

REGISTRATION NO. 333-

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

ISS GROUP, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	7372	58-2362189
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

41 PERIMETER CENTER EAST, SUITE 660

ATLANTA, GEORGIA 30346

(770) 395-0150

(Address, including zip code, and telephone number, including area code, of the
registrant's principal executive offices)

THOMAS E. NOONAN

CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER

ISS GROUP, INC.

41 PERIMETER CENTER EAST, SUITE 660

ATLANTA, GEORGIA 30346

(770) 395-0150

(Name, address, including zip code, and telephone number, including area code,
of agent for service)

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APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO THE PUBLIC: As soon as
practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended, check the following box. ☐ If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐ _____ If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐ _____ If this Form is a post-effective amendment filed solely to add exhibits to a registration statement, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ☐ _____ If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ☐

CALCULATION OF REGISTRATION FEE

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TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED	AMOUNT TO BE REGISTERED(1)	PROPOSED MAXIMUM OFFERING PRICE PER SHARE(2)	PROPOSED MAXIMUM AGGREGATE OFFERING PRICE(2)	AMOUNT OF REGISTRATION FEE
Common Stock, \$0.001 par value...	2,875,000 shares	\$11.00	\$31,625,000	\$9,330

(1) Includes 375,000 shares that the Underwriters have the option to purchase to cover over-allotments, if any.

(2) Estimated solely for the purpose of computing the amount of the registration fee pursuant to Rule 457(a).

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT THAT SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(A) OF THE SECURITIES ACT OF 1933, AS AMENDED, OR UNTIL THE REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE SECURITIES AND EXCHANGE COMMISSION, ACTING PURSUANT TO SUCH SECTION 8(A), MAY DETERMINE.

INFORMATION CONTAINED HEREIN IS SUBJECT TO COMPLETION OR AMENDMENT. A REGISTRATION STATEMENT RELATING TO THESE SECURITIES HAS BEEN FILED WITH THE SECURITIES AND EXCHANGE COMMISSION. THESE SECURITIES MAY NOT BE SOLD NOR MAY OFFERS TO BUY BE ACCEPTED PRIOR TO THE TIME THE REGISTRATION STATEMENT BECOMES EFFECTIVE. THIS PROSPECTUS SHALL NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF ANY OFFER TO BUY NOR SHALL THERE BE ANY SALE OF THESE SECURITIES IN ANY STATE IN WHICH SUCH OFFER, SOLICITATION OR SALE WOULD BE UNLAWFUL PRIOR TO REGISTRATION OR QUALIFICATION UNDER THE SECURITIES LAWS OF ANY SUCH STATE.

SUBJECT TO COMPLETION, DATED JANUARY 20, 1998

2,500,000 SHARES

[INTERNET SECURITY SYSTEMS LOGO]

**ISS GROUP, INC.
COMMON STOCK
(PAR VALUE \$0.001 PER SHARE)**

Of the 2,500,000 shares of Common Stock offered hereby, 2,200,000 shares are being sold by the Company and 300,000 shares are being sold by the Selling Stockholders. See "Principal and Selling Stockholders". The Company will not receive any of the proceeds from the sale of the shares being sold by the Selling Stockholders.

Prior to this Offering, there has been no public market for the Common Stock of the Company. It is currently estimated that the initial public offering price per share will be between \$9.00 and \$11.00. For factors to be considered in determining the initial public offering price, see "Underwriting".

SEE "RISK FACTORS" ON PAGE 6 FOR CERTAIN CONSIDERATIONS RELEVANT TO AN INVESTMENT IN THE COMMON STOCK.

Application will be made to list the Common Stock on the Nasdaq National Market under the symbol "ISSX".

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	INITIAL PUBLIC OFFERING PRICE	UNDERWRITING DISCOUNT (1)	PROCEEDS TO COMPANY (2)	PROCEEDS TO SELLING STOCKHOLDERS
Per Share.....	\$	\$	\$	\$
Total (3).....	\$	\$	\$	\$

(1) The Company and the Selling Stockholders have agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933.

(2) Before deducting estimated expenses of \$700,000 payable by the Company.

(3) The Company and the Selling Stockholders have granted the Underwriters an option for 30 days to purchase up to an additional 375,000 shares at the initial public offering price per share, less the underwriting discount, solely to cover over-allotments, if any, of which an option to purchase 310,000 shares has been granted by the Company and an option to purchase 65,000 shares has been granted by the Selling Stockholders. The Company will not receive any proceeds from the sale of shares by the Selling Stockholders. If such option is exercised in full, the total initial public offering price, underwriting discount, proceeds to Company and proceeds to Selling Stockholders will be \$, \$, \$, and \$, respectively. See "Principal and Selling Stockholders" and "Underwriting".

The shares offered hereby are offered severally by the Underwriters, as specified herein, subject to receipt and acceptance by them and subject to their right to reject any order in whole or in part. It is expected that certificates for the shares will be ready for

delivery in New York, New York, on or about , 1998, against payment therefor in immediately available funds.

GOLDMAN, SACHS & CO.

BANCAMERICA ROBERTSON STEPHENS

UBS SECURITIES

WESSELS, ARNOLD & HENDERSON

The date of this Prospectus is , 1998.

[PHOTOS TO COME]

Firecell, Fireblanket, Firewall Scanner, Internet Scanner, Internet Security Systems, Intranet Scanner, ISS, SAFEsuite, System Security Scanner, S3, Web Security Scanner and the ISS logo are trademarks of the Company. All other trademarks or trade names referred to in this Prospectus are the property of their respective owners.

The Company intends to furnish to its stockholders annual reports containing audited financial statements examined by its independent auditors.

CERTAIN PERSONS PARTICIPATING IN THIS OFFERING MAY ENGAGE IN TRANSACTIONS THAT STABILIZE, MAINTAIN OR OTHERWISE AFFECT THE PRICE OF THE COMMON STOCK, INCLUDING OVER-ALLOTMENT, STABILIZING AND SHORT-COVERING TRANSACTIONS IN SUCH SECURITIES, AND THE IMPOSITION OF A PENALTY BID, IN CONNECTION WITH THE OFFERING. FOR A DESCRIPTION OF THESE ACTIVITIES, SEE "UNDERWRITING".

PROSPECTUS SUMMARY

The following summary should be read in conjunction with, and is qualified in its entirety by, the more detailed information and the Consolidated Financial Statements and Notes thereto appearing elsewhere in this Prospectus. Except as otherwise noted, all information in this Prospectus, including share and per share information, assumes (i) the mandatory conversion into Common Stock of all outstanding shares of Series A and Series B Redeemable, Convertible Preferred Stock (the "Convertible Preferred Stock") upon the consummation of the Offering,

(ii) no exercise of stock options after December 31, 1997 and (iii) no exercise of the Underwriters' over-allotment option. Unless the context otherwise requires, the terms "Internet Security Systems", "ISS" and the "Company" refer to ISS Group, Inc. and its consolidated subsidiaries. See "Description of Capital Stock" and "Underwriting".

THE COMPANY

Internet Security Systems is the leading provider of network security monitoring, detection and response software that protects the security and integrity of enterprise information systems. The Company's SAFEsuite family of products enforces "best practice" information protection automatically across distributed computing environments by monitoring and responding to continuously changing network security risks. By dynamically detecting and responding to the security vulnerabilities and real-time threats inherent in open systems, SAFEsuite products protect distributed computing environments, including internal corporate networks, extranets and the Internet, from attacks, misuse and security policy violations. The Company's products rely on an innovative Adaptive Security Management ("ASM") approach to network security, which entails continuous security risk monitoring and response to develop and enforce an active network security policy. ISS pioneered the technology for vulnerability and threat detection through a dedicated security research and development team and believes that it has the most comprehensive vulnerability and threat database in existence. The Company has delivered its network security monitoring, detection and response solutions to over 1,500 organizations worldwide, including firms in the Global 2000, U.S. and international government agencies and major universities. Nine of the ten largest commercial banks in the United States have licensed the Company's products.

The proliferation of client/server architectures, the growth of the Internet as a business tool and the emergence of intranets have dramatically increased the openness of distributed computing environments. Although open computing environments have many business advantages, their accessibility and the relative anonymity of users makes these systems, and the integrity of the information that is stored on them, vulnerable to security threats. According to the 1997 Annual Information Week/Ernst & Young LLP Information Security Survey of information technology ("IT") managers and professionals, 42% of all United States respondents reported malicious acts from external sources, up from 16% in the previous year, and 43% reported malicious acts by employees, compared with 29% in the previous year. The conflict between the benefits of open systems that provide easy access to corporate information and the need to protect mission-critical information and applications from unauthorized use and disruption requires solutions that allow organizations to implement, enforce and evaluate an informed security policy.

ISS has developed ASM, a dynamic, process-driven approach to enterprise-wide network protection. The ASM process relies on the principles of monitoring, detection and response to the ever-changing vulnerabilities in and threats to the network protocols, operating systems and applications that comprise every network system. The Company's monitoring, detection and response products provide easy-to-use software solutions designed to enable network managers to centrally define and manage an enterprise-wide security policy for their existing network system infrastructure, including all Internet protocol-enabled devices. The Company's SAFEsuite family of products provides the ability to visualize, measure and analyze real-time security vulnerabilities and control threats across the entire enterprise network infrastructure, keeping the organization's IT personnel informed of changing network conditions and automatically making adjustments as necessary. Through custom policies or by using the Company's "best-practice" templates, network managers can minimize security risks without closing off the

organization's network to the benefits of open computing environments and the Internet. The Company's products extend across a broad range of platforms and work with the products of leading security and network management vendors to provide a single point of management and control for an enterprise-wide security policy across multiple hosts, operating systems and applications. Through the Company's senior research and development team of security experts known as the "X-Force", ISS maintains a proprietary and comprehensive knowledge base of computer exploits and attack methods, including what the Company believes is the most extensive collection of Windows NT vulnerabilities and threats.

The Company's objective is to be the leading provider of ASM systems that proactively protect the integrity and security of enterprise-wide information systems from vulnerabilities, misuse, attacks and other policy violations. ISS focuses on developing innovative and automated software solutions to provide customers with a comprehensive framework for protecting their networks by monitoring for vulnerabilities and real-time threats in order to enforce "best practice" network and system security policies. The Company is seeking to meet its objective by continuing its leadership position in security technology, expanding its domestic sales channels, promoting its professional services capabilities, expanding its international operations and creating ASM category awareness.

The Company was incorporated under the laws of Delaware on December 8, 1997 as a holding company for Internet Security Systems, Inc., a Georgia corporation incorporated on April 19, 1994. Prior to incorporation in Georgia, the Company operated as an unincorporated association and distributed its first product as shareware in 1992. The Company's principal executive offices are located at 41 Perimeter Center East, Suite 660, Atlanta, Georgia 30346. Its telephone number at that location is (770) 395-0150.

THE OFFERING

Common Stock offered by the Company.....	2,200,000 shares
Common Stock offered by the Selling Stockholders.....	300,000 shares
Common Stock to be outstanding after the Offering.....	15,878,428 shares(1)
Proposed Nasdaq National Market symbol.....	ISSX
Use of proceeds.....	For general corporate purposes, including working capital and possible acquisitions. See "Use of Proceeds".

(1) Excludes 1,883,850 shares of Common Stock issuable upon exercise of options outstanding at December 31, 1997 at a weighted average price of \$2.71 per share. See "Management -- Board of Directors" and "-- Restated 1995 Stock Incentive Plan", "Certain Transactions" and Note 6 of Notes to Consolidated Financial Statements.

SUMMARY CONSOLIDATED FINANCIAL DATA

The following table sets forth certain consolidated financial data for the Company. This information should be read in conjunction with the Consolidated Financial Statements and Notes thereto appearing elsewhere in this Prospectus. See "Management's Discussion and Analysis of Financial Condition and Results of Operations".

	APRIL 19, 1994 (INCEPTION) THROUGH DECEMBER 31, 1994	YEAR ENDED DECEMBER 31, ----- 1995 1996 1997 -----		
	(IN THOUSANDS, EXCEPT PER SHARE DATA)			
STATEMENT OF OPERATIONS DATA:				
Revenues.....	\$ 38	\$ 257	\$ 4,462	\$13,467
Operating income (loss).....	20	(140)	(1,205)	(4,147)
Net income (loss).....	20	(140)	(1,131)	(3,919)
Unaudited pro forma net loss per share(1).....				\$ (0.28)
Unaudited weighted average shares used in per share calculation(1).....				14,181
		DECEMBER 31, 1997 -----		
	HISTORICAL	PRO FORMA(2)	PRO FORMA AS ADJUSTED(3) -----	
	(IN THOUSANDS)			
BALANCE SHEET DATA:				
Cash and cash equivalents.....	\$ 3,929	\$ 3,929	\$23,689	
Working capital.....	2,272	2,272	22,032	
Total assets.....	9,866	9,866	29,626	
Long-term debt, net of current portion.....	70	70	70	
Convertible Preferred Stock.....	8,878	--	--	
Stockholders' equity (deficit).....	(5,058)	3,820	23,580	

(1) See Note 1 of Notes to Consolidated Financial Statements for the determination of shares used in computing unaudited pro forma net loss per share. Pro forma net loss per share is not included for periods prior to 1997 because such comparisons are not meaningful due to the conversion of all outstanding shares of Convertible Preferred Stock into Common Stock upon consummation of the Offering.

(2) Reflects the conversion of all Convertible Preferred Stock into an aggregate of 5,736,957 shares of Common Stock upon consummation of the Offering. See Note 4 of Notes to Consolidated Financial Statements.

(3) Pro forma as adjusted gives effect to the sale by the Company of 2,200,000 shares of Common Stock offered hereby after deducting estimated underwriting discounts and commissions and estimated offering expenses payable by the Company. See "Use of Proceeds".

RISK FACTORS

In addition to the other information in this Prospectus, prospective purchasers of the Common Stock offered hereby should carefully consider the following factors in evaluating the Company and its business.

LIMITED OPERATING HISTORY; HISTORY OF LOSSES

The Company was incorporated in April 1994 and has never achieved profitability, nor does the Company expect to achieve profitability in the foreseeable future. Accordingly, the Company has only a limited operating history upon which an evaluation of the Company and its prospects can be based and is subject to all of the risks inherent in the establishment of a new business enterprise. The Company's prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in their early state of development, particularly companies in new and rapidly evolving markets. To address these risks, the Company must, among other things, respond to competitive developments, continue to upgrade and expand its product offerings and continue to attract, retain and motivate qualified personnel. There can be no assurance that the Company will be successful in addressing such risks, that the Company's revenue growth will continue in the future or that the Company will achieve profitability in the future or, if achieved, that the Company could maintain such profitability on a quarterly or annual basis. See "Management's Discussion and Analysis of Financial Condition and Results of Operations".

SIGNIFICANT POTENTIAL FLUCTUATIONS IN FUTURE OPERATING RESULTS

The Company's future revenues and operating results are uncertain and are expected to fluctuate from quarter to quarter and from year to year due to a combination of factors, including the demand for the Company's products, the volume and timing of orders, the level of product and price competition, the expansion of the Company's domestic and international sales and marketing organizations, the Company's ability to develop new and enhanced products and control costs, the Company's ability to attract and retain key technical, sales and managerial personnel, the mix of distribution channels through which the Company's products are sold, the growth in the acceptance of, and activity on, the Internet and World Wide Web ("Web"), particularly by corporate, institutional and government users, the growth of private Internet protocol ("IP") networks (or "intranets"), the extent to which unauthorized access and use of online information is perceived as a threat to network security, customer budgets, seasonal trends in customer purchasing, foreign currency exchange rates and general economic factors. As the Company increasingly focuses on sales of the Company's product suite rather than individual products, the Company expects that the sales cycle associated with the purchase of the Company's products will lengthen. In addition, the amount of revenues associated with particular licenses can vary significantly based upon the number of products that are licensed and the number of devices involved in the installation. The Company has experienced and may continue to experience from time to time very large, individual license sales which can cause significant variations in quarterly license revenues. Moreover, small delays in customer orders can cause significant variability in the Company's license revenues and results of operations for any particular period. As a result, the timing of significant orders is unpredictable and, like many software companies, the Company typically realizes a significant portion of its software license revenues in the last month of a quarter. The Company establishes its expenditure levels for product development, sales and marketing and other operating expenses based, in large part, on its expected future revenues. As a result, if revenues fall below expectations, operating results and net income are likely to be adversely and disproportionately affected because only a small portion of the Company's expenses vary with its revenues.

Based upon all of the foregoing, the Company believes that the Company's quarterly and annual revenues, expenses and operating results are likely to vary significantly in the future and that period-to-period comparisons of its results of operations are not necessarily meaningful and, in any event, such comparisons should not be relied upon as indications of future performance. Moreover, although the Company's revenues have increased in recent periods, there can be no assurance that the Company's

revenues will grow in future periods, that they will grow at past rates or that the Company will achieve profitability on a quarterly or annual basis. Due to the foregoing or other factors, it is likely that the Company's operating results may be below market analysts' expectations in some future quarters, which could materially adversely affect the market price of the Common Stock. See "Selected Consolidated Financial Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Selected Quarterly Financial Results".

COMPETITION

The market for security monitoring, detection and response products and services is intensely competitive and the Company expects competition to increase further in the future. There can be no assurance that the Company can maintain its competitive position against current and potential competitors, especially those with significantly greater financial, marketing, service, support, technical and other competitive resources.

The Company's principal competitors generally fall within one of three categories: internal IT departments or consulting firms that assist such departments, relatively smaller software companies that offer applications with limited scope and larger software companies that are either in the process of entering the Company's market or have the potential to develop products to compete with the Company's products. Due to a lack of awareness of the Company's products and services or a lack of appreciation of the complexity involved in the development of automated systems to establish and, more importantly, maintain comprehensive and effective levels of security within a distributed computing environment, potential customers often rely on their IT departments to internally formulate security systems or to retain consultants to undertake such a project. Second, there are a number of companies that currently market or have under development software applications to provide network and Internet security. The Company expects additional competition from these established competitors and from other emerging companies. Any future mergers or consolidations among these competitors would make them more formidable competitors to the Company. There can be no assurance that the Company's current and potential competitors will not develop security monitoring, detection and response products that may be more effective than the Company's current or future products or that the Company's technologies and products will not be rendered obsolete by such developments. Finally, there are a number of companies that currently market and sell various software products, such as encryption, firewalls, operating system security and virus detection software, that have been broadly adopted by the Company's customers and potential customers to provide various levels of security within their computing environments. Some of these companies have released products which provide similar functionality as certain of the Company's products. In addition, vendors of operating system software or networking hardware may in the future enhance their products to include functionality that is currently provided by the Company's products. The widespread inclusion of the functionality of the Company's software as standard features of operating system software or networking hardware could render the Company's products obsolete and unmarketable, particularly if the quality of such functionality were comparable to that of the Company's products. Even if the security auditing and monitoring functionality provided as standard features by operating system software or networking hardware is more limited than that of the Company's software, there can be no assurance that a significant number of customers would not elect to accept more limited functionality in lieu of purchasing additional software. Many of these larger companies have longer operating histories, greater name recognition, access to larger customer bases and significantly greater financial, technical and marketing resources than the Company. As a result, they may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products than the Company. If these companies were to introduce products that effectively competed with the Company's products, they could be in a position to substantially lower the price of their security auditing and monitoring products or to bundle such products with their other products, which would make it more difficult for the Company to compete with them.

For the foregoing reasons, there can be no assurance that the Company will be able to compete successfully against its current and future competitors. Increased competition may result in price reductions, reduced gross margins and loss of market share, any of which would materially and adversely affect the Company's business, operating results and financial condition. See "Business -- Competition".

RAPID TECHNOLOGICAL CHANGE AND NEW PRODUCTS

The market for the Company's products is characterized by rapid technological advances, including by those seeking to establish more secure systems and those seeking to compromise such systems, evolving industry standards in computer hardware and software technology, changes in customer requirements and frequent new product introductions and enhancements. As a result, the Company must continually change and improve its products in response to changes in operating systems, application and networking software, computer and communications hardware, programming tools and computer language technology. In particular, the market for Internet and intranet software applications has only recently begun to develop and is rapidly evolving. Therefore, the Company's future success will depend upon its ability to continue to enhance its current product line and to develop and introduce new products that adequately address and respond to innovations in computer hacking methodologies, keep pace with technological developments, satisfy increasingly sophisticated customer requirements and achieve market acceptance. There can be no assurance that the Company will be successful in developing and marketing, on a timely and cost-effective basis, fully functional product enhancements or new products that respond to technological advances by computer hackers and other unauthorized users of online information, or that its new products will achieve market acceptance. If the Company does not respond adequately to the need to develop and introduce new products or enhancements of existing products in a timely manner, the Company's business, operating results and financial condition would be materially and adversely affected. See "Business -- Product Development".

As a result of the complexities inherent in the security of distributed computing environments and the broad functionality and performance demanded by customers for such products, major new product enhancements and new products can require long development and testing periods to achieve market acceptance. The Company has on occasion experienced delays in the scheduled introduction of new and enhanced products. In addition, software programs as complex as those offered by the Company may contain undetected errors or "bugs" when first introduced or as new versions are released that, despite testing by the Company, are discovered only after a product has been installed and used by customers. The deployment and use of the Company's products by one or more customers, if not properly completed, has resulted in the past and may result in the future in temporary disruptions to the operation of the customer's networking system, which may adversely affect the Company's relationship with such customers. There can be no assurance that errors will not be found in future releases of the Company's software, or that any such errors will not impair the market acceptance of these products and materially adversely affect the Company's business, operating results and financial condition.

The processes and methodologies used by computer hackers to access or sabotage networks and intranets are ever changing and generally not recognized until launched against one or more targets. Therefore, the Company, in most cases, is unable to anticipate these processes and methodologies. To the extent that customers' computing environments are compromised, such customers may perceive the Company's products as ineffective in protecting their systems, which may result in a reduction in orders from such customers and the loss of customer goodwill, which could adversely affect the Company's business, operating results and financial condition.

MANAGEMENT OF GROWTH

The Company's business has grown rapidly in the last three years, with total revenues increasing from \$257,000 in 1995 to over \$13 million in 1997 and the total number of employees increasing from seven in 1995 to 141 in 1997. This expansion has resulted in substantial growth in the scope of the Company's infrastructure, including operating and financial applications and the geographic area of its

operations and customers. Recent rapid growth has placed and, if such growth continues, is expected to continue to place, a significant strain on the Company's management and operations. In particular, the Company is in the process of upgrading its internal financial and reporting systems to enhance management's ability to obtain and more timely analyze information derived from its domestic and international operations. There can be no assurance, however, that the Company's existing or future controls, systems or procedures will be adequate to support the Company's operations. The Company's ability to manage its future growth, if any, will require the Company to continually improve its financial and management controls, reporting systems and procedures on a timely basis, implement new systems as necessary and expand, train and manage its employee workforce. There can be no assurance that the Company will be able to manage any future expansion successfully, and any inability to do so would have a material adverse effect on the Company's business, operating results and financial condition. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Overview".

RISKS ASSOCIATED WITH THE EMERGING MARKET FOR AUDITING AND MONITORING SECURITY PRODUCTS

The market for the Company's products is rapidly evolving. There can be no assurance that Internet protocols will continue to be used to facilitate communications or that the market for security monitoring, detection and response systems in general will continue to expand. Continued growth of this market will depend, in large part, upon the continued expansion of Internet usage and in the number of organizations adopting or expanding intranets, the ability of their respective infrastructures to support an increasing number of users and services, the public recognition of the potential threat posed by computer hackers and other unauthorized users and the continued development of new and improved services for implementation across the Internet and between the Internet and intranets. If the necessary infrastructure or complementary products and services are not developed in a timely manner and, consequently, the market for products to monitor Internet and intranet security fails to grow or grows more slowly than the Company currently anticipates, the Company's business, operating results and financial condition would be materially adversely affected. See "Business -- Industry Background".

Although the demand for Internet security systems and firewalls has grown in recent years, the market for security monitoring, detection and response software is still nascent and there can be no assurance that this market will grow or that, even if the market does grow, businesses will adopt the Company's products. Historically, network and Internet security monitoring, detection and response has been addressed by applications and solutions that have largely been developed by the internal IT departments of organization having large computing systems with a particular need for such products, including the U.S. Government, banking and financial institutions, technology firms and universities. In addition, many organizations do not separately budget for information security products. The Company has spent, and intends to continue to spend, considerable resources educating potential customers about the vulnerabilities associated with their Internet, intranet and networking systems and about the features and functions of the Company's SAFEsuite products. However, there can be no assurance that such expenditures will enable SAFEsuite products to achieve any additional degree of market acceptance, and if the market for SAFEsuite products fails to grow or grows more slowly than the Company currently anticipates, the Company's business, operating results and financial condition would be materially adversely affected. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business -- Sales and Marketing" and "-- Competition".

PRODUCT CONCENTRATION

The Company currently derives a majority of its revenues from software licenses and related maintenance fees and services for its Internet Scanner product. In 1997, the Company derived over 80% of its revenues from Internet Scanner and the Company expects that Internet Scanner-related revenues, including maintenance contracts, will continue to account for a majority of the Company's revenues for the foreseeable future. As a result, the Company's future operating results are dependent upon continued market acceptance of Internet Scanner and enhancements thereto. There can be no assurance that Internet Scanner will achieve continued market acceptance or that the Company will be successful in

marketing its SAFEsuite products or product enhancements. A decline in demand for, or market acceptance of, Internet Scanner as a result of competition, technological change or other factors would have a material adverse effect on the Company's business, operating results and financial condition.

INTERNATIONAL OPERATIONS

The Company derived approximately 4% and 21% of its total revenues from sales to customers outside North America in 1996 and 1997, respectively. The Company opened sales offices in Belgium in February 1996, Japan in February 1997, England in April 1997, France in April 1997 and Canada in December 1997, and believes that its future growth will require continued expansion of its operations in international markets. In order to expand internationally, the Company must establish additional foreign operations and hire additional personnel. To the extent that the Company is unable to do so in a timely and effective manner, the Company's growth, if any, in international sales will be limited, and the Company's business, operating results and financial condition could be materially and adversely affected. To date, the Company's revenues from international operations have primarily been denominated in United States dollars, although some sales have been denominated in foreign currencies. An increase in the value of the United States dollar relative to foreign currencies would make the Company's products more expensive and, therefore, potentially less competitive in those markets. In addition, even if international operations are successfully expanded, there can be no assurance that the Company will be able to maintain or increase international market demand for its products.

The Company's international operations are subject to risks inherent in international business activities, including, in particular, management of an organization spread over various countries, longer accounts receivable payment cycles in certain countries, compliance with a variety of foreign laws and regulations, unexpected changes in regulatory requirements, overlap of different tax structures, foreign currency exchange rate fluctuations, import and export licensing requirements, trade restrictions, changes in tariff and freight rates and regional economic conditions. There can be no assurance that such factors will not have a material adverse effect on the Company's future international sales and, consequently, the Company's business, operating results and financial condition. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business -- Sales and Marketing".

INCREASING RELIANCE ON INDIRECT DISTRIBUTION CHANNELS

Although direct sales to date have accounted for a majority of the Company's revenues, ISS expects that it will increasingly distribute its products to end users through various indirect distribution channels, including channel partners, value added resellers ("VARs"), original equipment manufacturers ("OEMs"), Internet service providers ("ISPs") and systems integrators. The Company's relationships with many of its channel partners have been established within the last 18 months, and the Company is unable to predict the extent to which these channel partners will be successful in marketing and selling licenses for the Company's products. The Company is dependent on the marketing and sales efforts of these channel partners, many of whom also market and sell competitive products or are able, under the terms of their agreements, to market and sell competitive products. The loss of any of the Company's major channel partners, either to competitive products offered by other companies or products developed internally by these channel partners, could have a material adverse effect on the Company's business, operating results and financial condition. In addition, there can be no assurance that the Company will be able to effectively manage potential conflicts among channel partners, that economic conditions or industry demand will not adversely affect these or other indirect channel partners or that these channel partners will not devote greater resources to marketing and supporting the products of other companies. The Company's future performance will also depend, in part, on its ability to attract additional channel partners that will be able to market and support the Company's products effectively, especially in markets in which the Company has not previously distributed its products. In addition, the Company depends in large part upon its channel partners for product installation and support for such channel partners' customers. There can be no assurance that revenue from channel partners that accounted for

significant revenues in past periods will continue, or if continued will reach or exceed historical levels. In addition, there can be no assurance that the Company's channel partners will continue to provide adequate installation and support to end users or will provide installation and support for new products. If the Company's channel partners fail to provide adequate installation and support, end users of the Company's products could cease using, or improperly implement and operate, such products, which could result in a substantial increase in customer support costs to the Company and thereby materially adversely affect the Company's business, operating results and financial condition. See "Business -- Sales and Marketing".

DEPENDENCE UPON KEY PERSONNEL

The Company's future operating results depend in significant part upon the continued service of a relatively small number of key technical and senior management personnel, especially Thomas E. Noonan, the Company's Chairman of the Board, President and Chief Executive Officer, and Christopher Klaus, the Company's founder and Chief Technology Officer, neither of whom is bound by an employment agreement. The Company's future success also depends on its continuing ability to attract and retain other highly qualified technical and managerial personnel. Competition for such personnel is intense, and the Company has at times in the past experienced difficulty in recruiting qualified personnel, especially engineers experienced in network security issues. There can be no assurance that the Company will retain its key managerial and technical employees or that it will be successful in attracting, assimilating or retaining other highly qualified technical and managerial personnel in the future. The loss of any member of the Company's key technical and senior management personnel or the inability to attract and retain additional qualified personnel could have a material adverse effect on the Company's business, operating results and financial condition. See "Management".

INTELLECTUAL PROPERTY RIGHTS; USE OF LICENSED TECHNOLOGY; TRADEMARK ISSUES

The Company relies primarily on a combination of copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect its proprietary rights. The Company also believes that factors such as the technological and creative skills of its personnel, new product developments, frequent product enhancements, name recognition and reliable product maintenance are essential to establishing and maintaining a technology leadership position. The Company seeks to protect its software, documentation and other written materials under the trade secret and copyright laws, which afford only limited protection. The Company has also submitted one United States patent application. There can be no assurance that a patent will issue from this application or, if issued, that such patent would provide meaningful competitive advantages to the Company. The Company generally licenses SAFEsuite products to end users in object code (machine-readable) format. Certain customers have required the Company to maintain a source-code escrow account with a third-party software escrow agent, and a failure by the Company to perform its obligations under any of the related license and maintenance agreements, or the insolvency of the Company, could conceivably cause the release of the Company's source code to such customers. Despite the Company's efforts to protect its proprietary rights, unauthorized parties may attempt to copy aspects of the Company's products or to obtain and use information that the Company regards as proprietary. Policing unauthorized use of the Company's products is difficult, and while the Company is unable to determine the extent to which piracy of its software products exists, software piracy can be expected to be a persistent problem. In addition, the laws of some foreign countries do not protect the Company's proprietary rights to as great an extent as do the laws of the United States. There can be no assurance that the Company's competitors will not independently develop similar technology.

Although the Company is not aware that any of its products infringes the proprietary rights of third parties, there can be no assurance that third parties will not claim infringement by the Company with respect to current or future products. The Company expects that software product developers will increasingly be subject to infringement claims as the number of products and competitors in the Company's industry segment grows and the functionality of products in different industry segments

overlaps. Any such claims, with or without merit, could be time consuming, result in costly litigation, cause product shipment delays or require the Company to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to the Company or at all, which could have a material adverse effect upon the Company's business, operating results and financial condition.

The name "Internet Security Systems" is currently not subject to trademark registration in the United States, and may not be a name for which trademark protection is available due to its general use in a variety of security-related applications. Although the Company has in the past asserted and intends to continue to assert its rights with respect to the name "Internet Security Systems" and has in the past taken and will take action against any use of such name in a manner that may create confusion for its products in relevant markets, there can be no assurance that the Company will be successful in such efforts, which could have a material adverse effect upon the Company's business, operating results and financial condition. See "Business -- Proprietary Rights and Trademark Issues".

PRODUCT LIABILITY; RISK OF PRODUCT DEFECTS

The Company's products are used to monitor and enhance network security which is typically a critical function for organizations. As a result, the licensing and support of products by the Company may entail the risk of product liability and related claims. Although the Company's license agreements typically contain provisions designed to limit the Company's exposure to potential product liability or related claims, there can be no assurance that such limitations will be effective under the laws of applicable domestic or foreign jurisdictions. A product liability claim brought against the Company could have a material adverse effect upon the Company's business, operating results and financial condition.

In addition, software products as complex as those offered by the Company may contain undetected errors or result in failures when first introduced or when new versions are released. In particular, the personal computer hardware environment is characterized by a wide variety of non-standard configurations that make pre-release testing for programming or compatibility errors very difficult and time-consuming. Despite testing by the Company and by current and potential customers, there can be no assurance that errors will not be found in new products or enhancements after commencement of commercial shipments. The occurrence of these errors could result in adverse publicity, loss of or delay in market acceptance or claims by customers against the Company, any of which could have a material adverse effect upon the Company's business, operating results and financial condition. See "Business -- Products" and "-- Product Development".

RISK OF TARGETED ATTACKS AGAINST THE COMPANY

Due to the Company's notoriety in monitoring, detecting and thwarting the activities of computer hackers, the Company in the past has been, and expects in the future that it will continue to be, a target of attacks by computer hackers who seek to infiltrate the Company's internal network system to obtain sensitive data and information or create bugs or viruses in an attempt to sabotage the functionality of the Company's products. There can be no assurance that the Company will be able to respond to such attacks in a timely or effective manner and any failure to do so could have a material adverse effect upon the Company's business, operating results and financial condition.

GOVERNMENT REGULATION OF TECHNOLOGY EXPORTS

A number of governments have imposed controls, export license requirements and restrictions on the export of certain technology, specifically with respect to encryption technology. Although the Company has incorporated encryption technology into its products, the Company has been able to receive prior approvals or authorizations to sell its products in foreign markets. There can be no assurance, however, that current export controls will not be extended to cover the Company's products which may have a material adverse effect on the Company's business, operating results and financial condition.

NO PRIOR MARKET FOR THE COMMON STOCK; POSSIBLE VOLATILITY OF SHARE PRICE

Prior to the Offering, there has been no public market for the Common Stock, and there can be no assurance that an active trading market will develop upon completion of the Offering or, if it does develop, that such market will be sustained. The initial public offering price of the Common Stock will be determined by negotiation between the Company and the representatives of the Underwriters, and may not be representative of the price that will prevail in the open market. See "Underwriting" for a discussion of the factors to be considered in determining the initial public offering price.

The market price of the Common Stock after the Offering may be significantly affected by factors such as the announcement of new products or product enhancements by the Company or its competitors, technological innovation by the Company or its competitors, quarterly variations in the Company's results of operations, and general market conditions or market conditions specific to particular industries. In particular, the stock prices for many companies in the technology and emerging growth sector have experienced wide fluctuations which have often been unrelated to the operating performance of such companies. Such fluctuations may adversely affect the market price of the Common Stock. Furthermore, in the past, following periods of volatility in the market price of a company's securities, securities class action claims have been brought against the issuing company. There can be no assurance that such litigation will not occur in the future with respect to the Company. Such litigation could result in substantial costs and a diversion of management's attention and resources, and any adverse determination in such litigation could also subject the Company to significant liabilities, any or all of which could have a material adverse effect on the Company's business, operating results and financial condition.

ANTI-TAKEOVER PROVISIONS

The Company's Certificate of Incorporation (the "Charter") and the Company's Bylaws (the "Bylaws") contain certain provisions that may have the effect of discouraging, delaying or preventing a change in control of the Company or unsolicited acquisition proposals that a stockholder might consider favorable. The Charter provides the Company's Board of Directors with the authority to issue up to 50,000,000 shares of Common Stock, and up to 20,000,000 shares of Preferred Stock in one or more series and to determine the price, rights (including voting rights), preferences, privileges and restrictions of each such series of Preferred Stock, without any vote or action by the Company's stockholders. The rights and preferences of any series of such Preferred Stock could include a preference over the Common Stock on the distribution of the Company's assets upon a liquidation or sale of the Company, preferential dividends, redemption rights, the right to elect one or more directors and other voting rights. The rights of the holders of the Common Stock will be subject to, and may be adversely affected by, the rights of the holders of any series of Preferred Stock that may be issued in the future. The Company has no current plans to issue Preferred Stock. The existence of large amounts of authorized but unissued Common Stock could be used to prevent or delay a change in control of the Company. In addition, the Charter and Bylaws include provisions establishing a Board of Directors with staggered, three-year terms, requiring supermajority voting to effect certain amendments to the Charter and Bylaws, limiting the persons who may call special meetings of stockholders, prohibiting stockholder action by written consent and establishing advance notice requirements for nominations for election to the Board of Directors or for proposing matters that can be acted upon at stockholders' meetings. Certain provisions of Delaware law and the Company's Restated 1995 Stock Incentive Plan (the "1995 Plan") may also have the effect of discouraging, delaying or preventing a change in control of the Company or unsolicited acquisition proposals. See "Management -- Restated 1995 Stock Incentive Plan" and "Description of Capital Stock -- Certain Anti-Takeover, Limited Liability and Indemnification Provisions".

SHARES ELIGIBLE FOR FUTURE SALE; REGISTRATION RIGHTS

Sales of substantial amounts of Common Stock in the public market, or the perception that such sales may occur, could adversely affect the prevailing market price of the Common Stock or the ability of the Company to raise capital through a public offering of its equity securities. Upon completion of the Offering, the Company will have outstanding 15,878,428 shares of Common Stock (not including shares issuable upon exercise of outstanding stock options). Under agreements entered into between the representatives of the Underwriters and each of the Company's officers, directors, principal stockholders and their respective affiliates (the "Lock-Up Agreements") who beneficially hold, in the aggregate 13,678,428 shares of Common Stock (which includes 20,000 shares acquired in 1998 upon the exercise of a stock option held by a Selling Stockholder) prior to the Offering, no shares held by such holders will be eligible for sale in the public market for a period of 180 days following the date of this Prospectus. The Company intends to file a registration statement under the Securities Act of 1933, as amended (the "Securities Act"), covering the sale of Common Stock reserved for issuance under the 1995 Plan. As of December 31, 1997, there were options outstanding under the 1995 Plan to purchase an aggregate of 1,803,850 shares and options issued outside of the 1995 Plan to purchase 80,000 shares; all shares acquired upon exercise of options within 180 days of the Offering are or will be subject to Lock-Up Agreements as required under the 1995 Plan. Following the expiration of the 180-day term of the Lock-Up Agreements, 16,359,365 shares, including the 2,500,000 shares offered hereby and approximately 480,937 shares subject to options that will be exercisable on or before the end of such term, will be eligible for sale in the public market subject, in some cases, to the requirements of Rule 144 or Rule 701 under the Securities Act. Goldman, Sachs & Co. in its sole discretion and at any time without notice, may release all or any portion of the securities subject to the Lock-Up Agreements. Any such decision to release securities would likely be based upon individual stockholder circumstances, prevailing market conditions and other relevant factors. Any such release could have a material adverse effect upon the price of the Common Stock. See "Underwriting".

Holders of the 5,736,957 shares of Common Stock that will be issued upon the conversion of the outstanding shares of Convertible Preferred Stock upon the consummation of the Offering are currently entitled to certain demand and piggy-back registration rights with respect to such shares and holders of an additional 7,901,971 shares of Common Stock are currently entitled to piggy-back registration rights. If the Company were required to register the shares held by such holders pursuant to the exercise of their demand or piggy-back registration rights, such sales could have an adverse effect upon the Company's ability to raise needed capital. See "Shares Eligible for Future Sale".

CONCENTRATION OF SHARE OWNERSHIP

Upon completion of the Offering, the directors, executive officers and principal stockholders of the Company and their respective affiliates will beneficially own approximately 74.4% of the outstanding Common Stock (approximately 72.7% if the Underwriters' over-allotment option is exercised in full). As a result, these stockholders will be able to exercise significant influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. Such concentration of ownership may have the effect of delaying or preventing a change in control of the Company. See "Principal and Selling Stockholders".

DISCRETION AS TO USE OF PROCEEDS

The Company has not yet identified specific uses of a significant portion of the net proceeds from the Offering. Therefore, the Company's management will retain broad discretion to allocate the net proceeds from the Offering to uses that the stockholders may not deem desirable, and there can be no assurance that the proceeds can or will yield a significant return. See "Use of Proceeds".

IMMEDIATE AND SUBSTANTIAL DILUTION

The midpoint of the filing range of the initial public offering price is substantially higher than the book value per share of the outstanding Common Stock. As a result, investors purchasing Common Stock in the Offering will incur immediate and substantial dilution of the net tangible book value per share of the Common Stock of \$8.51 from such mid-point of the filing range. In addition, the Company has issued options to acquire Common Stock at prices significantly below the mid-point of the filing range of the initial public offering price. To the extent such outstanding options are exercised, there will be further dilution to investors in the Offering. See "Dilution".

USE OF PROCEEDS

Based on an assumed initial public offering price of \$10.00 per share, the net proceeds from the sale of shares of Common Stock to be sold by the Company will be approximately \$19,760,000 (approximately \$22,643,000 if the Underwriters exercise their over-allotment option in full) after deduction of estimated underwriting discounts and commissions and estimated offering expenses payable by the Company.

The principal purposes of the Offering are to increase the Company's equity capital, to create a public market for the Common Stock, to facilitate future access by the Company to public equity markets, to provide liquidity to certain of the Company's existing stockholders and to provide increased visibility and credibility to the Company in a marketplace where many of its competitors are publicly-held companies.

The Company currently intends to use the net proceeds of the Offering for working capital and general corporate purposes, including financing accounts receivable and capital expenditures made in the ordinary course of its business, as well as for possible acquisitions of businesses, products and technologies that are complementary to those of the Company. Although the Company has not identified any specific businesses, products or technologies that it may acquire, nor are there any current agreements or negotiations with respect to any such transactions, the Company from time to time evaluates such opportunities. Pending such uses, the net proceeds will be invested in government securities and other short-term, investment-grade, interest-bearing instruments. The Company will not receive any proceeds from the sale of Common Stock by the Selling Stockholders.

DIVIDEND POLICY

The Company has never declared or paid any cash dividends on its capital stock other than a \$10,000 dividend paid in each of 1994 and 1995, and does not intend to pay any cash dividends on its Common Stock in the foreseeable future. The Company's bank credit facility currently permits the payment of cash dividends only to the extent that the Company maintains certain financial ratios and a specified minimum net worth. For a description of the Company's credit facility, see Note 3 of Notes to Consolidated Financial Statements.

DILUTION

At December 31, 1997, the pro forma net tangible book value of the Company was approximately \$3,820,000, or \$0.28 per share of Common Stock. Pro forma net tangible book value per share represents the amount of total tangible assets of the Company reduced by the amount of its total liabilities, divided by the number of shares of Common Stock outstanding after giving effect to the mandatory conversion of all shares of Convertible Preferred Stock upon the consummation of the Offering. After giving effect to the issuance by the Company of the 2,200,000 shares offered hereby at an assumed initial public offering price of \$10.00 per share and the receipt of the estimated net proceeds therefrom, the pro forma as adjusted net tangible book value of the Company as of December 31, 1997 would have been approximately \$23,580,000, or \$1.49 per share of Common Stock. This represents an immediate increase in pro forma net tangible book value of \$1.21 per share to existing stockholders and an immediate dilution of \$8.51 per share to new investors purchasing shares of Common Stock in the Offering. The following table illustrates the per share dilution:

Assumed initial public offering price per share.....	\$10.00
Pro forma net tangible book value per share as of December 31, 1997.....	\$0.28
Increase per share attributable to new investors.....	1.21

Pro forma as adjusted net tangible book value per share after the Offering.....	1.49

Dilution per share to new investors in the Offering.....	\$ 8.51
	=====

The following table sets forth, on a pro forma basis as of December 31, 1997, with respect to existing stockholders and new investors in the Offering, a comparison of the number of shares of Common Stock acquired from the Company, the percentage of ownership of such shares, the total cash consideration paid, the percentage of total cash consideration paid and the average price per share.

	SHARES PURCHASED		TOTAL CONSIDERATION		AVERAGE PRICE PER SHARE
	NUMBER	PERCENT	AMOUNT	PERCENT	
Existing stockholders(1).....	13,658,428	86.1%	\$ 9,080,000	29.2%	\$ 0.66
New investors(1).....	2,200,000	13.9	22,000,000	70.8	10.00
	-----	-----	-----	-----	-----
Total.....	15,858,428	100.0%	\$31,080,000	100.0%	
	=====	=====	=====	=====	

(1) The net effect of sales by the Selling Stockholders in the Offering will be to reduce the number of shares held by existing stockholders to 13,378,428 shares, or 84.3% of the total number of shares of Common Stock outstanding after the Offering, and to increase the number of shares held by new investors to 2,500,000 shares, or 15.7% of the total number of shares of Common Stock outstanding after the Offering.

The preceding table assumes no exercise of any stock options outstanding as of December 31, 1997, except for 20,000 shares that were acquired by a Selling Stockholder in January 1998 upon the exercise of a stock option with an exercise price of \$0.15 per share, which shares will be sold in the Offering. As of December 31, 1997, there were stock options outstanding to purchase a total of 1,883,850 shares of Common Stock with a weighted average exercise price of \$2.71 per share, all of which are exercisable, and 1,189,150 additional shares reserved for issuance under the 1995 Plan.

