed.

With StoneGate Security Appliances, Stonesoft can better take into consideration the different needs of customers of varying sizes. The solution is especially suitable for distributed environments, in other words organizations with offices in multiple locations that need to be securely connected.

The StoneGate Security Appliance family includes four different appliances that have been designed to function in different-sized network environments. The appliances are manufactured by the Finnish contract manufacturer, Mikrolog Oy. Depending on the customer's needs, the appliances can be used either as a combination firewall and VPN solution or as a VPN-only solution. All appliances can be managed from a single location.

CO-OPERATION WITH IBM

In January 2003 Stonesoft launched the StoneGate firewall/VPN solution for IBM eServer zSeries Mainframe computers (formerly S390). The IBM eServer zSeries is IBM's virtual Linux concept, where a single mainframe running virtual LANs and servers can replace hundreds of traditional servers.

StoneGate for zSeries is a unique solution, since it runs as another process in the virtual network concept removing the need for any additional hardware or other related external systems. With StoneGate for zSeries enterprises can now protect their virtual servers and virtual networks to secure their data centers.

In 2003 the co-operation with IBM started well and several solutions were delivered to customers in Europe and the US. There is clearly a good level of demand for the solution, and deliveries will continue during 2004.

In January 2004 Stonesoft announced similar co-operation for IBM eServer iSeries servers (formerly AS400). The solution will be available in the second quarter of 2004. StoneGate for iSeries helps customers to securely consolidate servers, providing a consolidated iSeries server with the necessary granular security. The market potential for this solution is promising, since there are hundreds of thousands companies globally using IBM eServer iSeries servers.

StoneGate is also available for eServer xSeries Intel®-compatible servers.

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SERVICE PROVIDERS

Managing the network security of a company requires a special expertise and technologies. Due to this, many companies have decided to outsource their network security to service providers. This trend has been seen especially in small and medium sized organizations. The service provider business is one of the fastest growing sectors in the field of information technology. The expected yearly growth is 20-40%.

Service providers need solutions that provide them with a cost-effective way to set up the services needed without heavy initial investments. In addition to set-up costs, economic value can also be generated through lower total cost of ownership, which is created by counting all the related cost to the solution/operations: telecommunications, continuous administration and management, the cost of hardware needed to produce the service, and support and maintenance fees.

Stonesoft's StoneGate is a perfectly suitable solution for service providers. In StoneGate all components - firewall, VPN and IDS/IPS - can be managed from one management system and all maintenance and upgrading can be managed remotely from a single location. This saves time and improves security, since the organization's most competent security personnel can be used for maintenance.

Service providers will be one of the most important customer segments for Stonesoft in 2004.

Market growth figures: IDC, Gartner, Broadview, Ubizen.



StoneGate Security Platform consists of firewall, VPN, IPS and their management.

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STRATEGY IS A CONTINUOUS PROCESS

Corporate strategies often end up collecting dust in desk drawers and never become a part of the daily work of all employees. In Stonesoft, strategy is seen as a continuous process. In 2003, the main emphasis was on sharpening the corporate strategy and translating it into practical activities, so that areas of focus supporting the strategy could be found in the operations of the whole company, each team and each individual.

It is impossible to carry out sustained work to develop the company in quarterly cycles. Companies need a much longer time span in order to develop. "The main purpose of Stonesoft's strategy process is make the company successful in the long term. We want to get the whole personnel involved in this process and we've put a lot of effort into implementing the strategy," says Saara Laine, Senior Vice President, who is responsible on Stonesoft's Executive Management for legal and business support, as well as human resources.

THE WHOLE PERSONNEL IS ACTIVELY INVOLVED

"All our employees are critical in terms of building our future," says Saara Laine. "If we are able to implant our strategy at all organizational levels and make it part of our everyday work, we can improve the company's ability to react to changes in the market. At the same time, we can help individual employees to better understand the value and significance of their own work for the whole company. Stonesoft's strategy process involves continuous learning at the individual level which is reflected throughout the organization."

"One clear goal in strategy implementation is to emphasize the importance of teamwork and strengthen the team spirit of the whole company. Even our just announced employee bonus program rewards teamwork rather than individual effort. Moreover, this program doesn't reward employees just on the basis of the financial result, but also considers long-term activity in line with the strategy," says Saara Laine.

The fruits of sustained effort cannot be harvested immediately. "It is too early to say anything yet about the effects of the new strategy process on Stonesoft's result. Our operations have clearly become more efficient and we feel that all employees have imbibed the strategy and are better able in their own work to get their priorities right," says Laine.



TOP MANAGEMENT IS COMMITTED TO THE STRATEGY

As a result of the process, Stonesoft's vision and strategy are more closely inter-linked with each other. "In defining our goals, the first requirement is to understand where we are going and what we are doing. We have focused on this by discussing it first in the Executive Management, and then with the managers and finally with the whole personnel. I believe our goals will become much clearer than ever before to many in Stonesoft as a result of this process," says Jorma Turunen, CEO.

"One of the main challenges of last fall was to take the strategy to the operational level by defining targets for the company, for teams and for individuals and the related action plans and result indicators. At the operational level it is important to create and enhance strategic awareness and to make strategy a continuing process. Characteristic of the whole strategy project has been the one hundred percent commitment of our company's top management," says Saara Laine.

FOUR-STAGE PROCESS

In practice, implanting the strategy at the operational level was a four-stage process, which is still continuing in 2004. The first stage was started in August 2003 by going through the company's philosophy, values, vision and an action plan for further strategy development. "In the first stage, we also increased the internal transparency of the company's operations by using our intranet to publish Stonesoft's whole global organization and the job descriptions of individual employees which are now available for all to see," says Laine.

In the second stage, the strategy for the whole company was deepened by creating operational targets, action plans and indicators for measuring operational success at the Group level. "The essential thing at the second stage was to communicate the corporate strategy to all employees and to increase strategic awareness at the team level. The whole process is strongly interactive," says Saara Laine.

The third stage saw the creation of targets, action plans and indicators for the teams. The team targets were linked clearly to the Group-level targets. "By this stage, employees had clearly grasped the strategy better, and the teams were able themselves to set targets for approval by the Executive Management. As a result of the creation of team targets and action plans, the targets for individuals became self-evident. The aim was to create sufficiently challenging but realistic goals for all," says Laine.

"The last stage is a continuous process. The key requirement for the successful fulfillment of the strategy is the continuity of the process. Action in line with the strategy is constantly and systematically visible at Stonesoft. We regularly monitor the results of our efforts and the degree of success in fulfilling the strategy, and we discuss those initiatives that come from the employees. If the market situation changes, or our chosen strategy turns out to be wrong in some respect, we must be able to react as quickly as possible," concludes Saara Laine.