CAPITALIZATION

The following table sets forth, as of December 31, 1997, the cash position and capitalization of the Company (i) on a historical basis; (ii) on a pro forma basis, giving effect to the conversion of each share of Convertible Preferred Stock into one share of Common Stock, which will occur upon the consummation of the Offering; and (iii) on a pro forma basis, as adjusted to give effect to the sale of the Common Stock offered hereby and the receipt of the estimated net proceeds therefrom as described under "Use of Proceeds".

	DECEMBER 31, 1997		
	HISTORICAL	PRO FORMA	PRO FORMA AS ADJUSTED
		(IN THOUSANDS)	
Cash and cash equivalents.....	\$ 3,929	\$ 3,929	\$23,689
	=====	=====	=====
Long-term debt, less current portion(1).....	\$ 70	\$ 70	\$ 70
Redeemable, Convertible Preferred Stock, \$0.001 par value, 5,736,957 shares authorized.....			
Series A Redeemable, Convertible Preferred Stock, 3,650,000 shares authorized, 3,650,000 shares issued and outstanding (historical) and none issued or outstanding (pro forma and pro forma as adjusted)....	3,621	--	--
Series B Redeemable, Convertible Preferred Stock, 2,086,957 shares authorized, 2,086,957 shares issued and outstanding (historical), and none issued or outstanding (pro forma and pro forma as adjusted)....	5,257	--	--
Stockholders' equity (deficit):			
Preferred Stock, \$0.001 per value, 20,000,000 shares authorized, none issued or outstanding(2).....	--	--	--
Common Stock, \$0.001 par value, 50,000,000 shares authorized, 7,921,471 shares (historical), 13,658,428 shares (pro forma) and 15,858,428 shares (pro forma as adjusted) issued and outstanding, respectively(3).....	8	14	16
Additional paid-in capital.....	124	8,996	28,754
Accumulated deficit.....	(5,190)	(5,190)	(5,190)
	-----	-----	-----
Total stockholders' equity (deficit).....	(5,058)	3,820	23,580
	-----	-----	-----
Total capitalization.....	\$(4,988)	\$ 3,890	\$23,650
	=====	=====	=====

(1) See Note 3 of Notes to Consolidated Financial Statements.

(2) The 20,000,000 shares of authorized Preferred Stock includes 3,650,000 shares designated as Series A Convertible Preferred Stock and 2,086,957 shares designated as Series B Convertible Preferred Stock.

(3) Pro forma and pro forma as adjusted Common Stock excludes 1,883,850 shares issuable upon the exercise of outstanding options as of December 31, 1997, and an additional 1,189,150 shares reserved for future issuance as of December 31, 1997 pursuant to the 1995 Plan. See "Management -- Restated 1995 Stock Incentive Plan," "Certain Transactions" and Note 6 of Notes to Consolidated Financial Statements.

SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data of the Company is qualified by reference to, and should be read in conjunction with, the Consolidated Financial Statements and Notes thereto and the other financial information appearing elsewhere in this Prospectus. The financial data set forth below for each of the three years in the period ending December 31, 1997, and as of December 31, 1996 and 1997, has been derived from the audited Consolidated Financial Statements of the Company appearing elsewhere in this Prospectus. The financial data for the period from inception (April 19, 1994) through December 31, 1994, and as of December 31, 1994 and 1995, has been derived from audited financial statements of the Company not included in this Prospectus. Historical results are not necessarily indicative of the results that may be expected in the future. See "Management's Discussion and Analysis of Financial Condition and Results of Operations".

	APRIL 19, 1994 (INCEPTION) THROUGH DECEMBER 31, 1994	YEAR ENDED DECEMBER 31, ----- 1995 1996 1997 -----		
	(IN THOUSANDS, EXCEPT PER SHARE DATA)			
STATEMENT OF OPERATIONS DATA:				
Revenues:				
Licenses.....	\$ 38	\$ 246	\$ 4,233	\$10,936
Support services.....	--	11	229	2,531
	-----	-----	-----	-----
	38	257	4,462	13,467
Costs and expenses:				
Cost of revenues.....	--	4	18	676
Research and development.....	5	97	1,225	3,434
Sales and marketing.....	11	252	3,768	11,731
General and administrative.....	2	44	656	1,773
	-----	-----	-----	-----
	18	397	5,667	17,614
	-----	-----	-----	-----
Operating income (loss).....	20	(140)	(1,205)	(4,147)
Interest income, net.....	--	--	74	228
	-----	-----	-----	-----
Net income (loss).....	\$ 20	\$ (140)	\$(1,131)	\$(3,919)
	=====	=====	=====	=====
Unaudited pro forma net loss per share(1).....				\$ (0.28)
				=====
Unaudited weighted average shares used in per share calculation(2).....				14,181
				=====

	DECEMBER 31,			
	1994	1995	1996	1997
	(IN THOUSANDS)			
BALANCE SHEET DATA:				
Cash and cash equivalents.....	\$ 9	\$ 6	\$ 2,007	\$ 3,929
Working capital (working capital deficit).....	10	(26)	2,298	2,272
Total assets.....	10	176	4,380	9,866
Long-term debt, net of current portion.....	--	--	140	70
Convertible Preferred Stock.....	--	--	3,614	8,878
Stockholders' equity (deficit).....	10	(7)	(1,160)	(5,058)

(1) Computed on the basis described in Note 1 of Notes to Consolidated Financial Statements.

(2) See Note 1 of Notes to Consolidated Financial Statements for the determination of shares used in computing unaudited pro forma net loss per share. Pro forma net loss per share is not included for periods prior to 1997 because such comparisons are not meaningful due to the conversion of all outstanding shares of Convertible Preferred Stock to Common Stock upon consummation of the Offering.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Consolidated Financial Statements and related Notes thereto included elsewhere in this Prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. The Company's actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth under "Risk Factors" and elsewhere in this Prospectus.

OVERVIEW

Internet Security Systems is the leading provider of network security monitoring, detection and response software that protects the security and integrity of enterprise information systems. The Company's products rely on an innovative Adaptive Security Management ("ASM") approach to network security which entails continuous security risk monitoring and response to develop an active and informed network security policy. From inception through December 31, 1995, the Company was considered to be in the development stage with activities primarily related to raising capital, recruiting personnel, conducting research and development activities, purchasing operating assets, building the Internet Security Systems identity and establishing the market for ASM products. During 1996 and 1997, the Company continued to invest in research and development, expand its marketing activities, build domestic and international sales channels and develop its general and administrative infrastructure.

Historically, the Company has generated substantially all its revenues from the license and related maintenance of its SAFEsuite products. In particular, most of the Company's revenues to date have been generated from the Company's Internet Scanner product, which was first introduced in 1992 and is currently offered in version 5.0. RealSecure, introduced in the fourth quarter of 1996, and System Security Scanner ("S3"), introduced in the first quarter of 1997, have generated lesser amounts of revenue for the Company. The Company has also derived a small portion of its revenue from responses to customer requests for training and implementation services, on a time and materials basis, to assist in the successful deployment of its products within customer networks, development of customers' security policies and assessing the effectiveness of security policy decisions. The Company believes that each of its current products and products in development, together with professional services, will represent important revenue sources in the future.

The Company recognizes its license revenue upon (i) delivery of software or, if the customer has evaluation software, delivery of the software key, and

(ii) issuance of the related license, assuming that no significant vendor obligations or customer acceptance rights exist. In October 1997, the American Institute of Certified Public Accountants issued Statement of Position ("SOP") No. 97-2, Software Revenue Recognition, which the Company adopted, effective January 1, 1997. Such adoption had no effect on the Company's methods of recognizing revenue from its license and maintenance activities. Prior to 1997, the Company's revenue policy was in accordance with the preceding authoritative guidance provided by SOP No. 91-1, Software Revenue Recognition. Revenues from perpetual licenses are recorded as license revenues in the statements of operations. Support service revenues include maintenance, term license revenues and professional services. Maintenance is a separate component of each contract and is recognized ratably over the contract term. Term licenses, which allow customer use of the product and maintenance for a specified period, generally twelve months, are also recognized ratably over the contract term. Professional services revenues are recognized as such services are performed. Research and development expenditures have been charged to operations as incurred. The Company has not capitalized any such development costs under Statement of Financial Accounting Standards ("SFAS") No. 86.

Pricing is based on the number of devices or engines being managed by the customer, scaled to provide discounts when the managed system is larger or several SAFEsuite products are licensed concurrently. Annual maintenance, which is virtually always purchased in conjunction with the licensing of a product, is a separate component that is offered for a fee generally equal to 20% of the perpetual

license fee and recognized ratably over the contract term. Maintenance packages typically include telephone support, product updates, access to the Company's security advisory notices and error corrections. ISS recommends that its customers renew their maintenance contracts and, to date, most customers have done so. Because of the dynamic nature of vulnerabilities and threats to distributed computing environments, the Company's ongoing program of security updates and increased awareness created by the Company's products, the Company believes that a substantial majority of its customers will continue to renew their maintenance contracts.

Licenses originate principally from the Company's direct sales force and telephone sales operations. Indirect sales channels, including resellers, security consultants, ISPs and OEMs that incorporate the Company's products into their own product offerings, are also important sources of revenues. Indirect channels provide less revenue per license to ISS since the channel partners usually receive discounts ranging from 35% to 50% of list price.

The Company's business has grown rapidly in the last three years, with total revenues increasing from \$257,000 in 1995 to \$13.5 million in 1997. However, ISS has experienced net losses in each of these years and, as of December 31, 1997, had an accumulated deficit of \$5.2 million. These losses resulted from significant costs incurred in the development and sale of the Company's products and services. During this period, the number of ISS employees increased from seven at December 31, 1995 to 141 at December 31, 1997. The Company currently expects to expand its sales and marketing operations, to continue an aggressive international expansion, to increase its investment level in product development and its proprietary database, and to improve its internal operating and financial infrastructure in support of the Company's business plan, all of which will increase operating expenses. As a result, ISS expects to continue to incur losses for the foreseeable future.

Because the market for the Company's products has only recently emerged, period-to-period comparisons of its operating results are not meaningful. Although ISS has experienced significant revenue growth recently, there can be no assurance that such growth rates are sustainable and they should not be relied upon as predictive of future performance. The Company's prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in the early stage of development, particularly companies in new and rapidly evolving markets. There can be no assurance that the Company will be successful in addressing such risks and difficulties or that ISS will achieve profitability in the future. See "Risk Factors -- Limited Operating History; History of Losses", "--Significant Potential Fluctuations in Operating Results" and "-- Management of Growth".

RESULTS OF OPERATIONS

The following table sets forth certain consolidated historical operating information for the Company, as a percentage of total revenues, for the periods indicated.

	YEAR ENDED DECEMBER 31,		
	1995	1996	1997
PERCENTAGE OF TOTAL REVENUES:			
Revenues:			
Licenses.....	95.7%	94.9%	81.2%
Support services.....	4.3	5.1	18.8
	100.0	100.0	100.0
Costs and expenses:			
Cost of revenues.....	1.6	0.4	5.0
Research and development.....	37.7	27.5	25.5
Sales and marketing.....	98.1	84.4	87.1
General and administrative.....	17.1	14.7	13.2
	154.5	127.0	130.8
Operating loss.....	(54.5)	(27.0)	(30.8)
Interest income, net.....	--	1.7	1.7
Net loss.....	(54.5)%	(25.3)%	(29.1)%

REVENUES

The Company's revenues increased from \$257,000 in 1995, to \$4.5 million in 1996 and to \$13.5 million in 1997. During these periods, Internet Scanner was the Company's primary revenue-generating product with license revenues accounting for approximately 96%, 93% and 66% of the Company's total revenues in 1995, 1996 and 1997, respectively. Maintenance revenue related to all licenses and annual contracts for product usage and support accounted for approximately 4%, 5% and 18% of total revenues in 1995, 1996 and 1997, respectively. The balance of revenues originated from the Company's more recent product offerings, S3 and RealSecure, and professional services provided on a time and materials basis. The Company had no customer that accounted for more than 10% of its revenues in 1997. The Company recognized over 95% of its revenues in 1995 and 1996 from sales to customers within North America; however, international operations were significantly expanded in 1997 and represent an increasing source of the Company's revenues. In 1997, revenues from customers outside North America were \$2.8 million, representing approximately 21% of total revenues.

COST OF REVENUES

Cost of revenues includes packaging and distribution costs for the Company's software products which, since the Company uses the Internet to provide product updates and keys necessary to activate a customer's software, is a minor cost. This category also includes the costs related to the Company's professional services offerings, which were provided by a dedicated employee group beginning in 1997 and is expected to be an area of future personnel growth in 1998. Gross margins were 98.4% in 1995, 99.6% in 1996 and 95.0% in 1997. The Company's gross margins will decline in future years if, as anticipated, professional services become a more significant portion of the Company's business.

RESEARCH AND DEVELOPMENT

Research and development expenses consist of salary and related costs of the Company's research and development personnel, including costs for employee benefits, computer equipment and support services used in product and technology development. This includes the "X-Force", a team composed of security experts dedicated to understanding, documenting and coding new vulnerability checks, real-time threats and attack signatures and solutions to global security issues. The Company believes that this primary research, which aids in the design of new products and product enhancements to respond to an ever-changing risk profile, is an essential ingredient for retaining its leadership position in its marketplace.

Accordingly, the Company has increased its research and development expenses from \$97,000 in 1995, to \$1.2 million in 1996 and to \$3.4 million in 1997, representing approximately 38%, 27% and 25% of revenues, respectively. ISS expects that research and development expenses will continue to increase in absolute dollars, and approximate the 1997 level as a percentage of revenues, as the Company recruits and hires additional experienced security experts and makes other investments in research and development.

SALES AND MARKETING

Sales and marketing expenses consist primarily of salaries and travel, commissions, advertising, maintenance of the ISS Web site, trade show expenses, personnel recruiting costs and costs of marketing materials. Sales and marketing expenses were \$252,000 in 1995, \$3.8 million in 1996 and \$11.7 million in 1997, representing approximately 98%, 84% and 87% of total revenues, respectively. This increase in absolute dollars is primarily the result of a significant increase in the number of regional United States sales locations, increased commissions commensurate with increased direct sales revenues and expanded international operations in the Europe and Asia/Pacific regions. The Company anticipates that sales and marketing expenses will continue to increase in absolute dollars, but decrease as a percentage of revenues, as it continues to expand its direct sales force and telephone sales operations and hires additional marketing and business development personnel to promote its indirect sales distribution channels.

GENERAL AND ADMINISTRATIVE

General and administrative expenses were \$44,000 in 1995, \$656,000 in 1996 and \$1.8 million in 1997, representing approximately 17%, 15% and 13% of revenues, respectively. Such expenses consisted primarily of salaries and personnel and related costs for the Company's executive, administrative, finance and human resources personnel, support services and professional services fees. The Company anticipates that these expenses will approximate 1997 levels as a percentage of revenues, but will increase in absolute dollars in 1998 as it upgrades internal and financial reporting systems to enhance management's ability to obtain and analyze information about its domestic and international operations. Also, the Company anticipates additional costs related to being a public company, including annual and other public reporting costs, directors' and officers' liability insurance, investor relations programs and professional services fees.

INCOME TAXES

No provision for federal, state or foreign income taxes has been recorded because the Company has experienced cumulative net losses since inception. As of December 31, 1997, ISS had net operating loss carryforwards of approximately \$3.9 million for federal tax purposes which will expire, if not utilized, in 2011 and 2012. The Company also has approximately \$295,000 of net operating loss carryforwards related to its foreign operations which will expire, if not utilized, in 2011. The Company has not recognized any benefit from the future use of such loss carryforwards because management's evaluation of all the available evidence in assessing the realizability of the tax benefits of such loss carryforwards indicates that the underlying assumptions of future profitable operations contain risks that do not provide sufficient assurance to recognize such tax benefits currently.

SELECTED QUARTERLY FINANCIAL RESULTS

The following tables set forth unaudited consolidated statement of operations data for the eight quarters ended December 31, 1997, as well as such data expressed as a percentage of the Company's total revenues for the periods indicated. This data has been derived from unaudited interim consolidated financial statements that, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of such information when read in conjunction with the Company's Consolidated Financial Statements and Notes thereto appearing elsewhere in this Prospectus. The operating results for any quarter are not necessarily indicative of results for any future period.

	QUARTER ENDED							
	MAR. 31, 1996	JUNE 30, 1996	SEPT. 30, 1996	DEC. 31, 1996	MAR. 31, 1997	JUNE 30, 1997	SEPT. 30, 1997	DEC. 31, 1997
(IN THOUSANDS)								
CONSOLIDATED STATEMENT OF OPERATIONS DATA:								
Revenues:								
Licenses.....	\$ 360	\$ 885	\$ 940	\$2,048	\$1,872	\$2,150	\$ 2,767	\$ 4,147
Support services.....	8	19	88	114	353	521	706	951
	368	904	1,028	2,162	2,225	2,671	3,473	5,098
Costs and expenses:								
Cost of revenues.....	1	4	2	11	87	137	176	276
Research and development....	176	275	332	442	493	569	895	1,477
Sales and marketing.....	242	871	965	1,690	1,754	2,342	3,051	4,584
General and administrative.....	95	153	155	253	320	301	443	709
	514	1,303	1,454	2,396	2,654	3,349	4,565	7,046
Operating loss.....	(146)	(399)	(426)	(234)	(429)	(678)	(1,092)	(1,948)
Interest income, net.....	18	29	15	12	35	68	66	59
Net loss.....	\$ (128)	\$ (370)	\$ (411)	\$ (222)	\$ (394)	\$ (610)	\$ (1,026)	\$ (1,889)

	QUARTER ENDED							
	MAR. 31, 1996	JUNE 30, 1996	SEPT. 30, 1996	DEC. 31, 1996	MAR. 31, 1997	JUNE 30, 1997	SEPT. 30, 1997	DEC. 31, 1997
AS A PERCENTAGE OF TOTAL REVENUES:								
Revenues:								
Licenses.....	97.8%	97.9%	91.4%	94.7%	84.1%	80.5%	79.7%	81.3%
Support services.....	2.2	2.1	8.6	5.3	15.9	19.5	20.3	18.7
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Costs and expenses:								
Cost of revenues.....	0.3	0.4	0.2	0.5	3.9	5.1	5.1	5.4
Research and development....	47.8	30.4	32.3	20.4	22.2	21.3	25.8	29.0
Sales and marketing.....	65.8	96.4	93.9	78.2	78.8	87.7	87.8	89.9
General and administrative.....	25.8	16.9	15.1	11.7	14.4	11.3	12.7	13.9
	139.7	144.1	141.5	110.8	119.3	125.4	131.4	138.2
Operating loss.....	(39.7)	(44.1)	(41.5)	(10.8)	(19.3)	(25.4)	(31.4)	(38.2)
Interest income, net.....	4.9	3.2	1.5	0.5	1.6	2.6	1.9	1.1
Net loss.....	(34.8)%	(40.9)%	(40.0)%	(10.3)%	(17.7)%	(22.8)%	(29.5)%	(37.1)%

During the Company's short history, its operating results have varied on a quarterly basis and may fluctuate significantly in the future on a quarterly and annual basis as a result of a combination of factors. These factors include the level of demand for the Company's products, the volume and timing of orders, the level of product and price competition, the Company's ability to expand its domestic and international

sales and marketing organizations, the ability to develop new and enhanced products, the ability to attract and retain key technical, sales and managerial personnel, the growth in acceptance of and activity on the Internet by corporate and government users, the level of growth of intranets, the extent to which unauthorized access and use of online information is perceived as a threat to network security, customer budgets, seasonal trends in customer purchasing, foreign currency exchange rates and general economic factors. In addition, the amount of revenues associated with particular licenses can vary significantly based upon the number of products licensed and the number of devices involved in the installation. The Company has experienced, and may continue to experience from time to time, large individual license sales which can cause significant variability in license revenues and results of operations for any particular period. The timing of significant orders is unpredictable and, like many software companies, the Company typically realizes a significant portion of software license revenues in the last month of the quarter. The Company establishes its expenditure levels for product development, sales and marketing and other operating expenses based, in large part, on its expected future revenues. As a result, if revenues fall below expectations, operating results are likely to be adversely and disproportionately affected because only a small portion of the Company's expenses vary with revenues.

LIQUIDITY AND CAPITAL RESOURCES

Since its inception, the Company has financed its operations primarily through sales of its equity securities in private placements. In February 1996 and February 1997, the Company received aggregate net proceeds of \$8.9 million from the sale of Convertible Preferred Stock, which shares will automatically convert into Common Stock upon consummation of the Offering.

Net cash used in operating activities of approximately \$1.6 million for the year ended December 31, 1997 resulted from \$3.9 million in net operating losses partially offset by a decrease in working capital. Although revenue growth increased accounts receivable by \$2.1 million in 1997, working capital decreased as accounts payable and accrued expenses grew \$2.7 million and deferred revenues increased \$1.5 million. The increase in deferred revenues was attributable to the growth of maintenance contracts and term licenses, which are recognized ratably as revenue over the contract term.

Cash provided by financing activities of \$5.2 million in 1997 consisted primarily of the proceeds from the issuance of Convertible Preferred Stock which has been invested in short-term investments. Purchase of computer equipment used in conducting the Company's business represented the primary component of cash used in investing activities.

As of December 31, 1997, the Company had \$3.9 million of cash and cash equivalents. The Company believes that the net proceeds of this Offering, together with existing cash, cash equivalents and short-term investments, will be sufficient to fund its anticipated operating losses and to meet its working capital and anticipated capital expenditures for at least the next 12 months. The Company currently intends to use the net proceeds of the Offering for working capital and general corporate purposes, including financing accounts receivable and capital expenditures made in the ordinary course of its business, as well as for possible acquisitions of businesses, products and technologies that are complementary to those of the Company. Although the Company has not identified any specific businesses, products or technologies that it may acquire, nor are there any current agreements or negotiations with respect to any such transactions, the Company from time to time evaluates such opportunities. Pending such uses, the net proceeds will be invested in government securities and other short-term, investment-grade, interest-bearing instruments.

BUSINESS

OVERVIEW

Internet Security Systems is the leading provider of network security monitoring, detection and response software that protects the security and integrity of enterprise information systems. The Company's SAFEsuite family of products enforces "best practice" information protection automatically across distributed computing environments by monitoring and responding to continuously changing network security risks. By dynamically detecting and responding to the security vulnerabilities and real-time threats inherent in open systems, SAFEsuite products protect distributed computing environments, including internal corporate networks, extranets and the Internet, from attacks, misuse and security policy violations. The Company's products rely on an innovative Adaptive Security Management ("ASM") approach to network security, which entails continuous security risk monitoring and response to develop and enforce an active network security policy. ISS pioneered the technology for vulnerability and threat detection through a dedicated security research and development team and believes that it has the most comprehensive vulnerability and threat database in existence. The Company has delivered its network security monitoring, detection and response solutions to over 1,500 organizations worldwide, including firms in the Global 2000, U.S. and international government agencies and major universities. Nine of the ten largest commercial banks in the United States have licensed the Company's products.

INDUSTRY BACKGROUND

The rise of client/server computing in recent years has driven the need for connectivity beyond local area networks ("LANs") to enterprise-wide networks spanning multiple LANs and wide area networks ("WANs"). Concurrently with the shift to distributed computing architectures, the use of the Internet by organizations has grown dramatically, driven largely by the development of the Web and graphically intuitive browsers, the proliferation of multimedia personal computers and the emergence of compelling Web-based content and commerce applications. International Data Corporation ("IDC") estimated in a July 1997 report that at the end of 1997 there would be over 29 million Web users in the United States and over 50 million users worldwide, with the number expected to increase to 94 million in the United States and 175 million worldwide by the end of 2001. Additionally, IDC estimates that the number of devices accessing the Web will increase from 64 million at the end of 1997 to 331 million by the end of 2001.

Growth of the Internet has to date been fueled primarily by the increased use of e-mail, general information browsing and the exchange of non-sensitive data. However, organizations are increasingly connecting their enterprise networks to the Internet to extend beyond these limited uses, thus facilitating and supporting a number of more valuable and sensitive activities, including business-to-business transactions, electronic data interchange (EDI), Web-based access to account and benefits information, secure messaging and online retail purchases and payments. The proliferation of client/server architectures and the growth of the Internet as a business tool has led to the emergence of "intranets" -- private enterprise information systems that use Internet protocols ("IP") and applications to share information and services both within and outside the enterprise network. As a result, businesses are able to share internal information and to run enterprise applications across geographically dispersed facilities, and customers, remote employees, suppliers and other business partners are able to inexpensively link into each other's enterprise information systems. In its July 1997 report, IDC projected that 9 million users in the U.S. and 16 million users worldwide had bought or would buy goods or services in Web-based transactions during 1997, with that number expected to grow to 42 million and 68 million users, respectively, by 2001. In addition, IDC estimates that commerce over the Internet will grow from less than \$11 billion in 1997 to more than \$223 billion in 2001.

THE NEED FOR NETWORK SECURITY

Although open computing environments have many business advantages, their accessibility and the relative anonymity of users makes these systems, and the integrity of the information that is stored on them, vulnerable to security threats. Distributed computing systems contain an organization's mission-

critical applications, such as payroll, financial reports, customer and supplier records and manufacturing and engineering designs. The advent and widespread adoption of open systems, together with their inherent vulnerabilities, present inviting opportunities for computer hackers, curious or disgruntled employees, contractors and competitors to compromise or destroy sensitive information within the system or to otherwise disrupt the normal operation of the system. In addition, client/server computing environments are inherently complex, typically involving a variety of hardware, operating systems, networking protocols and applications supplied by a multitude of vendors, making these networks difficult to manage, monitor and protect from unauthorized access. Each application, operating system and device introduced to a network contains additional vulnerabilities that may be exploited by an unauthorized network user. Newly introduced versions of products like Windows NT and Sun Solaris, which are designed to maximize connectivity both within and among networks, create many more new vulnerabilities. To adequately secure a network, IT managers must have the resources to not only correctly configure the security measures in each system, but also to understand risks created by any change to existing systems on the network. Exacerbating this situation is the limited supply of personnel knowledgeable in information security issues.

These factors create an urgent need for enterprises to protect their information systems from unauthorized access and misuse. The security risks are real. According to the 1997 Annual Information Week/Ernst & Young LLP Information Security Survey of IT managers and professionals, 42% of all United States respondents reported malicious acts from external sources, up from 16% in the previous year, 43% reported malicious acts from employees as compared to 29% in the previous year, and 55% reported insufficient IT professionals to monitor network security. Despite the convenience and the compelling economic incentives for the use of IP networks, they cannot reach their full potential as a platform for global communication and commerce until the current lack of security associated with these networks is adequately resolved.

Organizations have generally responded to perceived security threats by implementing passive point tools designed to protect individual components of their internal networks from unauthorized use or outside attacks. Some security concerns are being addressed through encryption, firewalls and other technologies, but these technologies can be circumvented. Encryption protects information during transmission, but it does not typically protect information at either the source or the destination. A "firewall" controls the flow of data between an internal network and outside networks or the Internet. While firewalls are necessary for access control, they must be initially configured, and regularly reconfigured, to accommodate new applications, users and business partners on the network, each of which creates additional risks. Furthermore, firewalls are vulnerable to hackers and others seeking to compromise network integrity and fail to protect against an improper use of the systems by internal authorized users within the network. In addition to encryption and firewalls, many organizations deploy operating system security mechanisms, such as user authentication, passwords and multi-level access rights, to prevent unauthorized access to information by external as well as internal users. Implementation issues such as easily-guessed passwords or default accounts left on newly installed devices diminish the effectiveness of these measures. Passive point tools do not address the fundamental issue that "open" systems are, by definition, open and that their inherent utility is itself the source of their vulnerability. This conflict between the benefits of open systems and the risks of their unauthorized use or disruption has not been widely recognized or addressed by IT managers.

To be effective, passive point tools that secure specific elements of an enterprise network need to be coordinated through an enterprise-wide computer security policy with systems to automatically enforce and evaluate the effectiveness of that policy. Many organizations have developed security policies that address the appropriate use of network resources, the proper configuration of network services, operating systems and applications and actions to be taken if there is a violation of such policy or an attack on the network; however, such organizations have not had the systems to automatically enforce and implement such policies across their entire IT infrastructure. Without such systems, the dynamic nature of enterprise networks causes the organization's actual security practice to diverge from the stated security policy, potentially exposing the organization to additional unanticipated risks. Direct

observation of vulnerabilities and threats can allow an organization to define and automatically enforce an integrated, enterprise-wide security policy that can be managed centrally and implemented on a distributed basis. Because of the shortage of personnel trained in network security issues, any security solution must be easy to use by both management and the organization's existing IT personnel. An effective network security solution also needs to work with existing security technologies as well as be flexible enough to incorporate new technologies.

THE ISS SOLUTION

ISS has developed Adaptive Security Management, a dynamic, process-driven approach to enterprise-wide network protection. The ASM process relies on the principles of monitoring, detection and response to the ever-changing vulnerabilities in and threats to network protocols, operating systems and applications that comprise every network system. The Company's monitoring, detection and response products provide easy-to-use software solutions designed to enable network managers to centrally define and manage an enterprise-wide security policy for their existing network system infrastructure, including all IP-enabled devices. The Company's SAFEsuite family of products provides the ability to visualize, measure and analyze real-time security vulnerabilities and control threats across the entire enterprise network infrastructure, keeping the organization's IT personnel informed of changing network conditions and automatically making adjustments as necessary. Through custom policies or by using the Company's "best practice" templates, network managers can minimize security risks without closing off the organization's network to the benefits of open computing environments and the Internet. The Company's solution reaches beyond the traditional approaches to network security in the following respects:

ADAPTIVE SECURITY MANAGEMENT

ASM is a proactive, risk management-based approach to network security management that links security practice and security policy through a continuous improvement process. ASM incorporates four critical processes: (i) continuously monitoring network traffic and the configuration of devices on the network; (ii) detecting security risks in network traffic and network devices; (iii) responding to network security risks to minimize such risks; and (iv) reporting response actions and updating security policies. The Company's products incorporate the ASM approach to enable continuous improvement to the security of the customer's existing systems by identifying and minimizing the security risks on the network. The Company's SAFEsuite family of products continuously monitors the network for security risks that violate the customer's security policy and provides actions to eliminate or minimize the security weaknesses. SAFEsuite is a critical enhancement to traditional passive security technologies such as encryption, firewalls and authentication. The Company's products provide a unique, active component to an organization's overall security infrastructure that enables end-to-end network protection. The software automatically identifies systems and activities that are not in compliance with a customer's policies, and provides a critical feedback mechanism for adjusting the security levels of networked systems based upon its findings. Without these capabilities, an organization is limited in its ability to effectively measure and control security across its enterprise network.

COMPREHENSIVE ENTERPRISE SECURITY SOLUTION

ISS combines ASM principles with its extensive knowledge of network vulnerabilities and threats to provide scalable security solutions. The Company sells its products individually as solutions to problems for a particular network function or as a suite of products that provide a comprehensive network security framework. The Company's products extend across a broad range of platforms and work with the products of leading security and network management vendors to provide a single point of management and control for an enterprise-wide security policy across multiple hosts, operating systems and applications. Products are designed to be easily installed, configured, managed and updated by a system administrator through an intuitive graphical user interface ("GUI") without interrupting or affecting network operation. The Company's products generate easy-to-understand reports ranging from executive-level trend analysis to detailed step-by-step instructions for eliminating security risks that include automatic links to vendor Web sites for software patches.

THE "X-FORCE"

Because there are few IT professionals specifically trained in network security issues, the Company created a senior research and development team composed of security experts who are dedicated to understanding, documenting and coding new vulnerability tests, real-time threats and attack signatures. The team is known in the industry as the "X-Force". The X-Force conducts primary research in the field of vulnerability and threat science which is the basis of the core competency of the Company. The Company believes that the X-Force is one of the largest and most sophisticated groups of IT security experts researching vulnerability and threat science and therefore represents one of the Company's competitive advantages. Organizations such as CERT (Computer Emergency Response Team), the FBI and leading technology companies routinely consult the X-Force on network security issues. Through the X-Force, ISS maintains a proprietary and comprehensive knowledge base of computer exploits and attack methods, including what the Company believes is the most extensive collection of Windows NT vulnerabilities and threats. To respond to an ever-changing risk profile, the X-Force continually updates this repository with the latest network vulnerability information, which aids in the design of new products and product enhancements.

STRATEGY

The Company's objective is to be the leading provider of ASM systems that proactively protect the integrity and security of enterprise-wide information systems from vulnerabilities, misuse, attacks and other policy violations. ISS focuses on developing innovative and automated software solutions to provide customers with a comprehensive framework for protecting their networks by monitoring for vulnerabilities and real-time threats in order to enforce "best practice" network and system security policies. Key elements of the Company's strategy are to:

- **CONTINUE LEADERSHIP POSITION IN SECURITY TECHNOLOGY.** The Company intends to maintain and enhance its technological leadership in the enterprise security market by hiring additional network and Internet security experts, broadening the Company's proprietary knowledge base and continuing to invest in product development and product enhancements. By solidifying its position as the leader in the emerging market for monitoring, detection and response software, the Company believes that customers and potential customers will view ISS as the firm of choice for establishing and maintaining effective security practices and policies.
- **EXPAND DOMESTIC SALES CHANNELS.** To increase the distribution and visibility of its products, ISS plans to execute its enterprise-wide systems sales strategy by expanding its regional direct sales program and increase market coverage by establishing additional indirect channels with key ISPs, systems integrators, VARs, OEMs and other channel partners to address enterprise-wide system opportunities. As the potential customer base for network security products encompasses a wide variety of industries, the Company believes that a multi-channel sales efforts will build customer awareness of the need for the Company's products and enable the Company to more rapidly penetrate these industry markets.
- **PROMOTE PROFESSIONAL SERVICES CAPABILITIES.** ISS intends to establish long-term relationships with its customers by serving as a "trusted advisor" in addressing network security issues. To fulfill this responsibility to its customers, the Company will expand its professional services capabilities to provide additional security system design, planning, installation, testing and consulting services to assist customers in the effective adaptation of their security policies as new computing products and systems are deployed or new users or infrastructure to existing systems are added. By providing professional services the Company can heighten customer awareness about network security issues, which creates opportunities for ISS to sell new products or product enhancements to its existing customers.
- **EXPAND INTERNATIONAL OPERATIONS.** ISS plans to aggressively expand its international operations to address the rapid global adoption of distributed computing environments. Many foreign countries do not have laws recognizing network intrusion or misuse as a crime or the resources to enforce such laws if they do exist, and therefore, the Company believes that organizations in such countries will have greater need for effective security solutions. The Company currently maintains

international offices in Belgium, Canada, England, France, Germany and Japan. ISS plans to expand in those regions where businesses, governments and other institutional users are using distributed networks and the Internet for their mission-critical needs.

- **CREATE ASM CATEGORY AWARENESS.** The Company intends to increase and broaden awareness of the need for ASM and the Company's enterprise monitoring, detection and response systems by increasing its level of public relations, educational events, seminars, advertising, direct marketing and trade show participation. ISS believes that the risks and dangers associated with the adoption of open computing systems have not received the same level of general recognition or publicity as have the benefits of using such systems. By increasing awareness of the vulnerabilities and threats that are endemic to open computing environments and the ability to manage such vulnerabilities and threats through ASM, the Company can demonstrate to its customers how better network protection can be achieved.

PRODUCT ARCHITECTURE

The ISS SAFEsuite family of products delivers the Company's ASM approach through a flexible architecture designed to be integrated with existing security and network system infrastructures. Passive point tools such as firewalls provide specific security functionality for components within the network infrastructure. SAFEsuite enhances the effectiveness of these tools by monitoring them for threats and vulnerabilities and responding with actions that align the customer's security practice with its security policy. SAFEsuite complements network and security management frameworks by providing information required for informed decisions to minimize security risks while maintaining the desired level of network functionality. Thus, the Company's products provide a risk management-based approach to security with scalable deployment of best-of-breed products and integrated enterprise-wide implementations.

The following depicts the SAFEsuite product architecture:

[Graphic that shows how the Company's central products are structured within a typical network system -- including a depiction of product interfaces with the X-Force knowledge base, user-defined exploits, firewall, router and user-defined adaptive program interfaces and the ISS database.]

The Adaptive Security Application Programming Interface ("ASAPI") is the focal point for automated interaction with static security technologies such as encryption, firewalls and authentication servers. ASAPI is a two-way communication protocol that allows SAFEsuite products to leverage information and capabilities available across the network and to proactively adapt configurations of security subsystems on the network. For example, SAFEsuite products identify valid Java and ActiveX applets in Web traffic by using the authentication information available in digital certificates such as those from VeriSign. When a security risk is identified, ASAPI is used to send a message directly to the appropriate passive protection tool to eliminate the risk (e.g., when an attacker is identified, the firewall is automatically reconfigured to block the attacker's IP address). ASAPI leverages existing infrastructure control standards such as Check Point Software Technologies' OPSEC (Open Platform for Secure Enterprise Connectivity), allowing deployment of the Company's products without requiring upgrades or changes to the customer's existing hardware or software.

The SAFEsuite policy management interface lets the customer choose from "best practice" templates or provides the ability to define a specific policy that establishes the level of risk appropriate for the network. The individual products automatically verify compliance with the policy in terms of actual system configuration and activity present on the network. Graphical reports express the deviations from the established policy, including the measures required to reduce the risk. The policy can include automatic intervention by a SAFEsuite product through ASAPI.

This product architecture allows all the SAFEsuite technologies to connect directly into common standards, providing comprehensive security reports for the entire enterprise. To ensure communication confidentiality between individual SAFEsuite components and to prevent misuse, SAFEsuite uses RSA encryption algorithms, which have become de facto encryption standards. The SAFEsuite Security Repository, a database containing information about the devices and security risks on a customer's

network, utilizes an Open Database Connectivity ("ODBC") interface and allows customers to select their preferred database such as Oracle, Microsoft SQL Server, Sybase, Informix or any ODBC-compliant database for data storage. All ISS products use a common taxonomy for identifying specific security issues. The various SAFEsuite products consolidate security data, enabling the user to quickly determine its risk posture and take appropriate actions. In addition, SAFEsuite products provide automated decision support by assessing priorities and providing a graphical representation of important security risk data sets. This allows key decision-makers to prioritize their program strategies for effective deployment of resources to minimize security risks.

The SAFEsuite architecture also delivers scalability in deployment options, usage models and ongoing operations. Each SAFEsuite product can be deployed as a stand-alone, best-of-breed solution to meet the needs of the local administrator or departmental user. Through support for remote, multi-level management consoles and the SAFEsuite Security Repository, database enterprise level users can analyze security risk conditions for the entire network. The SAFEsuite Security Repository allows the customer to address both vulnerabilities and threats, thereby minimizing network security risk and associated costs. SAFEsuite's frequent updates integrate the latest identified security vulnerabilities and threats into the operations of an existing ISS product installation.

PRODUCTS

The following table lists the SAFEsuite products currently offered by the Company, and includes a brief description of each product's functionality and current list pricing:

	DESCRIPTION	SCOPE	U.S. LIST PRICE	INTRODUCTION DATE

NETWORK SECURITY VULNERABILITY DETECTION, ANALYSIS AND REPORTING				

Internet Scanner	Comprehensive security assessment for all devices on an enterprise network	50 devices 100 devices 500 devices	\$ 3,495 \$ 5,395 \$14,650	October 1992

Intranet Scanner	Security assessment for internal devices on an enterprise network	10 devices 20 devices 50 devices	\$ 795 \$ 1,495 \$ 2,995	August 1996

Firewall Scanner	Security assessment for firewalls and gateways	1 firewall 5 firewalls 10 firewalls	\$ 995 \$ 4,495 \$ 7,995	August 1996

Web Security Scanner.....	Security assessment for Web servers	1 Web server 5 Web servers 10 Web servers	\$ 495 \$ 1,995 \$ 3,495	August 1996

INTERNAL SYSTEM SECURITY VULNERABILITY DETECTION, ANALYSIS AND REPORTING				

System Security Scanner -- S3	Internal security assessment for operating systems	5 computers 10 computers 20 computers	\$ 1,995 \$ 3,495 \$ 5,995	January 1997

NETWORK SECURITY THREAT AND MISUSE DETECTION, ANALYSIS AND RESPONSE				

RealSecure	Real time attack recognition, misuse detection and response for networks	1 engine 5 engines 10 engines	\$ 4,995 \$19,900 \$34,900	December 1996

INTERNET SCANNER

Internet Scanner provides automated security vulnerability detection and analysis for devices on a network and supports the security risk management process from policy development through implementation. In addition, Internet Scanner performs scheduled or event-driven probes of network communication services, operating systems, routers, e-mail and Web servers, firewalls and applications to identify weaknesses that could be exploited by intruders to gain access to the network. After selecting from a list of pre-defined "best practice" templates or customizing a template appropriate for the organization, Internet Scanner quickly produces a technical security policy document with detailed implementation instructions. Internet Scanner can then assess the entire network for compliance with the security policy, identifying the specific instances where security practice does not match the prescribed policy. Internet Scanner identifies and prioritizes security risks and generates a wide range of reports ranging from executive-level trend analysis to detailed step-by-step instructions for eliminating security risks including automatic links to vendor Web sites for software patches.

Internet Scanner is also packaged as separate modules -- Intranet Scanner, Web Security Scanner and Firewall Scanner -- each targeted for specific market segments. The Internet Scanner embodies all three network-scanning modules.

INTRANET SCANNER. Intranet Scanner assesses the vulnerability of a network to attack from intruders who have penetrated a firewall by systematically probing each network device to identify security vulnerabilities. Network platforms and devices, including Windows NT and Windows 95, Unix hosts, routers, e-mail servers, Web servers and firewalls are among those automatically checked by Intranet Scanner. Many system operators typically focus security measures on only those devices within the system that contain the most sensitive information. Other devices often are left vulnerable, thus enabling unauthorized users to compromise a less sensitive device (like a Unix printer server) to gain access that can springboard them into more sensitive systems. Intranet Scanner scans for such weak-link vulnerabilities in the chain of devices in the network, including vulnerabilities arising from the use of default and easily-guessable passwords for devices within the system, misconfigured file system servers and unprotected Windows NT registry settings. Intranet Scanner not only determines if an intruder could gain access, but also ascertains if a device is susceptible to denial of service attacks by vandals who may seek to deny access to or use of systems by authorized users.

WEB SECURITY SCANNER. Web Security Scanner tests the configuration of a Web server, evaluates the security of the underlying operating system and determines whether the Web server application has been updated with the latest security patches. This module searches the Web server's common gateway interface, active server page scripts and HTML (hypertext mark-up language) directories to detect whether known vulnerabilities exist within the customer's Web server system. For private HTML pages that are password protected, Web Security Scanner assesses vulnerability to a "brute-force attack" (i.e., a flooding of log-on attempts in an effort to overwhelm password screening and thereby gain unauthorized access) through checks of easily-guessable or default passwords. Finally, Web Security Scanner identifies any Java and ActiveX applets on the Web server that may conflict with the customer's security policy.

FIREWALL SCANNER. Firewall Scanner identifies vulnerabilities by monitoring the configuration of firewalls through a series of security checks. The improper configuration of a firewall can seriously compromise the effectiveness of the firewall as a security measure. Firewall Scanner's checks include attempting to bypass the firewall by trying to connect through packet filter-based firewalls, stateful inspection-based firewalls and application proxy servers. Blocked or permitted connections validate the firewall's configured filter rules. A firewall permitting an outside connection through to an inside vulnerable server can provide an intruder with the opportunity to compromise the entire network. The Firewall Scanner determines whether a SNMP (simple network management protocol) is enabled on the firewall allowing sensitive network information to be obtained by intruders and determines whether a vandal can bring down a firewall through numerous denial of service attacks.

In addition, the Company offers Advanced Packet Exchange ("APX") as a recent enhancement for Firewall Scanner. APX provides a GUI that facilitates the creation of low-level custom network packets. It then attempts to transmit them through the firewalls or routers conducting packet validation. This determines whether these packets were allowed or blocked at the gateway. By doing so, this technology enables more precise testing and assessment of the security rules associated with network access controls.

SYSTEM SECURITY SCANNER

System Security Scanner provides a host-based security assessment analyzing internal security weaknesses. While the Internet Scanner determines vulnerabilities by scanning devices at the network level, S3 detects vulnerabilities internally on the system level, by having an S3 agent resident on the devices. These S3 agents allow a continuous security policy to be managed and controlled across an enterprise from a central point. S3 compares an organization's stated security policy with the actual configuration of the host computer for potential security risks, including easily-guessed passwords, user privileges, file system access rights, service configurations, data integrity, and the existence of Trojan backdoors and suspicious activity that indicate an intrusion. S3 verifies that the components of the operating system have been updated with the latest patches from the operating system vendor. Each security risk is prioritized by S3, which also generates scripts that implement the appropriate corrective action.

REALSECURE

RealSecure is an automated, real-time intrusion detection, misuse and response system for computer networks. The RealSecure Attack Recognition Engine, which unobtrusively analyzes packets of information as they travel across the network, recognizes hostile activity on a network by interpreting network traffic patterns that indicate attacks. RealSecure's Suspicious Reassembly algorithm analyzes packets for unusual formations that can indicate an attack while simultaneously protecting RealSecure itself from these attacks. When an attack is recognized, the administrator is alerted via e-mail and an alarm is displayed on the central management console. In addition, the attack can be terminated automatically, logged to a database, or recorded for later forensic analysis. With RealSecure's distributed architecture, customers can install Attack Recognition Engines throughout their enterprise network to detect and stop internal misuse as well as attacks from outside the network perimeter. Increasing network speeds and numbers of attacks geometrically increase the potential workload for attack recognition solutions. RealSecure utilizes the Company's Digital FingerPrinting to recognize a large number of attack-patterns on high-speed networks. Additionally, the Company's Adaptive Filtering Algorithm tunes the packet filter rules in response to network load, allowing the engine to effectively function during bursts in network traffic.