CORPORATE GOVERNANCE

Stonesoft Corporation complies with the new 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, which will come into force on July 1, 2004.

1. GENERAL MEETING

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.

2. 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 the company's CEO and decides on his/her service terms.

The Board meets regularly 12 times a year and additionally when necessary. The Board met 13 times in 2003.

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 five members, one of whom is employed by the company.

Composition

Stonesoft Corporation's Board of Directors comprised the following:

Alexis Sozonoff
Hannu Turunen
Ilkka Hiidenheimo
Kai Karttunen
John C. Yates

The Board of Directors presentation on page 18.

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Board committees

The Board appointed a Compensation Committee in 2003 comprising Alexis Sozonoff and Ilkka Hiidenheimo.

Fees, share ownership and options of members of the Board

The fees paid to members of the Board in 2003 were as follows: the Chairman's fee was EUR 3,000 per month and a member's fee was EUR 1,500 per month.

Chief Executive Officer

The Board appoints 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 CEO is assisted in his duties by the Group's Executive Management.

Jorma Turunen (born 1956) has served as CEO since autumn 2002.

The CEO's service terms and conditions are defined in the CEO's service contract approved by the Board.

Executive Management

The company's Executive Management assists the CEO. At the end of the financial year, the Executive Management comprised the following:

Jorma Turunen, CEO
Ilkka Hiidenheimo, Chief Technical Officer
Tobias Christen, Senior Vice President, Product Management
Saara Laine, Senior Vice President and General Counsel, Legal/ Business Support and Human Resources
Mikko Hietanen, Chief Financial Officer
Juha Härkönen, Executive Vice President, North and South America
Jarmo Häärä, Executive Vice President, Asia-Pacific
Markus Björkqvist, Executive Vice President, Europe, Middle East & Africa

The Executive Management presentation on pages 19-20.

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External audit

The company's auditor is Ernst & Young Oy, the auditor of principal responsibility being Pekka Luoma, CPA. The auditor is elected until further notice.

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 Committee, 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).

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BOARD OF DIRECTORS

Alexis Sozonoff (born 1938)

Chairman of the Board 2003-

Chairman of Infinet Technologies, SARL, Geneva Switzerland

Member of the Board since 2001

Hannu Turunen (born 1957)

Chairman of the Board 2000-2003

Member of the Board since 1992

Ilkka Hiidenheimo (born 1960)

Chief Technical Officer, Stonesoft Corp.

Chairman of the Board 1990-1998

Member of the Board since 1990

Kai Karttunen (born 1961)

CEO, Stratos Ventures Ltd Oy

Chairman of the Board 1999-2000

Member of the Board since 1998

John C. Yates (born 1956)

Partner-in-Charge of the Technology Group, Morris, Manning & Martin L.L.P.

Member of the Board since 1998

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EXECUTIVE MANAGEMENT

Jorma Turunen
CEO

Jorma Turunen joined Stonesoft in October 2002 after having served in various management and marketing and sales positions in several companies in IT business and biochemical industry. He holds M.Sc. (Chem. Eng.) from the University of Oulu and executive MBA from Helsinki School of Economics. Jorma Turunen's special responsibilities at Stonesoft are business development, marketing and investor relations.



Tobias Christen
Senior Vice President,
Product Management

Tobias Christen, Ph.D., leads the product management team. Tobias Christen joined Stonesoft in 1999. Before his appointment in the product management he also served Stonesoft as a R&D Manager. Before joining Stonesoft he has worked in various research positions. Tobias Christen graduated in computer science at the Swiss Federal Institute of Technology in Zürich and received his Ph.D. in computer science from the same institution.



Ilkka Hiidenheimo
Chief Technical Officer

Ilkka Hiidenheimo is the founder of Stonesoft Corporation, has served as chairman of the board from 1990 to 1998. Prior to that he has served as a consultant and as a system designer and product manager in different companies. His areas of responsibility are technology, research and development, customer support and quality control.



Saara Laine
Senior Vice President
& General Counsel

Saara Laine has served as Director of Legal Affairs of Stonesoft Corporation since the beginning of 2000. Before that she has held various legal management and counselling positions in government and both Finnish and international IT-industry companies.

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



Veikko Ikäläinen
Chief Financial Officer

Veikko Ikäläinen, has been appointed as Stonesoft's Chief Financial Officer and member of the Management Team starting March 2004. He joined Stonesoft in early 2000 and has worked in various controlling roles within the company, in headquarters, Sophia Antipolis and most recently in Singapore.

Before joining Stonesoft he worked within transportation industry in various financial and administrative roles. Veikko holds an BBA from Helsinki Business Polytechnic and an MBA from De Montfort University in England.



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Juha Härkönen

Executive Vice President,
North and South
America

In March 2003 Juha Härkönen was appointed as the CEO of Stonesoft's U.S. subsidiary, Stonesoft Inc. He joined Stonesoft in 2000 as Quality Manager and has served as Manager of Global Customer Support and V.P. Customer Services.

Before joining Stonesoft, Juha Härkönen worked in the Finnish construction industry providing process re-engineering and quality development consultancy services. He holds Master of Science degrees in Industrial Production Management from the Technical University of Lappeenranta and in Quality Management from Cranfield University in England.



Markus Björkqvist

Executive Vice President, Europe, Middle East & Africa

Since the beginning of 1998, Markus Björkqvist has held positions at Stonesoft's EMEA region, first as Channel Manager, then Regional Director and now Vice President.

During the last fourteen years, he has accumulated solid experience of the IT and telecommunications industries while holding sales and marketing positions at major Finnish and international corporations.



Jarmo Häärä

Executive Vice President,
Asia-Pacific

Jarmo Häärä is responsible for the overall expansion and management of Stonesoft's Asia Pacific business in ASEAN countries, China, Japan, Australia, New Zealand and India. Prior to Stonesoft he has held various key management, engineering and sales positions as well as has gained a strong experience in Asian markets.

Jarmo Häärä graduated with a Master's Degree in Electrical Engineering in Helsinki University of Technology.

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REPORT BY THE BOARD OF DIRECTORS

FINANCIAL YEAR 1 JANUARY 2003 - 31 DECEMBER 2003

1. DEVELOPMENT OF OPERATIONS DURING THE FINANCIAL YEAR 2003

Stonesoft Corporation net sales, result, and financial position (figures for the previous year in parentheses)

The net sales of Stonesoft Corporation for January-December 2003 totaled EUR 23.2 million (EUR 30.2 million for 2002). The comparable net sales totaled EUR 28.1 million in 2002 (eSolutions Oy net sales EUR 2.1 million in January-February 2002) and the decrease in comparable net sales was EUR 4.9 million (17%).

The sales of StoneGate firewall/VPN products increased to EUR 5.7 million (EUR 4.6 million in 2002). The sales of services totaled EUR 14.9 million (EUR 18.5 million) and other sales totaled EUR 0.7 million (EUR 1.5 million). The total sales performance was influenced particularly by the reduction in sales of the company's high-availability StoneBeat products. StoneBeat license sales for 2003 were EUR 1.9 million (EUR 5.6 million).

The Group's operating loss before amortization of goodwill (EBITA) for the 2003 financial year was EUR 13.9 million (EUR 22.7 million operating loss), which included EUR 1.9 million (EUR 2.8 million) in nonrecurring costs due to the restructuring of operations. This was caused by measures carried out in 2003 to adjust operations and the cost level to correspond better with the level of business. These measures were carried out without endangering the company's core operations. As a result, the Group's operating costs decreased at the quarterly level by EUR 1.5 million. The number of employees decreased during the financial year by 72 and totaled 264 (336) at the end of the year, of whom 36% (35%) were employed outside Finland.

The Group's loss before extraordinary items was EUR 14.2 million (EUR 24.7 million loss).

The net loss for the year was EUR 14.8 million (EUR 16.7 million loss). The result for the previous year was improved by a EUR 10.2 million profit from the sale of Stonesoft e-Solutions Oy. The loss per share was EUR 0.26 (EUR 0.49 loss).

The Group's total assets at the end of the year were EUR 43.3 million (EUR 59.9 million). The equity ratio was 90% (90%) and gearing (the ratio of net debt to shareholders' equity) was -0.78 (-0.81). The Group's liquid assets at the end of 2003 totaled EUR 27.4 million (EUR 40.4 million). The total capital expenditure in the fiscal year was EUR 0.2 million (EUR 0.7 million).

2. DEVELOPMENT OF BUSINESS OPERATIONS

Markets and competitive environment

The number of attacks against data networks is continuously rising and therefore the demand for solutions improving network security is expected to grow.

STONESOFT

Customer demand seems to divide, on one hand, into more complex solutions for large enterprises and, on the other hand, into more simple mass products. The need for special solutions for different customer segments in challenging network environments is growing, as exemplified by specialized network security solutions for service providers and for IBM Mainframe computers.

Combining network security software and its pre-installation in hardware appliances is becoming more common. The advantages of pre-installed appliances include the ease of purchasing and implementation as well as the compatibility of hardware and software.

Different network security technologies are converging and even integrating such as firewall, intrusion detection systems (IDS) and intrusion prevention systems (IPS).

Development of Stonesoft's business operations

Stonesoft's strategy is to develop solutions especially for large enterprises that require the best possible security combined to centralized, simple management. Stonesoft has developed new solutions for the market segments where it sees the potential for growth.

StoneGate deliveries for IBM zSeries Mainframe computers started in the year's first quarter. During the year, six solutions were delivered to five customers, three of which were in the fourth quarter.

In September a new firewall/VPN appliance product family was announced. Stonesoft sells and markets its own appliance product family directly to resellers and distributors. At the same time the focus of the company's operations is moving from a pure software supplier to a manufacturer of hardware-based data security solutions. Stonesoft's core competence will remain, however, in the development of software-based solutions. The delivery of network security in pre-installed appliances is one way to deliver StoneGate to the end user. Deliveries of own appliances began in Europe in October. Sales have met the expectations. Stonesoft made appliance agreements with ten distributors in Europe by the end of the year.

Stonesoft's firewall/VPN software for StoneGate's version 2.0.5. was granted a Common Criteria Evaluation Assurance Level 4+ (EAL4+) certificate in September. The Common Criteria certificate is an ISO certificate recognized in 16 countries. It will open up new business opportunities in the public sector, especially in the USA and UK, where it is often a precondition for network security projects undertaken by the public sector. This should begin to favourably impact the results in the first half of 2004.

The addition of a new intrusion detection and prevention system to the StoneGate product family was announced in November. The StoneGate IPS (Intrusion Detection and Analysis with Active Response) recognizes attacks made against a network, gives the alarm and supplies additional information on network traffic. Special attention has been paid to reducing false alarms and the analysis of important events, which have been problematic in products already on the market.

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The StoneGate IPS is sold either as a separate product or as part of the StoneGate Security Platform, which combines firewall, VPN and intrusion detection and their management. The commercial deliveries will begin in the first half of 2004.

In December a patent was granted in the USA for the Multi-Link technology developed by Stonesoft. Multi-Link allows the automatic routing and load balancing of Internet and VPN traffic through multiple service providers. It eliminates problems associated with the availability, reliability and slowness of Internet connections.

3. MAJOR EVENTS AFTER THE FINANCIAL YEAR

In co-operation with IBM Stonesoft announced in January a project to develop a StoneGate firewall and VPN solution for IBM eServer iSeries servers. StoneGate will ensure security between the virtual networks and virtual servers inside iSeries servers and thus ease the consolidation of the servers. The new solution will be available at the beginning of the second quarter of 2004.

4. OUTLOOK FOR FUTURE DEVELOPMENT

Tight competition is expected to continue on the network security markets. Stonesoft has found its own market segments and partners corresponding to its own special expertise and will continue to focus on them.

- The growth of the intrusion detection solutions markets (StoneGate IPS product) is expected to be about 15-20% annually (source: IDC).
- The markets for outsourced network security services are expected to grow at 20-40% annually (source: Ubizen). The company believes that StoneGate technology is particularly well suited for this purpose.
- Stonesoft has developed a unique firewall solution for the IBM zSeries Mainframe computers. A corresponding new co-operation project together with IBM relating to the iSeries servers was announced in January 2004.
- Stonesoft has launched a new security appliance family, which complements the company's product range.

The company believes that, due to the improving prospects for StoneGate sales, the quarterly operating results before amortization of goodwill (EBITA) should start turning positive towards the end of 2004.

5. REVIEW OF MAJOR RESEARCH AND DEVELOPMENT ACTIVITIES

Stonesoft believes in innovative research and development and invests in protecting innovations. In 2003 the company's research and development focused on developing both new and existing high availability network security solutions. During the year the StoneGate Security Appliance product family was launched. Appliances have the security software pre-installed.