PRODUCT PRICING

ISS uses a range of fee structures to license its products, depending on the type of product and the intended use. The vulnerability detection products -- the Internet Scanner family of products and System Security Scanner -- are licensed based on the number of devices being scanned. The pricing scheme is scalable, providing low entry points for departmental users without capping the Company's revenue for large networks. Pricing for the threat detection product, RealSecure, is based on the number of engines deployed on the network. Thus, licensing fees for the Company's products are ultimately determined by the size of the customer's network, as the size will dictate the number of devices to be scanned or the number of engines to be deployed for a given performance level. In addition to license fees, customers virtually always purchase maintenance agreements in conjunction with their purchase of a software license for annual maintenance fees equal to 20% of the product's list price; maintenance agreements include annually renewable telephone support, product updates, access to the Company's X-Force Security Alerts and error corrections. The Company's continuing research into new security risks and resultant product updates provides significant ongoing value, and as a result, a substantial majority of the

Company's customers purchase maintenance agreements. Customers who use the Company's products to provide IT consulting services have license agreements that are based on a revenue sharing model. ISS has historically sold fully-paid perpetual licenses with a renewable annual maintenance fee, but it is currently in the process of increasing the licensing of its products on a subscription basis (which includes maintenance) for one or two year periods.

SERVICES

ISS offers specialized consulting and training services that are designed to complement the general knowledge and experience derived by IT professionals with specific information and assistance to promote customer success in the use of the Company's products.

The Company's Professional Services Group assists customers in the successful implementation of the Company's products. The Professional Services Group's senior operational and technical consultants work with the Company's customers to identify potential security risks within the customer's operations, business processes and constraints in order to develop an implementation strategy that will configure products in a manner that balances the customer's need for system security with ease-of-use and flexibility requirements. In this manner, ISS consultants assist customers in mapping the deployment of the Company's products to the customer's network and security policy and the metrics for assessing the effectiveness of and enforcing the security policy. The Company charges its customers for professional services on a time and materials basis.

In addition to performing consulting services for customers, ISS provides focused education and training in the use of its products and security issues through the ISS University program. Students who complete the curriculum and pass both a hands-on product test and a written test become ISS Certified Engineers.

PRODUCT DEVELOPMENT

The Company has developed its SAFEsuite products to operate in heterogeneous computing environments. Products are compatible with other vendors' products across a broad range of platforms, including Windows NT, Windows 95, Sun Solaris, SunOS, SGI IRIX, Linux, HP-UX and IBM AIX. The Company incorporates a modular design to permit plug-and-play capabilities for its products, although customers often use professional services provided by the Company or its strategic partners to install and configure products for use in larger or complex network systems.

The Company employs a two-pronged product development strategy to achieve its goal of providing the most comprehensive security coverage within the monitoring, detection and response market. First, the Company will continue to develop best-of-breed security products to address particular network configurations. Such new products, and the Company's existing products like Internet Scanner, System Security Scanner and RealSecure, are updated approximately every four to six months to add new features, improve functionality and incorporate responses to vulnerabilities and threats that have been added to the Company's vulnerability and threat database. These updates are usually provided as part of separate maintenance agreements sold with the product license.

Second, to complement its existing products and provide more comprehensive security coverage to networks, the Company is expanding its existing SAFEsuite products by developing additional enterprise-level products that incorporate ASM principles. These products will add functionality to the Company's existing product line by allowing customers to protect their network by continuously measuring and analyzing the status of their network's security and monitoring and controlling the real-time security risks across the enterprise network. These new products will be interoperable with existing Company products, allowing modular implementation.

Expenses for product development were \$97,000, \$1.2 million and \$3.4 million in 1995, 1996 and 1997, respectively. All product development activities are conducted at the Company's principal offices in Atlanta, where, as of December 31, 1997, 48 personnel were employed in product development teams.

In addition, Company personnel are members of the Computer Security Institute, Forum for Incident Response and Security Technicians (FIRST), Georgia Tech Industrial Partners Association and the International Computer Security Association (ICSA), enabling the Company to actively participate in the development of industry standards in the emerging market for network and Internet security systems and products.

CUSTOMERS

As of December 31, 1997, the Company had licensed versions of its SAFEsuite family of products to over 1,500 customers. The Company's target customers include both public and private sector organizations, that utilize IP-enabled information systems to facilitate mission-critical processes in their operations. The Company's customers represent a broad spectrum of organizations within diverse sectors, including financial services, technology, telecommunications, government and services.

The following is a list of certain of the Company's customers that have purchased licenses and services from the Company with an aggregate price of at least \$15,000 and which the Company believes are typical of its customer base.

FINANCIAL SERVICES

Charles Schwab
First Union
KeyCorp
Merrill Lynch
PNC Bank

TECHNOLOGY

Hewlett-Packard

IBM

Intel
Lucent Technologies
Microsoft

NCR

Siemens
Xerox

OTHER

Lockheed Martin
Merck

TELECOMMUNICATIONS

America Online
Bell Atlantic
BellSouth
GTE Internetworking
NETCOM On-Line Communications
Nippon Telephone & Telegraph

GOVERNMENT

NASA

Salt River Project
U.S. Department of the Air Force
U.S. Department of the Army
U.S. Department of Defense
U.S. State Department

SERVICES

EDS

KPMG Peat Marwick
Price Waterhouse

SAIC

SITA

SALES AND MARKETING

SALES ORGANIZATION

The Company's sales organization is divided regionally among the Americas, Europe and the Asia/Pacific regions. In the Americas region, ISS markets its software primarily through its direct sales organizations augmented by its indirect channels, including security consultants, VARs and systems consulting and integration firms. The direct sales organization for the Americas consists of regionally based sales representatives and sales engineers and a tele-sales organization located in Atlanta. At December 31, 1997, the Company's sales offices were located in the Atlanta, Austin, Boston, Chicago, Cincinnati, Dallas, Los Angeles, New York, Palo Alto, Philadelphia, San Francisco, Toronto and Washington, D.C. metropolitan areas. A dedicated group of professionals in the Atlanta headquarters covers Latin America. As of December 31, 1997, the Company employed 35 people in the Americas region direct

sales organization. The regionally-based direct sales representatives focus on opportunities where the Company believes it can realize more than \$200,000 in revenues.

In the Europe and Asia/Pacific regions, substantially all of the Company's sales occur through authorized resellers. Internationally, the Company has established regional sales offices in Brussels, London, Paris, Stuttgart and Tokyo. Personnel in these offices are responsible for market development, including managing the Company's relationships with its resellers, assisting them in winning and supporting key customer accounts and acting as a liaison between the end user and the Company's marketing and product development organizations. As of December 31, 1997, 15 employees were located in the Company's Europe and Asia/Pacific regional offices. The Company expects to continue to expand its field organization into additional countries in these regions.

SECURITY PARTNERS PROGRAM

The Company has established its Security Partners Program to train and organize security consulting practices, ISPs, systems integrators and VARs to match the Company's products with their own complementary products and services. By reselling SAFEsuite products, Security Partners provide additional value for specific market and industry segments, while maintaining the Company's ongoing commitment to quality software and guaranteed customer satisfaction. To support the varying needs of different partners, ISS has established four different levels of partnership opportunities: Consulting Partners, Premier Partners, Authorized Partners and Registered Partners. Consulting Partners consist of general systems integrators and others who use the Company's products to provide information security services for their clients. Consulting Partners may purchase travelling licenses that can be used for one concurrent user for one year. Premier Partners combine sales and integration of encryption, firewall and authentication technologies with the Company's products. Authorized and Registered Partners must purchase products from Premier Partners. In addition, all Security Partners are required to employ a designated number of ISS Certified Engineers. ISS provides its partners with technical support, sales and marketing tools, quarterly rebates and other sales incentives and cooperative marketing funds at varying levels depending on the level of partnership.

MARKETING PROGRAMS

The Company conducts a number of marketing programs to support the sale and distribution of its products. These programs are designed to inform existing and potential OEMs, resellers and end-user customers about the capabilities and benefits of the Company's products. Marketing activities include: press relations and education; publication of technical and educational articles in industry journals and in the Company's on-line magazine, ISS Alert; participation in industry tradeshow; product/technology conferences and seminars; competitive analysis; sales training; advertising; development and distribution of Company literature; and maintenance of the Company's Web site. A key element of the Company's marketing strategy is to establish the Company's products and its ASM model as the leading approach for enterprise-wide security management. The Company has implemented a multi-faceted program to leverage the use of the SAFEsuite product family and increase its acceptance, through relationships with various channel partners:

STRATEGIC RESELLERS. Although the Company has numerous resellers, certain of these relationships have generated significant leverage for the Company in targeted markets. The Company's strategic resellers, which include EDS, SAIC, Siemens, Softbank and Tivoli Systems, provide ISS broad brand awareness through enhanced marketing activity, access to large sales forces, competitive control points and access to larger strategic customer opportunities.

CONSULTANTS. The use of the Company's products by security consultants not only generates revenue for the Company from the license to the consultant, but also provides the Company with leads to potential end users with a concern for network security. Consultants who have generated substantial leads for the Company's sales organization include Andersen Consulting, Deloitte Touche Tohmatsu International, IBM, KPMG Peat Marwick and Price Waterhouse.

ISPS. The Company licenses its products to certain ISPs to be used as part of their value-added services for their customers. With the Company's products, ISPs can offer their users perimeter vulnerability scanning and assessment, intrusion detection for Web services and applications that typically reside outside the firewalled perimeter. ISS licenses its products to BellSouth, GTE, PSINet and other ISPs for these purposes and receives a percentage of the value-added revenue stream.

OEMS. A number of vendors of security products, including NCR and ODS Networks, have signed OEM agreements with the Company. These agreements enable OEMs to incorporate the Company's products into their own security offerings to provide a complete security package. The Company receives royalties from OEM vendors and increased acceptance of the Company's products under these arrangements, which in turn promotes sales of the Company's other products to the OEM's customers.

CUSTOMER SERVICE AND SUPPORT

The Company provides ongoing product support services under its license agreements. Maintenance contracts are typically sold to customers for a one-year term at the time of the initial product license and may be renewed for additional periods. Under its maintenance agreements with its customers, the Company provides, without additional charge, telephone support, documentation and software updates and error corrections. Customers that do not renew their maintenance agreements but wish to obtain product updates and new version releases are generally required to purchase such items from the Company at market prices. In general, major new product releases come out annually, minor updates come out every four to six months and new checks come out every two to four weeks. All product updates are available to customers with current maintenance agreements for downloading from the Company's Web site.

The Company believes that providing a high level of customer service and technical support is necessary to achieve rapid product implementation which, in turn, is essential to customer satisfaction and continued license sales and revenue growth. Accordingly, the Company is committed to continued recruiting and maintenance of a high-quality technical support team. The Company provides telephone support to customers who purchase maintenance agreements along with their product license. A team of dedicated engineers trained to answer questions on the installation and usage of the SAFEsuite products provides telephone support from 8:00 a.m. to 6:00 p.m., Eastern time, Monday through Friday, from the Company's corporate office in Atlanta. The Company provides telephone support 24 hours a day, seven days a week through a call-back procedure to certain customers who pay an additional fee for the service. In the United States and internationally, the Company's VARs provide telephone support to their customers with technical assistance from the Company.

Because security-knowledgeable IT personnel are in extremely short supply throughout the industry, ISS provides focused education and training in the use of its products and security issues through the ISS University program. Education on security effectiveness and minimizing security risks in IT infrastructure are natural extensions of the Company's position as a provider of network security monitoring, detection and response systems. ISS University offers certification on ISS products through the ICE (ISS Certified Engineer) program. ISS University also offers a CNSE (Certified Network Security Engineer) degree for network security management. The Company's reputation as a security expert provides the basis for the value of such security degrees. Leveraging the efforts of current security training organizations accelerates the acceptance of the Company's certification program by the industry. Participation hours, or credits, received from other complementary security training programs, such as those offered by Computer Security Institute, MIS Training and similar organizations, can be applied towards the hours required to be completed in the ISS University program.

COMPETITION

The market for monitoring, detection and response products and services is intensely competitive and the Company expects competition to increase further in the future. The Company believes that the principal competitive factors affecting the market for network security products include security effectiveness, manageability, technical features, performance, ease of use, price, scope of product offerings, distribution relationships and customer service and support. Although the Company believes that its SAFEsuite family of products generally competes favorably with respect to such factors, there can be no assurance that the Company can maintain its competitive position against current and potential competitors, especially those with significantly greater financial, marketing, service, support, technical and other competitive resources.

The Company's principal competitors generally fall within one of three categories: internal IT departments or consulting firms that assist such departments, relatively smaller software companies that offer applications with limited scope and larger software companies that are either in the process of entering the Company's market or have the potential to develop products to compete with the Company's products. Due to a lack of awareness of the Company's products and services or a lack of appreciation of the complexity involved in the development of automated systems to establish, and more importantly, maintain comprehensive and effective levels of security within a distributed computing environment, potential customers often rely on their IT departments to internally formulate security systems or to retain consultants to undertake such a project. However, because experts in security issues are in extremely short supply, such in-house solutions typically fail to provide a comprehensive and sophisticated approach to security, are not designed to adapt to changing security policies and are extremely expensive to develop. The Company expects that as IT consulting firms learn of the Company's products and their relative cost, they will be less inclined to undertake projects that require them to independently develop systems with functionalities similar to the Company's products.

In addition, a number of companies currently market or have under development software applications to provide network and Internet security. The Company believes that, to date, none of these relatively smaller companies offer products that are as robust in features or as comprehensive in scope as the SAFEsuite family of products. Although it is likely that the product development efforts of these companies will eventually enable them to offer a line of products to compete with the Company's current product line, the Company intends to continue to dedicate significant resources for product development and recruiting in order to expand the Company's product capabilities ahead of these competitors. Notwithstanding, the Company expects additional competition from these established competitors and from other emerging companies. Furthermore, any future mergers or consolidations among these competitors would make them more formidable competitors to the Company. There can be no assurance that the Company's current and potential competitors will not develop security auditing and monitoring products that may be more effective than the Company's current or future products or that the Company's technologies and products will not be rendered obsolete by such developments.

Finally, there are a number of companies that currently market and sell various software products, such as encryption, firewall, operating system security and virus detection software, that have been broadly adopted by the Company's customers and potential customers to provide various levels of security within their computing environments. Some of these companies have released products which provide similar functionality as certain of the Company's products. In addition, vendors of operating system software or networking hardware may in the future enhance their products to include functionality that is currently provided by the Company's products. The widespread inclusion of the functionality of the Company's software as standard features of operating system software or networking hardware could render the Company's products obsolete and unmarketable, particularly if the quality of such functionality were comparable to that of the Company's products. Furthermore, even if the security auditing and monitoring functionality provided as standard features by operating systems software or networking hardware is more limited than that of the Company's software, there can be no assurance that a significant number of customers would not elect to accept more limited functionality in lieu of purchasing additional software. Many of these larger companies have longer operating histories, greater name

recognition, access to larger customer bases and significantly greater financial, technical and marketing resources than the Company. As a result, they may be able to adapt more quickly to new or emerging technologies and changes in customer requirements or to devote greater resources to the promotion and sale of their products than the Company. The Company believes that the entry of these larger companies into its market will require them to undertake operations that are currently not within their core areas of expertise, and thus expose them to significant uncertainties in the product development process or in providing a range of products to comprehensively address the security risks and vulnerabilities which the SAFEsuite product family addresses. However, if these companies were to introduce products that effectively competed with the Company's products, they could be in a position to substantially lower the price of their security auditing and monitoring products or to bundle such products with their other products, which would make it more difficult for the Company to compete with them.

For the foregoing reasons, there can be no assurance that the Company will be able to compete successfully against its current and future competitors. Increased competition may result in price reductions, reduced gross margins and loss of market share, any of which would materially and adversely affect the Company's business, operating results and financial condition. See "Risk Factors – Competition".

PROPRIETARY RIGHTS AND TRADEMARK ISSUES

The Company relies primarily on a combination of copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect its proprietary rights. The Company also believes that factors such as the technological and creative skills of its personnel, new product developments, frequent product enhancements, name recognition and reliable product maintenance are essential to establishing and maintaining a technology leadership position. The Company seeks to protect its software, documentation and other written materials under the trade secret and copyright laws, which afford only limited protection. The Company also has submitted one United States patent application. There can be no assurance that a patent will issue from this application or, if issued, that such patent would provide meaningful competitive advantages to the Company. The Company generally licenses SAFEsuite products to end users in object code (machine-readable) format. Certain customers have required the Company to maintain a source-code escrow account with a third-party software escrow agent, and a failure by the Company to perform its obligations under any of the related license and maintenance agreements, or the insolvency of the Company, could conceivably cause the release of the Company's source code to such customers. The standard form agreement allows the end user to use the SAFEsuite products solely on the end user's computer equipment for the end user's internal purposes, and the end user is generally prohibited from sublicensing or transferring the products.

Despite the Company's efforts to protect its proprietary rights, unauthorized parties may attempt to copy aspects of the Company's products or to obtain and use information that the Company regards as proprietary. Policing unauthorized use of the Company's products is difficult, and while the Company is unable to determine the extent to which piracy of its software products exists, software piracy can be expected to be a persistent problem. In addition, the laws of some foreign countries do not protect the Company's proprietary rights to as great an extent as do the laws of the United States. There can be no assurance that the Company's competitors will not independently develop similar technologies.

Although the Company is not aware that any of its products infringes the proprietary rights of third parties, there can be no assurance that third parties will not claim infringement by the Company with respect to current or future products. The Company expects that software product developers will increasingly be subject to infringement claims as the number of products and competitors in the Company's industry segment grows and the functionality of products in different industry segments overlaps. Any such claims, with or without merit, could be time consuming, result in costly litigation, cause product shipment delays or require the Company to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to the Company or at all, which could have a material adverse effect upon the Company's business, operating results and financial condition.

The name "Internet Security Systems" is not currently subject to trademark registration in the United States, and may not be a name for which a trademark is registrable due to its general use in a variety of security-related applications. Although the Company has in the past asserted and intends to continue to assert its rights with respect to the name "Internet Security Systems" and has taken and will take action against any use of such name in a manner that may create confusion with the Company's products in relevant markets, there can be no assurance that the Company will be successful in such efforts, which could have a material adverse effect upon the Company's business, operating results and financial condition.

EMPLOYEES

As of December 31, 1997, the Company had 141 employees, of whom, 48 were engaged in product research and development, 50 were engaged in sales, six were engaged in customer service and support, six were engaged in professional services, 19 were engaged in marketing and business development and 12 were engaged in administrative functions. The Company believes that its relations with its employees are good.

FACILITIES

The Company presently occupies approximately 20,000 square feet of office space in Atlanta for its headquarters and research and development facilities pursuant to three leases expiring on various dates through 2001, with renewal options. The Company also leases office space for its sales and marketing personnel in Austin, Boston, Chicago, Cincinnati, Dallas, Nashua, New York, Palo Alto, Philadelphia, San Mateo and Washington, D.C., as well as Brussels, London, Paris, Stuttgart, Tokyo and Toronto. The Company believes that its existing facilities are adequate for its current needs and that additional space will be available as needed.

MANAGEMENT

DIRECTORS AND EXECUTIVE OFFICERS

Set forth below is certain information concerning the directors and executive officers of the Company.

NAME ----	AGE ---	POSITION(S) -----
Thomas E. Noonan.....	37	President, Chief Executive Officer and Chairman of the Board of Directors
Christopher W. Klaus.....	24	Chief Technical Officer, Secretary and Director
Richard Macchia.....	46	Vice President and Chief Financial Officer
H. Keith Cooley.....	44	Vice President (Engineering)
M. Thomas McNeight.....	53	Vice President (Americas Sales)
Alex Bogaerts.....	48	Vice President (Europe)
Lin Ja Hong.....	39	Vice President (Asia/Pacific)
Richard S. Bodman.....	59	Director
Robert E. Davoli.....	49	Director
Kevin J. O'Connor.....	36	Director
David N. Strohm.....	49	Director

Mr. Noonan has served as the President and as a Director of ISS since August 1995, and as its Chief Executive Officer and Chairman of the Board of Directors since November 1996. Prior to joining ISS, Mr. Noonan served as Vice President, Sales and Business Development with TSI International, an electronic commerce company then owned by Warburg Pincus and Dun & Bradstreet, from October 1994 until August 1995. From November 1989 until October 1994, Mr. Noonan held high-level sales and marketing positions at Dun & Bradstreet Software, a developer of enterprise business software. Prior to 1989, Mr. Noonan co-founded Actuation Electronics (a motion control company for precision applications) and founded Leapfrog Technologies (an object-oriented software development tools company for networked applications). Mr. Noonan holds a B.S. in mechanical engineering from the Georgia Institute of Technology and a C.S.S. in business administration and management from Harvard University.

Mr. Klaus founded ISS in April 1994 and served as its President until August 1995 and as its Chief Executive Officer until November 1996. Mr. Klaus continues to serve the Company as its Chief Technical Officer and a Director. Prior to founding ISS, Mr. Klaus developed a shareware version of the Internet Scanner while attending the Georgia Institute of Technology.

Mr. Macchia joined ISS as its Vice President and Chief Financial Officer in December 1997. From December 1989 through December 1997, Mr. Macchia was employed by First Financial Management Corporation ("FFMC") as its Executive Vice President (Finance), and by First Data Corporation as its Senior Vice President (Finance) following its merger with FFMC. Mr. Macchia received a B.B.A. in accounting from the University of Notre Dame.

Mr. Cooley has served as Vice President (Engineering) of ISS since January 1996. Mr. Cooley has over twenty years of executive-level experience in software development and customer support, most recently as a founding partner for Value Sourcing Group, an Atlanta-based management consultancy specializing in information technology, from 1995 to 1996. Prior to that, Mr. Cooley was employed by Dun & Bradstreet Software for over 16 years where he held various management and executive-level positions in marketing, development and support, and ended his tenure as Chief Information Officer. Mr. Cooley holds a B.S. in industrial engineering from the Georgia Institute of Technology.

Mr. McNeight has served as Vice President (Americas Sales) of ISS since August 1996. Prior to joining ISS, Mr. McNeight was employed for more than twenty years in various sales, sales management

and executive management positions with technology and service companies, having most recently been a principle in The Complex Sale, a strategic sales consulting and training firm, from December 1995 to August 1996. In 1995, Mr. McNeight was Senior Vice President, Americas Operations, for TSW International, Inc., a supplier of plant performance and maintenance management software. Additionally, Mr. McNeight was Chief Executive Officer of Aurum Software Inc. from 1993 to 1994 and, prior to that, spent thirteen years at Dun & Bradstreet, ending his tenure as Executive Vice President for the Americas. Mr. McNeight has a B.S. in chemistry from Oklahoma State University and an M.S. in management information sciences from Texas Christian University.

Mr. Bogaerts joined ISS as its Vice President (Europe) in February 1996. Before joining ISS, Mr. Bogaerts was an independent technology consultant from September 1995 to February 1996, and prior to that held sales, marketing and strategic marketing, and general management positions with Dun & Bradstreet Software from 1992 to September 1995, and with Ethica N.V., an enterprise IT management and consulting firm, from 1989 to 1992. Mr. Bogaerts received a degree in applied economics and management sciences from the University of Leuven, Belgium, and an M.B.A. through a joint program of the University of Leuven, the University of Chicago and Cornell University Business Schools.

Mr. Lin has served ISS as Vice President (Asia/Pacific) since January 1997 and manages the Company's Asia/Pacific operations from the Company's office in Tokyo. Mr. Lin has over twenty years of sales and marketing experience in the Asia/Pacific software market. From 1984 to December 1996, he held a number of sales, marketing and development positions with Dun & Bradstreet Technology Asia (formerly known as Ashisuto KK), most recently as its Vice President and General Manager of Sales and Operations. Mr. Lin holds a B.A. in business administration from Aoyama Gakuin University in Tokyo.

Mr. Bodman joined the Company's Board of Directors in July 1997. Since May 1996, Mr. Bodman has served as the Managing General Partner of AT&T Ventures, LLC, which manages numerous venture capital investments. Before joining AT&T Ventures, LLC, Mr. Bodman served AT&T Corporation in various senior management positions. Mr. Bodman serves on the board of directors of several public and private companies, including Tyco International, Inc., LIN Television, Inc. and Reed Elsevier plc. Mr. Bodman holds a B.S. in engineering from Princeton University and an M.S. in industrial management from the Massachusetts Institute of Technology.

Mr. Davoli has been a Director of the Company since February 1996. Mr. Davoli has been a General Partner of or an advisor to Sigma Partners, a venture capital firm, since January 1995. Mr. Davoli was President and Chief Executive Officer of Epoch Systems, Inc., a client/server storage management provider, from February 1993 to September 1994. From May 1986 through June 1992, Mr. Davoli was the President and Chief Executive Officer of SQL Solutions, a relational database management systems consulting and tools company that he founded and sold to Sybase, Inc. in January 1990. Mr. Davoli serves as a director of several privately held companies. Mr. Davoli received a B.A. in history from Ricker College.

Mr. O'Connor has served as a Director of the Company since October 1995. Mr. O'Connor has been the Chief Executive Officer and Chairman of DoubleClick, Inc. since January 1996. From September 1994 to December 1995, Mr. O'Connor served as Director of Research for Digital Communications Associates, a data communications company (now Attachmate Corporation), and from April 1992 to September 1994, as its Chief Technical Officer and Vice President, Research. From its inception in May 1983 until its sale in April 1992, Mr. O'Connor served as Vice President, Research of Intercomputer Communications Corp., a software development company. Mr. O'Connor received his B.S. in electrical engineering from the University of Michigan.

Mr. Strohm has served as a Director of the Company since January 1996. Since 1980, Mr. Strohm has been an employee of Greylock Management Corporation, a venture capital group ("Greylock"), and he is a general partner of several venture capital funds affiliated with Greylock. Mr. Strohm currently serves as a director of Banyan Systems, Inc., an enterprise networking software company, and Legato Systems, Inc., a data storage management software company. Mr. Strohm received his B.A. from Dartmouth College and his M.B.A. from Harvard Business School.

BOARD OF DIRECTORS

The Charter and Bylaws provide that the size of the Board of Directors of the Company (the "Board") shall be determined by resolution of the Board. The Board is currently composed of six members. Each director holds office until the next annual meeting of stockholders or until his or her successor is duly elected and qualified. The Company's Charter and Bylaws provide that, beginning with the first annual meeting of stockholders following this offering, the Board will be divided into three classes serving for staggered, three-year terms.

The Board has established a Compensation Committee and an Audit Committee. The members of the Compensation Committee are Robert E. Davoli, Kevin J. O'Connor and David N. Strohm, and the members of the Audit Committee are Richard S. Bodman, Robert E. Davoli and Thomas E. Noonan.

The Audit Committee of the Board was established in January 1998 and reviews, acts on and reports to the Board with respect to various auditing and accounting matters, including the selection of the Company's auditors, the scope of the annual audits, fees to be paid to the auditors, the performance of the Company's independent auditors and the accounting practices of the Company.

The Compensation Committee of the Board was established in February 1996 and re-authorized in January 1998. The Compensation Committee determines the salaries and incentive compensation of the officers of the Company and provides recommendations for the salaries and incentive compensation of the other employees of the Company. The Compensation Committee also administers the Company's various incentive compensation, stock and benefit plans.

Except for grants of stock options, directors of the Company generally do not receive compensation for services rendered as a director. The Company also does not pay compensation for committee participation or special assignments of the Board. Following this Offering, each director will be reimbursed for all out-of-pocket expenses incurred in attending meetings of the Board and committees thereof. Non-employee Board members will receive option grants at periodic intervals under the Automatic Option Grant Program of the 1995 Plan and will also be eligible to receive discretionary option grants under the Discretionary Option Grant Program of such plan. See "-- Restated 1995 Stock Incentive Plan".

On December 8, 1997, the Company granted to each of Messrs. Bodman, Davoli, O'Connor and Strohm an option to purchase 20,000 shares of Common Stock at an exercise price of \$7.00 per share. The options are immediately exercisable for all of the option shares. However, the shares purchasable upon exercise of the options are unvested and subject to repurchase, at the option exercise price paid per share, upon the early termination of the optionee's Board service. The shares subject to each option grant will vest as to 25% of the option shares upon the optionee's completion of each of the four years of Board service after the grant date. The options have a maximum term of 10 years measured from the grant date, subject to earlier termination following the cessation of the optionee's Board service. The options will immediately vest in the event of (i) certain changes in the ownership or control of the Company, unless such options are assumed by the successor corporation or (ii) the death or disability of the optionee while serving as a Board member.

The Bylaws provide for indemnification of directors and officers to the fullest extent permitted by Delaware law, except if limited by contract. Prior to consummation of this Offering, the Company will enter into indemnification agreements with all of its directors and will procure directors' and officers' liability insurance. In addition, the Charter limits the personal liability of Board members to the Company or its stockholders for breaches of the directors' fiduciary duties to the fullest extent permitted by Delaware law. See "Description of Capital Stock -- Certain Anti-Takeover, Limited Liability and Indemnification Provisions".

EMPLOYMENT CONTRACTS

The officers serve at the discretion of the Board. The Company does not presently have an employment contract in effect with any of its executive officers. The Compensation Committee, as Plan

Administrator of the 1995 Plan, has the authority to provide for the accelerated vesting of the shares of Common Stock subject to outstanding options held by the Chief Executive Officer and the Company's other executive officers or any unvested shares actually held by those individuals under the 1995 Plan, in the event the Company is acquired by merger, consolidation or asset sale or there is a change in control effected by a successful tender or exchange offer for more than 50% of the Company's outstanding voting securities or a change in the majority of the Board as a result of one or more contested elections for Board membership. Alternatively, the Compensation Committee may condition such accelerated vesting upon the individual's position with the Company being replaced with a lesser position or the termination of the individual's service within a designated period following the acquisition or take over. In addition, the Company has agreements with certain management members regarding acceleration of option vesting in the event of the consummation of a transaction that results in a change of control of the Company.

EXECUTIVE COMPENSATION

Summary Compensation Table. The following table provides certain summary information concerning the compensation earned by the Company's Chief Executive Officer and certain other executive officers of the Company (collectively, the "Named Officers") whose salary and bonus exceeded \$100,000 for services rendered in all capacities to the Company and its subsidiaries during 1997.

NAME AND PRINCIPAL POSITION(S)	ANNUAL COMPENSATION		LONG-TERM COMPENSATION
	SALARY	BONUS	OPTIONS (# OF SHARES)
Thomas E. Noonan..... President, Chief Executive Officer and Chairman of the Board	\$130,000	\$ (1)	--
Alex Bogaerts..... Vice President (Europe)	86,000(2)	114,870(2)	25,000
H. Keith Cooley..... Vice President (Engineering)	109,000	26,000	--
Lin Ja Hong..... Vice President (Asia/Pacific)	110,000	43,890	27,500
M. Thomas McNeight..... Vice President (Americas Sales)	125,000	91,300	--

(1) To be determined.

(2) Mr. Bogaerts' compensation, other than options, was paid to a consulting company owned by Mr. Bogaerts.

Option Grants in Last Fiscal Year. The following table provides certain information concerning stock options granted to each of the Named Officers during 1997. No stock appreciation rights were granted to these individuals during such year.

OPTION GRANTS IN 1997

NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED(1)	% OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN 1997	EXERCISE PRICE PER SHARE	EXPIRATION DATE	POTENTIAL REALIZABLE VALUE AT ASSUMED ANNUAL RATES OF STOCK PRICE APPRECIATION FOR OPTION TERM(2)	
					5%	10%
Thomas E. Noonan.....	--	--%	\$ --	--	\$ --	\$ --
Alex Bogaerts.....	25,000	2.3	0.60	4/20/07	9,433	23,906
H. Keith Cooley.....	--	--	--	--	--	--
Lin Ja Hong.....	20,000	1.8	0.60	3/9/07	7,547	19,125
	7,500	*	7.00	12/30/07	33,016	83,671
M. Thomas McNeight.....	--	--	--	--	--	--

* Indicates less than 1%.

(1) The options are immediately exercisable in full upon grant; however, the shares underlying all options vest over a four-year period at the rate of 25% per year and are subject to repurchase by the Company at the exercise price should the optionee cease employment prior to full vesting. In the event that the Company is acquired by merger, consolidation or asset sale, the option shares will accelerate in full unless the option is assumed by the successor corporation and the Company's repurchase rights with respect to the unvested option shares are assigned to such corporation. In the event that the option is so assumed by, and the Company's repurchase rights with respect to unvested shares are assigned to, the successor corporation and, within 12 months following the acquisition, the optionee's position is reduced to a lesser position or the optionee's employment is involuntarily terminated, the option shares will accelerate in part so that the next annual installment of option shares scheduled to vest will immediately vest in full and, to the extent the optionee continues in the Company's service, each installment of option shares scheduled to vest thereafter will vest on each subsequent anniversary of the acceleration date. Each option expires on the earlier of (i) ten years from the date of grant, or (ii) termination of the optionee's employment with the Company. All options were granted at fair market value as determined by the Board of Directors of the Company on the date of grant.

(2) Future value assumes appreciation in the market value of the Common Stock of 5% and 10% per year over the ten-year option period as mandated by the rules and regulations of the Commission and does not represent the Company's estimate or projection of the future value of the Common Stock. The actual value realized may be greater than or less than the potential realizable values set forth in the table.

Aggregate Option Exercises in Last Fiscal Year and Fiscal Year-End Option Values. No options were exercised by the Named Officers during 1997. The following table provides certain information concerning option exercises and option holdings for the fiscal year ended December 31, 1997 with respect to each of the Named Officers.

YEAR-END OPTION VALUES

NAME	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT DECEMBER 31, 1997		VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT DECEMBER 31, 1997(2)	
	EXERCISABLE(1)	UNEXERCISABLE	EXERCISABLE	UNEXERCISABLE
Thomas E. Noonan.....	--	--	\$ --	\$ --
Alex Bogaerts.....	45,000(3)	--	297,000	--
H. Keith Cooley.....	200,000	--	1,370,000	--
Lin Ja Hong.....	27,500(4)	--	128,000	--
M. Thomas McNeight.....	235,000	--	1,609,750	--

(1) The shares purchasable upon exercise of the options are subject to repurchase by the Company at the exercise price upon the optionee's termination of employment prior to vesting in the shares. The Company's repurchase right lapses with respect to, and the optionee vests in, 25% of the option shares upon the optionee's completion of each year of service. As of December 31, 1997, the number of vested shares for which each Named Officer's option was exercisable was as follows: Mr. Bogaerts -- 5,000 shares; Mr. Cooley -- 50,000; Mr. Lin -- no shares; Mr. McNeight -- 58,750 shares.

(2) Value determined by subtracting the exercise price from the fair market value of the Common Stock at December 31, 1997 (\$7.00 per share), as determined by the Company's Board of Directors, multiplied by the number of shares underlying the options.

(3) Represents options for 20,000 shares at an exercise price of \$0.15 per share and options for 25,000 shares at an exercise price of \$0.60 per share.

(4) Represents options for 20,000 shares at an exercise price of \$0.60 per share and options for 7,500 shares at an exercise price of \$7.00 per share.

RESTATED 1995 STOCK INCENTIVE PLAN

The Restated 1995 Stock Incentive Plan was first adopted by the Board of Directors of Internet Security Systems, Inc. on September 6, 1995 and approved by the stockholders of Internet Security Systems, Inc. on January 31, 1996. On December 8, 1997, the Company assumed the 1995 Plan and all outstanding options thereunder and converted such options on a share-for-share basis into options to purchase shares of the Company's Common Stock. Three million shares of Common Stock have been authorized for issuance under the 1995 Plan. In addition, the share reserve will automatically be increased on the first trading day of each calendar year, beginning with the 1999 calendar year, by an amount equal to 3% of the number of shares of Common Stock outstanding on the last trading day of the immediately preceding calendar year. In no event may any one participant in the 1995 Plan receive option grants or direct stock issuances for more than 300,000 shares per calendar year.

The 1995 Plan is divided into three separate components: (i) the Discretionary Option Grant Program under which eligible individuals may, at the discretion of the Plan Administrator, be granted options to purchase shares of Common Stock at an exercise price equal to, greater than or less than their fair market value on the grant date, (ii) the Stock Issuance Program under which such individuals may, in the Plan Administrator's discretion, be issued shares of Common Stock directly, through the purchase of such shares at a price equal to, greater than or less than their fair market value at the time of issuance or as a bonus for services rendered, and (iii) the Automatic Option Grant Program under which option grants will automatically be made at periodic intervals to eligible non-employee Board members to

purchase shares of Common Stock at an exercise price equal to 100% of the fair market value of such shares on the grant date.

The Discretionary Option Grant Program and the Stock Issuance Program are administered by the Compensation Committee of the Board. The Compensation Committee as Plan Administrator has complete discretion to determine which eligible individuals are to receive option grants or stock issuances, the time or times when such option grants or stock issuances are to be made, the number of shares subject to each such grant or issuance, the status of any granted option as either an incentive stock option or a non-statutory stock option under the Federal tax laws, the vesting schedule to be in effect for the option grant or stock issuance and the maximum term for which any granted option is to remain outstanding. The administration of the Automatic Option Grant Program is self-executing in accordance with the express provisions of such program.

The exercise price for the shares of Common Stock subject to option grants made under the 1995 Plan may be paid in cash or in shares of Common Stock (held for the requisite period necessary to avoid a charge to the Company's earnings for financial reporting purposes) valued at fair market value on the exercise date. The option may also be exercised through a same-day sale program without any cash outlay by the optionee. In addition, the Plan Administrator may provide financial assistance to one or more optionees in the exercise of their outstanding options by allowing such individuals to deliver a full-recourse, interest-bearing promissory note in payment of the exercise price and any associated withholding taxes incurred in connection with such exercise. During the 180-day period following the date of this Prospectus, optionees exercising options under the 1995 Plan will be required to enter into Lock-Up Agreements with the representatives of the Underwriters.

In the event that the Company is acquired by merger, consolidation or asset sale, each outstanding option under the Discretionary Option Grant Program which is not to be assumed by the successor corporation will automatically become fully exercisable, and all unvested shares under the Stock Issuance Program will immediately vest, except to the extent the Company's repurchase rights with respect to those shares are to be assigned to the successor corporation. In the event an outstanding option is assumed, and the Company's repurchase rights are assigned to the successor corporation, and, within 12 months following the merger, consolidation or asset sale either (i) the optionee is offered a lesser position compared to the position held by the optionee prior to the acquisition or (ii) the optionee's service is terminated, either involuntarily or through resignation as a result of being offered a lesser position, then the option will accelerate in part so that it will become immediately exercisable with respect to the next annual installment of option shares scheduled to vest. The Plan Administrator also has the authority under the Discretionary Option Grant and Stock Issuance Programs to grant options and to structure repurchase rights so that the shares subject to those options or repurchase rights will automatically vest in the event the individual is offered a lesser position or the individual's service is terminated, whether involuntarily or through a resignation as a result of being offered a lesser position, within a specified period (not to exceed 12 months) following a change in control of the Company effected by a successful tender offer for more than 50% of the outstanding voting stock or by proxy contest for the election of Board members. The Plan Administrator also has the discretion to provide for the automatic acceleration of outstanding options and the lapse of any outstanding repurchase rights upon certain changes in the ownership or control of the Company.

Stock appreciation rights are authorized for issuance under the Discretionary Option Grant Program which provide the holders with the election, subject to the Plan Administrator's approval, to surrender their outstanding options for an appreciation distribution from the Company equal to the excess of

(i) the fair market value of the vested shares of Common Stock subject to the surrendered option over (ii) the aggregate exercise price payable for such shares. In addition, the Plan Administrator has the authority to grant to certain officers and directors of the Company limited stock appreciation rights which, upon a hostile take-over of the Company (as defined in the 1995 Plan), generally provide the holders with the automatic right to surrender his or her outstanding options for an appreciation distribution from the Company equal to the excess of (i) the tender price paid in the hostile take-over for the vested shares

subject to the surrendered options over (ii) the aggregate exercise price payable for such shares. Such appreciation distribution may be made in cash or in shares of Common Stock.

The Plan Administrator has the authority to effect the cancellation of outstanding options under the Discretionary Option Grant Program with the consent of the affected option holders in return for the grant of new options for the same or different number of option shares with an exercise price per share based upon the fair market value of the Common Stock on the new grant date.

Under the Automatic Option Grant Program, each individual who first joins the Board as a non-employee Board member after the effective date of this Offering will receive an option to purchase 50,000 shares of Common Stock on the date he or she is first elected or appointed to the Board, provided such individual has not otherwise been in the prior employ of the Company. In addition, at each Annual Stockholders Meeting, beginning with the 1999 Annual Meeting, each individual who is to continue to serve as a non-employee Board member after the meeting will receive an additional option to purchase 5,000 shares of Common Stock.

Each automatic grant will have a term of 10 years, subject to earlier termination following the optionee's cessation of Board service. Each automatic option will be immediately exercisable; however, any shares purchased upon exercise of the option will be subject to repurchase should the optionee's service as a non-employee Board member cease prior to vesting in the shares. The initial 50,000-share grant will vest in four equal and successive annual installments over the optionee's period of Board service. Each additional 5,000-share grant will vest in two equal and successive annual installments over the optionee's period of Board service measured from the grant date. However, the shares subject to each outstanding automatic grant will immediately vest upon (i) certain changes in the ownership or control of the Company or (ii) the death or disability of the optionee while serving as a Board member.

The Board may amend or modify the 1995 Plan at any time. The 1995 Plan will terminate on the earlier of (i) September 6, 2005, (ii) the date on which all available shares have been issued as vested shares or (iii) the termination of all outstanding options in connection with certain changes in the ownership or control of the Company.

COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Board established a Compensation Committee in February 1996. During 1997, Robert E. Davoli, Kevin J. O'Connor and David N. Strohman served as members of the Compensation Committee. None of these individuals has served at any time as an officer or employee of the Company. Prior to the establishment of the Compensation Committee, all decisions relating to executive compensation were made by the Board. For a description of the transactions between the Company and members of the Compensation Committee and entities affiliated with such members, see "Certain Transactions". No executive officer of the Company serves as a member of the board of directors or compensation committee of any entity which has one or more executive officers serving as a member of the Board of Directors or Compensation Committee.

CERTAIN TRANSACTIONS

In February 1996 the Company sold an aggregate of 3,650,000 shares of Series A Preferred Stock for \$1.00 per share. The purchasers of record of the Series A Preferred Stock included, among others, Greylock Equity Limited Partnership ("Greylock"), and Sigma Associates III, L.P., Sigma Investors III, L.P. and Sigma Partners III, L.P. (collectively, the "Sigma Entities").

In connection with the sale of the Company's Series A Preferred Stock, the Company entered into an agreement with Greylock and the Sigma Entities concerning certain of the shares of the Common Stock sold by the underwriters of an initial public offering of the Common Stock to persons designated by the Company ("Directed Shares"). Under this agreement, in the event that the Company designates any person to receive Directed Shares, the Company must use its best efforts to cause (i) Greylock and (ii) the Sigma Entities to receive up to 100,000 shares of the Company's Common Stock sold in such offering at the initial public offering price. Also in connection with the sale of the Company's Series A Preferred Stock, the Company repurchased 100,000 shares of Common Stock from Christopher W. Klaus for \$15,000.

In February 1997 the Company sold an aggregate of 2,086,957 shares of Series B Preferred Stock for \$2.53 per share. The purchasers of record of the Series B Preferred Stock included, among others, (i) Greylock, (ii) the Sigma Entities and (iii) Kleiner Perkins Caufield & Byers VIII, KPCB Information Sciences Zaibatsu Fund II and KPCB Java Fund. In connection with the sale of the Company's Series B Preferred Stock, the Company entered into an agreement with AT&T Ventures ("AT&T") and Kleiner, Perkins, Caufield & Byers ("KPCB") concerning Directed Shares. In the event that the Company designates any person to receive Directed Shares, the Company must use its best efforts to cause each of AT&T and KPCB to receive up to 100,000 shares of the Company's Common Stock sold in such offering at the initial public offering price.

Pursuant to the terms of the Series A and Series B Preferred Stock Purchase Agreements, David N. Strohm, a General Partner of Greylock, and Robert E. Davoli, who is affiliated with the Sigma Entities, became directors of ISS. See "Principal and Selling Stockholders".

On December 8, 1997, the Company's Board of Directors granted to each of Richard S. Bodman, Robert E. Davoli, Kevin J. O'Connor and David N. Strohm (the Company's non-employee directors) a non-statutory option to purchase up to 20,000 shares of the Company's Common Stock outside the 1995 Plan, on the same terms as if those options had been granted pursuant to the Company's Automatic Option Grant Program under the 1995 Plan. See "Management -- Restated 1995 Stock Incentive Plan".

All future transactions, including loans, between the Company and its officers, directors, principal stockholders and their affiliates will be approved by a majority of the Board, including a majority of the independent and disinterested outside directors on the Board, and will continue to be on terms no less favorable to the Company than could be obtained from unaffiliated third parties.