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The development of the StoneGate firewall/VPN for IBM zSeries was continued with IBM. A patent was granted in the USA for the Multi-Link technology developed by Stonesoft.

The company's investments in product development in 2003 totaled EUR 6.5 million (EUR 7.4 million).

Stonesoft's product development units are located in Helsinki, Turku and Sophia Antipolis, France. Research and development employed 66 (94) persons at the end 2003.

Research and development expenditure is booked, in accordance with the Group's accounting principles, as an expense at the moment it occurred.

6. TRANSITION TO IFRS FINANCIAL STATEMENTS

Starting from 2005, all listed companies in the EU should prepare their Group financial statements in accordance with the IAS/IFRS standards. In June 2003, the IFRS 1 transition standard which regulates the preparation of the first IFRS financial statements was published. As work progresses on changing and renewing the standards, the IAS (International Accounting Standards) will be replaced with the new IFRS (International Financial Reporting Standards). The final contents of the standards to be applied in 2005 should be known by spring 2004.

An IFRS project was started in Stonesoft Corporation in early 2003 in order to survey the existing regulations, their effect on the Group's accounting policies, reporting and information systems. The work of monitoring changes and revisions of the standards continues.

In the light of current knowledge, the main changes in accounting policies affecting Stonesoft Corporation related to the recognition and measurement of financial instruments (IAS 39) and the capitalization of research and development expenditure (IAS 38).

Stonesoft will prepare its first full IFRS Group financial statements for 2005. The first interim report prepared according to the IFRS standards will be published for the first quarter of 2005. The Group financial statements published for 2004 will be prepared in accordance with current Finnish accounting practice. According to the transition plan, the opening balance sheet for 2004 based on the IFRS standards will be produced in the first half-year of 2004. The project team estimates that the company will be ready to produce comparative data for year 2005 Group reporting for each quarter of 2004.

7. PROPOSAL BY THE BOARD OF DIRECTORS FOR DISTRIBUTION OF PROFIT

The loss incurred by the Group for the financial year was EUR 14,432,183. At the end of the period, neither the Group nor the parent company had any distributable equity in its shareholders' equity. The Board of Directors proposes that the parent pay no dividend for 2002 and that the loss be debited to the retained earnings account.

8. DEVELOPMENT OF SHARE PRICES AND TURNOVER

On 2 January 2003, Stonesoft's shares were valued at EUR 0.64. At the end of the year, the share price was EUR 0.65. The highest share price was EUR 0.71 and the lowest EUR 0.65. During the year, the total turnover of Stonesoft shares amounted to EUR 19.1 million. Stonesoft's share price increased by 1.6 % during 2003. Over the same period, the Helsinki Stock Exchange HEX index decreased by 0.3 %, while the telecom & electronics sector index decreased by 10.8%. Based on the share price on 30 December 2003, Stonesoft's market capitalization was EUR 37.2 million.

9. SHARE CAPITAL AND OPTION PROGRAM

The Annual General Meeting held March 12, 2003 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:

The company's Board of Directors was authorized to decide, under the terms and conditions set out in clauses 1 to 6 below, on the following:

- a) a rights offering; and/or
- b) granting options; and/or
- c) issuing convertible bonds.

The terms and conditions of the authorization are:

1) 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.

2) 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.

3) 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.

4) 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.

5) 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.

6) The authorisation 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.

The Option Program III established in conjunction with the acquisitions made in 2000 was terminated during the financial year. The subscription rights of the program were linked to certain sales growth targets which were not achieved. The persons who received options on the basis of the program all gave their written consent to the company to terminate the option program. The program gave the right to subscribe to a maximum of 607,182 of the company's shares.

During 2003 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 2003, 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. No changes occurred in the share capital during the financial year.

10. CORPORATE ORGANIZATION, MANAGEMENT AND AUDITORS

Jorma Turunen was the CEO of the company for the year 2003.

The Chairman of the company's Board of Directors was Hannu Turunen until March 12, 2003, and Alexis Sozonoff thereafter. Other Members of the Board were John C. Yates, Kai Karttunen, Ilkka Hiidenheimo and Hannu Turunen.

Ernst & Young Oy serves as the company's auditor, with the auditor in charge being CPA Pekka Luoma.

Stonesoft Corp.
Board of Directors

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CORPORATE OPTION PLANS

OPTION PLAN 1

In order to provide a staff incentive, the special general meeting of shareholders of the Stone-soft Corporation held on March 15, 1999, passed a resolution to offer options with warrants to key employees. The options with warrants were offered for subscription subject to the following terms:

A total of 625,000 options with warrants were issued. Some of the options with warrants are granted to Stonesoft's wholly owned subsidiary to be issued for the company's current or future employees. The subscription period for the shares begin in stages as follows: September 1, 2000, September 1, 2001, September 1, 2002, September 1, 2003, and September 1, 2004. Subscription under all the warrants shall end on April 30, 2005. The subscription price of each share under the warrants is EUR 6.50. The company's share capital may be increased under the options with warrants by a maximum of EUR 50,000.

Upon termination of his or her employment or contract, the subscriber shall, unless otherwise indicated, immediately return warrants free of charge to the Company if the subscription period for the warrants involved has not yet begun.

Options subscribed for by the employees were entered in the Trade Register on September 30, 1999.

After the share split (1 to 4) carried out by the Company on December 28, 1999, one option entitles the holder to subscribe for four shares at the price of EUR 1.625 per share.

OPTION PLAN 2

In order to provide a staff incentive, the annual general meeting of shareholders of the Stone-soft Corporation held on March 3, 2000, passed a resolution to offer options with warrants to key employees. The options with warrants were offered for subscription subject to the following terms:

A total of 2,500,000 options with warrants were issued. Some of the options with warrants are granted to Stonesoft's wholly owned subsidiary to be issued for the company's current or future employees. The subscription period for the shares begin in stages as follows: September 1 2001, September 1, 2002, September 1, 2003, September 1, 2004 and September 2005. Subscription under all the warrants shall end on April 30, 2006. The subscription price of each share under the options with warrants is EUR 14.16. The company's share capital may be increased under the options with warrants with a maximum of EUR 50,000.

Upon termination of his or her employment or contact, the subscriber shall, unless otherwise indicated, immediately return warrants free of charge to the Company if the subscription period for the warrants involved has not yet begun.

Options subscribed for by the employees were entered in the Trade Register on August 16, 2000. A total of 2,492,500 options with warrants have been registered, allowing an increase of EUR 49.850 in share capital.