PRINCIPAL AND SELLING STOCKHOLDERS

The following table sets forth certain information regarding beneficial ownership of the Common Stock as of January 15, 1998 adjusted on a pro forma basis to reflect the automatic conversion of each share of Convertible Preferred Stock into one share of Common Stock, and as adjusted to reflect the sale of shares offered hereby, by (i) each person who is known by the Company to own beneficially more than five percent of the Common Stock, (ii) each of the Company's Named Officers and directors, (iii) all current officers and directors as a group, and (iv) each of the Selling Stockholders. Unless otherwise indicated, the address for the following stockholders is 41 Perimeter Center East, Suite 660, Atlanta, Georgia 30346.

BENEFICIAL OWNER	SHARES BENEFICIALLY OWNED BEFORE OFFERING (1)(2)		NUMBER OF SHARES OFFERED FOR SALE	SHARES BENEFICIALLY OWNED AFTER OFFERING(1)(2)	
	NUMBER	PERCENTAGE		NUMBER	PERCENTAGE
Christopher W. Klaus(3).....	4,373,836	32.0%	100,000	4,273,836	26.9%
Greylock Equity Limited Partnership(4).....	2,657,614	19.4	--	2,637,614	16.6
755 Page Mill Road Building A, Suite 100 Palo Alto, California 94304					
Sigma Entities(5).....	1,930,218	14.1	--	1,930,218	12.2
20 Custom House Street Suite 830 Boston, Massachusetts 02110					
Thomas E. Noonan(6).....	1,922,070	14.1	125,000	1,797,070	11.3
Kleiner Perkins Caufield & Byers Entities(7).....	1,429,858	10.5	--	1,429,858	9.0
2750 Sand Hill Road Menlo Park, California 94025					
Kevin J. O'Connor(8).....	713,475	5.2	55,000	658,475	4.1
DoubleClick 41 Madison Avenue 32nd floor New York, New York 10010					
Alex Bogaerts(9).....	45,000	*	--	45,000	*
H. Keith Cooley(10).....	200,000	1.4	20,000	180,000	1.1
Lin Ja Hong(11).....	27,500	*	--	27,500	*
M. Thomas McNeight(12).....	235,000	1.7	--	235,000	1.5
Richard S. Bodman(13).....	395,494	2.9	--	395,494	2.5
c/o AT&T Ventures, L.L.C. Two Wisconsin Circle Suite 610 Chevy Chase, Maryland 20815					
Robert E. Davoli(6).....	1,950,218	14.2	--	1,950,218	12.3
David N. Strohm(4).....	2,657,614	19.4	--	2,657,614	16.7
All directors and officers as a group(11 persons)(14).....	12,645,207	87.8		12,345,207	74.5

* Indicates less than 1%.

(1) Assumes no exercise of the Underwriters' over-allotment option.

(2) Beneficial ownership is calculated in accordance with the rules of the Commission. In computing the number of shares beneficially owned by a person and the percentage ownership of that person, shares of Common Stock subject to options held by that person that are currently exercisable or become exercisable within 60 days following January 15, 1998, are deemed outstanding. However, such shares are not deemed outstanding for the purpose of computing the percentage ownership of any other person. Unless otherwise indicated in the footnotes to this table, the persons and entities named in the table have sole voting and sole investment power with respect to all shares beneficially owned, subject to community property laws where applicable.

(3) Includes 3,560 shares held by Mr. Klaus' family. In addition to the number of shares shown as offered for sale in the table, Mr. Klaus has granted the Underwriters the right to purchase up to an additional 25,000 shares pursuant to the Underwriters' over-allotment option.

(4) Includes options immediately exercisable for 20,000 shares of Common Stock held by Mr. Strohm and 2,637,614 shares held by Greylock Equity Limited Partnership. Mr. Strohm, a director of the Company, is also a General Partner of Greylock Equity Limited Partnership. Mr. Strohm disclaims beneficial ownership of the shares held by Greylock Equity Limited Partnership except to the extent of his pecuniary interest therein arising from his general partnership interest therein.

(5) Includes options immediately exercisable for 20,000 shares of Common Stock held by Mr. Davoli, 311,506 shares held by Sigma Associates III, L.P., 28,792 shares held by Sigma Investors III, L.P. and 1,589,920 shares held by Sigma Partners III, L.P. Mr. Davoli, a director of the Company, is also a General Partner of Sigma Management III, L.P., which is the General Partner of Sigma Associates III, L.P., Sigma Investors III, L.P. and Sigma Partners III, L.P. Mr. Davoli disclaims beneficial ownership of the shares held by Sigma Associates III, L.P., Sigma Investors III, L.P. and Sigma Partners III, L.P. except to the extent of his pecuniary interest therein from his general partnership interest in Sigma Management III, L.P.

(6) Includes 175,000 shares held in family trusts. In addition to the number of shares shown as offered for sale in the table, Mr. Noonan has granted the Underwriters the right to purchase up to an additional 25,000 shares pursuant to the Underwriters' over-allotment option.

(7) Includes 393,211 shares held by Kleiner Perkins Caufield & Byers VIII, 35,746 shares held by KPCB Information Sciences Zaibatsu Fund II and 1,000,901 shares held by KPCB Java Fund.

(8) Includes options immediately exercisable for 20,000 shares of Common Stock. In addition to the number of shares shown as offered for sale in the table, Mr. O'Connor has granted the Underwriters the right to purchase up to an additional 15,000 shares pursuant to the Underwriters' over-allotment option.

(9) Includes options immediately exercisable for 45,000 shares of Common Stock.

(10) Includes options immediately exercisable for 180,000 shares of Common Stock.

(11) Includes options immediately exercisable for 27,500 shares of Common Stock.

(12) Includes options immediately exercisable for 235,000 shares of Common Stock.

(13) Includes options immediately exercisable for 20,000 shares of Common Stock and 337,945 shares held by AT&T Venture Fund II, L.P. and 37,549 shares held by Venture Fund I, L.P. for which Mr. Bodman serves as a General Partner.

(14) Includes options immediately exercisable for 692,500 shares of Common Stock.

DESCRIPTION OF CAPITAL STOCK

AUTHORIZED AND OUTSTANDING CAPITAL STOCK

The authorized capital stock of the Company consists of 50,000,000 shares of Common Stock, par value \$0.001 per share, and 20,000,000 shares of Preferred Stock, par value \$0.001 per share ("Preferred Stock"). Upon consummation of this Offering, no shares of Preferred Stock and 15,878,428 shares of Common Stock (16,188,428 shares if the Underwriters' overallotment option is exercised in full) will be outstanding. The following summary is qualified in its entirety by reference to the Company's Charter and Bylaws, copies of which are filed as exhibits to the Registration Statement of which this Prospectus is a part.

COMMON STOCK

As of December 31, 1997, there were 7,921,471 shares of Common Stock outstanding that were held by 8 stockholders. The holders of Common Stock are entitled to one vote per share on all matters to be voted upon by the stockholders. Subject to preferences that may be applicable to any outstanding Preferred Stock, the holders of Common Stock are entitled to receive ratably such dividends, if any, as may be declared from time to time by the Board of Directors out of funds legally available therefor. In addition, the Company's bank credit facility permits the payment of cash dividends only to the extent the Company maintains certain financial ratios and a specified minimum net worth. See "Dividend Policy". In the event of liquidation, dissolution or winding up of the Company, the holders of Common Stock are entitled to share ratably in all assets remaining after payment of liabilities, subject to prior distribution rights of Preferred Stock, if any, then outstanding. The Common Stock has no preemptive or conversion rights or other subscription rights. There are no redemption or sinking fund provisions applicable to the Common Stock. All outstanding shares of Common Stock are fully paid and nonassessable, and the shares of Common Stock to be issued upon completion of this offering will be fully paid and nonassessable.

PREFERRED STOCK

The Board of Directors has the authority to issue the Preferred Stock in one or more series and to fix the rights, preferences, privileges and restrictions thereof, including dividend rights, dividend rates, conversion rights, voting rights, terms of redemption, redemption prices, liquidation preferences and the number of shares constituting any series or the designation of such series, without further vote or action by the stockholders. The issuance of Preferred Stock may have the effect of delaying, deferring or preventing a change in control of the Company without further action by the stockholders and may adversely affect the voting and other rights of the holders of Common Stock. The issuance of Preferred Stock with voting and conversion rights may adversely affect the voting power of the holders of Common Stock, including the loss of voting control to others. At present, the Company has no plans to issue any shares of Preferred Stock.

CERTAIN ANTI-TAKEOVER, LIMITED LIABILITY AND INDEMNIFICATION PROVISIONS

SECTION 203 OF THE DELAWARE GENERAL CORPORATION LAW

The Company is subject to Section 203 of the Delaware General Corporation Law, as amended ("Section 203"), which subject to certain exceptions, prohibits a Delaware corporation from engaging in any business combination with any interested stockholder for a period of three years following the date that such stockholder became an interested stockholder, unless (i) prior to such date, the board of directors of the corporation approved either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder, (ii) upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock of the corporation outstanding at the time the transaction commenced, excluding for purposes of determining the number of shares outstanding those shares owned (x) by

persons who are directors and also officers and (y) by employee stock plans in which employee participants do not have the right to determine confidentially whether shares held subject to the plan will be tendered in a tender or exchange offer, or (iii) on or subsequent to such date, the business combination is approved by the board of directors and authorized at an annual or special meeting of stockholders, and not by written consent, by the affirmative vote of at least 66 2/3% of the outstanding voting stock that is not owned by the interested stockholder.

Section 203 defines business combinations to include (i) any merger or consolidation involving the corporation or any majority-owned subsidiary of the corporation and any other person or entity, (ii) subject to certain exceptions, any sale, transfer, pledge or other disposition of 10% or more of the assets of the corporation or any majority-owned subsidiary of the corporation involving the interested stockholder, (iii) subject to certain exceptions, any transaction that results in the issuance or transfer by the corporation or any majority-owned subsidiary of the corporation of any stock of the corporation to the interested stockholder, (iv) any transaction involving the corporation or any majority-owned subsidiary of the corporation that has the effect of increasing the proportionate share of the stock of any class or series of the corporation or any majority-owned subsidiary of the corporation beneficially owned by the interested stockholder, or (v) the receipt by the interested stockholder of the benefit of any loans, advances, guarantees, pledges or other financial benefits provided by or through the corporation or any majority-owned subsidiary of the corporation. In general, Section 203 defines an interested stockholder as any entity or person beneficially owning 15% or more of the outstanding voting stock of the corporation and any entity or person affiliated with or controlling or controlled by such entity or person.

CHARTER AND BYLAW PROVISIONS

The Company's Charter and Bylaws include provisions that may have the effect of discouraging, delaying or preventing a change in control of the Company or an unsolicited acquisition proposal that a stockholder might consider favorable, including a proposal that might result in the payment of a premium over the market price for the shares held by stockholders. These provisions are summarized in the following paragraphs.

CLASSIFIED BOARD OF DIRECTORS

The Charter and Bylaws provide, beginning with the first annual meeting of stockholders following this Offering, for the Board to be divided into three classes of directors serving staggered, three-year terms. The classification of the Board has the effect of requiring at least two annual stockholder meetings, instead of one, to replace a majority of members of the Board.

SUPERMAJORITY VOTING

The Charter requires the approval of the holders of at least 66 2/3% of the Company's combined voting power to effect certain amendments to the Charter unless such amendments are approved by a majority of the directors of the Company not affiliated or associated with any person holding (or which has announced an intention to acquire) 26% or more of the voting power of the Company's outstanding capital stock. The Bylaws may be amended by either (a) a majority of the Board or (b) the holders of a majority of the Company's voting stock, provided that certain amendments approved by stockholders require the approval of at least 66 2/3% of the Company's combined voting power unless such amendments are approved by a majority of the directors of the Company not affiliated or associated with any person holding (or which has announced an intention to acquire) 26% or more of the voting power of the Company's outstanding capital stock.

AUTHORIZED BUT UNISSUED OR UNDESIGNATED CAPITAL STOCK

The Company's authorized capital stock consists of 50,000,000 shares of Common Stock and 20,000,000 shares of Preferred Stock. No Preferred Stock will be designated upon consummation of this Offering. After this Offering, the Company will have outstanding 15,878,428 shares of Common Stock (16,188,428 shares if the Underwriters' over-allotment option is exercised in full). The authorized but unissued (and in the case of Preferred Stock, undesignated) stock may be issued by the Board in one or

more transactions. In this regard, the Company's Charter grants the Board broad power to establish the rights and preferences of authorized and unissued Preferred Stock. The issuance of shares of Preferred Stock pursuant to the Board's authority described above could decrease the amount of earnings and assets available for distribution to holders of Common Stock and adversely affect the rights and powers, including voting rights, of such holders and may have the effect of delaying, deferring or preventing a change in control of the Company. The Board does not currently intend to seek stockholder approval prior to any issuance of Preferred Stock, unless otherwise required by law.

SPECIAL MEETINGS OF STOCKHOLDERS

The Bylaws provide that special meetings of stockholders of the Company may be called only by the Board, or by the Company's Chairman of the Board or President.

NO STOCKHOLDER ACTION BY WRITTEN CONSENT

The Charter and the Bylaws provide that an action required or permitted to be taken at any annual or special meeting of the stockholders of the Company may only be taken at a duly called annual or special meeting of stockholders. This provision prevents stockholders from initiating or effecting any action by written consent, and thereby taking actions opposed by the Board.

NOTICE PROCEDURES

The Bylaws establish advance notice procedures with regard to all stockholder proposals, including proposals relating to the nomination of candidates for election as directors, the removal of directors and amendments to the Charter or Bylaws to be brought before meetings of stockholders of the Company. These procedures provide that notice of such stockholder proposals must be timely given in writing to the Secretary of the Company prior to the meeting. Generally, to be timely, notice must be received by the Secretary of the Company not less than 120 days prior to the meeting. The notice must contain certain information specified in the Bylaws.

OTHER ANTI-TAKEOVER PROVISIONS

See "Management -- Restated 1995 Stock Incentive Plan" for a discussion of certain provisions of the 1995 Plan which may have the effect of discouraging, delaying or preventing a change in control of the Company or unsolicited acquisition proposals.

LIMITATION OF DIRECTOR LIABILITY

The Charter limits the liability of directors of the Company (in their capacity as directors but not in their capacity as officers) to the Company or its stockholders to the fullest extent permitted by Delaware law. Specifically, directors of the Company will not be personally liable for monetary damages for breach of a director's fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the Company or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law, which relates to unlawful payments of dividends or unlawful stock repurchases or redemptions, or (iv) for any transaction from which the director derived an improper personal benefit.

INDEMNIFICATION ARRANGEMENTS

The Bylaws provide that the directors and officers of the Company shall be indemnified and provide for the advancement to them of expenses in connection with actual or threatened proceedings and claims arising out of their status as such, to the fullest extent permitted by the Delaware General Corporation Law. Prior to consummation of this Offering, the Company will enter into indemnification agreements with each of its directors and executive officers that provide for indemnification and expense advancement to the fullest extent permitted under the Delaware General Corporation Law.

REGISTRATION RIGHTS

Following the closing of the Offering, certain existing stockholders of the Company holding an aggregate of 13,354,928 shares of Common Stock will be entitled to certain rights with respect to the registration of such shares of Common Stock held by them under the Securities Act. Under the terms of the Rights Agreement between the Company and certain existing stockholders, beginning six months after this Offering, the existing holders of Convertible Preferred Stock have the right, subject to certain conditions and limitations, to require the Company to file a registration statement, including, if requested, a shelf registration statement, under the Securities Act in order to register all or part of the existing stockholders' shares of Common Stock. The Company may in certain circumstances defer such registrations and the underwriters have the right, subject to certain limitations, to limit the number of shares included in such registrations. In the event that the Company proposes to register any of its securities under the Securities Act, either for its own account or for the account of other security holders, certain of the existing stockholders of Common Stock and Convertible Preferred Stock are entitled to include their shares of Common Stock in such registration, subject to marketing and other limitations. Generally, the Company is required to bear the expense of all such registrations.

TRANSFER AGENT AND REGISTRAR

The Transfer Agent and Registrar for the Common Stock is .

SHARES ELIGIBLE FOR FUTURE SALE

Upon completion of this Offering, the Company will have 15,878,428 of Common Stock outstanding (assuming no exercise of the Underwriters' over-allotment option and no exercise of outstanding options under the Company's 1995 Plan or other options after December 31, 1997). Of such shares, the 2,500,000 shares sold in this Offering will be freely transferable without restriction or further registration under the Securities Act, except for any shares held by an existing "affiliate" of the Company, as that term is defined by the Securities Act (an "Affiliate"), which shares will be subject to the resale limitations of Rule 144 adopted under the Securities Act. As of the date of this Prospectus, 13,378,428 "restricted shares" as defined in Rule 144 will be outstanding. Of such shares, and without consideration of the contractual restrictions described below, 262,890 shares would be available for immediate sale in the public market without restriction pursuant to Rule 144(k). Beginning 90 days after the date of this Prospectus, and without consideration of the contractual restrictions described below, 13,108,538 shares would be eligible for sale in reliance upon Rule 144 promulgated under the Securities Act and 27,000 shares would be eligible for sale in reliance upon Rule 701 promulgated under the Securities Act.

In general, under Rule 144 as currently in effect, beginning 90 days after the Offering, a person (or persons whose shares are aggregated) who owns shares that were purchased from the Company (or any Affiliate) at least one year previously, including a person who may be deemed an Affiliate of the Company, is entitled to sell within any three-month period a number of shares that does not exceed the greater of (i) 1% of the then outstanding shares of the Common Stock (approximately 158,785 shares immediately after the Offering) or (ii) the average weekly trading volume of the Common Stock on the Nasdaq National Market during the four calendar weeks preceding the date on which notice of the sale is filed with the Securities and Exchange Commission (the "Commission"). Sales under Rule 144 are also subject to certain manner of sale provisions, notice requirements and the availability of current public information about the Company. Any person (or persons whose shares are aggregated) who is not deemed to have been an Affiliate of the Company at any time during the 90 days preceding a sale, and who owns shares within the definition of "restricted securities" under Rule 144 under the Securities Act that were purchased from the Company (or any Affiliate) at least two years previously, would be entitled to sell such shares under Rule 144(k) without regard to the volume limitations, manner of sale provisions, public information requirements or notice requirements.

Subject to certain limitations on the aggregate offering price of a transaction and other conditions, Rule 701 may be relied upon with respect to the resale of securities originally purchased from the Company by its employees, directors, officers, consultants or advisers prior to the date the issuer becomes subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), pursuant to written compensatory benefit plans or written contracts relating to the compensation of such persons. In addition, the Commission has indicated that Rule 701 will apply to typical stock options granted by an issuer before it becomes subject to the reporting requirements of the Exchange Act, along with the shares acquired upon exercise of such options (including exercises after the date of this Prospectus). Securities issued in reliance on Rule 701 are restricted securities and, subject to the contractual restrictions described above, beginning 90 days after the date of this Prospectus, may be sold (i) by persons other than Affiliates, subject only to the manner of sale provisions of Rule 144, and (ii) by Affiliates under Rule 144 without compliance with its one-year holding period requirement.

All stockholders of the Company, including the officers, directors and Selling Stockholders, have agreed not to sell any of their shares of Common Stock for 180 days after the date of this Prospectus without the prior written consent of the representatives of the Underwriters. As a result of these contractual restrictions and subject to the provisions of Rules 144(k), 144 and 701, as applicable, 15,878,428 shares will be eligible for sale upon expiration of the Lock-Up Agreements 180 days after the date of this Prospectus. See "Underwriting".

The Company has agreed not to offer, sell or otherwise dispose of any shares of Common Stock or any securities convertible into or exercisable or exchangeable for Common Stock or any rights to acquire

Common Stock for a period of 180 days after the date of this Prospectus, without the prior written consent of the representatives of the Underwriters, subject to certain limited exceptions. See "Underwriting".

After the Offering, the holders of 13,354,928 shares of Common Stock or their respective transferees, will be entitled to certain rights with respect to the registration of such shares under the Securities Act. See "Description of Capital Stock -- Registration Rights". Registration of such shares under the Securities Act would result in such shares becoming freely tradeable without restriction under the Securities Act (except for shares purchased by Affiliates) immediately upon the effectiveness of such registration.

The Company intends to file a registration statement under the Securities Act covering approximately 3,000,000 shares of Common Stock reserved for issuance under the 1995 Plan. See "Management -- Restated 1995 Stock Incentive Plan". Such registration statement is expected to be filed within 90 days after the date of this Prospectus and will automatically become effective upon filing. Following such filing, shares registered under such registration statement will, subject to the Lock-Up Agreements, Rule 144 volume limitations applicable to Affiliates and the lapsing of the Company's repurchase rights, be available for sale in the open market upon the exercise of vested options 90 days after the effective date of this Prospectus. At December 31, 1997, options to purchase 1,803,850 shares were issued and outstanding under the 1995 Plan and options to purchase 80,000 shares were issued and outstanding outside of the 1995 Plan.

VALIDITY OF COMMON STOCK

The validity of the Common Stock offered hereby will be passed upon for the Company by Brobeck, Phleger & Harrison LLP, Austin, Texas. Certain legal matters in connection with the offering will be passed upon for the Underwriters by Ropes & Gray, Boston, Massachusetts.

EXPERTS

The consolidated financial statements of the Company at December 31, 1996 and 1997, and for each of the three years in the period ended December 31, 1997, appearing in this Prospectus and the Registration Statement have been audited by Ernst & Young LLP, independent auditors, as set forth in their report thereon appearing elsewhere herein and in the Registration Statement, and are included in reliance upon such report given upon the authority of such firm as experts in accounting and auditing.

ADDITIONAL INFORMATION

The Company has filed with the Commission, Washington, D.C. 20549, a Registration Statement on Form S-1 under the Securities Act with respect to the Common Stock offered hereby. This Prospectus does not contain all of the information set forth in the Registration Statement and the exhibits and schedules to the Registration Statement. For further information with respect to the Company and the Common Stock offered hereby, reference is made to the Registration Statement and the exhibits and schedules filed as a part of the Registration Statement. Statements contained in this Prospectus concerning the contents of any contract or any other document are not necessarily complete; reference is made in each instance to the copy of such contract or any other document filed as an exhibit to the Registration Statement. Each such statement is qualified in all respects by such reference to such exhibit. The Registration Statement, including exhibits and schedules thereto, may be inspected without charge at the Commission's principal office in Washington, D.C., and copies of all or any part thereof may be obtained from the Public Reference Section of the Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, and at the Commission's regional offices located at Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661 and at 7 World Trade Center, 13th Floor, New York, New York 10048 after payment of fees prescribed by the Commission. The Commission also maintains a Web site which provides online access to reports, proxy and information statements and other information regarding registrants that file electronically with the Commission at the address <http://www.sec.gov>.

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REPORT OF INDEPENDENT AUDITORS

Board of Directors
ISS Group, Inc.

We have audited the accompanying consolidated balance sheets of ISS Group, Inc. (formerly Internet Security Systems, Inc.) as of December 31, 1996 and 1997, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of ISS Group, Inc. at December 31, 1996 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles.

/s/ ERNST & YOUNG LLP

*Atlanta, Georgia
January 13, 1998*

ISS GROUP, INC.

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31,		
	1996	1997	PRO FORMA 1997
			(UNAUDITED)
ASSETS			
Current assets:			
Cash and cash equivalents.....	\$ 2,007,000	\$ 3,929,000	\$ 3,929,000
Accounts receivable, less allowance for doubtful accounts of \$79,000, \$255,000 and \$255,000, respectively.....	1,949,000	4,038,000	4,038,000
Prepaid expenses and other current assets.....	128,000	281,000	281,000
	-----	-----	-----
Total current assets.....	4,084,000	8,248,000	8,248,000
Property and equipment:			
Computer equipment.....	267,000	1,688,000	1,688,000
Office furniture and equipment.....	59,000	268,000	268,000
Leasehold improvements.....	15,000	15,000	15,000
	-----	-----	-----
	341,000	1,971,000	1,971,000
Less accumulated depreciation.....	68,000	402,000	402,000
	-----	-----	-----
	273,000	1,569,000	1,569,000
Other assets.....	23,000	49,000	49,000
	-----	-----	-----
Total assets.....	\$ 4,380,000	\$ 9,866,000	\$ 9,866,000
	=====	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)			
Current liabilities:			
Accounts payable.....	\$ 341,000	\$ 2,002,000	\$ 2,002,000
Accrued expenses.....	731,000	1,798,000	1,798,000
Deferred revenues.....	644,000	2,106,000	2,106,000
Current portion of long term debt.....	70,000	70,000	70,000
	-----	-----	-----
Total current liabilities.....	1,786,000	5,976,000	5,976,000
Long term debt.....	140,000	70,000	70,000
Commitments and contingencies.....	--	--	--
Redeemable, Convertible Preferred Stock (5,737,000 shares authorized):			
Series A; \$.001 par value; 3,650,000 issued and outstanding (historical), none issued or outstanding (pro forma) (liquidation preference \$1 per share).....	3,614,000	3,621,000	--
Series B; \$.001 par value; 2,087,000 issued and outstanding (historical), none issued or outstanding (pro forma) (liquidation preference \$2.53 per share).....	--	5,257,000	--
Stockholders' equity (deficit):			
Preferred Stock; \$.001 par value; 20,000,000 shares authorized (including 5,737,000 designated as Redeemable, Convertible Preferred Stock), none issued or outstanding.....	--	--	--
Common Stock, \$.001 par value, 50,000,000 shares authorized, 7,902,000 and 7,921,000 shares issued and outstanding (historical), 13,658,000 shares issued and outstanding (pro forma).....	8,000	8,000	14,000
Additional paid-in capital.....	103,000	124,000	8,996,000
Accumulated deficit.....	(1,271,000)	(5,190,000)	(5,190,000)
	-----	-----	-----
Total stockholders' equity (deficit)....	(1,160,000)	(5,058,000)	3,820,000
	-----	-----	-----
Total liabilities and stockholders' equity (deficit).....	\$ 4,380,000	\$ 9,866,000	\$ 9,866,000

=====

See accompanying notes.

ISS GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

	YEAR ENDED DECEMBER 31,		
	1995	1996	1997
Revenues:			
Licenses.....	\$ 246,000	\$ 4,233,000	\$10,936,000
Support services.....	11,000	229,000	2,531,000
	257,000	4,462,000	13,467,000
Costs and expenses:			
Cost of revenues.....	4,000	18,000	676,000
Research and development.....	97,000	1,225,000	3,434,000
Sales and marketing.....	252,000	3,768,000	11,731,000
General and administrative.....	44,000	656,000	1,773,000
	397,000	5,667,000	17,614,000
Operating loss.....	(140,000)	(1,205,000)	(4,147,000)
Interest income.....	--	77,000	245,000
Interest expense.....	--	(3,000)	(17,000)
Net loss.....	\$(140,000)	\$(1,131,000)	\$(3,919,000)
Unaudited pro forma net loss per share of Common Stock.....			\$ (.28)
Unaudited weighted average number of shares used in calculating pro forma net loss per share of Common Stock.....			14,181,000

See accompanying notes.

ISS GROUP, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS (ACCUMULATED DEFICIT)	TOTAL STOCKHOLDERS' EQUITY (DEFICIT)
	----- SHARES	AMOUNT -----			
Balance at December 31, 1994.....	4,586,000	\$5,000	\$ (5,000)	\$ 10,000	\$ 10,000
Issuance of Common Stock to investor, September 8, 1995.....	1,293,000	1,000	49,000	--	50,000
Issuance of Common Stock to employees, December 29, 1995....	2,123,000	2,000	81,000	--	83,000
Cash dividends.....	--	--	--	(10,000)	(10,000)
Net loss.....	--	--	--	(140,000)	(140,000)
	-----	-----	-----	-----	-----
Balance at December 31, 1995.....	8,002,000	8,000	125,000	(140,000)	(7,000)
Repurchase of Common Stock from founder.....	(100,000)	--	(15,000)	--	(15,000)
Accretion related to Redeemable, Convertible Preferred Stock....	--	--	(7,000)	--	(7,000)
Net loss.....	--	--	--	(1,131,000)	(1,131,000)
	-----	-----	-----	-----	-----
Balance at December 31, 1996.....	7,902,000	8,000	103,000	(1,271,000)	(1,160,000)
Accretion related to Redeemable, Convertible Preferred Stock....	--	--	(11,000)	--	(11,000)
Issuance of Common Stock.....	19,000	--	32,000	--	32,000
Net loss.....	--	--	--	(3,919,000)	(3,919,000)
	-----	-----	-----	-----	-----
Balance at December 31, 1997.....	7,921,000	\$8,000	\$124,000	\$(5,190,000)	\$(5,058,000)
	=====	=====	=====	=====	=====

See accompanying notes.

ISS GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEAR ENDED DECEMBER 31,		
	1995	1996	1997
OPERATING ACTIVITIES			
Net loss.....	\$(140,000)	\$(1,131,000)	\$(3,919,000)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation.....	4,000	66,000	334,000
Non-cash expense.....	83,000	--	31,000
Changes in assets and liabilities:			
Accounts receivable.....	(148,000)	(1,802,000)	(2,089,000)
Prepaid expenses and other assets.....	(3,000)	(146,000)	(179,000)
Accounts payable and accrued expenses.....	117,000	955,000	2,728,000
Deferred revenues.....	37,000	607,000	1,462,000
Net cash used in operating activities.....	(50,000)	(1,451,000)	(1,632,000)
INVESTING ACTIVITIES			
Purchases of property and equipment.....	(23,000)	(320,000)	(1,630,000)
Net cash used in investing activities.....	(23,000)	(320,000)	(1,630,000)
FINANCING ACTIVITIES			
Proceeds from (payments on) long term debt.....	--	210,000	(70,000)
Net proceeds from Redeemable, Convertible Preferred Stock issuances.....	--	3,607,000	5,253,000
Proceeds from (payments on) notes payable to shareholder.....	30,000	(30,000)	--
Common Stock activities.....	50,000	(15,000)	1,000
Cash dividends.....	(10,000)	--	--
Net cash provided by financing activities.....	70,000	3,772,000	5,184,000
Net (decrease) increase in cash and cash equivalents.....	(3,000)	2,001,000	1,922,000
Cash and cash equivalents at beginning of year.....	9,000	6,000	2,007,000
Cash and cash equivalents at end of year.....	\$ 6,000	\$ 2,007,000	\$ 3,929,000
SUPPLEMENTAL CASH FLOW DISCLOSURE			
Interest paid.....	\$ --	\$ 1,000	\$ 17,000

See accompanying notes.

ISS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 1997

1. SIGNIFICANT ACCOUNTING POLICIES

CONSOLIDATION AND DESCRIPTION OF BUSINESS

The consolidated financial statements include the accounts of ISS Group, Inc. and its subsidiaries ("the Company"). All significant intercompany investment accounts and transactions have been eliminated in consolidation.

ISS Group, Inc. was incorporated in the State of Delaware on December 8, 1997 to be a holding company for Internet Security Systems, Inc., a Georgia company incorporated on April 19, 1994 to design, market, and sell computer network security assessment software. In March 1996, the Company formed Internet Security Systems Europe NV ("ISS Europe"), of which the Company owns 99.96% of the outstanding stock. In February 1997, the Company formed ISS Japan, KK, a wholly owned subsidiary. These subsidiaries have primary marketing and sales responsibilities for the Company's products in Europe and the Asia/Pacific regions.

The financial statements of foreign subsidiaries have been translated into United States dollars in accordance with Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 52 Foreign Currency Translation. Revenues with international customers, except in Japan, were denominated in U.S. dollars. Revenues from Japanese customers and international expenditures were denominated in the respective local currencies and translated using the average exchange rates for the year. The effect on the statements of operations related to transaction gains and losses is insignificant for all years presented. All balance sheet accounts have been translated using the exchange rates in effect at the balance sheet date and the effect of changes in exchange rates from year to year is insignificant.

The Company's business is focused on maintaining the latest security threat and vulnerability checks within existing products and creating new products and services that are consistent with the Company's goal of providing an adaptive security management approach to network security. This approach entails continuous security risk monitoring and response to develop an active and informed network security policy.

REVENUE RECOGNITION

The Company recognizes its license revenue upon (i) delivery of software or, if the customer has evaluation software, delivery of the software key, and (ii) issuance of the related license, assuming no significant vendor obligations or customer acceptance rights exist. In October 1997, the AICPA issued Statement of Position ("SOP") No. 97-2, Software Revenue Recognition, which the Company adopted, effective January 1, 1997. Such adoption had no effect on the Company's methods of recognizing revenue from its license and maintenance activities. Prior to 1997, the Company's revenue recognition policy was in accordance with the preceding authoritative guidance provided by SOP No. 91-1, Software Revenue Recognition.

Revenues from perpetual licenses are recorded as license revenues in the statements of operations. Support service revenues include maintenance, term license revenues, and professional services. Annual renewable maintenance is a separate component of each contract, and is recognized ratably over the contract term. Term licenses, which allow customer use of the product and maintenance for a specified period, generally twelve months, are also recognized ratably over the contract term. Professional services revenues are recognized as such services are performed.

ISS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) CASH AND CASH EQUIVALENTS

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Such amounts are stated at cost which approximates market value.

CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company maintains cash and cash equivalents with two financial institutions. The Company's sales are primarily to companies located in the United States, Europe and the Asia/Pacific regions. The Company performs periodic credit evaluations of its customers' financial condition and does not require collateral. Accounts receivable are due principally from large U.S. companies under stated contract terms. The Company provides for estimated credit losses at the time of sale. Such losses have not been significant to date.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method for financial reporting purposes over the estimated useful lives of the assets (primarily three years).

RESEARCH AND DEVELOPMENT COSTS

Research and development costs are charged to expense as incurred. The Company has not capitalized any such development costs under SFAS No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed, because the costs incurred by the Company between the attainment of technological feasibility for the related software product through the date when the product is available for general release to customers is insignificant.

ADVERTISING COSTS

The cost of advertising is expensed as incurred. The Company incurred \$34,000, \$485,000 and \$572,000 of advertising costs for the years ended December 31, 1995, 1996 and 1997, respectively. Such amounts are included in sales and marketing expense in the statements of operations.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates, and such differences may be material to the consolidated financial statements.

STOCK BASED COMPENSATION

The Company grants stock options generally for a fixed number of shares to certain employees with an exercise price equal to the fair value of the shares at the date of grant. The Company accounts for stock option grants in accordance with Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and, accordingly, recognizes no compensation expense for stock option grants for which the terms are fixed. In October 1995, the FASB issued SFAS No. 123, Accounting for Stock-Based Compensation, which provides an alternative to APB Opinion No. 25 in accounting for stock-based compensation issued to employees. As permitted by SFAS No. 123, the Company continues

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) STOCK BASED COMPENSATION (CONTINUED) to account for stock-based compensation in accordance with APB Opinion No. 25 and has elected the pro forma disclosure alternative of SFAS No. 123 (see Note 6).

PRO FORMA BALANCE SHEET (UNAUDITED)

In conjunction with an initial public offering of the Company's Common Stock, all outstanding shares of Series A and Series B Redeemable, Convertible Preferred Stock automatically convert into shares of Common Stock. As such, the effect of the conversions has been reflected in the unaudited pro forma balance sheet at December 31, 1997.

LOSS PER SHARE

In 1997, the FASB issued SFAS No. 128, Earnings per Share. SFAS No. 128 replaced the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants, and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share. Because of the significant impact of the assumed conversion of the Series A and Series B Redeemable, Convertible Preferred Stock into Common Stock upon consummation of the initial public offering of the Company's Common Stock on the Company's capital structure and loss per share, historical loss per share information has been excluded from the face of the statements of operations as it is not considered meaningful.

Unaudited pro forma net loss per share was computed by dividing net loss by the unaudited weighted average number of shares of Common Stock outstanding after giving retroactive effect to cheap stock, as defined below, and the conversion of the 3,650,000 shares of Series A and 2,087,000 shares of Series B Redeemable, Convertible Preferred Stock into 5,737,000 shares of Common Stock which will occur upon consummation of the Company's initial public offering.

Pursuant to the Securities and Exchange Commission Staff Accounting Bulletin No. 83, common stock and common stock equivalents issued at prices below the assumed initial public offering price per share ("cheap stock") during the twelve-month period immediately preceding the initial filing date of the Company's Registration Statement for its initial public offering have been included in the calculation of unaudited pro forma net loss per share (using the treasury stock method at the assumed initial public offering price) even though the effect is to reduce the unaudited pro forma net loss per share.

Basic and diluted historical net loss per share (see Note 10) was computed by dividing net loss plus accretion of the Series A and Series B Redeemable, Convertible Preferred Stock by the weighted average number of shares of Common Stock plus cheap stock using the treasury stock method at the assumed initial public offering price of \$10.00 per share. Common Stock equivalents were antidilutive and therefore were not included in the computation of weighted average shares used in computing diluted loss per share for the years ended December 31, 1995, 1996 and 1997. Cheap stock, which includes the Series B Redeemable, Convertible Preferred Stock, is included as outstanding for all periods even though the effect is to reduce net loss per share for the years ended December 31, 1995, 1996 and 1997.

RECENTLY ISSUED ACCOUNTING STANDARDS

In June 1997, the FASB issued SFAS No. 130, Reporting Comprehensive Income, which establishes standards for reporting and displaying comprehensive income, as defined, and its components in

ISS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

1. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) RECENTLY ISSUED ACCOUNTING STANDARDS (CONTINUED) financial statements. The Company's adoption of SFAS No. 130 had no impact on the consolidated financial statements.

In June 1997, the FASB issued SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. SFAS No. 131 establishes standards for the way that public business enterprises report information about operating segments in annual financial statements for periods beginning after December 15, 1997. The Statement requires that business segment financial information be reported in the financial statements utilizing the management approach. The management approach is defined as the manner in which management organizes the segments within the enterprise for making operating decisions and assessing performance. Management believes the adoption of SFAS No. 131 will not have a material impact on the financial statements.

RECLASSIFICATIONS

Certain reclassifications were made to the prior years' financial statements to conform with the 1997 presentation.

2. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts reported in the balance sheets for cash and cash equivalents, accounts receivable and accounts payable approximate their fair values. The carrying amounts reported in the balance sheets for long-term debt approximate their fair values as the interest rate related to such debt is variable and commensurate with the Company's credit worthiness.

3. DEBT

At December 31, 1996 and 1997, the Company had outstanding balances of \$210,000 and \$140,000, respectively, under an equipment line of credit. Interest on such line accrues at 1.25% above the prime rate and is payable on a monthly basis. Borrowings under the equipment line are secured by equipment and are due in annual installments of \$70,000 in 1998 and 1999.

At December 31, 1996, the Company had an unused \$500,000 revolving line of credit which matured on October 31, 1997 and was not renewed by the Company.

4. REDEEMABLE, CONVERTIBLE PREFERRED STOCK

Redeemable, Convertible Preferred Stock consists of the following:

SERIES	DATE OF ISSUANCE	GROSS PROCEEDS	NET PROCEEDS	SHARES ISSUED AND OUTSTANDING
A	February 2, 1996	\$3,650,000	\$3,607,000	3,650,000
B	February 14, 1997	5,280,000	5,253,000	2,087,000
		\$8,930,000	\$8,860,000	5,737,000
		=====	=====	=====

Accretion related to the Company's Series A and Series B Redeemable, Convertible Preferred Stock was recorded over the respective redemption period by charges against additional paid-in capital with corresponding increases to the carrying value of the Series A and Series B Redeemable, Convertible Preferred Stock. Such increases aggregated \$7,000 and \$11,000 for the years ended December 31, 1996 and 1997, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

4. REDEEMABLE, CONVERTIBLE PREFERRED STOCK (CONTINUED) The rights, preferences, qualifications, limitations, and restrictions of the holders of the Series A and Series B Redeemable, Convertible Preferred Stock are as follows:

a. Dividend Rights. Dividends as specifically declared by the Company's Board of Directors are to be in preference to payment of any dividend (other than dividends payable solely in Common Stock) with respect to the Common Stock.

b. Liquidation Rights. In the event of any liquidation, dissolution or winding up of the Corporation, whether voluntary or not, Series A and Series B holders shall be paid an amount equal to \$1.00 per share and \$2.53 per share, respectively, (adjusted for stock splits, combinations, or similar events) plus, in each case, all declared and unpaid dividends, if any, before any amount shall be paid to holders of Common Stock. Any remaining assets and surplus funds shall be distributed ratably among the holders of the Common Stock, the Series A Preferred Stock and the Series B Preferred Stock on an as-converted basis. In no event shall the holders of the Series A Preferred Stock and Series B Preferred Stock be entitled to receive more than \$2.00 and \$5.06 per share, respectively, unless such holders have converted their shares of Series A Preferred Stock or Series B Preferred Stock into Common Stock prior to the occurrence of a liquidation, dissolution or winding up of the Corporation.

c. Mandatory Redemption. If the Series A or Series B Preferred Stock has not been redeemed or converted into Common Stock prior to September 30, 2000 each share of Series A and Series B Preferred Stock is redeemable at the request of the holders of at least 51% of the outstanding shares. If the redemption provisions are exercised, redemption will occur in stages in the years 2001, 2002, and 2003. The redemption price is equal to the original price plus all declared and unpaid dividends.

d. Voting Rights. The Series A and Series B Preferred Stock generally vote equally with shares of Common Stock on an "as if converted" basis except that the holders of Series A Preferred Stock, voting as a separate series, shall elect two members of the Company's Board of Directors. The holders of Common Stock and Series A and Series B Preferred Stock, voting together as a class, shall elect all the remaining directors.

e. Protective Provisions. The Series A and Series B Preferred Stock holders have certain protective provisions which prohibit the Company from certain activities (e.g. sale of substantially all of the Company's assets, changes to Series A and Series B instruments, dividend declarations, creating new classes of Preferred Stock senior to the Series A or Series B Preferred Stock) without first obtaining the approval of holders of at least a majority of the then outstanding shares of the Series A and Series B Preferred Stock holders, as defined.

f. Conversion. Shares of Series A and Series B Preferred Stock are convertible, at the option of the holder, to Common Stock at any time at the rate of one share of Common Stock for each share of Preferred Stock. The Series A and Series B Preferred Stock automatically converts to Common Stock upon the closing of (i) an underwritten public offering of the Company's Common Stock in which the aggregate proceeds for such shares is at least \$10,000,000 and the per share price is at least \$6.00 per share (adjusted for any stock split, dividend, combination, recapitalization, or the like) or (ii) the written election of holders of not less than a majority of the then outstanding shares of such series.

In connection with the issuance of the Series A Preferred Stock, the Company effected an 89.92-for-1 share stock split of its Common Stock. The Company has designated 3,650,000 shares of the authorized Preferred Stock as Series A Preferred Stock and 2,087,000 shares as Series B Preferred

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

4. REDEEMABLE, CONVERTIBLE PREFERRED STOCK (CONTINUED) Stock. All par value and share amounts in the accompanying financial statements have been retroactively adjusted to reflect the stock split and changes to the articles of incorporation.

5. STOCKHOLDERS' EQUITY

On April 19, 1994, the Company issued 4,586,000 shares of Common Stock to the founder in exchange for the assignment of technology previously developed and distributed by the founder as shareware. In connection with the issuance of Series A Preferred Stock (see Note 4), the founder entered into a Stock Repurchase Agreement (the "Founder's Agreement") with the Company. Under the Founder's Agreement the Company has the right to acquire, at fair market value, up to 2,293,000 shares of the founder's Common Stock upon the founder's separation from the Company, as defined. The Company's repurchase rights expire ratably over a four year period beginning February 1, 1996 or upon the consummation of an initial public offering of the Company's Common Stock.

On September 8, 1995, the Company issued 1,293,000 shares of Common Stock to an investor for \$50,000.

On December 29, 1995, the Company issued 2,123,000 shares of Common Stock to two employees and recorded \$83,000 of compensation expense. In connection with the issuance of Series A Preferred Stock (see Note 4), the employees entered into a Stock Repurchase Agreement (the "Agreement") with the Company. Under the Agreement, the Company has the right to acquire, at fair market value, up to 1,633,000 shares of such employees' Common Stock upon the employees' separation from the Company, as defined. The Company's repurchase rights expire ratably over a four year period beginning February 1, 1996 or upon the consummation of an initial public offering of the Company's Common Stock.

On February 2, 1996 the Company acquired 100,000 shares of its Common Stock from the founder for \$15,000.

The Company has reserved 8,810,000 shares of Common Stock for future issuance upon conversion of outstanding Series A and Series B Preferred Stock and exercise of options to purchase Common Stock.

In December 1997, the Company commenced plans to offer up to 2,200,000 of newly issued shares of Common Stock in an initial public offering plus 310,000 shares that the underwriters have the option to purchase to cover over-allotments, if any.

6. STOCK OPTION PLANS

In 1995, the Company established the 1995 Incentive Stock Plan (the "Plan") to provide for the granting of qualified or nonqualified options to purchase shares of the Company's Common Stock. In 1997, the Company amended the Plan to increase the number of shares reserved for future issuance under such plan to 3,000,000 shares.

Effective with the 1997 Plan amendment, options granted under the Plan became immediately exercisable, subject to a right of repurchase by the Company at the original exercise price for all unvested shares. Vesting occurs in equal annual installments over four years, generally measured from the date of the grant. Once an optionee vests in the shares underlying the option and until certain events occur, including an initial public offering of the Company's common stock, the Company has a right of first refusal to repurchase such shares after an individual has received a bona fide third party offer with respect to such vested shares. All options are issued at fair market value on the date of grant. Fair market value of the Company's Common Stock, in the absence of trading on a national or regional stock exchange, is determined by the Company's Board of Directors.

ISS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

6. STOCK OPTION PLANS (CONTINUED)

The Plan also includes an Automatic Option Grant Program (the "Program"). Under the Program, each individual who first joins the Company's Board of Directors as a non-employee Board member after the effective date of an initial public offering will receive an option to purchase 20,000 shares of Common Stock on the date he or she is first elected or appointed to the Board of Directors, provided such individual has not otherwise been in the prior employ of the Company. In addition, at each annual stockholders' meeting, beginning with the 1999 annual meeting, each individual who is to continue to serve as a non-employee Board of Directors member after the meeting will receive an additional option to purchase 5,000 shares of Common Stock. Options under the Program will be issued at fair market value at the date of the grant.

On December 8, 1997, the Company's Board of Directors granted to each of the Company's four non-employee directors a nonstatutory option to purchase up to 20,000 shares of Common Stock outside the Plan, on the same terms as if those options had been granted under the Program of the 1995 Plan. The Company reserved 80,000 shares of Common Stock for issuance under these options.

A summary of the Company's stock option activity is as follows:

	1996		1997	
	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER OF SHARES	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding at beginning of year.....	--	\$ --	810,000	\$.16
Granted.....	810,000	.16	1,101,000	4.54
Exercised.....	--	--	(7,000)	.15
Canceled.....	--	--	(20,000)	.41
Outstanding at end of year.....	810,000	.16	1,884,000	2.71
Exercisable at end of year.....	--	--	1,884,000	2.71
Weighted average fair value of options granted during the year.....	\$.04		\$ 2.34	

The following table summarizes information concerning currently outstanding options, all of which are exercisable:

	OPTIONS OUTSTANDING		
RANGE OF EXERCISE PRICES	NUMBER OF OPTIONS OUTSTANDING AT DECEMBER 31, 1997	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICE
\$.15-.60.....	1,067,000	8.6 years...	\$.28
\$1.00-7.00.....	817,000	9.9 years...	5.89
	1,884,000		

Pro forma information regarding net income and net income per share is required by SFAS No. 123, which also requires that the information be determined as if the Company had accounted for its employee stock options granted subsequent to December 31, 1994 under the fair value method prescribed by that Statement. The fair value for options granted was estimated at the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used for 1996 and 1997, respectively: risk-free interest rates of 5.97% and 6.28%; no dividend yield; a .60 volatility factor; and an expected life of the

options of 4 years.

ISS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

6. STOCK OPTION PLANS (CONTINUED) The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics different from those of traded options, and because the changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of pro forma disclosures, the estimated fair value of the option is amortized to expense over the options' vesting period. The following pro forma information adjusts the net loss and unaudited pro forma net loss per share of Common Stock for the impact of SFAS No. 123:

	YEAR ENDED DECEMBER 31, 1997

Unaudited pro forma net loss.....	\$(3,975,000)
	=====
Unaudited pro forma net loss per share as adjusted.....	\$ (.28)
	=====

7. COMMITMENTS

In 1996, the Company entered into noncancellable operating leases for new facilities that expire in July 2001. The Company has the option to extend the terms of the leases for one additional five year term upon expiration of the initial terms.

Future minimum payments under noncancellable operating leases with initial terms of one year or more consisted of the following at December 31:

	OPERATING LEASES

1998.....	\$ 400,000
1999.....	277,000
2000.....	276,000
2001.....	105,000

Total minimum lease payments.....	\$1,058,000
	=====

Rent expense was approximately \$4,000, \$105,000 and \$401,000 for the years ended December 31, 1995, 1996 and 1997, respectively.

8. INCOME TAXES

On January 1, 1996 the Company adopted the liability method of accounting for income taxes. Under this method, deferred income tax assets and liabilities are determined based on the differences between the financial reporting and the tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Prior to 1996, the Company qualified as an S-Corporation and any income taxes were the responsibilities of the shareholders.

ISS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

8. INCOME TAXES (CONTINUED) A reconciliation of the provision for income taxes to the statutory federal income tax rate is as follows:

	YEAR ENDED DECEMBER 31,	
	1996	1997
Statutory rate at 34%, applied to pre-tax loss.....	\$(384,000)	\$(1,332,000)
State income taxes, net of federal tax benefit.....	(45,000)	(157,000)
Research and development tax credit.....	(28,000)	(159,000)
Foreign operations.....	100,000	--
Other.....	46,000	(26,000)
Change in valuation allowance.....	311,000	1,674,000
	\$ --	\$ --
	=====	=====

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's net deferred income tax assets are as follows:

	DECEMBER 31,	
	1996	1997
Depreciation.....	\$ --	\$ 69,000
Accrued liabilities.....	20,000	148,000
Allowance for doubtful accounts.....	30,000	97,000
Net operating loss carryforwards.....	233,000	1,484,000
Research and development tax credit carryforwards.....	28,000	187,000
	311,000	1,985,000
Less valuation allowance.....	(311,000)	(1,985,000)
Net deferred income tax assets.....	\$ --	\$ --
	=====	=====

For financial reporting purposes, a valuation allowance has been recognized to reduce the net deferred income tax assets to zero. The Company has not recognized any benefit from the future use of such loss carryforwards because management's evaluation of all the available evidence in assessing the realizability of the tax benefits of such loss carryforwards indicates that the underlying assumptions of future profitable operations contain risks that do not provide sufficient assurance to recognize such tax benefits currently.

The Company has approximately \$3,906,000 of net operating loss carryforwards for federal income tax purposes that expire in varying amounts between 2011 and 2012. A small portion of the net operating loss carryforwards may be subject to certain limitations in the event of a change in ownership. The Company also has approximately \$295,000 of net operating loss carryforwards related to its foreign operations which have no expiration date. Additionally, the Company has approximately \$187,000 of research and development tax credit carryforwards which expire between 2011 and 2012.

9. EMPLOYEE BENEFIT PLANS

In January 1996, the Company established a 401(k) plan that covers substantially all employees over 21 years of age. The Company may make contributions to the plan at its discretion. The Company made no contributions to the plan for the years ended December 31, 1996 or 1997.

ISS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

10. LOSS PER SHARE

The following table sets forth the computation of basic, diluted and unaudited pro forma net loss per share:

	HISTORICAL			PRO FORMA
	1995	1996	1997	1997
Numerator:				
Net loss.....	\$ (140,000)	\$(1,131,000)	\$ (3,919,000)	\$ (3,919,000)
Accretion of Series A and Series B Redeemable, Convertible Preferred Stock.....	--	(7,000)	(11,000)	(11,000)
	\$ (140,000)	\$(1,138,000)	\$ (3,930,000)	\$ (3,930,000)
Denominator:				
Denominator for basic loss per share -- weighted average shares.....	5,001,000	7,916,000	7,908,000	7,908,000
Cheap stock.....	2,096,000	2,096,000	2,096,000	536,000
Redeemable, Convertible Preferred Stock.....	--	--	--	5,737,000
	7,097,000	10,012,000	10,004,000	14,181,000
Basic loss per share.....	\$ (.02)	\$ (.11)	\$ (.39)	
Diluted loss per share.....	\$ (.02)	\$ (.11)	\$ (.39)	
Pro forma loss per share (unaudited).....				\$ (.28)

See Note 1 for a discussion of the statement of operations presentation of only unaudited pro forma net loss per share.

11. EXPORT SALES

Export sales from the United States to the Europe and Asia/Pacific regions represented approximately 10% and 3%, respectively, of total revenues for the year ended December 31, 1997. Export sales were not significant for the years ended December 31, 1995 and 1996. Revenues generated from the Company's foreign operations located in the Asia/Pacific region totalled approximately 8% of total revenues for the year ended December 31, 1997. The Company had no revenue generating foreign operations prior to 1997.

UNDERWRITING

Subject to the terms and conditions of the Underwriting Agreement, the Company and the Selling Stockholders have agreed to sell to each of the Underwriters named below, and each of such Underwriters, for whom Goldman, Sachs & Co., BancAmerica Robertson Stephens, UBS Securities LLC and Wessels, Arnold & Henderson, L.L.C. are acting as representatives, has severally agreed to purchase from the Company and the Selling Stockholders, the respective number of shares of Common Stock set forth opposite its name below:

UNDERWRITER -----	NUMBER OF SHARES OF COMMON STOCK -----
Goldman, Sachs & Co.	
BancAmerica Robertson Stephens	
UBS Securities LLC.....	
Wessels, Arnold & Henderson, L.L.C.	
 Total.....	 2,500,000 =====

Under the terms and conditions of the Underwriting Agreement, the Underwriters are committed to take and pay for all of the shares offered hereby, if any are taken.

The Underwriters propose to offer the shares of Common Stock in part directly to the public at the initial public offering price set forth on the cover page of this Prospectus, and in part to certain securities dealers at such price less a concession of \$ per share. The Underwriters may allow, and such dealers may realow, a concession not in excess of \$ per share to certain brokers and dealers. After the shares of Common Stock are released for sale to the public, the offering price and other selling terms may from time to time be varied by the representatives.

The Company and Selling Stockholders have granted the Underwriters an option exercisable for 30 days after the date of the Prospectus to purchase up to an aggregate of 375,000 additional shares of Common Stock solely to cover over-allotments, if any. If the Underwriters exercise their over-allotment option, the Underwriters have severally agreed, subject to certain conditions, to purchase approximately the same percentage thereof that the number of shares to be purchased by each of them, as shown in the foregoing table, bears to the 2,500,000 shares of Common Stock offered.

The Company and the Selling Stockholders have agreed that, during the period beginning from the date of this Prospectus and continuing to and including the date 180 days after the date of this Prospectus, they will not offer, sell, contract to sell or otherwise dispose of any securities of the Company (other than pursuant to employee stock option plans existing on the date of this Prospectus) which are substantially similar to the shares of Common Stock or which are convertible or exchangeable into shares of Common Stock or any securities which are substantially similar to the shares of Common Stock, without the prior written consent of the representatives of the Underwriters.

In connection with the Offering, the Underwriters may purchase and sell the Common Stock in the open market. These transactions may include over-allotment and stabilizing transactions and purchases to cover syndicate short positions created by the Underwriters in connection with the Offering. Stabilizing transactions consist of certain bids or purchases for the purpose of preventing or retarding a decline in the market price of the Common Stock; and syndicate short positions created by the Underwriters involve the sale by the Underwriters of a greater number of shares of Common Stock than they are required to purchase from the Company in the Offering. The Underwriters also may impose a penalty bid, whereby selling concessions allowed to syndicate members or other broker-dealers in respect of the securities sold in the Offering for their account may be reclaimed by the syndicate if such shares of Common Stock are repurchased by the syndicate in stabilizing or covering transactions. These activities may stabilize,

maintain or otherwise affect the market price of the Common Stock which may be higher than the price that might otherwise prevail in the open market; and these activities, if commenced, may be discontinued at any time. These transactions may be effected on the Nasdaq National Market, in the over-the-counter market or otherwise.

The representatives of the Underwriters have informed the Company that they do not expect sales to accounts over which the Underwriters exercise discretionary authority to exceed five percent of the total number of shares of Common Stock offered by them.

Prior to this Offering, there has been no public market for the shares of Common Stock. The initial public offering price will be negotiated among the Company and the representatives of the Underwriters. Among the factors to be considered in determining the initial public offering price of the Common Stock, in addition to prevailing market conditions, will be the Company's historical performance, estimates of the business potential and earnings prospects of the Company, an assessment of the Company's management and the consideration of the above factors in relation to market valuation of companies in related businesses.

The Underwriters have reserved for sale, at the initial public offering price up to percent of the shares of Common Stock offered hereby for employees of the Company and certain other individuals who have expressed an interest in purchasing such shares of Common Stock in this Offering. The number of shares available for sale to the general public will be reduced to the extent such persons purchase such reserved shares. Any reserved shares not so purchased will be offered by the Underwriters to the general public on the same basis as other shares offered hereby.

Application will be made to list the Common Stock on the Nasdaq National Market under the symbol "ISSX". The Company has agreed to indemnify the several Underwriters against certain liabilities, including liabilities under the Securities Act.

NO PERSON HAS BEEN AUTHORIZED TO GIVE ANY INFORMATION OR TO MAKE ANY REPRESENTATIONS OTHER THAN THOSE CONTAINED IN THIS PROSPECTUS, AND, IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATIONS MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED. THIS PROSPECTUS DOES NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY ANY SECURITIES OTHER THAN THE SECURITIES TO WHICH IT RELATES OR AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY ANY SECURITIES OTHER THAN THE SECURITIES TO WHICH IT RELATES OR AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY SUCH SECURITIES IN ANY CIRCUMSTANCES IN WHICH SUCH OFFER OR SOLICITATION IS UNLAWFUL. NEITHER THE DELIVERY OF THIS PROSPECTUS NOR ANY SALE MADE HEREUNDER SHALL, UNDER ANY CIRCUMSTANCES, CREATE ANY IMPLICATION THAT THERE HAS BEEN NO CHANGE IN THE AFFAIRS OF THE COMPANY SINCE THE DATE HEREOF OR THAT THE INFORMATION CONTAINED HEREIN IS CORRECT AS OF ANY TIME SUBSEQUENT TO ITS DATE.

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THROUGH , 1998 (THE 25TH DAY AFTER THE DATE OF THIS PROSPECTUS), ALL DEALERS EFFECTING TRANSACTIONS IN THE COMMON STOCK, WHETHER OR NOT PARTICIPATING IN THIS DISTRIBUTION, MAY BE REQUIRED TO DELIVER A PROSPECTUS. THIS IS IN ADDITION TO THE OBLIGATION OF DEALERS TO DELIVER A PROSPECTUS WHEN ACTING AS UNDERWRITERS AND WITH RESPECT TO THEIR UNSOLD ALLOTMENTS OR SUBSCRIPTIONS.

2,500,000 SHARES

ISS GROUP, INC.

COMMON STOCK
(PAR VALUE \$0.001 PER SHARE)

[INTERNET SECURITY SYSTEMS LOGO]

GOLDMAN, SACHS & CO.

BANCAMERICA ROBERTSON STEPHENS

UBS SECURITIES

WESSELS, ARNOLD & HENDERSON
REPRESENTATIVES OF THE UNDERWRITERS

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

All capitalized terms used and not defined in Part II of this Registration Statement shall have the meaning assigned to them in the Prospectus which forms a part of this Registration Statement.

ITEM 13. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION

The following table sets forth the costs and expenses, other than underwriting discounts and commissions, payable by the registrant connection with the sale of Common Stock being registered. All amounts are estimates, except the SEC registration fee and the NASD filing fee.

SEC Registration fee.....	\$ 9,330
NASD fee.....	3,663
Nasdaq National Market listing fee.....	50,000
Printing and engraving expenses.....	150,000
Legal fees and expenses.....	250,000
Accounting fees and expenses.....	175,000
Blue sky fees and expenses.....	5,000
Transfer agent fees.....	5,000
Miscellaneous.....	52,007

Total.....	\$700,000
	=====

ITEM 14. INDEMNIFICATION OF DIRECTORS AND OFFICERS

Subsection (a) of Section 145 of the General Corporation Law of the State of Delaware empowers a corporation to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection with such action, suit or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful.

Subsection (b) of Section 145 empowers a corporation to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by right of the corporation to procure a judgment in its favor by reason of the fact that such person acted in any of the capacities set forth above, against expenses (including attorneys' fees) actually and reasonably incurred by him in connection with the defense or settlement of such action or suit if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, except that no indemnification may be made in respect to any claim issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

Section 145 further provides that to the extent a director or officer of a corporation has been successful on the merits or otherwise in the defense of any such action, suit or proceeding referred to in subsections (a) and (b) of Section 145 or in the defense of any claim, issue or matter therein, he shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by him in

connection therewith; that the indemnification provided for by Section 145 shall not be deemed exclusive of any other rights which the indemnified party may be entitled; that indemnification provided by Section 145 shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of such person's heirs, executors and administrators; and empowers the corporation to purchase and maintain insurance on behalf of a director or officer of the corporation against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against such liabilities under Section 145.

Section 102(b)(7) of the General Corporation Law of the State of Delaware provides that a certificate of incorporation may contain a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of the director (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law, or (iv) for any transaction from which the director derived an improper personal benefit.

Article Eleventh of the Registrant's Charter provides that, to the fullest extent permitted by the Delaware General Corporation Law as the same exists or as it may hereafter be amended, no director of the Registrant shall be personally liable to the Registrant or its stockholders for monetary damages for breach of fiduciary duty as a director.

Section 6.1 of the Registrant's Bylaws further provides that the Registrant shall, to the maximum extent and in the manner permitted by the General Corporation Law of Delaware, indemnify each of its directors and officers against expenses (including attorneys' fees), judgments, fines, settlements, and other amounts actually and reasonably incurred in connection with any proceeding, arising by reason of the fact that such person is or was an agent of the registrant.

Prior to the consummation of this offering, the Company will enter into indemnification agreements with each of its directors and executive officers that provide for indemnification and expense advancement to the fullest extent permitted under the Delaware General Corporation Law.

The Registrant maintains \$ _____ of officers' and directors' liability insurance.

Reference is made to Section _____ of the Underwriting Agreement filed as

Exhibit 1.1 hereto, indemnifying officers and directors of the Registrant against certain liabilities.

ITEM 15. RECENT SALES OF UNREGISTERED SECURITIES

Within the last three years, the Registrant has sold the following securities or engaged in the following transactions which were not registered under the Securities Act of 1933:

- (1) On September 6, 1995, Internet Security Systems, Inc. ("Oldco") sold 1,293,475 shares of its Common Stock, par value \$1.00 per share ("Oldco Common Stock") to Kevin J. O'Connor for \$50,000.
- (2) On December 29, 1995, Oldco issued 1,959,770 shares of Oldco Common Stock to Thomas E. Noonan and 162,890 shares of Oldco Common Stock to Glenn McGonnigle in consideration for their employment with Oldco.
- (3) On February 2 and 21, 1996, Oldco sold an aggregate of 3,650,000 shares of its Series A Preferred Stock, par value \$1.00 per share, for an aggregate of \$3,650,000 to Greylock Equity Limited Partnership, Sigma Associates III, L.P., Sigma Investors III, L.P., Sigma Partners III, L.P. and John P. Imlay, Jr. Also in connection with the sale of Oldco's Series A Preferred Stock, Oldco repurchased 100,000 shares of Oldco Common Stock from Christopher W. Klaus for \$15,000.

(4) On February 14, 1997 the Oldco sold an aggregate of 2,086,957 shares of its Series B Preferred Stock, par value \$1.00 per share, for an aggregate of \$5,280,001.20 to Greylock Equity Limited Partnership, Sigma Associates III, L.P., Sigma Investors III, L.P., Sigma Partners III, L.P., John P. Imlay, Jr., Kleiner Perkins Caufield & Byers VIII, KPCB Information Sciences Zaibatsu Fund II, KPCB Java Fund, AT&T Venture Fund II, L.P. and Venture Fund I, L.P.

(5) In December 1997, the Registrant, Oldco and the shareholders of Oldco entered into an exchange agreement whereby (i) each share of Oldco Common Stock was exchanged for one share of the Company's Common Stock, (ii) each share of Oldco's Series A Preferred Stock was exchanged for one share of the Company's Series A Preferred Stock and (iii) each share of Oldco's Series B Preferred Stock was exchanged for one share of the Company's Series B Preferred Stock.

(6) The Company has from time to time granted stock options to employees. The following table sets forth certain information regarding such grants:

	NUMBER OF SHARES	RANGE OF EXERCISE PRICES
	-----	-----
April 19, 1994 (inception) through December 31, 1995.....	--	\$ --
January 1, 1996 through December 31, 1996.....	810,350	0.15-0.60
January 1, 1997 through December 31, 1997.....	1,020,500	0.60-7.00

The above securities were offered and sold by the Registrant in reliance upon exemptions for registration pursuant to either (i) Section 4(2) of the Securities Act, as transactions not involving any public offering, or (ii) Rule 701 under the Securities Act. No underwriters were involved in connections with the sales of securities referred to in this Item 15.

ITEM 16. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Exhibits:

- 1.1* -- Form of Underwriting Agreement.
- 3.1 -- Certificate of Incorporation.
- 3.2 -- Bylaws.
- 4.1* -- Specimen Common Stock certificate.
- 4.2 -- See Exhibits 3.1 and 3.2 for provisions of the Certificate of Incorporation and Bylaws of the Registrant defining the rights of holders of Common Stock of the Registrant.
- 5.1* -- Opinion of Brobeck, Phleger & Harrison LLP.
- 10.1 -- Restated 1995 Stock Incentive Plan.
- 10.2 -- Directed Shares Agreements.
- 10.3 -- Internet Security Systems, Inc. Amended and Restated Rights Agreement.
- 10.4* -- Stock Exchange Agreement dated December 9, 1997.
- 10.5 -- [Reserved]
- 21.1 -- Subsidiaries of Registrant.
- 23.1 -- Consent of Ernst & Young LLP.

- 23.2* -- Consent of Brobeck, Phleger & Harrison LLP (included in the opinion filed as Exhibit 5.1).
- 24.1 -- Power of attorney pursuant to which amendments to this registration statement may be filed (included on the signature page in Part II hereof).
- 27.1 -- Financial Data Schedule (for SEC use only).

* To be filed by amendment

(b) Financial Statement Schedules

The following financial statement schedule of the Company is included in

Part II of the Registration Statement:

Report of Ernst & Young LLP, Independent Auditors

Schedule II – Valuation and Qualifying Accounts

Except for the financial statement schedule listed above, the financial statement schedules for which provision is made in the applicable accounting regulations of the Commission are either not required under the related instructions or are inapplicable and have therefore been omitted.

ITEM 17. UNDERTAKINGS

The registrant hereby undertakes to provide to the Underwriters at the closing specified in the Underwriting Agreement certificates in such denominations and registered in such names as required by the Underwriters to permit prompt delivery to each purchaser.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Registrant pursuant to the Delaware General Corporation Law, the Charter or the Bylaws of the registrant, the Underwriting Agreement, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act, and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer, or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered hereunder, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question of whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

The undersigned registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act, the information omitted from the form of Prospectus filed as part of this Registration Statement in reliance upon Rule 430A and contained in a form of Prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this Registration Statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of Prospectus shall be deemed to be a new Registration Statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

SIGNATURES

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES ACT OF 1933, AS AMENDED, THE REGISTRANT HAS DULY CAUSED THIS REGISTRATION STATEMENT TO BE SIGNED ON ITS BEHALF BY THE UNDERSIGNED, THEREUNTO DULY AUTHORIZED, IN THE CITY OF ATLANTA, STATE OF GEORGIA, ON THIS 20TH DAY OF JANUARY, 1998.

ISS GROUP, INC.

By: /s/ THOMAS E. NOONAN

Thomas E. Noonan
President, Chief Executive Officer
and
Chairman of the Board

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each individual whose signature appears below constitutes and appoints Thomas E. Noonan, Richard Macchia and Jon Ver Steeg and each of them, his true and lawful attorney-in-fact and agents, with full power of substitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this Registration Statement, and to sign any registration statement for the same offering covered by this Registration Statement that is to be effective upon filing pursuant to Rule 462(b) promulgated under the Securities Act of 1933, and all post-effective amendments thereto, and to file the same, with all exhibits thereto and all documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or his or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES ACT OF 1933, AS AMENDED, THIS REGISTRATION STATEMENT HAS BEEN SIGNED BY THE FOLLOWING PERSONS IN THE CAPACITIES AND ON THE DATES INDICATED:

NAME -----	TITLE -----	DATE -----
/s/ THOMAS E. NOONAN ----- Thomas E. Noonan	Chairman, President and Chief Executive (Principal Executive Officer)	January 20, 1998
/s/ CHRISTOPHER W. KLAUS ----- Christopher W. Klaus	Chief Technical Officer, Secretary and Director	January 20, 1998
/s/ RICHARD MACCHIA ----- Richard Macchia	Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	January 20, 1998
/s/ RICHARD S. BODMAN ----- Richard S. Bodman	Director	January 20, 1998
/s/ ROBERT E. DAVOLI ----- Robert E. Davoli	Director	January 20, 1998

NAME ----	TITLE -----	DATE ----
/s/ KEVIN J. O'CONNOR ----- Kevin J. O'Connor	Director	January 20, 1998
/s/ DAVID N. STROHM ----- David N. Strohm	Director	January 20, 1998

REPORT OF INDEPENDENT AUDITORS

We have audited the consolidated financial statements of ISS Group, Inc. as of December 31, 1996 and 1997, and for each of the three years in the period ended December 31, 1997, and have issued our report thereon dated January 13, 1998 (included elsewhere in this Registration Statement). Our audits also included the financial statement schedule listed in Item 16(b) of this Registration Statement. This schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits.

In our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ ERNST & YOUNG LLP

Atlanta, Georgia
January 13, 1998

SCHEDULE II – VALUATION AND QUALIFYING ACCOUNTS

	BALANCE AT BEGINNING OF YEAR -----	PROVISION -----	WRITEOFFS -----	BALANCE AT END OF YEAR -----
1995				
Allowance for Doubtful Accounts.....	\$ -- =====	\$ -- =====	\$ -- =====	\$ -- =====
1996				
Allowance for Doubtful Accounts.....	\$ -- =====	\$ 86,000 =====	\$ (7,000) =====	\$ 79,000 =====
1997				
Allowance for Doubtful Accounts.....	\$79,000 =====	\$195,000 =====	\$ (19,000) =====	\$255,000 =====

EXHIBIT 3.1
CERTIFICATE OF INCORPORATION
OF
ISS GROUP, INC.

ARTICLE I.

The name of this Corporation shall be ISS Group, Inc.

ARTICLE II.

The address of the registered office of the Corporation in the State of Delaware is 1209 Orange Street, City of Wilmington, County of New Castle, State of Delaware. The name of the registered agent at that address is The Corporation Trust Company.

ARTICLE III.

The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the Delaware General Corporation Law.

ARTICLE IV.

The name and mailing address of the incorporator of the Corporation is:

Brad Eastman Brobeck, Phleger & Harrison LLP 301 Congress Avenue, Suite 1200 Austin, Texas 78701

ARTICLE V.

A. Authorized Shares. The aggregate number of shares that the Corporation shall have authority to issue is 70,000,000, (i) 50,000,000 shares of which shall be Common Stock, with a par value of \$0.001 per share, and (ii) 20,000,000 shares of which shall be Preferred Stock, with a par value of \$0.001 per share.

B. Common Stock. Each share of Common Stock shall have one vote on each matter submitted to a vote of the stockholders of the Corporation. Subject to the provisions of applicable law and the rights of the holders of the outstanding shares of Preferred Stock, if any, the holders of shares of Common Stock shall be entitled to receive, when and as declared by the Board of Directors of the Corporation, out of the assets of the Corporation legally available therefor, dividends or other distributions, whether payable in cash, property or securities of the

Corporation. The holders of shares of Common Stock shall be entitled to receive, in proportion to the number of shares of Common Stock held, the net assets of the Corporation upon dissolution after any preferential amounts required to be paid or distributed to holders of outstanding shares of Preferred Stock, if any, are so paid or distributed.

C. Preferred Stock. The Preferred Stock may be issued from time to time by the Board of Directors as shares of one or more series. The first series shall consist of 3,650,000 shares and is designated "Series A Preferred Stock" with such rights, preferences, qualifications, limitations and restrictions as set forth in subsection 1 hereof. The second series shall consist of 2,086,957 shares and is designated "Series B Preferred Stock" with such rights, preferences, qualifications, limitations and restrictions as set forth in subsection 1 hereof. The description of shares of each additional series of Preferred Stock, including any designations, preferences, conversion and other rights, voting powers, restrictions, limitations as to dividends, qualifications, and terms and conditions of redemption shall be as set forth in resolutions adopted by the Board of Directors.

Subject to the designation rights, preferences, qualifications, limitations and restrictions of the Series A Preferred Stock and Series B Preferred Stock set forth in subsection 1 hereof, the Board of Directors is expressly authorized, at any time, by adopting resolutions providing for the issuance of, or providing for a change in the number of, shares of any particular series of Preferred Stock and, if and to the extent from time to time required by law, by filing certificates of amendment or designation which are effective without stockholder action, to increase or decrease the number of shares included in each series of Preferred Stock, but not below the number of shares then issued, and to set in any one or more respects the designations, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends, qualifications, or terms and conditions of redemption relating to the shares of each such series. The authority of the Board of Directors with respect to each series of Preferred Stock shall include, but not be limited to, setting or changing the following:

- a. the dividend rate, if any, on shares of such series, the times of payment and the date from which dividends shall be accumulated, if dividends are to be cumulative;
- b. whether the shares of such series shall be redeemable and, if so, the redemption price and the terms and conditions of such redemption;
- c. the obligation, if any, of the Corporation to redeem shares of such series pursuant to a sinking fund;
- d. whether shares of such series shall be convertible into, or exchangeable for, shares of stock of any other class or classes and, if so, the terms and conditions of such conversion or exchange, including the price or prices or the rate or rates of conversion or exchange and the terms of adjustment, if any;

e. whether the shares of such series shall have voting rights, in addition to the voting rights provided by law, and, if so, the extent of such voting rights;

f. the rights of the shares of such series in the event of voluntary or involuntary liquidation, dissolution or winding-up of the Corporation; and

g. any other relative rights, powers, preferences, qualifications, limitations or restrictions thereof relating to such series.

1. SERIES A PREFERRED STOCK AND SERIES B PREFERRED STOCK. The rights, preferences, qualifications, limitations and restrictions of the Series A Preferred Stock and Series B Preferred Stock are as follows:

a. Dividend Rights.

The holders of the Series A Preferred Stock and Series B Preferred Stock shall be entitled only to such dividends as shall be specifically declared by the Board of Directors of the Corporation with respect to the Series A Preferred Stock and Series B Preferred Stock out of funds legally available therefor. Any such dividend so declared shall be in preference to payment of any dividend (other than dividends payable solely in Common Stock of the Corporation) with respect to the Common Stock. Dividends, if declared and paid, must be paid on, or, if declared and set apart for payment on, must be declared and set apart for payment on, all outstanding series of Preferred Stock contemporaneously, and if less than full dividends are paid on or declared and set apart for payment on all outstanding series, then the same percentage of the respective dividend rate on each outstanding series of Preferred Stock shall be paid on or declared and set apart. No dividend or distribution shall be declared or paid on any shares of Common Stock (other than dividends payable solely in Common Stock of the Corporation) unless at the same time an equivalent dividend or distribution is paid or declared and set aside for payment on the Preferred Stock (on an as if converted to Common Stock basis).

b. Liquidation Rights.

(1) In the event of any liquidation, dissolution or winding up of the Corporation, whether voluntary or not, the holders of Series A Preferred Stock and Series B Preferred Stock shall be entitled to receive, before any amount shall be paid to holders of Common Stock, an amount per share equal to \$1.00 (the "Series A Original Issue Price") and \$2.53 (the "Series B Original Issue Price"), respectively, as equitably adjusted for stock splits, combinations or similar events plus, in each case, all declared and unpaid dividends, if any (such amount being herein referred to as the "Preference"). If, upon the occurrence of a liquidation,

dissolution or winding up, the assets and surplus funds distributed among the holders of all series of Preferred Stock shall be insufficient to permit the payment to such holders of the full amount of the Preference, then the entire assets and surplus funds of the Corporation legally available for distribution shall be distributed ratably among the holders of all series of Preferred Stock based upon the aggregate Original Issue Price of all shares of Preferred Stock held by each holder. If, upon the occurrence of a liquidation, dissolution or winding up, after the payment to the holders of all series of Preferred Stock of the full amount of the Preference, assets or surplus funds remain in the Corporation, all such remaining assets and surplus funds shall be distributed ratably among the holders of the Common Stock, the Series A Preferred Stock and the Series B Preferred Stock on an as-converted basis. Notwithstanding anything to the contrary in this subsection

1(b), in no event shall the holders of the Series A Preferred Stock and Series B Preferred Stock be entitled to receive more than \$2.00 and \$5.06 per share, respectively, unless such holders have converted their shares of Series A Preferred Stock or Series B Preferred Stock into Common Stock prior to the occurrence of a liquidation, dissolution or winding up of the Corporation and the amount to be distributed to the holders of Common Stock of the Corporation upon the occurrence of such event, after paying the preferences of the holder of the Series A Preferred Stock and Series B Preferred Stock, exceeds such amount

(2) For purposes of subsection 1(b)(1), a liquidation, dissolution or winding up of the Corporation shall be deemed to be occasioned by, and to include, the Corporation's sale of all or substantially all of its assets or the acquisition of this Corporation by another entity by means of merger (other than a merger which solely effects a change of domicile) or consolidation, where, after such merger or consolidation, less than fifty percent (50%) of the surviving entity is held by persons who were stockholders of the Corporation immediately before the merger or consolidation.

c. Redemption.

(1) Mandatory Redemption of Preferred Stock. Subject to the terms and conditions of this subsection 1(c), to the extent that any outstanding shares of the Series A Preferred Stock or Series B Preferred Stock have not been redeemed or converted into Common Stock prior to September 30, 2000, the Corporation shall upon receiving at any time thereafter and at least 90 days before the first Redemption Date (as defined below), a written request by the holders of at least fifty-one percent (51%) of the then outstanding shares of Series A Preferred Stock and Series B Preferred Stock voting together as one class (the "Election"), for the redemption of all the Series A Preferred Stock and Series B Preferred Stock under this subsection 1(c)(1), redeem on January 31, 2001, January 31, 2002 and January 31, 2003 (each a "Redemption Date"), a number of shares of Series A Preferred Stock and Series B Preferred Stock equal to one-third, one-half and all, respectively, of the then remaining outstanding shares

of Series A Preferred Stock and Series B Preferred Stock. Such shares are to be redeemed from any source of funds legally available therefor at the redemption price therefor described in this subsection. The redemption price for each share of Series A Preferred Stock shall be an amount equal to the Series A Original Issue Price plus the amount of all declared and unpaid dividends thereon (if any). The redemption price for each share of Series B Preferred Stock shall be an amount equal to the Series B Original Issue Price plus the amount of all declared and unpaid dividends thereon (if any). If upon any Redemption Date scheduled under this subsection for the redemption of Series A Preferred Stock or Series B Preferred Stock, the funds and assets of the Corporation legally available to redeem such stock shall be insufficient to redeem all shares of Series A Preferred Stock and Series B Preferred Stock then scheduled to be redeemed, then any such unredeemed shares shall be carried forward and shall be redeemed (together with any other shares of Preferred Stock then scheduled to be redeemed) at the next such scheduled Redemption Date to the full extent of legally available funds of the Corporation at such time, and any such unredeemed shares shall continue to be so carried forward until redeemed. Shares of Series A Preferred Stock and Series B Preferred Stock which are subject to redemption but which have not been redeemed due to insufficient legally available funds and assets of the Corporation shall continue to be outstanding and entitled to all dividends declared on such Preferred Stock (if any), liquidation, conversion and other rights, preferences, privileges and restrictions of such Preferred Stock until such shares have been converted or redeemed.

(2) Partial Redemption. No redemption shall be made under this subsection 1(c) of only a part of the then outstanding Preferred Stock unless the Corporation shall effect such redemption pro rata among all holders of then outstanding Series A Preferred Stock and Series B Preferred Stock, based upon the aggregate redemption price of all shares of Preferred Stock held by each holder thereof on the applicable Redemption Date.

(3) Redemption Notice. At least twenty (20) but no more than sixty (60) days prior to any Redemption Date, written notice shall be mailed by the Corporation, postage prepaid, to each holder of record (at the close of business on the business day next preceding the day which notice is given) of the Preferred Stock to be redeemed, at the address last shown on the records of the Corporation for such holder or given by the holder to the Corporation for the purpose of notice or, if no such address appears or is given, at the place where the principal executive office of the Corporation is located, notifying such holder of the redemption to be effected, specifying the subsection hereof under which such redemption is being effected, the Redemption Date, the applicable redemption price, the number of such holder's shares of Series A Preferred Stock and Series B Preferred Stock to be redeemed, the place at which payment may be obtained and the date on which such holder's conversion rights (as set forth in subsection 1(f)) as to such shares terminate (which date shall in no event be earlier than the

business day prior to the Redemption Date) and calling upon such holder to surrender to the Corporation, in the manner and at the place designated, the certificate or certificates representing the shares to be redeemed (the "Redemption Notice").

(4) Surrender of Certificates. On or before each designated Redemption Date, each holder of Preferred Stock to be redeemed shall (unless such holder has previously exercised his right to convert such shares of Preferred Stock into Common Stock as provided in subsection 1(f) below), surrender the certificate(s) representing such shares of Preferred Stock to be redeemed to the Corporation, in the manner and at the place designated in the Redemption Notice, and thereupon the applicable redemption price for such shares shall be payable to the order of the person whose name appears on such certificate(s) as the owner thereof, and each surrendered certificate shall be canceled and retired. If less than all of the shares represented by such certificate are redeemed, then the Corporation shall promptly issue a new certificate representing the unredeemed shares.

(5) Effect of Redemption. If the Redemption Notice shall have been duly given, and if on the Redemption Date the applicable redemption price is either paid or made available for payment through the deposit arrangements specified in subsection 6 below, then notwithstanding that the certificates evidencing any of the shares of Preferred Stock so called for redemption shall not have been surrendered, such shares shall not thereafter be transferred on the Corporation's books and all of the rights of the holders of such shares with respect to such shares shall terminate after the Redemption Date, except only the right of the holders to receive the applicable redemption price without interest upon surrender of their certificate(s) therefor.

(6) Deposit of Redemption Price. On or prior to a Redemption Date, the Corporation may, at its option, deposit with a bank or trust company having a capital and surplus of at least \$100,000,000, as a trust fund, a sum equal to the aggregate applicable redemption price for all shares of Series A Preferred Stock and Series B Preferred Stock to be redeemed on such Redemption Date but not yet redeemed, with irrevocable instructions and authority to the bank or trust company to pay, on or after the Redemption Date, the applicable redemption price to the respective holders of all shares of Series A Preferred Stock and Series B Preferred Stock called for redemption on that Redemption Date upon the surrender of their share certificate. From and after the date of such deposit, the shares so called for redemption shall be redeemed. The deposit shall constitute full payment for the shares to their holders, and from and after the date of the deposit, the shares shall be deemed to be no longer outstanding, and the holders thereof shall cease to be stockholders with respect to such shares and shall have no rights with respect thereto except the right to receive from the bank or trust company payment of the redemption price of the shares, without interest, upon

surrender of their certificates therefor, and the right to convert such shares as provided in subsection 1(f) below. Any funds so deposited and unclaimed at the end of one (1) year after such Redemption Date shall be released or repaid to the Corporation, after which time the holders of shares called for redemption who have not claimed such funds shall be entitled to receive payment of the redemption price only from the Corporation.

d. Voting Rights.

(1) Voting Other than for Directors. The holder of each share of Series A Preferred Stock and Series B Preferred Stock shall be entitled to the number of votes equal to the number of full shares of Common Stock into which such holder's shares of Series A Preferred Stock and Series B Preferred Stock could be converted on the record date for the vote or written consent of stockholders and, except as otherwise required by law, shall have voting rights and powers equal to the voting rights and powers of the Common Stock. The holder of each share of Series A Preferred Stock and Series B Preferred Stock shall be entitled to notice of any stockholders' meeting in accordance with the bylaws of the corporation and shall vote together with (and not as a separate class from) holders of the Common Stock upon all other matters submitted to a vote of stockholders, except those matters required pursuant to subsection 1(e) or by law to be submitted to a class or series vote. Fractional votes shall not, however, be permitted and any fractional voting rights resulting from the above formula (after aggregating all shares of Common Stock into which shares of Preferred Stock held by each holder could be converted) shall be rounded to the nearest whole number (with one-half rounded upward to one).

(2) Voting for Directors. Prior to a Public Offering (as defined in Article X) the holders of the Series A Preferred Stock, voting as a separate series, shall elect two

(2) members of the Corporation's Board of Directors and the holders of Common Stock, Series A Preferred Stock and Series B Preferred Stock, voting together as a class, shall elect all the remaining directors. In the case of any vacancy in the office of a director elected by a specific group of stockholders, a successor shall be elected to hold office for the unexpired term of such director by the affirmative vote of a majority of the shares of such specified group given at a special meeting of such stockholders duly called or by an action by written consent for that purpose. Subject to the requirements of applicable law any director who shall have been elected by a specified group of stockholders may be removed during the aforesaid term of office, either for or without cause, by, and only by, the affirmative vote of the holders of a majority of the shares of such specified group, given at a special meeting of such stockholders duly called or by an action by written consent for that purpose and any such vacancy thereby created may be filled by the vote of the holders of a majority of the shares of such specified group represented at such meeting or in such consent.

e. Protective Provisions. In addition to any other class vote that may be required by law, so long as the number of shares of Series A Preferred Stock and Series B Preferred Stock outstanding equals or exceeds thirty percent (30%) of the number of shares of Series A Preferred Stock and Series B Preferred Stock authorized hereby, the Corporation shall not, without first obtaining the approval (by vote or written consent, as provided by law) of the holders of at least a majority of the then outstanding shares of the Series A Preferred Stock and Series B Preferred Stock voting together as a single class:

(1) sell, convey or otherwise dispose of all or substantially all of its property or business, or merge into or effect a reorganization with any other corporation (other than a wholly owned subsidiary corporation) in which the stockholders of this corporation immediately prior to the transaction possess less than 50% of the voting power of the surviving entity (or its parent) immediately after the transaction (any and all of the foregoing being herein referred to as an "Acquisition Transaction"). Notwithstanding the foregoing, in the event that an Acquisition Transaction is proposed, such Acquisition Transaction shall first be submitted to the vote of the holders of the Common Stock, the Series A Preferred Stock and the Series B Preferred Stock voting together as a single class in the manner described in subsection 1(d)(1) above. If holders of 75% of the outstanding voting equity securities (with the vote of the holders of the Series A Preferred Stock and the Series B Preferred Stock determined on an as converted basis) vote to approve such Acquisition Transaction, the Series A Preferred Stock and the Series B Preferred Stock shall not be entitled to a separate class vote with respect to such Acquisition Transaction and such Acquisition Transaction shall be approved;

(2) change the rights, preferences, privileges or restrictions of the Series A Preferred Stock or Series B Preferred Stock;

(3) declare any dividends;

(4) create or authorize a new class or series of securities having rights, preferences or privileges on parity with or senior to the Series A Preferred Stock or Series B Preferred Stock; or

(5) amend or repeal any provision of, or add any provision to, the Corporation's Certificate of Incorporation or by-laws if such action would alter or change the preferences, rights, privileges or powers of, or the restrictions provided for the benefit of the Series A Preferred Stock or Series B Preferred Stock.

f. Conversion. The holders of the Series A Preferred Stock and Series B Preferred Stock have conversion rights as follows (the "Conversion Rights"):

(1) Right to Convert. Each share of Series A Preferred Stock shall be convertible, at the option of the holder thereof, at any time after the date of issuance of such share at the office of the Corporation or any transfer agent for the Series A Preferred Stock, into such number of fully paid and nonassessable shares of Common Stock as is determined by dividing the Series A Original Issue Price by the Series A Conversion Price, determined as hereinafter provided, in effect at the time of the conversion. The Series A Conversion Price shall initially be one dollar (\$1.00). Such initial Series A Conversion Price shall be subject to adjustment as hereinafter provided. Upon conversion of a share of Series A Preferred Stock, all declared and unpaid dividends on such share of Series A Preferred Stock shall be paid, to the extent funds are legally available therefor, either in cash or in shares of Common Stock of the Corporation, at the election of the Corporation, wherein the shares of Common Stock shall be valued at the fair market value at the time of such conversion, as determined in good faith by the Board of Directors of the Corporation. Each share of Series B Preferred Stock shall be convertible, at the option of the holder thereof, at any time after the date of issuance of such share at the office of the Corporation or any transfer agent for the Series B Preferred Stock, into such number of fully paid and nonassessable shares of Common Stock as is determined by dividing the Series B Original Issue Price by the Series B Conversion Price, determined as hereinafter provided, in effect at the time of the conversion. The Series B Conversion Price shall initially be two dollars and 53/100 cents (\$2.53). Such initial Series B Conversion Price shall be subject to adjustment as hereinafter provided. Upon conversion of a share of Series B Preferred Stock, all declared and unpaid dividends on such share of Series B Preferred Stock shall be paid, to the extent funds are legally available therefor, either in cash or shares of Common Stock of the Corporation, at the election of the Corporation, wherein the shares of Common Stock shall be valued at the fair market value at the time of such conversion, as determined in good faith by the Board of Directors of the Corporation.

(2) Automatic Conversion. Each share of Series A Preferred Stock and Series B Preferred Stock shall automatically be converted into shares of Common Stock at the then effective Series A Conversion Price or Series B Conversion Price, respectively, upon: (i) the closing of a firm underwritten public offering pursuant to an effective registration statement under the Securities Act of 1933, as amended, covering the offer and sale of shares of the Corporation's Common Stock at a price per share of Common Stock, prior to underwriter commissions and offering expenses, of not less than \$6.00 per share (appropriately adjusted for any stock split, dividend, combination, recapitalization or the like) and an aggregate offering price (before deduction of underwriter commissions and offering expenses) of not less than \$10,000,000; or, (ii) the written election of holders of not less than a majority of the then outstanding shares of such series (collectively, an "Event of Conversion"). In the event of the automatic conversion of the Preferred Stock upon a public offering as aforesaid,

the person(s) entitled to receive the Common Stock issuable upon such conversion of Preferred Stock shall not be deemed to have converted such Preferred Stock until immediately prior to the closing of such sale of securities.