OPTION PLAN 3

At its meeting on October 10, 2000, the Board of Directors decided to issue options with warrants under the authorization given by the general annual meeting of shareholders on March 3, 2000, to the owners of Architek S.r.l. The options with warrants were offered for subscription subject to the following terms:

A total of three options with warrants were issued, authorizing the holders to subscribe for a maximum of 607,182 shares. The right to subscribe for shares depends on the sales of a specific software suite during the period from January 1, 2001 - December 31, 2003. The earliest date for subscription is July 14, 2004. The subscription right shall lapse in 60 days from the date when the subscription right has been conclusively confirmed in accordance with the terms of the option. The subscription price of each share under this option plan is EUR 0.02. Based on the options with warrants, the Company's share capital may be increased by a maximum of EUR 12,143.64.

Options subscribed for by the employees were entered in the Trade Register on October 13, 2000.

In the meeting held on February 12, 2003 the Board of Directors has decided to end the option plan 3 and to ask the Trade Register to remove the records regarding the option plan 3. The relevant entry to the Trade register was made on February 18, 2003.

OPTION PLAN 4

The special general meeting of shareholders of the Stonesoft Corporation held on August 28, 2001, approved a new option plan proposed by the Board of Directors.

Under this plan, a total of 1,500,000 options with warrants were offered for subscription to the members of the Boards of Directors of the companies in the Stonesoft Group, other management or staff. Each option with warrants entitles the holder to subscribe for one share in Stonesoft with a par value of EUR 0.02. The subscription period for the shares begin in stages as follows: May 1, 2002, November 1, 2003, and November 1, 2004. The subscription period for all the shares shall end on October 31, 2006. The subscription price of each share shall be EUR 2.43.

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GROUP INCOME STATEMENT

<i>thousand euros</i>		1.1. - 31.12.2003	1.1. - 31.12.2002
	<i>note</i>		
Net Sales	1	23 197	30 173
Other operating income	2	840	755
Materials and services	3	-1 780	-2 972
Personnel costs	4	-20 147	-27 713
Depreciations and reduction in value	5	-2 713	-4 443
Other operating expenses		-14 464	-20 979
Operating profit / loss		-15 067	-25 178
Financial income and expenses	6	817	480
Profit / loss before extraordinary items		-14 250	-24 699
Extraordinary items +/-	7	35	8 734
Profit / loss before appropriations and taxes		-14 214	-15 965
Direct taxes	8	-573	-742
Profit / loss for financial year		-14 787	-16 707

STONESOFT

thousand euros

GROUP BALANCE SHEET

ASSETS		31.12.2003	31.12.2002
	<i>note</i>		
Non-current assets			
Intangible assets	9	1 038	1 476
Consolidated goodwill	9	1 507	2 713
Tangible assets	10	1 267	2 139
Investments	11	6	4
Non-current assets total		3 818	6 332
Current assets			
Inventories		91	73
Long-term receivables		60	147
Short-term receivables	12	11 880	12 946
Investments	13	24 126	34 955
Cash in hand and at banks		3 315	5 462
Current assets total		39 472	53 584
Total		43 291	59 916
EQUITY AND LIABILITIES			
Shareholders' equity			
Share capital	14	1 146	1 146
Other restricted capital	14	75 743	76 277
Retained earnings / loss	14	-26 981	-10 856
Profit / loss for the financial year	14	-14 787	-16 707
Shareholders' equity total		35 121	49 860
Provisions		159	30
Liabilities			
Long-term liabilities	15	0	2
Short-term liabilities	15	8 011	10 024
Liabilities total		8 011	10 026
Total		43 291	59 916

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GROUP CASHFLOW STATEMENT

	2003	2002
<i>thousand euros</i>		
Cash flow from operating activities		
Operating profit / loss	-15 067	-25 178
Adjustments to operating profit / loss	2 842	4 777
Financial income and expenses	817	480
Change in net working capital	-1 036	5 331
Extraordinary items	35	-1 426
Taxes paid	-415	-741
Total	-12 823	-16 758
Cash flow from investing activities		
Investments to intangible and tangible assets	-197	-386
Investments to (-) / sales of (+) shares in subsidiaries	0	11 962
Investments to (-) / sales of (+) other shares	-3	34
Total	-200	11 609
Cash flow from financing activities		
Change in long-term receivables	-2	-24
Other	48	-69
Total	46	-93
Change in cash and cash equivalents	-12 977	-5 242
Cash and cash equivalents at the beginning of the period	40 418	45 659
Cash and cash equivalents at the end of the period	27 441	40 418

STONESOFT

PARENT COMPANY INCOME STATEMENT

<i>thousand euros</i>		1.1.-31.12.2003	1.1.-31.12.2002
	<i>note</i>		
Net sales	1	16 510	17 624
Other operating income	2	1 271	2 074
Materials and services	3	-1 624	-535
Personnel costs	4	-7 672	-8 114
Depreciations and reduction in value	5	-868	-1 938
Other operating expenses		-23 010	-35 028
Operating profit / loss		-15 393	-25 917
Financial income and expenses	6	852	-222
Profit / loss before extraordinary items		-14 541	-26 140
Extraordinary items +/-	7	150	8 444
Profit / loss before appropriations and taxes		-14 390	-17 696
Direct taxes	8	-42	-266
Profit / loss for financial year		-14 432	-17 962

STONESOFT

PARENT COMPANY BALANCE SHEET

thousand euros

ASSETS		31.12.2003	31.12.2002
	<i>note</i>		
Non-current assets			
Intangible assets	9	1 024	1 324
Tangible assets	10	524	813
Investments	11	9 183	9 220
Non-current assets total		10 731	11 357
Current assets			
Inventories		82	65
Short-term receivables	12	9 210	11 590
Investments	13	24 046	34 872
Cash in hand and at banks		1 758	2 593
Current assets total		35 096	49 120
Total		45 828	60 477
EQUITY AND LIABILITIES			
Shareholders' equity			
Share capital	14	1 146	1 146
Share premium account	14	76 821	76 821
Retained earnings / loss	14	-29 631	-11 670
Profit / loss for the financial year	14	-14 432	-17 962
Shareholders' equity total		33 903	48 336
Provisions		43	0
Liabilities			
Short-term liabilities	15	11 881	12 141
Liabilities total		11 881	12 141
Total		45 828	60 477