(3) Mechanics of Conversion. No fractional shares of Common Stock shall be issued upon conversion of Preferred Stock. In lieu of any fractional shares to which the holder would otherwise be entitled (after aggregating all shares of Preferred Stock held by such holder such that the maximum number of whole shares of Common Stock is issued to such holder upon conversion), the Corporation shall pay cash equal to such fraction multiplied by the then effective Conversion Price. Before any holder of Series A Preferred Stock or Series B Preferred Stock shall be entitled to convert the same into full shares of Common Stock and to receive certificates therefor, such holder shall surrender the certificate or certificates therefor, duly endorsed, at the office of the Corporation or of any transfer agent for the Series A Preferred Stock or Series B Preferred Stock, and shall give written notice to the Corporation at such office that such holder elects to convert the same; provided, however, that in the event of an automatic conversion pursuant to subsection 1(f)(2) hereof, the outstanding shares of Series A Preferred Stock or Series B Preferred Stock shall be converted automatically without any further action by the holders of such shares and whether or not the certificates representing such shares are surrendered to the Corporation or its transfer agent, and provided further that the Corporation shall not be obligated to issue certificates evidencing the shares of Common Stock issuable upon such automatic conversion unless the certificates evidencing such shares of Series A Preferred Stock or Series B Preferred Stock are either delivered to the Corporation or its transfer agent as provided above, or the holder notifies the Corporation or its transfer agent that such certificates have been lost, stolen or destroyed and executes an agreement satisfactory to the Corporation to indemnify the Corporation from any loss incurred by it in connection with such certificates.

The Corporation shall, as soon as practicable after such delivery, or after such agreement and indemnification, issue and deliver at such office to such holder, a certificate or certificates for the number of shares of Common Stock to which such holder shall be entitled as aforesaid and a check payable to the holder in the amount of any cash amounts payable as the result of a conversion into fractional shares of Common Stock. Such conversion shall be deemed to have been made immediately prior to the close of business on the date of such surrender of the shares of Series A Preferred Stock or Series B Preferred Stock to be converted, or, in the case of automatic conversion, on the date of written election to convert or on the date of and immediately prior to the closing of the offering, and the person or persons entitled to receive the shares of Common Stock issuable upon such conversion shall be treated for all purposes as the record holder or holders of such shares of Common Stock on such date.

(4) Adjustments of Conversion Price for Diluting Issues.

(a) Adjustments for Dilutive Issuances.

(i) Special Definitions. For purposes of this Section f(4), the following definitions shall apply:

A. "Options" shall mean rights, options or warrants to subscribe for, purchase or otherwise either Common Stock or Convertible Securities.

B. "Original Issue Date" shall mean the date on which the first share of Series B Preferred Stock was first issued.

C. "Convertible Securities" shall mean any evidences of indebtedness, shares or other securities convertible into or exchangeable for Common Stock.

D. "Additional Shares of Common Stock" shall mean all shares of Common Stock issued (or, pursuant to Section f(4)(a)(iii) deemed to be issued) by the Corporation after the Original Issue Date, other than shares of Common Stock issued or issuable:

(1) upon conversion of the Series A Preferred Stock or Series B Preferred Stock;

(2) to officers, directors and employees of, consultants to, and dealers, distributors or resellers for, the Corporation pursuant to an option plan, purchase plan or other employee or consultant incentive plan, pursuant to stock grants or any other plan or arrangement approved by the Board of Directors;

(3) as a dividend or distribution on Series A Preferred Stock or Series B Preferred Stock or pursuant to any event for which adjustment is made pursuant to subsection 1(f)(4)(b),(c) or (d) hereof; or

(4) to persons or entities with whom the Corporation has business relationships, including under equipment leasing arrangements, bank or other institutional loans, acquisitions of companies or product lines or other arrangements or transactions wherein the principal purpose of the issuance of such shares (or warrants or options) is for non-equity financing purposes; provided, that such arrangements are approved by the majority vote or written consent of the Board of Directors of the Corporation.

E. "Issue Price" with respect to any issuance of Additional Shares of Common Stock shall mean the price per share obtained by dividing the total consideration received by the Corporation in respect of such Additional Shares of Common Stock, computed in accordance with subsection 1(f)(4)(a)(v) hereof by the aggregate number of

shares of such Additional Shares of Common Stock issued, computed in accordance with subsection 1(f)(4)(a)(iii) hereof.

(ii) No Adjustment of Conversion Price. No adjustment in the Conversion Price for any series of Preferred Stock shall be made hereunder in respect of the issuance of Additional Shares of Common Stock unless the consideration per share for an Additional Share of Common Stock issued or deemed to be issued by the Corporation is less than the Conversion Price for such series of Preferred Stock in effect on the date of, and immediately prior to, such issue.

(iii) Deemed Issue of Additional Shares of Common Stock.

A. Options and Convertible Securities. Except as otherwise provided in subsection 1(f)(4)(a)(ii), in the event the Corporation at any time or from time to time after the Original Issue Date shall issue any Options or Convertible Securities or shall fix a record date for the determination of holders of any class of securities entitled to receive any such Options or Convertible Securities, then the maximum number of shares (as set forth in the instrument relating thereto without regard to any provisions contained therein for a subsequent adjustment of such number) of Common Stock issuable upon the exercise of such Options or, in the case of Convertible Securities and Options therefor, the conversion or exchange of such Convertible Securities, shall be deemed to be Additional Shares of Common Stock issued as of the time of such issue of Options or Convertible Securities or, in case such a record date shall have been fixed, as of the close of business on such record date, provided that Additional Shares of Common Stock shall not be deemed to have been issued unless the consideration per share (determined pursuant to subsection 1(f)(4)(a)(v) hereof) of such Additional Shares of Common Stock would be less than the Conversion Price in effect on the date of and immediately prior to such issue, or such record date, as the case may be, and provided further that in any such case in which Additional Shares of Common Stock are deemed to be issued:

(1) no further adjustment in the Conversion Price shall be made upon the subsequent issue of Convertible Securities or shares of Common Stock upon the exercise of such Options or conversion or exchange of such Convertible Securities;

(2) upon the expiration of any such Options or any rights of conversion or exchange under such Convertible Securities which shall not have been exercised, the Conversion Price computed upon the original issue thereof (or upon the occurrence of a record date with respect thereto), and any subsequent adjustments based thereon, shall, upon such expiration, be recomputed as if:

(aa) in the case of Convertible Securities or Options for Common Stock, the only Additional Shares of Common Stock issued were shares of Common Stock, if any, actually issued upon the exercise of such Options or the conversion or exchange of such Convertible Securities and the consideration received therefor was the

consideration actually received by the Corporation for the issue of all such Options, whether or not exercised, plus the consideration actually received by the Corporation upon such exercise, or for the issue of all such Convertible Securities which were actually converted or exchanged, plus the additional consideration, if any, actually received by the Corporation upon such conversion or exchange, and

(bb) in the case of Options for Convertible Securities, only the Convertible Securities, if any, actually issued upon the exercise thereof were issued at the time of issue of such Options, and the consideration received by the Corporation for the Additional Shares of Common Stock deemed to have been then issued was the consideration actually received by the Corporation for the issue of all such Options, whether or not exercised, plus the consideration deemed to have been received by the Corporation upon the issue of the Convertible Securities with respect to which such Options were actually exercised;

(3) no readjustment pursuant to clause (bb) above shall have the effect of increasing the Conversion Price to an amount which exceeds the lower of (i) the Conversion Price on the original adjustment date, or (ii) the Conversion Price that would have resulted from any issuance of Additional Shares of Common Stock between the original adjustment date and such readjustment date; and

(4) in the case of any Options which expire by their terms not more than thirty (30) days after the date of issue thereof, no adjustment of the Conversion Price shall be made until the expiration or exercise of all such Options.

(iv) Adjustment of Conversion Price Upon Issuance of Additional Shares of Common Stock. In the event the Corporation shall after the Original Issue Date issue Additional Shares of Common Stock (including Additional Shares of Common Stock deemed to be issued pursuant to subsection 1(f)(4)(a)(iii)) without consideration or for a consideration per share less than the Conversion Price in effect on the date of and immediately prior to such issue, then and in such event such Conversion Price shall be reduced, concurrently with such issue, to a price (calculated to the nearest cent) determined by multiplying such Conversion Price by a fraction, the numerator of which shall be the number of shares of Common Stock outstanding immediately prior to such issue plus the number of shares of Common Stock which the aggregate consideration received by the Corporation for the total number of Additional Shares of Common Stock so issued would purchase at such Conversion Price, and the denominator of which shall be the number of shares of Common Stock outstanding immediately prior to such issue plus the number of such Additional Shares of Common Stock so issued; and provided further that, for the purposes of this subsection

1(f)(4)(a)(iv), all shares of Common Stock issuable upon conversion of outstanding Convertible Securities, including the Series A Preferred Stock and Series B Preferred Stock, shall be deemed to be outstanding, and immediately

after any Additional Shares of Common Stock are deemed issued pursuant to subsection 1(f)(4)(a)(iii), such Additional Shares of Common Stock shall be deemed to be outstanding.

(v) Determination of Consideration. For purposes of this subsection 1(f)(4), the consideration received by the Corporation for the issue of any Additional Shares of Common Stock shall be computed as follows:

A. Cash and Property. Such consideration shall:

(1) insofar as it consists of cash, be computed at the aggregate amount of cash received by the Corporation excluding amounts paid or payable for accrued interest or accrued dividends;

(2) insofar as it consists of services or property other than cash, be computed at the fair value thereof at the time of such issue, as determined in good faith by the Board of Directors; and

(3) in the event Additional Shares of Common Stock are issued together with other shares or securities or other assets of the Corporation for consideration which covers both, be the proportion of such consideration so received, computed as provided in clauses

(1) and (2) above and as determined in good faith by the Board of Directors.

B. Options and Convertible Securities. The consideration per share received by the Corporation for Additional Shares of Common Stock deemed to have been issued pursuant to subsection

1(f)(4)(a)(iii), relating to Options and Convertible Securities, shall be determined by dividing

(1) the total amount, if any, received or receivable by the Corporation as consideration for the issue of such Options or Convertible Securities, plus the minimum aggregate amount of additional consideration (as set forth in the instruments relating thereto, without regard to any provision contained therein for a subsequent adjustment of such consideration) payable to the Corporation upon the exercise in full of such Options or the conversion or exchange in full of such Convertible Securities, or in the case of Options for Convertible Securities, the exercise in full of such Options for Convertible Securities and the conversion or exchange in full of such Convertible Securities, by

(2) the maximum number of shares of Common Stock (as set forth in the instruments relating thereto, without regard to any provision contained therein for a subsequent adjustment of such number) issuable upon the exercise in full of such Options or the conversion or exchange in full of such Convertible Securities.

(vi) No adjustment shall be made to the Conversion Price pursuant to subsection 1(f)(iv) unless such adjustment would require a decrease of the Conversion Price of at least \$.05 in such Conversion Price; provided that any adjustments which by reason of this subsection 1(f)(vi) are not required to be made, shall be carried forward and shall be made at the time of and together with the next subsequent adjustment which, together with any adjustment so carried forward, shall require a decrease of at least \$.05 in the Conversion Price then in effect hereunder.

(b) Adjustments for Subdivisions, Combinations or Consolidations of Common Stock. In the event the outstanding shares of Common Stock shall be subdivided (by stock split, stock dividend or otherwise), into a greater number of shares of Common Stock, the Conversion Price for a series of Preferred Stock then in effect shall, concurrently with the effectiveness of such subdivision, be proportionately decreased. In the event the outstanding shares of Common Stock shall be combined or consolidated, by reclassification or otherwise, into a lesser number of shares of Common Stock, the Conversion Price for a series of Preferred Stock then in effect shall, concurrently with the effectiveness of such combination or consolidation, be proportionately increased.

(c) Adjustments for Other Distributions. In the event the Corporation at any time or from time to time makes, or fixes a record date for the determination of holders of Common Stock entitled to receive, any distribution payable in securities of the Corporation other than shares of Common Stock and other than as otherwise adjusted in this subsection 1(f), (and provision is not made for payment of such distribution to holders of the Series A Preferred Stock and Series B Preferred Stock on an as-converted basis) then and in each such event provision shall be made so that the holders of Series A Preferred Stock and Series B Preferred Stock shall receive upon conversion thereof, in addition to the number of shares of Common Stock receivable thereupon, the amount of securities of the Corporation which they would have received had their shares of Series A Preferred Stock and Series B Preferred Stock been converted into Common Stock on the date of such event and had they thereafter, during the period from the date of such event to and including the date of conversion, retained such securities receivable by them as aforesaid during such period, subject to all other adjustments called for during such period under this subsection 1(f) with respect to the rights of the holders of the Series A Preferred Stock and Series B Preferred Stock.

(d) Adjustments for Reclassification. Exchange and Substitution. If the Common Stock issuable upon conversion of the Series A Preferred Stock and Series B Preferred Stock shall be changed into the same or a different number of shares of any other class or classes of stock, whether by capital reorganization, reclassification or otherwise (other than a subdivision, combination or consolidation of shares provided for above), the Conversion Price for such series of Preferred Stock then in effect shall, concurrently with the effectiveness of such reorganization or reclassification, be proportionately adjusted such that the Series A Preferred Stock and Series B Preferred Stock shall be convertible into, in lieu of the number of shares of Common Stock which the holders would otherwise have been entitled to receive, a number of shares of such other class or classes of stock equivalent to the number of shares of Common Stock that would have been subject to receipt by the holders upon conversion of such shares of Series A Preferred Stock and Series B Preferred Stock immediately before that change.

(5) No Impairment. The Corporation will not, by amendment of its Certificate of Incorporation or through any reorganization, transfer of assets, consolidation, merger, dissolution, issue or sale of securities or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms to be observed or performed hereunder by the Corporation, but will at all times in good faith assist in the carrying out of all the provisions of this subsection 1(f) and in the taking of all such action as may be necessary or appropriate in order to protect the Conversion Rights of the holders of the Series A Preferred Stock and Series B Preferred Stock against impairment.

(6) Certificate as to Adjustments. Upon the occurrence of each adjustment or readjustment of a Conversion Price pursuant to this subsection 1(f), the Corporation at its expense shall promptly compute such adjustment or readjustment in accordance with the terms hereof and furnish to each holder of Series A Preferred Stock and Series B Preferred Stock a certificate setting forth such adjustment or readjustment and showing in detail the facts upon which such adjustment or readjustment is based. The Corporation shall, upon the written request at any time of any holder of Series A Preferred Stock or Series B Preferred Stock, furnish or cause to be furnished to such holder a like certificate setting forth (i) such adjustments and readjustments, (ii) the Conversion Price for such series at the time in effect, and (iii) the number of shares of Common Stock and the amount, if any, of other property which at the time would be received upon the conversion of such holder's shares of Series A Preferred Stock or Series B Preferred Stock.

(7) Residual Rights. All rights accruing to the outstanding shares of the Corporation not expressly provided for to the contrary herein shall be vested with the Common Stock.

2. SHARES ACQUIRED BY THE CORPORATION. Shares of Common Stock that have been acquired by the Corporation shall become treasury shares and may be resold or otherwise disposed of by the Corporation for such consideration, not less than the par value thereof, as shall be determined by the Board of Directors, unless or until the Board of Directors shall by resolution provide that any or all treasury shares so acquired shall constitute authorized, but unissued shares.

ARTICLE VI.

A director of the Corporation shall not be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law, or (iv) for any transaction from which the director derived any improper personal benefit. If the Delaware General Corporation Law is amended after approval by the stockholders of this Article to authorize Corporation action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the fullest extent permitted by the Delaware General Corporation Law as so amended.

ARTICLE VII.

The management of the business and the conduct of the affairs of the Corporation shall be vested in its Board of Directors. The number of directors which shall constitute the whole Board of Directors shall be fixed by, or in the manner provided in, the Bylaws of the Corporation.

ARTICLE VIII.

Meetings of stockholders may be held within or without the State of Delaware, as the Bylaws may provide. The books of the Corporation may be kept (subject to any provision contained in the statutes) outside the State of Delaware at such place or places as may be designated from time to time by the Board of Directors or in the Bylaws of the Corporation.

ARTICLE IX.

Election of directors at an annual or special meeting of stockholders need not be by written ballot unless the Bylaws of the Corporation shall so provide.

ARTICLE X.

A. At each annual meeting of stockholders, directors of the Corporation shall be elected to hold office until the expiration of the term for which they are elected, and until their successors have been duly elected and qualified; except that if any such election shall not be so held, such election shall take place at a stockholders' meeting called and held in accordance with the Delaware General Corporation Law. At the annual meeting of stockholders (the "First Public Company Annual Meeting") following the closing of a public offering of the Corporation's capital stock pursuant to an effective registration statement filed under the Securities Act of 1933, as amended (a "Public Offering"), the directors of the Corporation shall be divided into three classes as nearly equal in size as is practicable, hereby designated as Class I, Class II and Class III. The term of office of the initial Class I directors shall expire at the next succeeding annual meeting of stockholders, the term of office of the initial Class II directors shall expire at the second succeeding annual meeting of stockholders and the term of office of the initial Class III directors shall expire at the third succeeding annual meeting of stockholders. For the purposes hereof, the initial Class I, Class II and Class III directors shall be those directors designated and elected at the First Public Company Annual Meeting. At each annual meeting after the First Public Company Annual Meeting, directors to replace those of a Class whose terms expire at such annual meeting shall be elected to hold office until the third succeeding annual meeting and until their respective successors shall have been duly elected and qualified. If the number of directors is hereafter changed, any newly created directorships or decrease in directorships shall be so apportioned among the classes as to make all classes as nearly equal in number as is practicable.

B. Vacancies occurring on the Board of Directors for any reason may be filled by vote of a majority of the remaining members of the Board of Directors, although less than a quorum, at a meeting of the Board of Directors. A person so elected by the Board of Directors to fill a vacancy shall hold office until the next succeeding annual meeting of stockholders of the Corporation and until his or her successor shall have been duly elected and qualified.

ARTICLE XI.

In furtherance and not in limitation of the powers conferred by statute, the Board of Directors is expressly authorized to make, alter, amend or repeal the Bylaws of the Corporation.

ARTICLE XII.

Effective upon the closing of a Public Offering, stockholders of the Corporation may not take action by written consent in lieu of a meeting but must take any actions at a duly called annual or special meeting.

ARTICLE XIII.

Notwithstanding any other provisions of this Certificate of Incorporation or any provision of law which might otherwise permit a lesser vote or no vote, but in addition to any affirmative

vote of the holders of the capital stock required by law or this Certificate of Incorporation, the affirmative vote of the holders of at least two-thirds (2/3) of the combined voting power of all of the then-outstanding shares of the Corporation entitled to vote shall be required to alter, amend or repeal Articles X, XII or XIII or any provisions thereof, unless such amendment shall be approved by a majority of the directors of the Corporation not affiliated or associated with any person or entity holding (or which has announced an intention to obtain) 26% or more of the voting power of the Corporation's outstanding capital stock.

ARTICLE XIV.

The Corporation reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation, in the manner now or hereafter prescribed by statute, and all rights conferred on stockholders herein are granted subject to this reservation.

* * *

THE UNDERSIGNED, being the incorporator hereinbefore named, for the purpose of forming a corporation to do business both within and without the State of Delaware and in pursuance of the General Corporation Law of Delaware, does make and file this Certificate, hereby declaring and certifying that the facts herein stated are true, and accordingly has hereunto set his hand this 5th day of December, 1997.

/s/ Brad Eastman

Brad Eastman,
Incorporator

EXHIBIT 3.2
BYLAWS
OF
ISS GROUP, INC.,
A DELAWARE CORPORATION

ARTICLE I

Offices

Section 1. Registered Office. The registered office of the corporation shall be the office of The Corporation Trust Company, 1209 Orange Street, Wilmington, County of New Castle, Delaware 19801.

Section 2. Other Offices. The corporation may have offices at such other places both within and without the State of Delaware as the Board of Directors may from time to time determine or the business of the corporation may require.

ARTICLE II

Corporate Seal

Section 3. Corporate Seal. The corporate seal shall consist of a die bearing the name of the corporation. Said seal may be used by causing it, or a facsimile thereof, to be impressed or affixed or reproduced or otherwise.

ARTICLE III

Stockholders' Meetings

Section 4. Place of Meetings. Meetings of the stockholders of the corporation shall be held at such place, either within or without the State of Delaware, as may be designated from time to time by the Board of Directors, or, if not so designated, then at the office of the corporation required to be maintained pursuant to Section 2 hereof.

Section 5. Annual Meeting.

(a) The annual meeting of the stockholders of the corporation, for the purpose of election of Directors and for such other business as may lawfully come before it, shall be held on such date and at such time as may be designated from time to time by the Board of Directors.

(b) At an annual meeting of the stockholders, only such business shall be conducted as shall have been properly brought before the meeting. To be properly brought

before an annual meeting, business must be: (A) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors, (B) otherwise properly brought before the meeting by or at the direction of the Board of Directors, or (C) otherwise properly brought before the meeting by a stockholder. For business to be properly brought before an annual meeting by a stockholder, the stockholder must have given timely notice thereof in writing to the Secretary of the corporation. To be timely, a stockholder's notice must be delivered to or mailed and received at the principal executive offices of the corporation not less than one hundred twenty

(120) calendar days in advance of the date of the Notice of Annual Meeting released to stockholders in connection with the previous year's annual meeting of stockholders; provided, however, that in the event that no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than thirty (30) days from the date contemplated at the time of the previous year's notice of annual meeting, notice by the stockholder to be timely must be so received a reasonable time before the notice of annual meeting is released to stockholders. A stockholder's notice to the Secretary shall set forth as to each matter the stockholder proposes to bring before the annual meeting: (i) a brief description of the business desired to be brought before the annual meeting and the reasons for conducting such business at the annual meeting, (ii) the name and address, as they appear on the corporation's books, of the stockholder proposing such business, (iii) the class and number of shares of the corporation which are beneficially owned by the stockholder,

(iv) any material interest of the stockholder in such business and (v) any other information that is required to be provided by the stockholder pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "1934 Act"), in such stockholder's capacity as a proponent to a stockholder proposal. Notwithstanding anything in these Bylaws to the contrary, no business shall be conducted at any annual meeting except in accordance with the procedures set forth in this paragraph (b). The chairperson of the annual meeting shall, if the facts warrant, determine and declare at the meeting that business was not properly brought before the meeting and in accordance with the provisions of this paragraph (b), and, if the chairperson should so determine, the chairperson shall so declare at the meeting that any such business not properly brought before the meeting shall not be transacted.

(c) Only persons who are nominated in accordance with the procedures set forth in this paragraph (c) shall be eligible for election as Directors. Nominations of persons for election to the Board of Directors of the corporation may be made at a meeting of stockholders by or at the direction of the Board of Directors or by any stockholder of the corporation entitled to vote in the election of Directors at the meeting who complies with the notice procedures set forth in this paragraph (c). Such nominations, other than those made by or at the direction of the Board of Directors, shall be made pursuant to timely notice in writing to the Secretary of the corporation in accordance with the provisions of paragraph (b) of this Section 5. Such stockholder's notice shall set forth (i) as to each person, if any, whom the stockholder proposes to nominate for election or re-election as a Director: (A) the name, age, business address and residence address of such person, (B) the principal occupation or employment of such person, (C) the class and number of shares of the corporation which are beneficially owned by such person, (D) a description of all arrangements or understandings

between the stockholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nominations are to be made by the stockholder, and (E) any other information relating to such person that is required to be disclosed in solicitations of proxies for election of Directors, or is otherwise required in each case pursuant to Regulation 14A under the 1934 Act (including without limitation such person's written consent to being named in the proxy statement, if any, as a nominee and to serving as a Director if elected); and (ii) as to such stockholder giving notice, the information required to be provided pursuant to paragraph (b) of this Section

5. At the request of the Board of Directors, any person nominated by a stockholder for election as a Director shall furnish to the Secretary of the corporation that information required to be set forth in the stockholder's notice of nomination which pertains to the nominee. No person shall be eligible for election as a Director of the corporation unless nominated in accordance with the procedures set forth in this paragraph (c). The chairperson of the meeting shall, if the facts warrant, determine and declare at the meeting that a nomination was not made in accordance with the procedures prescribed by these Bylaws, and if the chairperson should so determine, the chairperson shall so declare at the meeting, and the defective nomination shall be disregarded.

Section 6. Special Meetings.

(a) Special meetings of the stockholders of the corporation may be called, for any purpose or purposes, by (i) the Chairperson of the Board of Directors, (ii) the President or (iii) the Board of Directors pursuant to a resolution adopted by a majority of the total number of authorized directors (whether or not there exist any vacancies in previously authorized directorships at the time any such resolution is presented to the Board of Directors for adoption).

(b) If a special meeting is called by any person or persons other than the Board of Directors, the request shall be in writing, specifying the general nature of the business proposed to be transacted, and shall be delivered personally or sent by registered mail or by telegraphic or other facsimile transmission to the Chairperson of the Board of Directors, the President, or the Secretary of the corporation. No business may be transacted at such special meeting otherwise than specified in such notice. The Board of Directors shall determine the time and place of such special meeting, which shall be held not less than thirty-five (35) nor more than one hundred twenty

(120) days after the date of the receipt of the request. Upon determination of the time and place of the meeting, the officer receiving the request shall cause notice to be given to the stockholders entitled to vote, in accordance with the provisions of Section 7 of these Bylaws. If the notice is not given within sixty (60) days after the receipt of the request, the person or persons requesting the meeting may set the time and place of the meeting and give the notice. Nothing contained in this paragraph (b) shall be construed as limiting, fixing or affecting the time when a meeting of stockholders called by action of the Board of Directors may be held.

Section 7. Notice of Meetings. Except as otherwise provided by law or the Certificate of Incorporation, as the same may be amended or restated (hereinafter, the

"Certificate of Incorporation"), written notice of each meeting of stockholders shall be given not less than ten (10) nor more than sixty (60) days before the date of the meeting to each stockholder entitled to vote at such meeting, such notice to specify the place, date, time and purpose or purposes of the meeting. Notice of any meeting of stockholders may be waived in writing, signed by the person entitled to notice thereof, either before or after such meeting, and will be waived by any stockholder by his attendance thereat in person or by proxy, except when the stockholder attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. Any stockholder so waiving notice of such meeting shall be bound by the proceedings of any such meeting in all respects as if due notice thereof had been given.

Section 8. Quorum. At all meetings of stockholders, except where otherwise provided by statute or by the Certificate of Incorporation, or by these Bylaws, the presence, in person or by proxy duly authorized, of the holders of a majority of the outstanding shares of stock entitled to vote shall constitute a quorum for the transaction of business. In the absence of a quorum, any meeting of stockholders may be adjourned, from time to time, either by the chairperson of the meeting or by vote of the holders of a majority of the shares represented thereat, but no other business shall be transacted at such meeting. The stockholders present at a duly called or convened meeting, at which a quorum is present, may continue to transact business until adjournment, notwithstanding the withdrawal of enough stockholders to leave less than a quorum. Except as otherwise provided by law, the Certificate of Incorporation or these Bylaws, all action taken by the holders of a majority of the votes cast, excluding abstentions, at any meeting at which a quorum is present shall be valid and binding upon the corporation; provided, however, that Directors shall be elected by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote on the election of Directors. Where a separate vote by a class or classes is required, a majority of the outstanding shares of such class or classes, present in person or represented by proxy, shall constitute a quorum entitled to take action with respect to that vote on that matter and the affirmative vote of the majority (plurality, in the case of the election of Directors) of shares of such class or classes present in person or represented by proxy at the meeting shall be the act of such class.

Section 9. Adjournment and Notice of Adjourned Meetings. Any meeting of stockholders, whether annual or special, may be adjourned from time to time either by the chairperson of the meeting or by the vote of a majority of the shares casting votes, excluding abstentions. When a meeting is adjourned to another time or place, notice need not be given of the adjourned meeting if the time and place thereof are announced at the meeting at which the adjournment is taken. At the adjourned meeting, the corporation may transact any business which might have been transacted at the original meeting. If the adjournment is for more than thirty (30) days or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

Section 10. Voting Rights. For the purpose of determining those stockholders entitled to vote at any meeting of the stockholders, except as otherwise provided by law, only persons in whose names shares stand on the stock records of the corporation on the record date, as provided in Section 12 of these Bylaws, shall be entitled to vote at any meeting of stockholders. Every person entitled to vote or execute consents shall have the right to do so either in person or by an agent or agents authorized by a written proxy executed by such person or his duly authorized agent, which proxy shall be filed with the Secretary at or before the meeting at which it is to be used. An agent so appointed need not be a stockholder. No proxy shall be voted after three (3) years from its date of creation unless the proxy provides for a longer period. Elections of Directors need not be by written ballot, unless otherwise provided in the Certificate of Incorporation.

Section 11. Joint Owners of Stock. If shares or other securities having voting power stand of record in the names of two (2) or more persons, whether fiduciaries, members of a partnership, joint tenants, tenants in common, tenants by the entirety, or otherwise, or if two (2) or more persons have the same fiduciary relationship respecting the same shares, unless the Secretary is given written notice to the contrary and is furnished with a copy of the instrument or order appointing them or creating the relationship wherein it is so provided, their acts with respect to voting shall have the following effect: (a) if only one (1) votes, his act binds all; (b) if more than one (1) votes, the act of the majority so voting binds all; (c) if more than one (1) votes, but the vote is evenly split on any particular matter, each faction may vote the securities in question proportionally, or may apply to the Delaware Court of Chancery for relief as provided in the General Corporation Law of Delaware, Section 217(b). If the instrument filed with the Secretary shows that any such tenancy is held in unequal interests, a majority or even-split for the purpose of clause (c) shall be a majority or even-split in interest.

Section 12. List of Stockholders. The Secretary shall prepare and make, at least ten (10) days before every meeting of stockholders, a complete list of the stockholders entitled to vote at said meeting, arranged in alphabetical order, showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten (10) days prior to the meeting, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if not specified, at the place where the meeting is to be held. The list shall be produced and kept at the time and place of meeting during the whole time thereof and may be inspected by any stockholder who is present.

Section 13. No Action Without Meeting. Effective upon the closing of the corporation's initial public offering of securities pursuant to a registration statement filed under the Securities Act of 1933, as amended (a "Public Offering"), the stockholders of the corporation may not take action by written consent without a meeting and must take any actions at a duly called annual or special meeting. Meetings of stockholders may be held within or without the State of Delaware, as the Bylaws may provide. The books of the corporation may be kept

(subject to any provision contained in the statutes) outside the State of Delaware at such place or places as may be designated from time to time by the Board of Directors or in these Bylaws of the corporation.

Section 14. Organization.

(a) At every meeting of stockholders, the Chairperson of the Board of Directors, or, if a Chairperson has not been appointed, is absent, or designates the next senior officer present to so act, the President, or, if the President is absent, the most senior Vice President present, or, in the absence of any such officer, a chairperson of the meeting chosen by a majority in interest of the stockholders entitled to vote, present in person or by proxy, shall act as chairperson. The Secretary, or, in his absence, an Assistant Secretary directed to do so by the President, shall act as secretary of the meeting.

(b) The Board of Directors of the corporation shall be entitled to make such rules or regulations for the conduct of meetings of stockholders as it shall deem necessary, appropriate or convenient. Subject to such rules and regulations of the Board of Directors, if any, the chairperson of the meeting shall have the right and authority to prescribe such rules, regulations and procedures and to do all such acts as, in the judgment of such chairperson, are necessary, appropriate or convenient for the proper conduct of the meeting, including, without limitation, establishing an agenda or order of business for the meeting, rules and procedures for maintaining order at the meeting and the safety of those present, limitations on participation in such meeting to stockholders of record of the corporation and their duly authorized and constituted proxies and such other persons as the chairperson shall permit, restrictions on entry to the meeting after the time fixed for the commencement thereof, limitations on the time allotted to questions or comments by participants and regulation of the opening and closing of the polls for balloting on matters which are to be voted on by ballot. Unless and to the extent determined by the Board of Directors or the chairperson of the meeting, meetings of stockholders shall not be required to be held in accordance with rules of parliamentary procedure.

ARTICLE IV

Directors

Section 15. Number and Term of Office. The number of Directors which shall constitute the whole of the Board of Directors shall be seven (7). The number of authorized Directors may be modified from time to time by amendment of this Section 15 in accordance with the provisions of Section 44 hereof. At each annual meeting of stockholders, directors of the Corporation shall be elected to hold office until the expiration of the term for which they are elected, and until their successors have been duly elected and qualified; except that if any such election shall not be so held, such election shall take place at a stockholders' meeting called and held in accordance with the Delaware General Corporation Law. After the Corporation's first Public Offering, the directors of the corporation shall be divided into three classes as nearly

equal in size as is practicable, hereby designated Class I, Class II and Class

III. The term of office of the initial Class I directors shall expire at the next succeeding annual meeting of stockholders, the term of office of the initial Class II directors shall expire at the second succeeding annual meeting of stockholders and the term of office of the initial Class III directors shall expire at the third succeeding annual meeting of stockholders. At each annual meeting of stockholders thereafter, directors to replace those of a class whose terms expire at such annual meeting shall be elected to hold office until the third succeeding annual meeting and until their respective successors shall have been duly elected and qualified. If the number of directors is hereafter changed, any newly created directorships or decrease in directorships shall be so apportioned among the classes as to make all classes as nearly equal in number as is practicable.

The number of directors which constitute the whole board of directors of the Corporation shall be designated in the Bylaws of the corporation or by resolution adopted by the Board of Directors. Vacancies occurring on the Board of Directors for any reason may be filled by vote of a majority of the remaining members of the Board of Directors, although less than a quorum, at any meeting of the Board of Directors. A person so elected by the Board of Directors to fill a vacancy shall hold office until the next succeeding annual meeting of stockholders of the corporation and until his or her successor shall have been duly elected and qualified. Directors need not be stockholders unless so required by the Certificate of Incorporation. If, for any reason, the Directors shall not have been elected at an annual meeting, they may be elected as soon thereafter as convenient at a special meeting of the stockholders called for that purpose in the manner provided in these Bylaws.

Section 16. Powers. The powers of the corporation shall be exercised, its business conducted and its property controlled by the Board of Directors, except as may be otherwise provided by statute or by the Certificate of Incorporation.

Section 17. Vacancies. Unless otherwise provided in the Certificate of Incorporation, vacancies and newly created directorships resulting from any increase in the authorized number of Directors may be filled by a majority of the Directors then in office, although less than a quorum, or by a sole remaining Director, and each Director so elected shall hold office for the unexpired portion of the term of the Director whose place shall be vacant and until his or her successor shall have been duly elected and qualified. A vacancy in the Board of Directors shall be deemed to exist under this Section 17 in the case of the death, removal or resignation of any Director, or if the stockholders fail at any meeting of stockholders at which Directors are to be elected (including any meeting referred to in Section 19 below) to elect the number of Directors then constituting the whole Board of Directors.

Section 18. Resignation. Any Director may resign at any time by delivering his or her written resignation to the Secretary, such resignation to specify whether it will be effective at a particular time, upon receipt by the Secretary or at the pleasure of the Board of Directors. If no such specification is made, it shall be deemed effective at the pleasure of the Board of Directors. When one or more Directors shall resign from the Board of Directors, effective at

a future date, a majority of the Directors then in office, including those who have so resigned, shall have power to fill such vacancy or vacancies, the vote thereon to take effect when such resignation or resignations shall become effective, and each Director so chosen shall hold office for the unexpired portion of the term of the Director whose place shall be vacated and until his successor shall have been duly elected and qualified.

Section 19. Removal. At a special meeting of stockholders called for the purpose in the manner hereinabove provided, subject to any limitations imposed by law or the Certificate of Incorporation, the Board of Directors, or any individual Director, may be removed from office, with or without cause, and a new Director or Directors elected by a vote of stockholders holding a majority of the outstanding shares entitled to vote at an election of Directors.

Section 20. Meetings.

(a) **Annual Meetings.** The annual meeting of the Board of Directors shall be held immediately before or after the annual meeting of stockholders and at the place where such meeting is held. No notice of an annual meeting of the Board of Directors shall be necessary and such meeting shall be held for the purpose of electing officers and transacting such other business as may lawfully come before it.

(b) **Regular Meetings.** Except as hereinafter otherwise provided, regular meetings of the Board of Directors shall be held in the office of the corporation required to be maintained pursuant to Section 2 hereof. Unless otherwise restricted by the Certificate of Incorporation, regular meetings of the Board of Directors may also be held at any place within or without the State of Delaware which has been designated by resolution of the Board of Directors or the written consent of all directors.

(c) **Special Meetings.** Unless otherwise restricted by the Certificate of Incorporation, special meetings of the Board of Directors may be held at any time and place within or without the State of Delaware whenever called by the Chairperson of the Board, the President or any two of the Directors.

(d) **Telephone Meetings.** Any member of the Board of Directors, or of any committee thereof, may participate in a meeting by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and participation in a meeting by such means shall constitute presence in person at such meeting.

(e) **Notice of Meetings.** Written notice of the time and place of all special meetings of the Board of Directors shall be given at least one (1) day before the date of the meeting. Notice of any meeting may be waived in writing at any time before or after the meeting and will be waived by any Director by attendance thereat, except when the Director attends the meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

(f) Waiver of Notice. The transaction of all business at any meeting of the Board of Directors, or any committee thereof, however called or noticed, or wherever held, shall be as valid as though had at a meeting duly held after regular call and notice, if a quorum be present and if, either before or after meeting, each of the Directors not present shall sign a written waiver of notice, or a consent to holding such meeting, or an approval of the minutes thereof. All such waivers, consents or approvals shall be filed with the corporate records or made a part of the minutes of the meeting.

Section 21. Quorum and Voting.

(a) Unless the Certificate of Incorporation requires a greater number and except with respect to indemnification questions arising under Section 42 hereof, for which a quorum shall be one-third of the exact number of Directors fixed from time to time in accordance with Section 15 hereof, but not less than one (1), a quorum of the Board of Directors shall consist of a majority of the exact number of directors fixed from time to time in accordance with Section 15 of these Bylaws, but not less than one (1); provided, however, at any meeting whether a quorum be present or otherwise, a majority of the Directors present may adjourn from time to time until the time fixed for the next regular meeting of the Board of Directors, without notice other than by announcement at the meeting.

(b) At each meeting of the Board of Directors at which a quorum is present, all questions and business shall be determined by a vote of the majority of the Directors present, unless a different vote is required by law, the Certificate of Incorporation or these Bylaws.

Section 22. Action Without Meeting. Unless otherwise restricted by the Certificate of Incorporation or these Bylaws, any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if all members of the Board of Directors or committee, as the case may be, consent thereto in writing, and such writing or writings are filed with the minutes of proceedings of the Board of Directors or committee.

Section 23. Fees and Compensation. Directors shall be entitled to such compensation for their services as may be approved by the Board of Directors, including, if so approved, by resolution of the Board of Directors, a fixed sum and expenses of attendance, if any, for attendance at each regular or special meeting of the Board of Directors and at any meeting of a committee of the Board of Directors. Nothing herein contained shall be construed to preclude any Director from serving the corporation in any other capacity as an officer, agent, employee, or otherwise and receiving compensation therefor.

Section 24. Committees.

(a) Executive Committee. The Board of Directors may by resolution passed by a majority of the whole Board of Directors appoint an Executive Committee to consist of one

(1) or more members of the Board of Directors. The Executive Committee, to the extent permitted by law and specifically granted by the Board of Directors, shall have, and may exercise when the Board of Directors is not in session, all powers of the Board of Directors in the management of the business and affairs of the corporation, including, without limitation, the power and authority to declare a dividend or to authorize the issuance of stock, except such committee shall not have the power or authority to amend the Certificate of Incorporation, to adopt an agreement of merger or consolidation, to recommend to the stockholders the sale, lease or exchange of all or substantially all of the corporation's property and assets, to recommend to the stockholders of the corporation a dissolution of the corporation or a revocation of a dissolution or to amend these Bylaws.

(b) Other Committees. The Board of Directors may, by resolution passed by a majority of the whole Board of Directors, from time to time appoint such other committees as may be permitted by law. Such other committees appointed by the Board of Directors shall consist of one (1) or more members of the Board of Directors and shall have such powers and perform such duties as may be prescribed by the resolution or resolutions creating such committees, but in no event shall such committee have the powers denied to the Executive Committee in these Bylaws.

(c) Term. Each member of a committee of the Board of Directors shall serve a term on the committee coexistent with such member's term on the Board of Directors. The Board of Directors, subject to the provisions of subsections (a) or (b) of this Bylaw may at any time increase or decrease the number of members of a committee or terminate the existence of a committee. The membership of a committee member shall terminate on the date of his or her death or voluntary resignation from the committee or from the Board of Directors. The Board of Directors may at any time for any reason remove any individual committee member and the Board of Directors may fill any committee vacancy created by death, resignation, removal or increase in the number of members of the committee. The Board of Directors may designate one or more Directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee, and, in addition, in the absence or disqualification of any member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another member of the Board of Directors to act at the meeting in the place of any such absent or disqualified member.

(d) Meetings. Unless the Board of Directors shall otherwise provide, regular meetings of the Executive Committee or any other committee appointed pursuant to this Section 24 shall be held at such times and places as are determined by the Board of Directors, or by any such committee, and when notice thereof has been given to each member of such committee, no further notice of such regular meetings need be given thereafter. Special meetings of any such committee may be held at any place which has been determined from time to time by such committee, and may be called by any Director who is a member of such committee, upon written notice to the members of such committee of the time and place of such

special meeting given in the manner provided for the giving of written notice to members of the Board of Directors of the time and place of special meetings of the Board of Directors. Notice of any special meeting of any committee may be waived in writing at any time before or after the meeting and will be waived by any Director by attendance thereat, except when the Director attends such special meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. A majority of the authorized number of members of any such committee shall constitute a quorum for the transaction of business, and the act of a majority of those present at any meeting at which a quorum is present shall be the act of such committee.

Section 25. Organization. The Chairperson of the Board shall preside at every meeting of the Board of Directors, if present. In the case of any meeting, if there is no Chairperson of the Board or if the Chairperson is not present, a chairperson chosen by a majority of the directors present shall act as chairperson of such meeting. The Secretary of the corporation or, in the absence of the Secretary, any person appointed by the Chairperson shall act as secretary of the meeting.

ARTICLE V

Officers

Section 26. Officers Designated. The officers of the corporation shall include, if and when designated by the Board of Directors, the Chairperson of the Board of Directors, the Chief Executive Officer, the President, one or more Vice Presidents, the Secretary, the Chief Financial Officer and the Treasurer, all of whom shall be elected at the annual organizational meeting of the Board of Directors. The order of the seniority of the Vice Presidents shall be in the order of their nomination, unless otherwise determined by the Board of Directors. The Board of Directors may also appoint one or more Assistant Secretaries, Assistant Treasurers and such other officers and agents with such powers and duties as it shall deem necessary. The Board of Directors may assign such additional titles to one or more of the officers as it shall deem appropriate. Any one person may hold any number of offices of the corporation at any one time unless specifically prohibited therefrom by law. The salaries and other compensation of the officers of the corporation shall be fixed by or in the manner designated by the Board of Directors.

Section 27. Tenure and Duties of Officers.

(a) General. All officers shall hold office at the pleasure of the Board of Directors and until their successors shall have been duly elected and qualified, unless sooner removed. Any officer elected or appointed by the Board of Directors may be removed at any time by the Board of Directors. If the office of any officer becomes vacant for any reason, the vacancy may be filled by the Board of Directors.

(b) Duties of Chairperson of the Board of Directors. The Chairperson of the Board of Directors, when present, shall preside at all meetings of the Board of Directors and, unless the Chairperson has designated the next senior officer to so preside, at all meetings of the stockholders. The Chairperson of the Board of Directors shall perform other duties commonly incident to such office and shall also perform such other duties and have such other powers as the Board of Directors shall designate from time to time.

(c) Duties of the Chief Executive and Chief Operating Officers. Unless the Board of Directors designates otherwise, the Chairperson of the Board shall be the chief executive officer of the corporation and the President shall be the chief operating officer of the corporation. Subject to the control of the Board of Directors, the chief executive officer shall have general executive charge, management and control, of the properties, business and operations of the corporation with all such powers as may be reasonably incident to such responsibilities; and subject to the control of the chief executive officer, the chief operating officer shall have general operating charge, management and control, of the properties, business and operations of the corporation with all such powers as may be reasonably incident to such responsibilities. The chief executive officer and, if and to the extent designated by the chief executive officer, the chief operating officer, may agree upon and execute all leases, contracts, evidences of indebtedness and other obligations in the name of the corporation and may sign all certificates for shares of capital stock of the corporation, and each shall have such other powers and duties as are designated in accordance with these Bylaws and as from time to time may be assigned to each by the Board of Directors.

(d) Duties of President. Unless the Board of Directors otherwise determines, subject to the control of the chief executive officer, the President shall have the authority to agree upon and exercise all leases, contracts, evidences of indebtedness and other obligations in the name of the corporation; and, unless the Board of Directors otherwise determines, he shall, in the absence of the Chairperson of the Board or if there be no Chairperson of the Board, preside at all meetings of the stockholders and (should he be a director) of the Board of Directors, and the President shall have such other powers and duties as designated in accordance with these Bylaws and as from time to time may be assigned to him by the Board of Directors.

(e) Duties of Vice Presidents. If and to the extent determined by the Board of Directors, the Vice Presidents, in the order of their seniority, may assume and perform the duties of the President in the absence or disability of the President or whenever the office of President is vacant. The Vice Presidents shall perform other duties commonly incident to their office and shall also perform such other duties and have such other powers as the Board of Directors or the President shall designate from time to time.