STONESOFT

PARENT COMPANY CASHFLOW STATEMENT

	2003	2002
<i>thousand euros</i>		
Cash flow from operating activities		
Operating profit / loss	-15 393	-25 917
Adjustments to operating profit / loss	1 056	2 707
Financial income and expenses	852	451
Change in net working capital	2 171	6 456
Extraordinary items	0	-247
Taxes paid	-42	-266
Total	-11 356	-16 817
Cash flow from investing activities		
Investments to intangible and tangible assets	-279	-532
Investments to (-) / sales of (+) shares in subsidiaries	-25	14 229
Total	-304	13 697
Cash flow from financing activities		
Total	0	0
Change in cash and cash equivalents	-11 660	-3 120
Cash and cash equivalents at the beginning of the period	37 465	40 585
Cash and cash equivalents at the end of the period	25 804	37 465

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NOTES TO THE FINANCIAL STATEMENTS

ACCOUNTING PRINCIPLES

Scope of the consolidated financial statements

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 (former Fence Technologies Oy)
Stonesoft Inc (USA)
Optiwise Inc (USA)
Stonesoft France S.A.S
Stonesoft AB (Sweden)
Stonesoft Networks Ltd (UK)
Stonesoft Germany GmbH
Stonesoft Japan K.K
Unirel Sistemi S.r.l (Italy)
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)

Including Optiwise Oy, Jan-Oct 2003 financial results (merged to parent company October 31, 2003)

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 shares 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.

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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.

	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Depreciation period of capital assets				
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.

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NOTES TO THE INCOME STATEMENT

thousand euros

1a. Net sales by market areas	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Emea	16 765	20 798	10 946	8 873
Americas	4 605	6 806	3 737	6 182
Asia Pacific	1 827	2 570	1 827	2 570
Total	23 197	30 173	16 510	17 624

1b. Net sales by business functions	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Software and appliance revenue				
Own licenses and appliances	7 628	10 217	7 508	9 710
Other licenses	238	554	197	-55
Software and appliance revenue total	7 865	10 771	7 705	9 655
Service revenue				
Consultation and training	6 749	8 872	486	393
Support, own	7 393	8 247	7 336	7 848
Support, other	753	1 341	669	11
Service revenue total	14 896	18 460	8 492	8 252
Other revenue				
Hardware	584	1 121	504	-13
Other revenue	-148	-179	-192	-270
Total	23 197	30 173	16 510	17 624

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2. Other income from business operations

	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Government subsidy for R&D activities	111	65	111	65
Sales of fixed assets	34	30	0	0
Rental income	591	521	514	426
Income from personnel canteen	95	117	62	67
Others	9	23	5	0
Group internal administration fee	0	0	580	1 516
Total	840	755	1 271	2 074

3. Materials and services

	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Materials and goods				
Purchases during the financial period	1 637	2 520	1 482	269
Change in stocks	-18	204	-17	47
	1 619	2 724	1 465	316
External services	161	248	159	219
Total	1 780	2 972	1 624	535

4. Wages, salaries and indirect employee expenses

	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Wages and salaries	16 591	22 814	6 246	6 390
Pension expenses	1 829	3 861	1 017	1 101
Other indirect employee expenses	1 726	1 038	409	623
Total	20 147	27 713	7 672	8 114

Salaries and fees paid to the Board of Directors and CEO

354	623	285	511
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Number of personnel

298	403	127	141
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5. Depreciation

	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Goodwill	1 206	2 470	18	0
Tangible assets	941	1 413	371	409
Intangible assets	566	560	478	425
Extraordinary depreciation of investments and assets	0	0	0	1 104
Total	2 713	4 443	868	1 938

6. Financial income and expenses

	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Dividend income				
From Group companies	0	0	27	0
From others	2	3	2	3
Interest and other financial income	1 123	867	1 098	796
Financial income total	1 125	870	1 127	799
Reduction on value of investment	0	0	0	673
Interest and other financial expenses	308	390	275	348
Financial income and expenses, total	817	480	852	-222
Financial income and expenses includes				
exchange rate gains / losses (net)	-135	-154	-114	-154
gains / losses from securities market	605	77	605	77

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7. Extraordinary items	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Extraordinary income				
Group contribution	0	0	848	444
Profit from sale of Stonesoft eSolutions Oy	0	10 160	0	8 247
Payment to receivables written down in previous years	37	0	0	0
Extraordinary income, total	37	10 160	848	8 691
Extraordinary expenses				
Closing down the Optiwise business	1	1 081	0	0
Optiwise Oy, loss due to the merger	0	0	697	0
Closing down the business of Athena Security Group Inc	0	87	0	0
Correction to intercompany items, year 2000	0	247	0	247
Others	0	11	0	0
Extraordinary expenses, total	1	1 426	697	247
Extraordinary items, total	35	8 734	150	8 444
8. Income taxes	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Income taxes on extraordinary items	-11	-2 533	0	0
Income taxes on actual business	-407	2 020	-42	-36
Change in deferred tax liability/receivable	-158	0	0	0
Taxes from previous financial periods	3	-229	0	-229
Direct taxes, total	-573	-742	-42	-266

NOTES TO THE BALANCE SHEET

thousand euros

	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
9. Intangible assets				
Intangible rights				
Acquisition cost 1.1.	1 627	1 321	1 278	933
Additions	47	308	97	347
Reductions	-16	-2	-16	-2
Transfers	56	0	0	0
Acquisition cost 31.12.	1 714	1 627	1 359	1 278
Accumulated depreciation 1.1.	-766	-513	-568	-372
Depreciation for financial period	-305	-253	-249	-196
Accumulated depreciation on reductions and transfers	-2	0	16	0
Accumulated depreciation 31.12.	-1 073	-766	-801	-568
Balance sheet value 31.12.	641	861	558	710
Goodwill				
Acquisition cost 1.1.	10 121	11 922	0	0
Additions	0	0	100	0
Reductions	0	1 801	0	0
Acquisition cost 31.12.	10 121	10 121	100	0
Accumulated depreciation 1.1.	-7 408	-4 938	0	0
Depreciation for financial period	-1 206	-2 470	-18	0
Accumulated depreciation 31.12.	-8 614	-7 408	-18	0
Balance sheet value 31.12.	1 507	2 713	82	0

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Other long-term expense items

Acquisition cost 1.1.	1 223	1 221	1 145	1 145
Additions	3	2	0	0
Transfers	60	0	0	0
Acquisition cost 31.12.	1 285	1 223	1 145	1 145
Accumulated depreciation 1.1.	-609	-302	-531	-302
Depreciation for financial period	-261	-306	-229	-228
Accumulated depreciation on transfers	-19	0	0	0
Accumulated depreciation 31.12.	-889	-609	-760	-531
Balance sheet value 31.12.	397	615	385	614