(f) Duties of Secretary. The Secretary shall attend all meetings of the stockholders and of the Board of Directors and shall record all acts and proceedings thereof in the minute book of the corporation. The Secretary shall give notice in conformity with these Bylaws of all meetings of the stockholders and of all meetings of the Board of Directors and any

committee thereof requiring notice. The Secretary shall perform all other duties given in these Bylaws and other duties commonly incident to such office and shall also perform such other duties and have such other powers as the Board of Directors shall designate from time to time. The President may direct any Assistant Secretary to assume and perform the duties of the Secretary in the absence or disability of the Secretary, and each Assistant Secretary shall perform other duties commonly incident to such office and shall also perform such other duties and have such other powers as the Board of Directors or the President, shall designate from time to time.

(g) Duties of Chief Financial Officer. The Chief Financial Officer shall keep or cause to be kept the books of account of the corporation in a thorough and proper manner and shall render statements of the financial affairs of the corporation in such form and as often as required by the Board of Directors, the Chairperson of the Board or the President. The Chief Financial Officer, subject to the order of the Board of Directors, shall have the custody of all funds and securities of the corporation. The Chief Financial Officer shall perform other duties commonly incident to such office and shall also perform such other duties and have such other powers as the Board of Directors, the Chairperson of the Board or the President shall designate from time to time. The Chairperson of the Board or the President may direct the Treasurer or any Assistant Treasurer to assume and perform the duties of the Chief Financial Officer in the absence or disability of the Chief Financial Officer, and each Assistant Treasurer shall perform other duties commonly incident to such office and shall also perform such other duties and have such other powers as the Board of Directors, the Chairperson of the Board or the President shall designate from time to time.

Section 28. Delegation of Authority. The Board of Directors may from time to time delegate the powers or duties of any officer to any other officer or agent, notwithstanding any provision hereof.

Section 29. Resignations. Any officer may resign at any time by giving written notice to the Board of Directors or to the President or to the Secretary. Any such resignation shall be effective when received by the person or persons to whom such notice is given, unless a later time is specified therein, in which event the resignation shall become effective at such later time. Unless otherwise specified in such notice, the acceptance of any such resignation shall not be necessary to make it effective. Any resignation shall be without prejudice to the rights, if any, of the corporation under any contract with the resigning officer.

Section 30. Removal. Any officer may be removed from office at any time, either with or without cause, by the vote or written consent of a majority of the Directors in office at the time, or by any committee or superior officers upon whom such power of removal may have been conferred by the Board of Directors.

ARTICLE VI

Execution of Corporate Instruments and Voting of Securities Owned by the Corporation

Section 31. Execution of Corporate Instruments. The Board of Directors may, in its discretion, determine the method and designate the signatory officer or officers, or other person or persons, to execute on behalf of the corporation any corporate instrument or document, or to sign on behalf of the corporation the corporate name without limitation, or to enter into contracts on behalf of the corporation, except where otherwise provided by law or these Bylaws, and such execution or signature shall be binding upon the corporation.

Unless otherwise specifically determined by the Board of Directors or otherwise required by law, promissory notes, deeds of trust, mortgages and other evidences of indebtedness of the corporation, and other corporate instruments or documents requiring the corporate seal, and certificates of shares of stock owned by the corporation, shall be executed, signed or endorsed by the Chairperson of the Board of Directors, or the President or any Vice President, and by the Secretary or Chief Financial Officer or Treasurer or any Assistant Secretary or Assistant Treasurer. All other instruments and documents requiring the corporate signature, but not requiring the corporate seal, may be executed as aforesaid or in such other manner as may be directed by the Board of Directors.

All checks and drafts drawn on banks or other depositaries on funds to the credit of the corporation or in special accounts of the corporation shall be signed by such person or persons as the Board of Directors shall authorize so to do.

Unless authorized or ratified by the Board of Directors or within the agency power of an officer, no officer, agent or employee shall have any power or authority to bind the corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or for any amount.

Section 32. Voting of Securities Owned by the Corporation. All stock and other securities of other corporations owned or held by the corporation for itself, or for other parties in any capacity, shall be voted, and all proxies with respect thereto shall be executed, by the person authorized so to do by resolution of the Board of Directors, or, in the absence of such authorization, by the Chairperson of the Board of Directors, the President, or any Vice President.

ARTICLE VII

Shares of Stock

Section 33. Form and Execution of Certificates. Certificates for the shares of stock of the corporation shall be in such form as is consistent with the Certificate of Incorporation and applicable law. Every holder of stock in the corporation shall be entitled to have a certificate signed by or in the name of the corporation by the Chairperson of the Board of Directors, or

the President or any Vice President and by the Secretary or Chief Financial Officer or Treasurer or any Assistant Treasurer or Assistant Secretary, certifying the number of shares owned by him in the corporation. Where such certificate is countersigned by a transfer agent other than the corporation or its employee, or by a registrar other than the corporation or its employee, any other signature on the certificate may be a facsimile. In case any officer, transfer agent, or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent, or registrar before such certificate is issued, it may be issued with the same effect as if he were such officer, transfer agent, or registrar at the date of issue. Each certificate shall state upon the face or back thereof, in full or in summary, all of the designations, preferences, limitations, restrictions on transfer and relative rights of the shares authorized to be issued.

Section 34. Lost Certificates. A new certificate or certificates shall be issued in place of any certificate or certificates theretofore issued by the corporation alleged to have been lost, stolen, or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost, stolen, or destroyed. The corporation may require, as a condition precedent to the issuance of a new certificate or certificates, the owner of such lost, stolen, or destroyed certificate or certificates, or his legal representative, to advertise the same in such manner as it shall require or to give the corporation a surety bond in such form and amount as it may direct as indemnity against any claim that may be made against the corporation with respect to the certificate alleged to have been lost, stolen or destroyed.

Section 35. Transfers.

(a) Transfers of record of shares of stock of the corporation shall be made only on its books by the holders thereof, in person or by attorney duly authorized and upon the surrender of a properly endorsed certificate or certificates for a like number of shares.

(b) The corporation shall have power to enter into and perform any agreement with any number of stockholders of any one or more classes of stock of the corporation to restrict the transfer of shares of stock of the corporation of any one or more classes owned by such stockholders in any manner not prohibited by the Delaware General Corporation Law.

Section 36. Fixing Record Dates.

(a) In order that the corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, the Board of Directors may fix, in advance, a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted by the Board of Directors, and which record date shall not be more than sixty (60) nor less than ten (10) days before the date of such meeting. If no record date is fixed by the Board of Directors, the record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the day next preceding the day on which notice is given, or if notice is waived, at the close of

business on the day next preceding the day on which the meeting is held. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

(b) In order that the corporation may determine the stockholders entitled to receive payment of any dividend or other distribution or allotment of any rights or the stockholders entitled to exercise any rights in respect of any change, conversion or exchange of stock, or for the purpose of any other lawful action, the Board of Directors may fix, in advance, a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted, and which record date shall be not more than sixty (60) days prior to such action. If no record date is fixed by the Board of Directors, the record date for determining stockholders for any such purpose shall be at the close of business on the day on which the Board of Directors adopts the resolution relating thereto.

Section 37. Registered Stockholders. The corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

ARTICLE VIII

Other Securities of the Corporation

Section 38. Execution of Other Securities. All bonds, debentures and other corporate securities of the corporation, other than stock certificates (covered in Section 33), may be signed by the Chairperson of the Board of Directors, the President or any Vice President, or such other person as may be authorized by the Board of Directors, and the corporate seal impressed thereon or a facsimile of such seal imprinted thereon and attested by the signature of the Secretary or an Assistant Secretary, or the Chief Financial Officer or Treasurer or an Assistant Treasurer; provided, however, that where any such bond, debenture or other corporate security shall be authenticated by the manual signature of a trustee under an indenture pursuant to which such bond, debenture or other corporate security shall be issued, the signatures of the persons signing and attesting the corporate seal on such bond, debenture or other corporate security may be the imprinted facsimile of the signatures of such persons. Interest coupons appertaining to any such bond, debenture or other corporate security, authenticated by a trustee as aforesaid, shall be signed by the Treasurer or an Assistant Treasurer of the corporation or such other person as may be authorized by the Board of Directors, or bear imprinted thereon the facsimile signature of such person. In case any officer who shall have signed or attested any bond, debenture or other corporate security, or whose facsimile signature shall appear thereon or on any such interest coupon, shall have ceased to be such officer before any bond, debenture or other corporate security so signed or attested shall have been delivered, such bond, debenture or other corporate

security nevertheless may be adopted by the corporation and issued and delivered as though the person who signed the same or whose facsimile signature shall have been used thereon had not ceased to be such officer of the corporation.

ARTICLE IX

Dividends

Section 39. Declaration of Dividends. Dividends upon the capital stock of the corporation, subject to the provisions of the Certificate of Incorporation, if any, may be declared by the Board of Directors pursuant to law at any regular or special meeting. Dividends may be paid in cash, in property, or in shares of the capital stock, subject to the provisions of the Certificate of Incorporation.

Section 40. Dividend Reserve. Before payment of any dividend, there may be set aside out of any funds of the corporation available for dividends such sum or sums as the Board of Directors from time to time, in their absolute discretion, think proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the corporation, or for such other purpose as the Board of Directors shall think conducive to the interests of the corporation, and the Board of Directors may modify or abolish any such reserve in the manner in which it was created.

ARTICLE X

Fiscal Year

Section 41. Fiscal Year. The fiscal year of the corporation shall be fixed by resolution of the Board of Directors.

ARTICLE XI

Indemnification

Section 42. Indemnification of Directors, Officers, Employees and Other Agents.

(a) Directors and Executive Officers. The corporation shall indemnify its Directors and executive officers to the fullest extent not prohibited by the Delaware General Corporation Law; provided, however, that the corporation may limit the extent of such indemnification by individual contracts with its Directors and executive officers; and, provided, further, that the corporation shall not be required to indemnify any Director or executive officer in connection with any proceeding (or part thereof) initiated by such person or any proceeding by such person against the corporation or its Directors, officers, employees or other agents unless (i) such indemnification is expressly required to be made by law, (ii) the proceeding was authorized by the Board of Directors of the corporation or (iii) such indemnification is provided by the corporation, in its sole discretion, pursuant to the powers vested in the corporation under the Delaware General Corporation Law.

(b) Other Officers, Employees and Other Agents. The corporation shall have power to indemnify its other officers, employees and other agents as set forth in the Delaware General Corporation Law.

(c) Good Faith.

(1) For purposes of any determination under this Bylaw, a Director or executive officer shall be deemed to have acted in good faith and in a manner such officer reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, to have had no reasonable cause to believe that such officer's conduct was unlawful, if such officer's action is based on information, opinions, reports and statements, including financial statements and other financial data, in each case prepared or presented by:

(a) one or more officers or employees of the corporation whom the Director or executive officer believed to be reliable and competent in the matters presented;

(b) counsel, independent accountants or other persons as to matters which the Director or executive officer believed to be within such person's professional competence; and

(c) with respect to a Director, a committee of the Board upon which such Director does not serve, as to matters within such committee's designated authority, which committee the Director believes to merit confidence; so long as, in each case, the Director or executive officer acts without knowledge that would cause such reliance to be unwarranted.

(2) The termination of any proceeding by judgment, order, settlement, conviction or upon a plea of nolo contendere or its equivalent shall not, of itself, create a presumption that the person did not act in good faith and in a manner which such person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal proceeding, that such person had reasonable cause to believe that his conduct was unlawful.

(3) The provisions of this paragraph (c) shall not be deemed to be exclusive or to limit in any way the circumstances in which a person may be deemed to have met the applicable standard of conduct set forth by the Delaware General Corporation Law.

(d) Expenses. The corporation shall advance, prior to the final disposition of any proceeding, promptly following request therefor, all expenses incurred by any Director or executive officer in connection with such proceeding upon receipt of an undertaking by or on behalf of such person to repay said amounts if it should be determined ultimately that such person is not entitled to be indemnified under this Bylaw or otherwise.

Notwithstanding the foregoing, unless otherwise determined pursuant to paragraph (e) of this Bylaw, no advance shall be made by the corporation if a determination is reasonably and promptly made (i) by the Board of Directors by a majority vote of a quorum consisting of Directors who were not parties to the proceeding, or (ii) if such quorum is not obtainable, or, even if obtainable, a quorum of disinterested directors so directs, by independent legal counsel in a written opinion, that the facts known to the decision-making party at the time such determination is made demonstrate clearly and convincingly that such person acted in bad faith or in a manner that such person did not believe to be in or not opposed to the best interests of the corporation.

(e) Enforcement. Without the necessity of entering into an express contract, all rights to indemnification and advances to Directors and executive officers under this Bylaw shall be deemed to be contractual rights and be effective to the same extent and as if provided for in a contract between the corporation and the Director or executive officer. Any right to indemnification or advances granted by this Bylaw to a Director or executive officer shall be enforceable by or on behalf of the person holding such right in any court of competent jurisdiction if (i) the claim for indemnification or advances is denied, in whole or in part, or (ii) no disposition of such claim is made within ninety (90) days of request therefor. The claimant in such enforcement action, if successful in whole or in part, shall be entitled to be paid also the expense of prosecuting his claim. The corporation shall be entitled to raise as a defense to any such action that the claimant has not met the standards of conduct that make it permissible under the Delaware General Corporation Law for the corporation to indemnify the claimant for the amount claimed. Neither the failure of the corporation (including its Board of Directors, independent legal counsel or its stockholders) to have made a determination prior to the commencement of such action that indemnification of the claimant is proper in the circumstances because such person has met the applicable standard of conduct set forth in the Delaware General Corporation Law, nor an actual determination by the corporation (including its Board of Directors, independent legal counsel or its stockholders) that the claimant has not met such applicable standard of conduct, shall be a defense to the action or create a presumption that claimant has not met the applicable standard of conduct.

(f) Non-Exclusivity of Rights. The rights conferred on any person by this Bylaw shall not be exclusive of any other right which such person may have or hereafter acquire under any statute, provision of the Certificate of Incorporation, Bylaws, agreement, vote of stockholders or disinterested Directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding office. The corporation is specifically authorized to enter into individual contracts with any or all of its Directors, officers, employees or agents respecting indemnification and advances, to the fullest extent not prohibited by the Delaware General Corporation Law.

(g) Survival of Rights. The rights conferred on any person by this Bylaw shall continue as to a person who has ceased to be a Director, officer, employee or other agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

(h) Insurance. To the fullest extent permitted by the Delaware General Corporation Law, the corporation, upon approval by the Board of Directors, may purchase insurance on behalf of any person required or permitted to be indemnified pursuant to this Bylaw.

(i) Amendments. Any repeal or modification of this Bylaw shall only be prospective and shall not affect the rights under this Bylaw in effect at the time of the alleged occurrence of any action or omission to act that is the cause of any proceeding against any agent of the corporation.

(j) Saving Clause. If this Bylaw or any portion hereof shall be invalidated on any ground by any court of competent jurisdiction, then the corporation shall nevertheless indemnify each Director and executive officer to the full extent not prohibited by any applicable portion of this Bylaw that shall not have been invalidated, or by any other applicable law.

(k) Certain Definitions. For the purposes of this Bylaw, the following definitions shall apply:

(1) The term "proceeding" shall be broadly construed and shall include, without limitation, the investigation, preparation, prosecution, defense, settlement, arbitration and appeal of, and the giving of testimony in, any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative.

(2) The term "expenses" shall be broadly construed and shall include, without limitation, court costs, attorneys' fees, witness fees, fines, amounts paid in settlement or judgment and any other costs and expenses of any nature or kind incurred in connection with any proceeding.

(3) The term the "corporation" shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, and employees or agents, so that any person who is or was a director, officer, employee or agent of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under the provisions of this Bylaw with respect to the resulting or surviving corporation as he would have with respect to such constituent corporation if its separate existence had continued.

(4) References to a "director," "officer," "employee," or "agent" of the corporation shall include without limitation, situations where such person is serving at the request of the corporation as a director, officer, employee, trustee or agent of another corporation, partnership, joint venture, trust or other enterprise.

(5) References to "other enterprises" shall include employee benefit plans; references to "fines" shall include any excise taxes assessed on a person with respect to an employee benefit plan; and references to "serving at the request of the corporation" shall include any service as a director, officer, employee or agent of the corporation which imposes duties on, or involves services by, such director, officer, employee, or agent with respect to an employee benefit plan, its participants, or beneficiaries; and a person who acted in good faith and in a manner he reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner "not opposed to the best interests of the corporation" as referred to in this Bylaw.

ARTICLE XII

Notices

Section 43. Notices.

- (a) Notice to Stockholders. Whenever, under any provisions of these Bylaws, notice is required to be given to any stockholder, it shall be given in writing, timely and duly deposited in the United States mail, postage prepaid, and addressed to such stockholder's last known post office address as shown by the stock record of the corporation or its transfer agent.
- (b) Notice to Directors. Any notice required to be given to any Director may be given by the method stated in subsection (a), or by facsimile, telex or telegram, except that such notice other than one which is delivered personally shall be sent to such address as such Director shall have filed in writing with the Secretary, or, in the absence of such filing, to the last known post office address of such Director.
- (c) Address Unknown. If no address of a stockholder or Director be known, notice may be sent to the office of the corporation required to be maintained pursuant to Section 2 hereof.
- (d) Affidavit of Mailing. An affidavit of mailing, executed by a duly authorized and competent employee of the corporation or its transfer agent appointed with respect to the class of stock affected, specifying the name and address or the names and addresses of the stockholder or stockholders, or Director or Directors, to whom any such notice or notices was or were given, and the time and method of giving the same, shall be conclusive evidence of the statements therein contained.
- (e) Time Notices Deemed Given. All notices given by mail, as above provided, shall be deemed to have been given as at the time of mailing, and all notices given by facsimile, telex or telegram shall be deemed to have been given as of the sending time recorded at the time of transmission.
- (f) Methods of Notices. It shall not be necessary that the same method of giving notice be employed in respect of all Directors, but one permissible method may be

employed in respect of any one or more, and any other permissible method or methods may be employed in respect of any other or others.

(g) Failure to Receive Notice. The period or limitation of time within which any stockholder may exercise any option or right, or enjoy any privilege or benefit, or be required to act, or within which any Director may exercise any power or right, or enjoy any privilege, pursuant to any notice sent such person in the manner above provided, shall not be affected or extended in any manner by the failure of such stockholder or such Director to receive such notice.

(h) Notice to Person with Whom Communication Is Unlawful. Whenever notice is required to be given, under any provision of law or of the Certificate of Incorporation or Bylaws of the corporation, to any person with whom communication is unlawful, the giving of such notice to such person shall not be required and there shall be no duty to apply to any governmental authority or agency for a license or permit to give such notice to such person. Any action or meeting which shall be taken or held without notice to any such person with whom communication is unlawful shall have the same force and effect as if such notice had been duly given. In the event that the action taken by the corporation is such as to require the filing of a certificate under any provision of the Delaware General Corporation Law, the certificate shall state, if such is the fact and if notice is required, that notice was given to all persons entitled to receive notice except such persons with whom communication is unlawful.

(i) Notice to Person with Undeliverable Address. Whenever notice is required to be given, under any provision of law or the Certificate of Incorporation or Bylaws of the corporation, to any stockholder to whom (i) notice of two consecutive annual meetings, and all notices of meetings to such person during the period between such two consecutive annual meetings, or (ii) all, and at least two, payments (if sent by first class mail) of dividends or interest on securities during a twelve-month period, have been mailed addressed to such person at such person's address as shown on the records of the corporation and have been returned undeliverable, the giving of such notice to such person shall not be required. Any action or meeting which shall be taken or held without notice to such person shall have the same force and effect as if such notice had been duly given. If any such person shall deliver to the corporation a written notice setting forth such person's then current address, the requirement that notice be given to such person shall be reinstated. In the event that the action taken by the corporation is such as to require the filing of a certificate under any provision of the Delaware General Corporation Law, the certificate need not state that notice was not given to persons to whom notice was not required to be given pursuant to this paragraph.

ARTICLE XIII

Amendments

Section 44. Amendments. Except as otherwise set forth in paragraph (i) of Section 42 of these Bylaws, these Bylaws may be amended or repealed and new Bylaws adopted by the stockholders entitled to vote. The Board of Directors shall have the power, if such power is conferred upon the Board of Directors by the Certificate of Incorporation, to adopt amend or repeal Bylaws (including, without limitation, the amendment of any Bylaw setting forth the number of Directors who shall constitute the whole Board of Directors).

ARTICLE XIV

Loans to Officers

Section 45. Loans to Officers. The corporation may lend money to, or guarantee any obligation of, or otherwise assist any officer or other employee of the corporation or of its subsidiaries, including any officer or employee who is a Director of the corporation or its subsidiaries, whenever, in the judgment of the Board of Directors, such loan, guarantee or assistance may reasonably be expected to benefit the corporation. The loan, guarantee or other assistance may be with or without interest and may be unsecured, or secured in such manner as the Board of Directors shall approve, including, without limitation, a pledge of shares of stock of the corporation. Nothing in this Bylaw shall be deemed to deny, limit or restrict the powers of guaranty or warranty of the corporation at common law or under statute.

ARTICLE XV

Annual Report

Section 46. Annual Report. (a) Subject to the provisions of Section 46(b) below, the Board of Directors shall cause an annual report to be sent to each stockholder of the corporation not later than one hundred twenty (120) days after the close of the corporation's fiscal year. Such report shall include a balance sheet as of the end of such fiscal year and an income statement and statement of changes in financial position for such fiscal year, accompanied by any report thereon of independent accounts or, if there is no such report, the certificate of an authorized officer of the corporation that such statements were prepared without audit from the books and records of the corporation. Such report shall be sent to stockholders at least fifteen (15) days prior to the next annual meeting of stockholders after the end of the fiscal year to which it relates.

(b) If and so long as there are fewer than 100 holders of record of the corporation's shares, the requirement of sending of an annual report to the stockholders of the corporation is hereby expressly waived.

EXHIBIT 10.1

ISS GROUP, INC. RESTATED 1995 STOCK INCENTIVE PLAN (Amended and Restated through December 4, 1997)

ARTICLE ONE

GENERAL PROVISIONS

I. PURPOSE OF THE PLAN

This Restated 1995 Stock Incentive Plan is intended to promote the interests of ISS Group, Inc., a Delaware corporation, by providing eligible persons with the opportunity to acquire a proprietary interest, or otherwise increase their proprietary interest, in the Corporation as an incentive for them to remain in the service of the Corporation.

Capitalized terms herein shall have the meanings assigned to such terms in the attached Appendix.

II. STRUCTURE OF THE PLAN

A. The Plan shall be divided into three (3) separate equity programs:

(i) the Discretionary Option Grant Program under which eligible persons may, at the discretion of the Plan Administrator, be granted options to purchase shares of Common Stock,

(ii) the Stock Issuance Program under which eligible persons may, at the discretion of the Plan Administrator, be issued shares of Common Stock directly, either through the immediate purchase of such shares or as a bonus for services rendered the Corporation (or any Parent or Subsidiary), and

(iii) the Automatic Option Grant Program under which eligible non-employee Board members shall automatically receive options at periodic intervals to purchase shares of Common Stock.

B. The provisions of Articles One and Five shall apply to all equity programs under the Plan and shall accordingly govern the interests of all persons under the Plan.

III. ADMINISTRATION OF THE PLAN

A. Prior to the Section 12(g) Registration Date, the Plan shall be administered by the Board.

B. Beginning with the Section 12(g) Registration Date, the Board shall have the authority to administer the Discretionary Option Grant and Stock Issuance Programs with respect to Section 16 Insiders but may delegate such authority in whole or in part to the Primary Committee. Administration of the Plan with respect to all other persons eligible to participate may, at the Board's discretion, be vested in the Primary Committee or a Secondary Committee, or the Board may retain the power to administer the Plan with respect to all such persons.

C. Members of the Primary Committee or any Secondary Committee shall serve for such period of time as the Board may determine and may be removed by the Board at any time. The Board may also at any time terminate the functions of any Secondary Committee and reassume all powers and authority previously delegated to such committee.

D. Each Plan Administrator shall, within the scope of its administrative functions under the Plan, have full power and authority to establish such rules and regulations as it may deem appropriate for proper administration of the Plan and to make such determinations under, and issue such interpretations of, the provisions of such Plan and any outstanding options or stock issuances thereunder as it may deem necessary or advisable. Decisions of the Plan Administrator within the scope of its administrative functions under the Plan shall be final and binding on all parties who have an interest in the Plan or any option or stock issuance thereunder.

E. Service on the Primary Committee or the Secondary Committee shall constitute service as a Board member, and members of each such committee shall accordingly be entitled to full indemnification and reimbursement as Board members for their service on such committee. No member of the Primary Committee or the Secondary Committee shall be liable for any act or omission made in good faith with respect to the Plan or any option grants or stock issuances under the Plan.

F. Administration of the Automatic Option Grant Program shall be self-executing in accordance with the terms of such program.

IV. ELIGIBILITY

A. Prior to the Section 12(g) Registration Date, only Employees shall be eligible to participate in the Plan.

B. Beginning with the Section 12(g) Registration Date, the persons eligible to participate in the Discretionary Option Grant and Stock issuance Programs shall be as follows:

(i) Employees,

(ii) non-employee members of the Board or the board of directors of any Parent or Subsidiary, and

(iii) consultants and other independent advisors who provide services to the Corporation (or any Parent or Subsidiary).

C. Only non-employee Board members shall be eligible to participate in the Automatic Option Grant Program.

D. Each Plan Administrator shall, within the scope of its administrative jurisdiction under the Plan, have full authority (subject to the provisions of the Plan) to determine, (i) with respect to the option grants under the Discretionary Option Grant Program, which eligible persons are to receive option grants, the time or times when such option grants are to be made, the number of shares to be covered by each such grant, the status of the granted option as either an Incentive Option or a Non-Statutory Option, the time or times at which each option is to become exercisable, the vesting schedule (if any) applicable to the option shares and the maximum term for which the option is to remain outstanding and (ii) with respect to stock issuances under the Stock Issuance Program, which eligible persons are to receive stock issuances, the time or times when such issuances are to be made, the number of shares to be issued to each Participant, the vesting schedule (if any) applicable to the issued shares and the consideration to be paid for such shares.

E. The Plan Administrator shall have the absolute discretion either to grant options in accordance with the Discretionary Option Grant Program or to effect stock issuances in accordance with the Stock Issuance Program.

V. STOCK SUBJECT TO THE PLAN

A. The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Common Stock. The maximum number of shares of Common Stock which may be issued over the term of the Plan shall not exceed 3,000,000 shares.

B. The number of shares of Common Stock available for issuance under the Plan shall automatically increase on the first trading day of each calendar year, beginning with the 1999 calendar year, by an amount equal to three percent (3.0%) of the total number of shares of Common Stock outstanding on the last trading day of the immediately preceding calendar year. No Incentive Options may be granted on the basis of the additional shares of Common Stock resulting from such annual increases.

C. No one person participating in the Plan may receive options, separately exercisable stock appreciation rights and direct stock issuances for more than 300,000 shares of Common Stock per calendar year beginning with the calendar year in which the Section 12(g) Registration Date occurs.

D. Shares of Common Stock subject to outstanding options shall be available for subsequent issuance under the Plan to the extent (i) the options expire or terminate for any reason prior to exercise in full or (ii) the options are cancelled in accordance with the cancellation-regrant provisions of Article Two. Unvested shares issued under the Plan and subsequently repurchased by the Corporation at the original issue price paid per share pursuant to the Corporation's repurchase rights under the Plan shall be added back to the number of shares of Common Stock reserved for issuance under the Plan and shall accordingly be available for reissuance through one or more subsequent option grants or direct stock issuances under the Plan. However, should the exercise price of an option under the Plan be paid with shares of Common Stock or should shares of Common Stock otherwise issuable under the Plan be withheld by the corporation in satisfaction of the withholding taxes incurred in connection with the exercise of an option or the vesting of a stock issuance under the Plan, then the number of shares of Common Stock available for issuance under the Plan shall be reduced by the gross number of shares for which the option is exercised or which vest under the stock issuance, and not by the net number of shares of Common Stock issued to the holder of such option or stock issuance.

E. Should any change be made to the Common Stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration, appropriate adjustments shall be made to (i) the maximum number and/or class of securities issuable under the Plan, (ii) the number and/or class of securities for which any one person may be granted options, separately exercisable stock appreciation rights and direct stock issuances per calendar year, (iii) the number and/or class of securities for which grants are subsequently to be made under the Automatic Option Grant Program to new and continuing non-employee Board members, and (iv) the number and/or class of securities and the exercise price per share in effect under each outstanding option in order to prevent the dilution or enlargement of benefits thereunder. The adjustments determined by the Plan Administrator shall be final, binding and conclusive.

ARTICLE TWO

DISCRETIONARY OPTION GRANT PROGRAM

I. OPTION TERMS

Each option shall be evidenced by one or more documents in the form approved by the Plan Administrator; provided, however, that each such document shall comply with the terms specified below. Each document evidencing an Incentive Option shall, in addition, be subject to the provisions of the Plan applicable to such options.

A. EXERCISE PRICE.

1. The exercise price per share shall be fixed by the Plan Administrator and may be equal to, greater than or less than the Fair Market Value per share of Common Stock on the option grant date.

2. The exercise price shall become immediately due upon exercise of the option and shall, subject to the provisions of Section I of Article Five and the documents evidencing the option, be payable in cash or check made payable to the Corporation. Should the Common Stock be registered under Section 12(g) of the 1934 Act at the time the option is exercised, then the exercise price may also be paid as follows:

(i) in shares of Common Stock held for the requisite period necessary to avoid a charge to the Corporation's earnings for financial reporting purposes and valued at Fair Market Value on the Exercise Date, or

(ii) to the extent the option is exercised for vested shares, through a special sale and remittance procedure pursuant to which the Optionee shall concurrently provide irrevocable instructions (A) to a Corporation-designated brokerage firm to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate exercise price payable for the purchased shares plus all applicable Federal, state and local income and employment taxes required to be withheld by the Corporation by reason of such exercise and (B) to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale.

Except to the extent such sale and remittance procedure is utilized, payment of the exercise price for the purchased shares must be made on the Exercise Date.

B. EXERCISE AND TERM OF OPTIONS. Each option shall be exercisable at such time or times, during such period and for such number of shares as shall be determined by the Plan

Administrator and set forth in the documents evidencing the option grant. However, no option shall have a term in excess of ten (10) years measured from the option grant date.

C. EFFECT OF TERMINATION OF SERVICE.

1. The following provisions shall govern the exercise of any options held by the Optionee at the time of cessation of Service or death:

(i) Should the Optionee cease to remain in Service for any reason other than Permanent Disability or Misconduct, then the Optionee shall have a period of three (3) months following the date of such cessation of Service during which to exercise each outstanding option held by such Optionee.

(ii) Should the Optionee's Service terminate by reason of Permanent Disability, then the Optionee shall have a period of twelve (12) months following the date of such cessation of Service during which to exercise each outstanding option held by such Optionee.

(iii) If the Optionee dies while holding an outstanding option, then the personal representative of his or her estate or the person or persons to whom the option is transferred pursuant to the Optionee's will or the laws of inheritance shall have a twelve (12)-month period following the date of the Optionee's death to exercise such option.

(iv) Under no circumstances, however, shall any such option be exercisable after the specified expiration of the option term.

(v) During the applicable post-Service exercise period, the option may not be exercised in the aggregate for more than the number of vested shares for which the option is exercisable on the date of the Optionee's cessation of Service. Upon the expiration of the applicable exercise period or (if earlier) upon the expiration of the option term, the option shall terminate and cease to be outstanding for any vested shares for which the option has not been exercised. However, the option shall, immediately upon the Optionee's cessation of Service, terminate and cease to be outstanding with respect to any and all option shares for which the option is not otherwise at the time exercisable or in which the Optionee is not otherwise at that time vested.

(vi) Should the Optionee's Service be terminated for Misconduct, then all outstanding options held by the Optionee shall terminate immediately and cease to remain outstanding.

(vii) In the event of a Corporate Transaction or Change in Control, the provisions of Section III of this Article Two shall govern the

period for which outstanding options are to remain exercisable following the Optionee's cessation of Service and shall supersede any provisions to the contrary in this paragraph.

2. The Plan Administrator shall have the discretion, exercisable either at the time an option is granted or at any time while the option remains outstanding, to:

(i) extend the period of time for which the option is to remain exercisable following the Optionee's cessation of Service or death from the limited period otherwise in effect for that option to such greater period of time as the Plan Administrator shall deem appropriate, but in no event beyond the expiration of the option term, and/or

(ii) permit the option to be exercised, during the applicable post-Service exercise period, not only with respect to the number of vested shares of Common Stock for which such option is exercisable at the time of the Optionee's cessation of Service but also with respect to one or more additional installments in which the Optionee would have vested under the option had the Optionee continued in Service.

D. LIMITED TRANSFERABILITY OF OPTIONS. During the lifetime of the Optionee, Incentive Options shall be exercisable only by the Optionee and shall not be assignable or transferable other than by will or by the laws of descent and distribution following the Optionee's death. However, a Non-Statutory Option may, in connection with the Optionee's estate plan, be assigned in whole or in part during the Optionee's lifetime to one or more members of the Optionee's immediate family or to a trust established exclusively for one or more such family members. The assigned portion may only be exercised by the person or persons who acquire a proprietary interest in the option pursuant to the assignment. The terms applicable to the assigned portion shall be the same as those in effect for the option immediately prior to such assignment and shall be set forth in such documents issued to the assignee as the Plan Administrator may deem appropriate.

E. STOCKHOLDER RIGHTS. The holder of an option shall have no stockholder rights with respect to the shares subject to the option until such person shall have exercised the option, paid the exercise price and become a holder of record of the purchased shares.

F. UNVESTED SHARES. The Plan Administrator shall have the discretion to grant options which are exercisable for unvested shares of Common Stock. Should the Optionee cease Service while holding such unvested shares, the Corporation shall have the right to repurchase, at the exercise price paid per share, any or all of those unvested shares. The terms upon which such repurchase right shall be exercisable (including the period and procedure for exercise and the appropriate vesting schedule for the purchased shares) shall be established by the Plan Administrator and set forth in the document evidencing such repurchase right.

G. FIRST REFUSAL RIGHTS. Until the Section 12(g) Registration Date, the Corporation shall have the right of first refusal with respect to any proposed disposition by the Optionee (or any successor in interest) of any shares of Common Stock issued under the Plan. Such right of first refusal shall be exercisable in accordance with the terms established by the Plan Administrator and set forth in the document evidencing such right.

H. MARKET STAND-OFF. In connection with any underwritten public offering by the Corporation of its equity securities pursuant to an effective registration statement filed under the Securities Act of 1933, including the Corporation's initial public offering, the Optionee may not sell, make any short sale of, loan, hypothecate, pledge, grant any option for the purchase of, or otherwise dispose or transfer for value or otherwise agree to engage in any of the foregoing transactions with respect to, any shares of Common Stock acquired upon exercise of an option granted under the Plan without the prior written consent of the Corporation or its underwriters. Such restriction (the "Market Stand-Off") shall be in effect for such period of time from and after the effective date of the final prospectus for the offering as may be requested by the Corporation or such underwriters. The Optionee shall be required to execute such agreements as the Corporation or the underwriters request in connection with the Market Stand-Off.

I. FORFEITURE FOR COMPETITION. If, at any time while the Optionee remains in Service or after the Optionee's termination of Service while the option remains outstanding, the Optionee provides services to a competitor of the Corporation (or any Parent or Subsidiary), whether as an employee, officer, director, independent contractor, consultant, agent or otherwise, such services being of a nature that can reasonably be expected to involve the skills and experience used or developed by the Optionee while in the Corporation's Service, then the Optionee's rights under any options outstanding under the Plan shall be forfeited and terminated, subject to a determination to the contrary by the Plan Administrator.

II. INCENTIVE OPTIONS

The terms specified below shall be applicable to all Incentive Options. Except as modified by the provisions of this Section II, all the provisions of the Plan shall be applicable to Incentive Options. Options which are specifically designated as Non-Statutory Options shall not be subject to the terms of this Section II.

A. ELIGIBILITY. Incentive Options may only be granted to Employees.

B. EXERCISE PRICE. The exercise price per share shall not be less than one hundred percent (100%) of the Fair Market Value per share of Common Stock on the option grant date.

C. DOLLAR LIMITATION. The aggregate Fair Market Value of the shares of Common Stock (determined as of the respective date or dates of grant) for which one or more options granted to any Employee under the Plan (or any other option plan of the Corporation or any Parent or Subsidiary) may for the first time become exercisable as Incentive Options during any one (1) calendar year shall not exceed the sum of One Hundred Thousand Dollars (\$100,000).

To the extent the Employee holds two (2) or more such options which become exercisable for the first time in the same calendar year, the foregoing limitation on the exercisability of such options as Incentive Options shall be applied on the basis of the order in which such options are granted.

D. 10% STOCKHOLDER. If any Employee to whom an Incentive Option is granted is a 10% Stockholder, then the option term shall not exceed five (5) years measured from the option grant date and the exercise price per share of the option shall be equal to at least one hundred ten percent (110%) of the Fair Market Value per share of Common Stock on the option grant date.

III. CORPORATE TRANSACTION/CHANGE IN CONTROL

A. In the event of any Corporate Transaction, each outstanding option shall automatically accelerate so that each such option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable for all of the shares of Common Stock at the time subject to such option and may be exercised for any or all of those shares as fully-vested shares of Common Stock. However, an outstanding option shall NOT so accelerate if and to the extent: (i) such option is, in connection with the Corporate Transaction, either to be assumed by the successor corporation (or parent thereof) or to be replaced with a comparable option to purchase shares of the capital stock of the successor corporation (or parent thereof), (ii) such option is to be replaced with a cash incentive program of the successor corporation which preserves the spread existing on the unvested option shares at the time of the Corporate Transaction and provides for subsequent payout in accordance with the same vesting schedule applicable to such option or (iii) the acceleration of such option is subject to other limitations imposed by the Plan Administrator at the time of the option grant. The determination of option comparability under clause (i) above shall be made by the Plan Administrator, and its determination shall be final, binding and conclusive.

B. All outstanding repurchase rights shall also terminate automatically, and the shares of Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction, except to the extent: (i) those repurchase rights are to be assigned to the successor corporation (or parent thereof) in connection with such Corporate Transaction or (ii) such accelerated vesting is precluded by other limitations imposed by the Plan Administrator at the time the repurchase right is issued.

C. Immediately following the consummation of the Corporate Transaction, all outstanding options shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof).

D. If an outstanding option is assumed by the successor corporation (or parent thereof) in connection with a Corporate Transaction, and the Corporation's repurchase rights with respect to the unvested option shares are assigned to such successor corporation (or parent thereof), and at the time of or within twelve (12) months following such Corporate Transaction either (i) the

Optionee is offered a Lesser Position in replacement of the position held by him or her immediately prior to the Corporate Transaction or (ii) the Optionee's Service terminates by reason of an Involuntary Termination, then, effective as of the date on which such Lesser Position is offered to the Optionee or the effective date of such Involuntary Termination, respectively, the option shall automatically accelerate in part so that, in addition to the number of vested shares of Common Stock for which the option is exercisable at such time, the option shall become exercisable with respect to the next annual installment of option shares for which the option is scheduled to become exercisable in accordance with the exercise schedule established for the option (and the Corporation's repurchase rights shall automatically lapse with respect to such option shares). Following such acceleration, to the extent the Optionee continues in Service, the exercise schedule for the option shall be adjusted so that the option shall become exercisable, with respect to each subsequent annual installment of option shares under the original exercise schedule, on each subsequent anniversary of the effective date of such option acceleration. In the event that both the offer of a Lesser Position and a subsequent Involuntary Termination of an Optionee's Service occur within twelve (12) months following a Corporate Transaction, then acceleration of the option shares shall occur only in connection with the offer of such Lesser Position and no additional acceleration shall occur in connection with such subsequent Involuntary Termination. Following an Involuntary Termination that occurs within twelve (12) months following a Corporate Transaction, the option shall remain exercisable for any or all of the vested option shares until the earlier of (i) the expiration of the option term or (ii) the expiration of the one (1)-year period measured from the effective date of the Involuntary Termination.

E. Each option which is assumed in connection with a Corporate Transaction shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to the Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction. Appropriate adjustments shall also be made to (i) the number and class of securities available for issuance under the Plan following the consummation of such Corporate Transaction, (ii) the exercise price payable per share under each outstanding option, provided the aggregate exercise price payable for such securities shall remain the same and (iii) the maximum number of securities and/or class of securities for which any one person may be granted stock options, separately exercisable stock appreciation rights and direct stock issuances under the Plan.

F. Notwithstanding Sections III.A., III.B. and III.D of this Article Two, the Plan Administrator shall have the discretion, exercisable either at the time the option is granted or at any time while the option remains outstanding, to provide for the automatic acceleration of one or more outstanding options (and the automatic termination of one or more outstanding repurchase rights with the immediate vesting of the shares of Common Stock subject to those rights) upon the occurrence of a Corporate Transaction, whether or not those options are to be assumed or replaced (or those repurchase rights are to be assigned) in the Corporate Transaction. The Plan Administrator shall also have the discretion to grant options which do not accelerate whether or not such options are assumed (and to provide for repurchase rights that do not terminate whether or not such rights are assigned) in connection with a Corporate Transaction.

G. The Plan Administrator shall also have the discretion, exercisable at the time the option is granted or at any time while the option remains outstanding, to provide for the automatic acceleration, of any options which are assumed or replaced in a Corporate Transaction and do not otherwise accelerate at that time (and the termination of any of the Corporation's outstanding repurchase rights which do not otherwise terminate at the time of the Corporate Transaction) in the event that within twelve (12) months following the effective date of such Corporate Transaction either (i) the Optionee should be offered a Lesser Position in replacement of the position held by him or her immediately prior to the Corporate Transaction or (ii) the Optionee's Service should subsequently terminate by reason of an Involuntary Termination. Following an Involuntary Termination that occurs within twelve (12) months following a Corporate Transaction, any options accelerated under this Section III. G shall remain exercisable for the vested option shares until the earlier of (i) the expiration of the option term or (ii) the expiration of the one (1)-year period measured from the effective date of the Involuntary Termination.

H. The Plan Administrator shall have the discretion, exercisable either at the time the option is granted or at any time while the option remains outstanding, to (i) provide for the automatic acceleration of one or more outstanding options (and the automatic termination of one or more outstanding repurchase rights with the immediate vesting of the shares of Common Stock subject to those rights) upon the occurrence of a Change in Control or (ii) condition any such option acceleration (and the termination of any outstanding repurchase rights) upon the occurrence of either of the following events within a specified period (not to exceed twelve (12) months) following the effective date of such Change in Control: (a) the offer to the Optionee of a Lesser Position in replacement of the position held by him or her immediately prior to the Change in Control or (b) the Involuntary Termination of the Optionee's Service. Any options accelerated in connection with a Change in Control shall remain fully exercisable until the expiration or sooner termination of the option term; provided, however, that following an Involuntary Termination that occurs within twelve (12) months following a Change in Control, any options accelerated under this Section III.H shall remain exercisable for the vested option shares until the earlier of (i) the expiration of the option term or (ii) the expiration of the one (1)-year period measured from the effective date of the Involuntary Termination.

I. The portion of any Incentive Option accelerated in connection with a Corporate Transaction or Change in Control shall remain exercisable as an Incentive Option only to the extent the applicable One Hundred Thousand Dollar (\$100,000) limitation is not exceeded. To the extent such dollar limitation is exceeded, the accelerated portion of such option shall be exercisable as a Non-Statutory Option under the Federal tax laws.

J. The grant of options under the Option Grant Program shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

IV. CANCELLATION AND REGRANT OF OPTIONS

The Plan Administrator shall have the authority to effect, at any time and from time to time, with the consent of the affected option holders, the cancellation of any or all outstanding options under the Plan and to grant in substitution therefor new options covering the same or different number of shares of Common Stock but with an exercise price per share based on the Fair Market Value per share of Common Stock on the new option grant date.

V. STOCK APPRECIATION RIGHTS

A. The Plan Administrator shall have full power and authority to grant to selected Optionee's tandem stock appreciation rights and/or limited stock appreciation rights.

B. The following terms shall govern the grant and exercise of tandem stock appreciation rights:

(i) One or more Optionees may be granted the right, exercisable upon such terms as the Plan Administrator may establish, to elect between the exercise of the underlying option for shares of Common Stock and the surrender of that option in exchange for a distribution from the Corporation in an amount equal to the excess of

(a) the Fair Market Value (on the option surrender date) of the number of shares in which the Optionee is at the time vested under the surrendered option (or surrendered portion thereof) over (b) the aggregate exercise price payable for such shares.

(ii) No such option surrender shall be effective unless it is approved by the Plan Administrator. If the surrender is so approved, then the distribution to which the Optionee shall be entitled may be made in shares of Common Stock valued at Fair Market Value on the option surrender date, in cash, or partly in shares and partly in cash, as the Plan Administrator shall in its sole discretion deem appropriate.

(iii) If the surrender of an option is rejected by the Plan Administrator, then the Optionee shall retain whatever rights the Optionee had under the surrendered option (or surrendered portion thereof) on the option surrender date and may exercise such rights at any time prior to the later of (a) five (5) business days after the receipt of the rejection notice or (b) the last day on which the option is otherwise exercisable in accordance with the terms of the documents evidencing such option, but in no event may such rights be exercised more than ten (10) years after the option grant date.