10. Tangible assets

	Stonesoft Group		Stonesoft Oyj	
Machinery and equipment	2003	2002	2003	2002
Acquisition cost 1.1.	6 758	6 623	2 436	2 156
Additions	163	341	83	280
Reductions	-2 106	-206	-1 854	0
Acquisition cost 31.12.	4 815	6 758	665	2 436
Accumulated depreciation 1.1.	-4 720	-3 465	-1 630	-1 221
Accumulated depreciation on reductions	2 094	96	1 854	0
Depreciation for financial period	-938	-1 351	-371	-409
Accumulated depreciation 31.12.	-3 564	-4 720	-148	-1 630
Balance sheet value 31.12.	1 251	2 038	517	806

Other tangible assets

Acquisition cost 1.1.	238	297	7	7
Additions	2	5	2	2
Reductions	-6	-64	-2	-2
Transfers	-116	0	0	0
Acquisition cost 31.12.	118	238	7	7
Accumulated depreciation 1.1.	-137	-76	0	0
Accumulated depreciation on reductions and transfers	38	0	0	0
Depreciation for financial period	-3	-62	0	0
Accumulated depreciation 31.12.	-102	-137	0	0
Balance sheet value 31.12.	16	100	7	7

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11. Investments

	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Stocks and shares				
Acquisition cost 1.1.	4	342	8 045	15 132
Additions	3	0	46	343
Reductions	0	-338	-83	-5 389
Loss of value	0	0	0	-2 041
Acquisition cost 31.12.	6	4	8 008	8 045
Capital loans to Group companies				
Balance sheet value 1.1.	0	0	1 175	1 848
Reductions	0	0	0	-673
Balance sheet value 31.12.	0	0	1 175	1 175

Group companies 31.12.2003

Stocks and shares held by the Group

	Group shareholding %	Parent company shareholding %	Book value held by the parent company 1000Eur
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, Reading	100	100,00	2
Stonesoft France S.A.S., France, Sophia Antipolis	100	100,00	40
Stonesoft Germany GmbH, Ismaning	100	100,00	46
Stonesoft Espana S.A., Spain, Madrid	100	100,00	60
Stonesoft Japan K.K., Tokio	100	100,00	94
Stonesoft Netherlands B.V., Amsterdam	100	100,00	20
Optiwise Inc, USA, Atlanta	100	100,00	17
Stonesoft Italy S.r.l, Milano	100	99,99	18
Unirel Sistemi S.r.l, Italy, Firenze	100	99,99	213
Stonegate AG, Switzerland, 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, Brazil, São Paulo,	100	100,00	260
BVBA Stonesoft Belgium, Diegem	100	99,00	18
Stonesoft Tunis SARL, Tunis,	100	100,00	7
Total			8008

12. Short-term receivables	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Accounts receivable	5 905	5 682	4 484	3 987
Receivables from Group companies				
Accounts receivable	0	0	44	1 671
Other receivables	0	0	4 105	5 423
Prepayments and accrued income				
Periodized interest	0	0	95	0
Rental deposits	0	0	53	56
Other prepayments and accrued income	1 384	2 522	306	453
Other receivables	281	273	123	0
Deferred tax credits				
Due to periodization difference	106	107	106	107
Due to accumulated losses	16 323	12 231	16 323	12 231
of which booked to tax receivables	4 310	4 469	0	0
Short term receivables, total	11 880	12 946	9 210	11 590
13. Securities included in financial assets	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Investments				
Replacement value	24 845	35 781	24 765	35 698
Book value	24 126	34 955	24 046	34 872
Difference	719	826	719	826

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14. Shareholders' equity	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Share capital				
Share capital 1.1	1 146	1 146	1 146	1 146
Share capital 31.12	1 146	1 146	1 146	1 146
Other restricted shareholders' equity				
Share premium account 1.1.	76 821	76 818	76 821	76 818
Option subscriptions	0	3	0	3
Share premium account 31.12	76 821	76 821	76 821	76 821
Translation difference, restricted	-1 078	-544	0	0
Other restricted shareholders' equity total	75 743	76 277	76 821	76 821
Retained earnings / loss				
Retained earnings / loss 1.1.	-27 563	-11 462	-29 631	-11 670
Translation difference, free	582	606	0	0
Retained earnings / loss 31.12.	-26 981	-10 856	-29 631	-11 670
Profit / loss for the financial period	-14 787	-16 707	-14 432	-17 962
Shareholders' equity, total	35 121	49 860	33 903	48 336

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Calculation on distributable funds	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Retained earnings / loss	-26 981	-10 856	-29 631	-11 670
Profit / loss for the financial period	-14 787	-16 707	-14 432	-17 962
Other reserves				
Portion of accumulated depreciation difference entered in shareholders' equity	0	-2	0	0
Translation difference	582	606	0	0
Total	-41 186	-26 959	-44 064	-29 632

15. Liabilities	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Long-term liabilities				
Hire purchase liability	0	2	0	0
Short term liabilities				
Advances received	115	164	107	164
Accounts payable	965	1 159	716	564
Debts to the Group companies				
Other debts	0	0	5 621	5 653
Substantial items included in deferred liabilities				
Matched maintenance cost	4 187	4 516	4 174	3 995
Other deferred liabilities	1 883	2 927	1 095	1 397
Other debts	861	1 258	169	368
Short term liabilities total	8 011	10 024	11 881	12 141
Liabilities total	8 011	10 026	11 881	12 141

16. Pledges	Stonesoft Group		Stonesoft Oyj	
	2003	2002	2003	2002
Leasing liabilities				
Payable in year 2004	848	1 400	702	1 183
Payable later	896	664	776	534
Rental liabilities and pledges				
Rental liabilities	9 180	10 841	8 229	9 445
Rental pledges	117	192	65	92
Pledges issued for companies in the same Group	0	0	100	100
Other pledges	18	18	0	0
Pledges total	11 059	13 115	9 873	11 354

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STONESOFT GROUP KEY RATIOS

thousand euros

	2003	2002	2001	2000	1999
Net sales	23 197	30 173	57 703	59 568	27 683
Net sales change- %	-23 %	-48 %	-3 %	115 %	166 %
Operating profit/loss before goodwill amortization (EBITA)	-13 861	-22 708	-10 417	-1 511	3 073
% of net sales	-60 %	-75 %	-18 %	-3 %	11 %
Operating profit/loss after goodwill amortization (EBIT)	-15 067	-25 178	-12 866	-3 623	2 698
% of net sales	-65 %	-83 %	-22 %	-6 %	10 %
Profit/loss before extraordinary items and taxes	-14 250	-24 699	-11 858	-2 822	3 080
% of net sales	-61 %	-82 %	-21 %	-5 %	11 %
Profit/loss before taxes	-14 214	-15 965	-13 094	-6 104	2 239
% of net sales	-61 %	-53 %	-23 %	-10 %	8 %
ROE - %	-35 %	-44 %	-13 %	-4 %	20 %
ROI - %	-33 %	-42 %	-15 %	-4 %	29 %
Equity ratio- %	90 %	90 %	88 %	87 %	73 %
Net gearing	-0,78	-0,81	-0,68	-0,67	-0,50
Total assets	43 291	59 916	82 039	93 388	27 600
Capital investments	197	699	727	5 944	2 071
% of net sales	1 %	2 %	1 %	10 %	7 %
R&D costs	6 541	7 436	9 086	6 270	2 261
% of net sales	28 %	25 %	16 %	11 %	8 %
Number of employees (weighted average)	298	403	581	450	168
Number of employees at the end of the year	264	336	571	574	340

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Share specific ratios	2003	2002	2001	2000	1999
Earnings per share (euro)	-0,26	-0,49	-0,15	-0,01	0,06
Equity per share (euro)	0,61	0,87	1,16	1,34	0,37
Dividend per share (euro)	0	0	0	0	0
Dividend / profit- %	0 %	0 %	0 %	0 %	0 %
Weighted amount of shares (option dillution effect included)	57 302 732	57 302 088	57 643 083	55 499 114	42 926 752
Amount of shares at the end of the period	57 302 732	57 302 732	57 301 132	57 267 532	52 536 140

CALCULATION OF BUSINESS RATIOS

Return on Equity (ROE) % =

$$\frac{\text{Result before extraordinary items - taxes} \times 100}{\text{Shareholders' equity + minority interest}}$$

Return on Investment (ROI) % =

$$\frac{\text{Result before extraordinary items + interest and other financial expenses} \times 100}{\text{Balance sheet total - interest free debts}}$$

Earnings per Share (EPS), eur =

$$\frac{\text{Result before extraordinary items - taxes -/+ minority interest}}{\text{Share issue-adjusted shares on date of financial statement}}$$

Dividend per Share, eur =

$$\frac{\text{Total dividend}}{\text{Year-end number of shares adjusted for stock issue}}$$

Equity Ratio % =

$$\frac{\text{Shareholders' equity + minority interest} \times 100}{\text{Balance sheet total - advances received}}$$

Net Gearing =

$$\frac{\text{Liabilities at interest - cash in hand and at banks}}{\text{Shareholders' equity + minority interest + voluntary provisions and depreciation differences less deferred tax liability}}$$

Equity per Share, eur =

$$\frac{\text{Shareholders' equity}}{\text{Year-end number of shares adjusted for stock issue}}$$

Dividend/ Profit % =

$$\frac{\text{Dividend per share} \times 100}{\text{Earnings per share}}$$

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INFORMATION ON SHAREHOLDERS

Number of shareholders 31.12.2003	Shareholders		Shares and Voting Rights number
	number	%	
1-100	2082	20,4%	168 715
101 - 1.000	5124	50,2%	2 461 776
1.001 - 10.000	2616	25,6%	8 634 219
10.001 - 50.000	300	2,9%	6 375 876
50.001 - 100.000	31	0,3%	2 263 815
100.001 - 1.000.000	47	0,5%	15 363 062
1.000.001 -	5	0,1%	22 035 269
	10 205	100%	57 302 732

Distribution of ownership by sector 31.12.2003	Holdings		Shares and Voting Rights number
	number	%	
Companies	554	5,4 %	4 498 736
Financial and insurance institutions	21	0,2 %	3 203 947
Public-sector organisations	13	0,1 %	1 089 000
Non-profit organisations	31	0,3 %	1 404 225
Households	9 508	93,3 %	41 147 294
Foreign and nominee-registered owners	78	0,7 %	5 959 530
	10 205	100,0 %	57 302 732

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Major shareholders 31.12.2003

	number	%
Hiidenheimo, Ilkka	10 417 400	18,2 %
Turunen, Hannu	7 550 000	13,2 %
Evli Pankki Oyj *	1 404 590	2,5 %
Suoniemi, Antti	1 387 600	2,4 %
Nordea Pankki Suomi Oyj *	1 275 679	2,2 %
Assetman Oy	1 000 000	1,7 %
Silventola, Anssi	895 000	1,6 %
Westersträhle, Karl	878 700	1,5 %
FIM Forte Sijoitusrahasto	834 600	1,5 %
Kosonen, Jukka	770 000	1,3 %
LUX ILI 211-450413	770 000	1,3 %
Others	30 119 163	52,6 %
	57 302 732	100,0 %

* Incl. nominee-registered, total	3 652 232	6,4 %
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Shares and share options held by the members of the Board of Directors 31.12.2003

	Shares	Options
Karttunen, Kai	0	74 000
Sozonoff, Alexis	0	44 100
Yates, John	0	74 000
Hiidenheimo, Ilkka	10 417 400	0
Turunen, Hannu	7 550 000	0
	17 967 400	192 100

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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.-31.12.2003. 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 14,432,183.41, 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, February 26, 2004

Ernst & Young Oy
Authorized Public Accountant Firm

Pekka Luoma
Authorized Public Accountant

LIST OF THE STOCK EXCHANGE RELEASES IN 2003

03.02.2003	Stonesoft Corporation Financial Statements 2002
12.02.2003	Proposals by the board or directors of Stonesoft Corp. to the Annual General Meeting of shareholders
12.02.2003	Termination of Stock Option Plan III
18.02.2003	Notice of Annual General Meeting
12.03.2003	Decisions made by the Annual General Meeting on 12 March 2003
13.03.2003	First meeting of the board of directors elected on March 12, 2003
14.03.2003	Stonesoft to reduce its expenditure
24.04.2003	Stonesoft Corporation's interim report
20.05.2003	Stonesoft to adjust its expenditure and organisation
24.07.2003	Stonesoft Corporation's interim report
08.09.2003	Stonesoft launches own Appliance Product Family
18.09.2003	Stonesoft's firewall and VPN solution StoneGate passes Common Criteria
24.10.2003	Stonesoft Corporation's interim report
01.12.2003	Stonesoft Financial Reports in 2004
04.12.2003	Veikko Ikäläinen appointed as new CFO

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