C. The following terms shall govern the grant and exercise of limited stock appreciation rights:

(i) One or more Section 16 Insiders may be granted limited stock appreciation rights with respect to their outstanding options.

(ii) Upon the occurrence of a Hostile Take-Over, each such individual holding one or more options with such a limited stock appreciation right shall have the unconditional right (exercisable for a thirty (30)-day period following such Hostile Take-Over) to surrender each such option to the Corporation, to the extent the option is at the time exercisable for vested shares of Common Stock. In return for the surrendered option, the Optionee shall receive a cash distribution from the Corporation in an amount equal to the excess of (a) the Take-Over Price of the shares of Common Stock which are at the time vested under each surrendered option (or surrendered portion thereof) over (b) the aggregate exercise price payable for such shares. Such cash distribution shall be paid within five (5) days following the option surrender date.

(iii) The Plan Administrator shall pre-approve, at the time the limited right is granted, the subsequent exercise of that right in accordance with the terms of the grant and the provisions of this Section V.C. No additional approval of the Plan Administrator or the Board shall be required at the time of the actual option surrender and cash distribution.

(iv) The balance of the option (if any) shall continue in full force and effect in accordance with the documents evidencing such option.

ARTICLE THREE

STOCK ISSUANCE PROGRAM

I. STOCK ISSUANCE TERMS

Shares of Common Stock may be issued under the Stock Issuance Program through direct and immediate issuances without any intervening option grants. Each such stock issuance shall be evidenced by a Stock Issuance Agreement which complies with the terms specified below.

A. PURCHASE PRICE.

1. The purchase price per share shall be fixed by the Plan Administrator and may be less than, equal to or greater than the Fair Market Value per share of Common Stock on the issue date.
2. Subject to the provisions of Section I of Article Four, shares of Common Stock may be issued under the Stock Issuance Program for any of the following items of consideration which the Plan Administrator may deem appropriate in each individual instance:
 - (i) cash or check made payable to the Corporation, or
 - (ii) past services rendered to the Corporation (or any Parent or Subsidiary).

B. VESTING PROVISIONS.

1. Shares of Common Stock issued under the Stock Issuance Program may, in the discretion of the Plan Administrator, be fully and immediately vested upon issuance or may vest in one or more installments over the Participant's period of Service or upon attainment of specified performance objectives.
2. Any new, substituted or additional securities or other property (including money paid other than as a regular cash dividend) which the Participant may have the right to receive with respect to the Participant's unvested shares of Common Stock by reason of any stock dividend, stock split, recapitalization, combination of shares, exchange of shares or other change affecting the outstanding Common Stock as a class without the Corporation's receipt of consideration shall be issued subject to (i) the same vesting requirements applicable to the Participant's unvested shares of Common Stock and (ii) such escrow arrangements as the Plan Administrator shall deem appropriate.

3. The Participant shall have full stockholder rights with respect to any shares of Common Stock issued to the Participant under the Stock Issuance Program, whether or not the Participant's interest in those shares is vested. Accordingly, the Participant shall have the right to vote such shares and to receive any regular cash dividends paid on such shares.

4. Should the Participant cease to remain in Service while holding one or more unvested shares of Common Stock issued under the Stock Issuance Program or should the performance objectives not be attained with respect to one or more such unvested shares of Common Stock, then those shares shall be immediately surrendered to the Corporation for cancellation, and the Participant shall have no further stockholder rights with respect to those shares. To the extent the surrendered shares were previously issued to the Participant for consideration paid in cash or cash equivalent (including the Participant's purchase-money indebtedness), the Corporation shall repay to the Participant the cash consideration paid for the surrendered shares and shall cancel the unpaid principal balance of any outstanding purchase-money note of the Participant attributable to such surrendered shares.

5. The Plan Administrator may in its discretion waive the surrender and cancellation of one or more unvested shares of Common Stock (or other assets attributable thereto) which would otherwise occur upon the non-completion of the vesting schedule applicable to such shares. Such waiver shall result in the immediate vesting of the Participant's interest in the shares of Common Stock as to which the waiver applies. Such waiver may be effected at any time, whether before or after the Participant's cessation of Service or the attainment or non-attainment of the applicable performance objectives.

C. FIRST REFUSAL RIGHTS. Until the Section 12(g) Registration Date, the Corporation shall have the right of first refusal with respect to any proposed disposition by the Participant (or any successor in interest) of any shares of Common Stock issued under the Stock Issuance Program. Such right of first refusal shall be exercisable in accordance with the terms established by the Plan Administrator and set forth in the document evidencing such right.

II. CORPORATE TRANSACTION/CHANGE IN CONTROL

A. All of the Corporation's outstanding repurchase rights under the Stock Issuance Program shall terminate automatically, and all the shares of Common Stock subject to those terminated rights shall immediately vest in full, in the event of any Corporate Transaction, except to the extent (i) those repurchase rights are assigned to the successor corporation (or parent thereof) in connection with such Corporate Transaction or (ii) such accelerated vesting is precluded by other limitations imposed in the Stock Issuance Agreement.

B. Notwithstanding Section II.A. of this Article Three, the Plan Administrator shall have the discretionary authority, exercisable either at the time the unvested shares are issued or any time while the Corporation's repurchase rights remain outstanding under the Stock Issuance Program, to provide that those rights shall automatically terminate in whole or in part, and the shares of Common Stock subject to those terminated rights shall immediately vest, in the event

of a Corporate Transaction, whether or not those repurchase rights are to be assigned to the successor corporation (or its parent) in connection with such Corporate Transaction. The Plan Administrator shall also have the discretion to provide for repurchase rights with terms different from those in effect under this Section II in connection with a Corporate Transaction.

C. The Plan Administrator shall have the discretion, exercisable either at the time the unvested shares are issued or at any time while the Corporation's repurchase rights remain outstanding, to provide that any repurchase rights that are assigned in the Corporate Transaction shall automatically terminate, and the shares of Common Stock subject to those terminated rights shall immediately vest in full, in the event that either of the following events should occur either at the time of or within a specified period (not to exceed twelve (12) months) following the effective date of the Corporate Transaction: (a) the Participant is offered a Lesser Position in replacement of the position held by him or her immediately prior to the Corporate Transaction or (b) the Participant's Service terminates by reason of an Involuntary Termination.

D. The Plan Administrator shall have the discretion, exercisable either at the time the unvested shares are issued or at any time while the Corporation's repurchase right remains outstanding, to (i) provide for the automatic termination of one or more outstanding repurchase rights and the immediate vesting of the shares of Common Stock subject to those rights upon the occurrence of a Change in Control or (ii) condition any such accelerated vesting upon the occurrence of either of the following events at the time of or within a specified period (not to exceed twelve (12) months) following the effective date of such Change in Control: (a) the Participant is offered a Lesser Position in replacement of the position held by him or her immediately prior to the Change in Control or (b) the Involuntary Termination of the Participant's Service.

III. SHARE ESCROW/LEGENDS

Unvested shares may, in the Plan Administrator's discretion, be held in escrow by the Corporation until the Participant's interest in such shares vests or may be issued directly to the Participant with restrictive legends on the certificates evidencing those unvested shares.

IV. MARKET STAND-OFF

In connection with any underwritten public offering by the Corporation of its equity securities pursuant to an effective registration statement filed under the Securities Act of 1933, including the Corporation's initial public offering, the Participant may not sell, make any short sale of, loan, hypothecate, pledge, grant any option for the purchase of, or otherwise dispose or transfer for value or otherwise agree to engage in any of the foregoing transactions with respect to, any shares of Common Stock acquired under the Plan without the prior written consent of the Corporation or its underwriters. Such restriction (the "Market Stand-Off") shall be in effect for such period of time from and after the effective date of the final prospectus for the offering as may be requested by the Corporation or such underwriters. The Participant shall be

required to execute such agreements as the Corporation or the underwriters request in connection with the Market Stand-Off.

ARTICLE FOUR

AUTOMATIC OPTION GRANT PROGRAM

I. OPTION TERMS

A. GRANT DATES. Options shall be made on the dates specified below:

1. Each individual who is first elected or appointed as a non-employee Board member on or at any time after the Underwriting Date shall automatically be granted, on the date of such initial election or appointment, a Non-Statutory Option to purchase 50,000 shares of Common Stock, provided that individual has not previously been in the employ of the Corporation or any Parent or Subsidiary.
2. On the date of each Annual Stockholders Meeting held after the Underwriting Date, each individual who is to continue to serve as a non-employee Board member, whether or not that individual is standing for re-election to the Board, shall automatically be granted a Non-Statutory Option to purchase 5,000 shares of Common Stock, provided such individual has served as a non-employee Board member for at least six (6) months.

B. EXERCISE PRICE.

1. The exercise price per share shall be equal to one hundred percent (100%) of the Fair Market Value per share of Common Stock on the option grant date.
2. The exercise price shall be payable in one or more of the alternative forms authorized under the Discretionary Option Grant Program. Except to the extent the sale and remittance procedure specified thereunder is utilized, payment of the exercise price for the purchased shares must be made on the Exercise Date.

C. OPTION TERM. Each option shall have a term of ten (10) years measured from the option grant date.

D. EXERCISE AND VESTING OF OPTIONS. Each option shall be immediately exercisable for any or all of the option shares. However, any shares purchased under the option shall be subject to repurchase by the Corporation, at the exercise price paid per share, upon the Optionee's cessation of Board service prior to vesting in those shares. Each initial 50,000-share option shall vest, and the Corporation's repurchase right shall lapse, in a series of four (4) successive equal annual installments upon the Optionee's completion of each year of Board service over the four (4)-year period measured from the option grant date. Each annual 5,000-share option shall vest, and the Corporation's repurchase right shall lapse, in a series of two (2) successive equal annual installments upon the Optionee's completion of each year of Board service over the two (2)-year period measured from the option grant date.

E. CESSATION OF BOARD SERVICE. The following provisions shall govern the exercise of any options outstanding at the time of the Optionee's cessation of Board service:

(i) The Optionee (or, in the event of Optionee's death, the personal representative of the Optionee's estate or the person or persons to whom the option is transferred pursuant to the Optionee's will or in accordance with the laws of descent and distribution) shall have a twelve (12)-month period following the date of such cessation of Board service in which to exercise each such option.

(ii) During the twelve (12)-month exercise period, the option may not be exercised in the aggregate for more than the number of vested shares of Common Stock for which the option is exercisable at the time of the Optionee's cessation of Board service.

(iii) Should the Optionee cease to serve as a Board member by reason of death or Permanent Disability, then all shares at the time subject to the option shall immediately vest so that such option may, during the twelve (12)-month exercise period following such cessation of Board service, be exercised for all or any portion of those shares as fully-vested shares of Common Stock.

(iv) In no event shall the option remain exercisable after the expiration of the option term. Upon the expiration of the twelve (12)-month exercise period or (if earlier) upon the expiration of the option term, the option shall terminate and cease to be outstanding for any vested shares for which the option has not been exercised. However, the option shall, immediately upon the Optionee's cessation of Board service for any reason other than death or Permanent Disability, terminate and cease to be outstanding to the extent the option is not otherwise at that time exercisable for vested shares.

II. CORPORATE TRANSACTION/CHANGE IN CONTROL/HOSTILE TAKE-OVER

A. In the event of any Corporate Transaction, the shares of Common Stock at the time subject to each outstanding option but not otherwise vested shall automatically vest in full so that each such option shall, immediately prior to the effective date of the Corporate Transaction, become fully exercisable for all of the shares of Common Stock at the time subject to such option and may be exercised for all or any portion of those shares as fully-vested shares of Common Stock. Immediately following the consummation of the Corporate Transaction, each automatic option grant shall terminate and cease to be outstanding, except to the extent assumed by the successor corporation (or parent thereof).

B. In connection with any Change in Control, the shares of Common Stock at the time subject to each outstanding option but not otherwise vested shall automatically vest in full so that each such option shall, immediately prior to the effective date of the Change in Control, become fully exercisable for all of the shares of Common Stock at the time subject to such option and may be exercised for all or any portion of those shares as fully-vested shares of Common Stock. Each such option shall remain exercisable for such fully-vested option shares until the expiration or sooner termination of the option term or the surrender of the option in connection with a Hostile Take-Over.

C. Upon the occurrence of a Hostile Take-Over, the Optionee shall have a thirty (30)-day period in which to surrender to the Corporation each of his or her outstanding automatic option grants. The Optionee shall in return be entitled to a cash distribution from the Corporation in an amount equal to the excess of (i) the Take-Over Price of the shares of Common Stock at the time subject to each surrendered option (whether or not the Optionee is otherwise at the time vested in those shares) over (ii) the aggregate exercise price payable for such shares. Such cash distribution shall be paid within five (5) days following the surrender of the option to the Corporation.

D. Each option which is assumed in connection with a Corporate Transaction shall be appropriately adjusted, immediately after such Corporate Transaction, to apply to the number and class of securities which would have been issuable to the Optionee in consummation of such Corporate Transaction had the option been exercised immediately prior to such Corporate Transaction. Appropriate adjustments shall also be made to the exercise price payable per share under each outstanding option, provided the aggregate exercise price payable for such securities shall remain the same.

E. The grant of options under the Automatic Option Grant Program shall in no way affect the right of the Corporation to adjust, reclassify, reorganize or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

III. REMAINING TERMS

The remaining terms of each option granted under the Automatic Option Grant Program shall be the same as the terms in effect for options made under the Discretionary Option Grant Program.

ARTICLE FIVE

MISCELLANEOUS

I. FINANCING

The Plan Administrator may permit any Optionee or Participant to pay the option exercise price under the Discretionary Option Grant Program or the purchase price of shares issued under the Stock Issuance Program by delivering a full-recourse, interest bearing promissory note payable in one or more installments. The terms of any such promissory note (including the interest rate and the terms of repayment) shall be established by the Plan Administrator in its sole discretion. In no event may the maximum credit available to the Optionee or Participant exceed the sum of (i) the aggregate option exercise price or purchase price payable for the purchased shares (less the par value, if any, of those shares) plus (ii) any Federal, state and local income and employment tax liability incurred by the Optionee or the Participant in connection with the option exercise or share purchase.

II. TAX WITHHOLDING

A. The Corporation's obligation to deliver shares of Common Stock upon the exercise of options or upon the issuance or vesting of such shares under the Plan shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

B. The Plan Administrator may, in its discretion, provide any or all holders of Non-Statutory Options or unvested shares of Common Stock under the Plan with the right to use shares of Common Stock in satisfaction of all or part of the Taxes incurred by such holders in connection with the exercise of their options or the vesting of their shares. Such right may be provided to any such holder in either or both of the following formats:

(i) Stock Withholding: The election to have the Corporation withhold, from the shares of Common Stock otherwise issuable upon the exercise of such Non-Statutory Option or the vesting of such shares, a portion of those shares with an aggregate Fair Market Value equal to the percentage of the Taxes (not to exceed one hundred percent (100%)) designated by the holder.

(ii) Stock Delivery: The election to deliver to the Corporation, at the time the Non-Statutory Option is exercised or the shares vest, one or more shares of Common Stock previously acquired by such holder (other than in connection with the option exercise or share vesting triggering the Taxes) with an aggregate Fair Market Value equal to the percentage of the Taxes (not to exceed one hundred percent (100%)) designated by the holder.

III. EFFECTIVE DATE AND TERM OF PLAN

A. The Plan became effective when adopted by the board of directors of Internet Security Systems, Inc., a Georgia Corporation, (the "Predecessor Corporation") on September 6, 1995 and was approved by the stockholders of the Predecessor Corporation on January 31, 1996. Effective as of February 28, 1997, the board of directors of the Predecessor Corporation restated, subject to approval by the stockholders, the Plan to make the following changes: (i) to re-name the Plan the "Restated 1995 Stock Incentive Plan", (ii) to increase the number of shares of the Predecessor Corporation's common stock available for issuance thereunder by 600,000 shares from 948,029 to 1,548,029 shares, (iii) to add the Stock Issuance Program, (iv) to give the Plan Administrator additional discretion to structure options as immediately exercisable options, subject to repurchase at the option exercise price paid per share, (v) to give the Plan Administrator additional discretion to provide for the accelerated vesting of options or issued shares of Common Stock in connection with a Corporate Transaction or Change in Control or upon either (a) the offer to an Optionee or Participant of a Lesser Position or (b) the Involuntary Termination of an Optionee or Participant's Service following such Corporate Transaction or Change in Control and (vi) to incorporate certain features which would be appropriate after the Section 12(g) Registration Date including, in particular the power to grant stock appreciation rights, certain amendments to the administrative provisions of the Plan to comply with applicable Federal securities and tax laws and the imposition of a 300,000-share limit on the number of shares which may be awarded to any individual under the Plan after the Section 12(g) Registration Date, as required by Section 162(m) of the Code.

The provisions of the February 28, 1997 restatement of the Plan shall apply only to options granted and stock issuances made under the Plan from and after February 28, 1997. All options outstanding under the Plan at the time of the February 28, 1997 restatement shall continue to be governed by the terms and conditions of the Plan (and the respective instruments evidencing each such option) as in effect on the date each such option was granted; provided, however, that one or more provisions of the restated Plan, may, in the Plan Administrator's discretion, be extended to one or more such options.

B. On December 3, 1997, in connection with incorporation of the Corporation, the Plan was assumed by the Corporation and each option outstanding thereunder was assumed by the Corporation and converted into an option to purchase shares of the Corporation's Common Stock on a 1-for-1 basis, at the original option exercise price per share and subject to the original terms and conditions of each such option. Also on December 3, 1997, the Board, in anticipation of the initial public offering of the Common Stock and subject to approval by the Corporation's stockholders, further amended the Plan to (i) render non-employee Board members and consultants and independent advisors eligible to receive option grants under the Plan after the Section 12(g) Registration Date, (ii) add the Automatic Option Grant Program, (iii) increase the number of shares of Common Stock issuable under the Plan from 1,548,029 to 3,000,000 shares and (iv) provide for an automatic annual increase in the total number of shares of Common Stock authorized for issuance under the Plan.

C. The Plan shall terminate upon the earliest of (i) September 6, 2005, (ii) the date on which all shares available for issuance under the Plan shall have been issued as vested shares or (iii) the termination of all outstanding options in connection with a Corporate Transaction. All options and unvested stock issuances outstanding at that time under the Plan shall continue to have full force and effect in accordance with the provisions of the documents evidencing such options or issuances.

IV. AMENDMENT OF THE PLAN

A. The Board shall have complete and exclusive power and authority to amend or modify the Plan in any or all respects. However, no such amendment or modification shall adversely affect the rights and obligations with respect to options or unvested stock issuances at the time outstanding under the Plan unless the Optionee or the Participant consents to such amendment or modification. In addition, certain amendments may require stockholder approval pursuant to applicable laws and regulations.

B. Options may be granted under the Discretionary Option Grant Program and shares may be issued under the Stock Issuance Program which are in each instance in excess of the number of shares of Common Stock then available for issuance under the Plan, provided any excess shares actually issued under those programs shall be held in escrow until there is obtained stockholder approval of an amendment sufficiently increasing the number of shares of Common Stock available for issuance under the Plan. If such stockholder approval is not obtained within twelve (12) months after the date the first such excess issuances are made, then (i) any unexercised options granted on the basis of such excess shares shall terminate and cease to be outstanding and (ii) the Corporation shall promptly refund to the Optionees and the Participants the exercise or purchase price paid for any excess shares issued under the Plan and held in escrow, together with interest (at the applicable Short Term Federal Rate) for the period the shares were held in escrow, and such shares shall thereupon be automatically cancelled and cease to be outstanding.

V. USE OF PROCEEDS

Any cash proceeds received by the Corporation from the sale of shares of Common Stock under the Plan shall be used for general corporate purposes.

VI. WITHHOLDING

The Corporation's obligation to deliver shares of Common Stock upon the exercise of any options or upon the vesting of any shares issued under the Plan shall be subject to the satisfaction of all applicable Federal, state and local income and employment tax withholding requirements.

VII. REGULATORY APPROVALS

A. The implementation of the Plan, the granting of any options under the Plan and the issuance of any shares of Common Stock (i) upon the exercise of any option or (ii) under the Stock Issuance Program shall be subject to the Corporation's procurement of all approvals and permits required by regulatory authorities having jurisdiction over the Plan, the options granted under it and the shares of Common Stock issued pursuant to it.

B. No shares of Common Stock or other assets shall be issued or delivered under the Plan unless and until there shall have been compliance with all applicable requirements of Federal and state securities laws and all applicable listing requirements of any stock exchange (or the Nasdaq National Market, if applicable) on which Common Stock is then listed for trading.

VIII. NO EMPLOYMENT OR SERVICE RIGHTS

Nothing in the Plan shall confer upon the Optionee or the Participant any right to continue in Service for any period of specific duration or interfere with or otherwise restrict in any way the rights of the Corporation (or any Parent or Subsidiary employing or retaining such person) or of the Optionee or the Participant, which rights are hereby expressly reserved by each, to terminate such person's Service at any time for any reason, with or without cause.

APPENDIX

The following definitions shall be in effect under the Plan:

A. AUTOMATIC OPTION GRANT PROGRAM shall mean the automatic option grant program in effect under the Plan.

B. BOARD shall mean the Corporation's Board of Directors.

C. CHANGE IN CONTROL shall mean a change in ownership or control of the Corporation effected through either of the following transactions:

(i) the acquisition, directly or indirectly, by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation), of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's stockholders, or

(ii) a change in the composition of the Board over a period of thirty-six (36) consecutive months or less such that a majority of the Board members ceases, by reason of one or more contested elections for Board membership, to be comprised of individuals who either (A) have been Board members continuously since the beginning of such period or (B) have been elected or nominated for election as Board members during such period by at least a majority of the Board members described in clause (A) who were still in office at the time the Board approved such election or nomination.

D. CODE shall mean the Internal Revenue Code of 1986, as amended.

E. COMMITTEE shall mean a committee of one (1) or more Board members appointed by the Board to exercise one or more administrative functions under the Plan.

F. COMMON STOCK shall mean the Corporation's common stock.

G. CORPORATE TRANSACTION shall mean either of the following stockholder-approved transactions to which the Corporation is a party:

(a) a merger or consolidation in which securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities are transferred to a person or persons different

from the persons holding those securities immediately prior to such transaction, or

(b) the sale, transfer or other disposition of all or substantially all of the Corporation's assets in complete liquidation or dissolution of the Corporation.

H. CORPORATION shall mean ISS Group, Inc., a Delaware corporation.

I. DISCRETIONARY OPTION GRANT PROGRAM shall mean the option grant program in effect under the Plan.

J. EMPLOYEE shall mean an individual who is in the employ of the Corporation (or any Parent or Subsidiary), subject to the control and direction of the employer entity as to both the work to be performed and the manner and method of performance.

K. EXERCISE DATE shall mean the date on which the Corporation shall have received written notice of the option exercise.

L. FAIR MARKET VALUE per share of Common Stock on any relevant date shall be determined in accordance with the following provisions:

(a) If the Common Stock is at the time traded on the Nasdaq National Market, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question, as such price is reported by the National Association of Securities Dealers on the Nasdaq National Market. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(b) If the Common Stock is at the time listed on any Stock Exchange, then the Fair Market Value shall be the closing selling price per share of Common Stock on the date in question on the Stock Exchange determined by the Plan Administrator to be the primary market for the Common Stock, as such price is officially quoted in the composite tape of transactions on such exchange. If there is no closing selling price for the Common Stock on the date in question, then the Fair Market Value shall be the closing selling price on the last preceding date for which such quotation exists.

(c) For purposes of any option grants made on the Underwriting Date, the Fair Market Value shall be deemed to be equal to the price per share at which the Common Stock is sold in the initial public offering pursuant to the Underwriting Agreement.

(d) For purposes of any option grants made prior to the Underwriting Date, the Fair Market Value shall be determined by the Plan Administrator after taking into account such factors as the Plan Administrator shall deem appropriate.

M. HOSTILE TAKE-OVER shall mean the acquisition, directly or indirectly, by any person or related group of persons (other than the Corporation or a person that directly or indirectly controls, is controlled by, or is under common control with, the Corporation) of beneficial ownership (within the meaning of Rule 13d-3 of the 1934 Act) of securities possessing more than fifty percent (50%) of the total combined voting power of the Corporation's outstanding securities pursuant to a tender or exchange offer made directly to the Corporation's stockholders which the Board does not recommend such stockholders to accept.

N. 1934 ACT shall mean the Securities Exchange Act of 1934, as amended.

O. INCENTIVE OPTION shall mean an option which satisfies the requirements of Code Section 422.

P. INVOLUNTARY TERMINATION shall mean the termination of the Service of any individual which occurs by reason of:

(a) such individual's involuntary dismissal or discharge by the Corporation for reasons other than Misconduct, or

(b) such individual's voluntary resignation following the offer to such individual of a Lesser Position in replacement of the position held by him or her immediately prior to the Corporate Transaction or Change in Control.

Q. LESSER POSITION for an Optionee or Participant shall mean a new position or a change in the Optionee or Participant's position which, compared with such individual's position with the Corporation immediately prior to the Corporate Transaction or Change in Control, (i) offers a lower level of compensation (including base salary, fringe benefits and target bonuses under any corporate-performance based bonus or incentive programs), or (ii) materially reduces such individual's duties or level of responsibility.

R. MISCONDUCT shall mean the commission of any act of fraud, embezzlement or dishonesty by the Optionee or Participant, any unauthorized use or disclosure by such person of confidential information or trade secrets of the Corporation (or any Parent or Subsidiary), or any other intentional misconduct by such person adversely affecting the business or affairs of the Corporation (or any Parent or Subsidiary) in a material manner. The foregoing definition shall not be deemed to be inclusive of all the acts or omissions which the Corporation (or any Parent or Subsidiary) may consider as grounds for the dismissal or discharge of any Optionee, Participant or other person in the Service of the Corporation (or any Parent or Subsidiary).

S. 1934 ACT shall mean the Securities Exchange Act of 1934, as amended.

T. NON-STATUTORY OPTION shall mean an option not intended to satisfy the requirements of Code Section 422.

U. OPTIONEE shall mean any person to whom an option is granted under the Plan.

V. PARENT shall mean any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation, provided each corporation in the unbroken chain (other than the Corporation) owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

W. PARTICIPANT shall mean any person who is issued shares of Common Stock under the Stock Issuance Program.

X. PERMANENT DISABILITY or PERMANENTLY DISABLED shall mean the inability of the Optionee or the Participant to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of twelve (12) months or more. However, solely for purposes of the Automatic Option Grant Program, Permanent Disability or Permanently Disabled shall mean the inability of the non-employee Board member to perform his or her usual duties as a Board member by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of twelve (12) months or more.

Y. PLAN shall mean the Corporation's Restated 1995 Stock Incentive Plan, as set forth in this document.

Z. PLAN ADMINISTRATOR shall mean the particular entity, whether the Primary Committee, the Board or the Secondary Committee, which is authorized to administer the Option Grant and Stock Issuance Programs with respect to one or more classes of eligible persons, to the extent such entity is carrying out its administrative functions under those programs with respect to the persons under its jurisdiction.

AA. PRIMARY COMMITTEE shall mean the committee of two (2) or more non-employee Board members appointed by the Board to administer the Option Grant and Stock Issuance Programs with respect to Section 16 Insiders.

AB. SECONDARY COMMITTEE shall mean a committee of one (1) or more Board members appointed by the Board to administer the Option Grant and Stock Issuance Programs with respect to eligible persons other than Section 16 Insiders.

AC. SECTION 12(G) REGISTRATION DATE shall mean the date on which the Common Stock is first registered under Section 12(g) of the 1934 Act.

AD. SECTION 16 INSIDER shall mean an officer or director of the Corporation subject to the short-swing profit liabilities of Section 16 of the 1934 Act.

AE. SERVICE shall mean the provision of services to the Corporation (or any Parent or Subsidiary) by a person in the capacity of an Employee, a non-employee member of the board of directors or a consultant or independent advisor, except to the extent otherwise specifically provided in the documents evidencing the option grant.

AF. STOCK EXCHANGE shall mean either the American Stock Exchange or the New York Stock Exchange.

AG. STOCK ISSUANCE AGREEMENT shall mean the agreement entered into by the Corporation and the Participant at the time of issuance of shares of Common Stock under the Stock Issuance Program.

AH. STOCK ISSUANCE PROGRAM shall mean the stock issuance program in effect under the Plan.

AI. SUBSIDIARY shall mean any corporation (other than the Corporation) in an unbroken chain of corporations beginning with the Corporation, provided each corporation (other than the last corporation) in the unbroken chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such chain.

AJ. TAKE-OVER PRICE shall mean the greater of (i) the Fair Market Value per share of Common Stock on the date the option is surrendered to the Corporation in connection with a Hostile Take-Over or (ii) the highest reported price per share of Common Stock paid by the tender offeror in effecting such Hostile Take-Over. However, if the surrendered option is an Incentive Option, the Take-Over Price shall not exceed the clause (i) price per share.

AK. TAXES shall mean the Federal, state and local income and employment tax liabilities incurred by the holder of Non-Statutory Options or unvested shares of Common Stock in connection with the exercise of those options or the vesting of those shares.

AL. 10% STOCKHOLDER shall mean the owner of stock (as determined under Code Section 424(d)) possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Corporation (or any Parent or Subsidiary).

AM. UNDERWRITING AGREEMENT shall mean the agreement between the Corporation and the underwriter or underwriters managing the initial public offering of the Common Stock.

AN. UNDERWRITING DATE shall mean the date on which the Underwriting Agreement is executed and the initial public offering price of the Common Stock is established.

EXHIBIT 10.2

February 2, 1996

Greylock Equity Limited Partnership
755 Page Mill Road, A-100
Palo Alto, California 94304
Attn: David Strohm

Sigma Partners
2884 Sand Hill Road, Suite 121
Menlo Park, California 94025
Attn: Bob Davoli

Dear Sirs:

Internet Security Systems, Inc., a Georgia Corporation (the "Company"), may at a future date elect to sell its Common Stock in a bona fide, firm commitment underwriting pursuant to a registration statement filed under the Securities Act of 1933 (an "IPO"). In the event that the Company consummates an IPO, it may contract with an underwriter for certain persons designated by the Company to be entitled to purchase from such underwriter shares of the Company's Common Stock at the "IPO Price." The IPO Price means the public offering price of the Company's Common Stock in its IPO. The shares so offered are designated "Directed Shares." In the event that the Company, upon consummation of an IPO, offers any Directed Shares to any person, the Company will use its best efforts to cause the underwriters to allow each of Greylock Equity Limited Partnership or their affiliates or designates and Sigma Partners or their affiliates or designates (each a "Holder" and collectively, the "Holders") to purchase at a price per share equal to the IPO Price, the lesser of (i) 100,000 Shares of the Company's Common Stock to be sold in the IPO or, (ii) a number of Shares of Common Stock equal to the total number of Directed Shares offered by the Company multiplied by the Holder's percentage ownership of the Company's Common Stock on an as converted basis before any shares are issued in the IPO. The proportion of such Holder's ownership of Common Stock shall be deemed to include all securities convertible into or exercisable for Common Stock, including Preferred Stock, calculated as if such securities had converted into Common Stock at the then applicable conversion ratio. The Holders acknowledge and agree that, subject to the foregoing, the Company, acting

Greylock Equity Limited Partnership
Sigma Partners
February 2, 1996

Page 2

through its Board of Directors shall have the sole and exclusive discretion to determine those persons who shall receive Directed Shares. Notwithstanding the foregoing, the Holders' rights hereunder shall be limited to the extent required by applicable law or rules of the SEC, the National Association of Securities Dealers, Inc. or any exchange upon which the shares sold in the IPO may be traded.

Very truly yours,

INTERNET SECURITY SYSTEMS, INC.

By:

Title:

Agreed and accepted:

GREYLOCK EQUITY LIMITED PARTNERSHIP

By: Greylock Equity GP Limited Partnership, Its General Partner

By:

SIGMA PARTNERS

By:

Title:

February 14, 1997

AT & T Venture Fund II, L.P.
Venture Fund I, L.P.
Chevy Chase Metro Building
2 Wisconsin Circle, Suite 610
Chevy Chase, Maryland 20815
Attn: Jim Pastoriza

Kleiner Perkins Caufield & Byers
2750 Sand Hill Road
Menlo Park, California 94025
Attn: Ted Schlein

Dear Sirs:

Internet Security Systems, Inc., a Georgia Corporation (the "Company"), may at a future date elect to sell its Common Stock in a bona fide, firm commitment underwriting pursuant to a registration statement filed under the Securities Act of 1933 (an "IPO"). In the event that the Company consummates an IPO, it may contract with an underwriter for certain persons designated by the Company to be entitled to purchase from such underwriter shares of the Company's Common Stock at the "IPO Price." The IPO Price means the public offering price of the Company's Common Stock in its IPO. The shares so offered are designated "Directed Shares." In the event that the Company, upon consummation of an IPO, offers any Directed Shares to any person, the Company will use its best efforts to cause the underwriters to allow each of AT & T Ventures or their affiliates or designates and Kleiner Perkins Caufield & Byers or their affiliates or designates (each a "Holder" and collectively, the "Holders") to purchase at a price per share equal to the IPO Price, the lesser of (i) 100,000 Shares of the Company's Common Stock to be sold in the IPO or, (ii) a number of Shares of Common Stock equal to the total number of Directed Shares offered by the Company multiplied by the Holder's percentage ownership of the Company's Common Stock on an as converted basis before any shares are issued in the IPO. The proportion of such Holder's ownership of Common Stock shall be deemed to include all securities convertible into or exercisable for Common Stock, including Preferred Stock, calculated as if such securities had converted into Common Stock at the then applicable conversion ratio. The Holders acknowledge and agree that, subject to the foregoing, the Company, acting

AT & T Ventures
Kleiner Perkins Caufield & Byers
February 14, 1997

Page 2

through its Board of Directors shall have the sole and exclusive discretion to determine those persons who shall receive Directed Shares. Notwithstanding the foregoing, AT&T Ventures the Holders' rights hereunder shall be limited to the extent required by applicable law or rules of the SEC, the National Association of Securities Dealers, Inc. or any exchange upon which the shares sold in the IPO may be traded.

Very truly yours,

INTERNET SECURITY SYSTEMS, INC.

By:

Title:

Agreed and accepted:

AT & T VENTURE FUND II, L.P.

By:

Name:

Title:

VENTURE FUND I, L.P.

By:

Name:

Title:

KLEINER PERKINS CAUFIELD & BYERS

By:

Name:

Title:

EXHIBIT 10.3

INTERNET SECURITY SYSTEMS, INC.

AMENDED AND RESTATED

RIGHTS AGREEMENT

FEBRUARY 14, 1997

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AMENDED AND RESTATED RIGHTS AGREEMENT

THIS AMENDED AND RESTATED RIGHTS AGREEMENT (the "AGREEMENT") is entered into as of February 14, 1997, by and among Internet Security Systems, Inc., a Georgia corporation (the "COMPANY"), and those shareholders of the Company listed on Exhibit A hereto (the "Key Management Holders") and the purchasers listed on the signature page hereof (each a "PREFERRED HOLDER" and together the "PREFERRED HOLDERS").

RECITALS

A. The Company, Greylock Equity Limited Partnership, Sigma Associates III, L.P., Sigma Investors III, L.P., Sigma Partners III, L.P. and John P. Imlay desire to amend and restate that certain Rights Agreement dated as of February 2, 1996 and as amended February 15, 1996, by and among them (the "Prior Agreement") and allow Kleiner Perkins Caufield & Byers, AT & T Ventures and the Key Management Holders to become a party to the amended and restated agreement.

B. The Preferred Holders have purchased or will purchase shares of Series A Preferred Stock and Series B Preferred Stock (the "PREFERRED STOCK"); all or certain of which shares of Series B Preferred Stock are being purchased pursuant to the terms of a Series B Preferred Stock Purchase Agreement dated of even date herewith (the "PURCHASE AGREEMENT").

C. The execution of this Agreement is a condition to the closing of the transactions contemplated by the Purchase Agreement.

D. The Company desires to enter into this Agreement and grant the Preferred Holders the rights contained herein in order to fulfill such condition.

NOW, THEREFORE, in consideration of the mutual promises and covenants hereinafter set forth, the parties amend and restate the Prior Agreement in its entirety and agree as follows:

SECTION 1

CERTAIN DEFINITIONS

Certain Definitions. As used in this Agreement, the following terms shall have the following respective meanings:

1.1 "EMPLOYEE REGISTRABLE SECURITIES" means (i) the shares of the Common Stock of the Company held by the Key Management Holders and (ii) any other shares of the Common Stock of the Company issued as a dividend or other distribution with respect to such shares.

1.2 "EXCHANGE ACT" shall mean the Securities Exchange Act of 1934, as amended, and the rules and regulations of the SEC promulgated thereunder, all as the same shall be in effect at that time.

1.3 "INITIAL PUBLIC OFFERING" or "IPO" means the Company's sale of its Common Stock in a bona fide, firm commitment underwriting pursuant to a registration statement under the Securities Act.

1.4 The terms "REGISTER", "REGISTERED" and "REGISTRATION" refer to a registration effected by preparing and filing a registration statement in compliance with the Securities Act (as defined below), and the declaration or ordering of the effectiveness of such registration statement.

1.5 "REGISTRABLE SECURITIES" means (i) the shares of Common Stock of the Company issuable or issued upon conversion of the Preferred Stock of the Company (the "SHARES"), and (ii) any other shares of the Company's Common Stock issued as (or issuable upon conversion or exercise of any warrant, right or other security which is issued as) a dividend or other distribution with respect to or exchange for or replacement of the Shares, excluding in all cases, however, any Registrable Securities sold by a person in a transaction in which a Preferred Holder's rights under this Agreement are not assigned; provided, however, that Registrable Securities shall only be treated as Registrable Securities if and so long as, they have not been (A) sold to or through a broker or dealer or underwriter in a public distribution or a public securities transaction or (B) sold in a transaction exempt from the registration and prospectus delivery requirements of the Securities Act under Section 4(1) thereof so that all transfer restrictions and restrictive legends with respect thereto are removed upon the consummation of such sale.

1.6 "SECURITIES ACT" shall mean the Securities Act of 1933, as amended, and the rules and regulations of the SEC promulgated thereunder, all as the same shall be in effect at the time.

1.7 "SEC" shall mean the Securities and Exchange Commission or any other federal agency at the time administering the Securities Act.

SECTION 2

PIGGYBACK RIGHTS

2.1 Notice of Registration. If at any time or from time to time, the Company shall determine to register any of its securities for its own account in an underwritten public offering, the Company will:

(i) promptly give to the Preferred Holders and Key Management Holders written notice thereof; and

(ii) include in such registration (and any related qualification under blue sky laws or other compliance), and underwriting, all the Registrable Securities and Employee

Registrable Securities (subject to cutback as set forth in Section 2.2) specified in a written request or requests made within thirty (30) days after receipt of such written notice from the Company by any Preferred Holder or Key Management Holder.

2.2 Underwriting. The right of any Preferred Holder or Key Management Holder to registration pursuant to this Section 2 shall be conditioned upon such Preferred Holder's or Key Management Holder's participation in such underwriting and the inclusion of Registrable Securities or Employee Registrable Securities in the underwriting to the extent provided herein. If any Preferred Holder or Key Management Holder proposes to distribute its securities through such underwriting, such Preferred Holder or Key Management Holder shall (together with the Company and any other holders distributing their securities through such underwriting) enter into an underwriting agreement in customary form with the managing underwriter selected for such underwriting by the Company. Notwithstanding any other provision of this Section 2, if the managing underwriter determines that marketing factors require a limitation of the number of shares to be underwritten, the managing underwriter may limit to 40% the Registrable Securities and may limit or exclude the Employee Registrable Securities to be included in such registration (except with respect to the Company's IPO, in which case all Registrable Securities may be excluded). The Company shall so advise the Preferred Holders and Key Management Holders and the other holders distributing their securities through such underwriting pursuant to piggyback registration rights similar to this Section 2, and the number of shares of Registrable Securities and Employee Registrable Securities and other securities that may be included in the registration and underwriting shall be allocated among the Preferred Holders and Key Management Holders in proportion, as nearly as practicable, to the respective amounts of Registrable Securities and Employee Registrable Securities held by such Preferred Holders and Key Management Holders at the time of filing the registration statement; provided, however, that no person who is not a Preferred Holder under this Agreement shall be granted registration rights or be entitled to have shares included in such underwriting unless all of the Registrable Securities which the Preferred Holders have requested to be included in such underwriting have been so included. If any Preferred Holder or Key Management Holder disapproves of the terms of any such underwriting, he or she may elect to withdraw therefrom by written notice to the Company and the managing underwriter, and such Preferred Holder or Key Management Holder shall be deemed to have withdrawn if such Preferred Holder or Key Management Holder fails to execute underwriting documents requested by the managing underwriter within the time period requested for execution of such documents. Any securities excluded or withdrawn from such underwriting shall be withdrawn from such registration, and shall not be transferred in a public distribution prior to one hundred eighty (180) days after the effective date of the registration statement relating thereto.

2.3 Right to Terminate Registration. The Company shall have the right to terminate or withdraw any registration initiated by it under this Section 2 prior to the effectiveness of such registration, whether or not any Preferred Holder or Key Management Holder has elected to include securities in such registration.

DEMAND REGISTRATION

3.1 Demand Registration. During the period commencing six (6) months after the Company's Initial Public Offering and until this Agreement terminates, Preferred Holders shall be entitled to have the Company effect two (2) demand registrations of Registrable Securities then owned by such Preferred Holders requesting such registration. A request for such registration (a "REGISTRATION REQUEST") must be made in writing and must be made by the holders of at least thirty percent (30%) of the Common Stock issued or issuable upon the conversion of the then outstanding Preferred Stock, which stock must have an offering value of at least \$2,500,000. The Company shall use its best efforts to cause the Registrable Securities specified in such Registration Request to be registered as soon as reasonably practicable so as to permit the sale thereof, and in connection therewith shall prepare and file a registration statement with the SEC under the Securities Act to effect such registration. Such registration statement shall contain such required information pursuant to the rules and regulations promulgated under the Securities Act and such additional information as deemed necessary by the managing underwriter or if there is no managing underwriter, as deemed necessary by mutual agreement between the Preferred Holders requesting registration and the Company. Such Registration Request shall (i) specify the number of shares intended to be offered and sold; (ii) express the present intention of the requesting Preferred Holders to offer or cause the offering of such shares for distribution; (iii) describe the nature or method of the proposed offer and sale thereof; and (iv) contain the undertaking of the requesting Preferred Holders to provide all such information and materials and take all such action as may be required in order to permit the Company to comply with all applicable requirements of the SEC and to obtain any desired acceleration of the effective date of such registration statement. Notwithstanding the foregoing, if the Company shall furnish to the requesting Preferred Holders a certificate signed by a duly authorized officer of the Company stating that in the good faith judgment of the Board of Directors of the Company it would be seriously detrimental to the Company for such registration statement to be filed on or before the date filing would be required, then the Company shall be entitled to postpone filing of the registration statement for up to one hundred twenty (120) days; provided, however, that the Company shall be entitled to issue such a certificate only one (1) time in any given 12 month period. If a registration has become effective but is withdrawn before completion of the offering contemplated thereby because of adverse business developments at the Company that were not known to the requesting Preferred Holders when they requested that the Company initiate such registration proceedings, such registration shall not count as one of the two registrations referred to in the first sentence of this Section. If a registration is filed on behalf of Preferred Holders and such registration is withdrawn at the request of the Preferred Holders of at least fifty percent (50%) of the Registrable Securities requesting registration for any reason other than adverse business developments at the Company that were not known to the requesting Preferred Holders, such registration will count as one of the two registrations referred to in the first sentence of this section.

3.2 Underwritten Public Offering. If requested, and provided that the underwriter or underwriters are of recognized national standing and reasonably satisfactory to the Company, the Company shall enter into an underwriting agreement with such underwriters containing

representations, warranties, indemnities and agreements then customarily included by an issuer in underwriting agreements with respect to secondary distributions. The Company shall not cause the registration under the Securities Act of any other shares of its Common Stock to become effective (other than registration of an employee stock plan, or registration in connection with any Rule 145 or similar transaction) during the effectiveness of a registration requested hereunder for an underwritten public offering if, in the judgment of the underwriter or underwriters, marketing factors would adversely affect the price of the Registrable Securities subject to such underwritten registration.

3.3 Rights of Key Management Holders. If the Preferred Holders shall cause the Company to effect a demand registration pursuant to this Section 3, then the Key Management Holders may request in writing that all or part of the Employee Registrable Securities held thereby be included in such demand registration. The right of any Key Management Holder to registration pursuant to this Section 3.3 shall be conditioned upon such Key Management Holder's participation in such underwriting and the inclusion of the Employee Registrable Securities in the underwriting to the extent provided herein. If any Key Management Holder proposes to distribute its securities through such underwriting, such key Management Holder shall (together with the Preferred Holders, the Company and any other holders distributing their securities through such underwriting) enter into an underwriting agreement in customary form with the managing underwriter selected for such underwriting by the Company. Notwithstanding any other provision of this Section 3, if the managing underwriter and the Board of Directors of the Company determine that marketing factors require a limitation of the number of shares to be underwritten, the managing underwriter may limit or exclude the Employee Registrable Securities to be included in such registration. The Company shall so advise the Key Management Holder, and the number of shares of Employee Registrable Securities that may be included in the registration and underwriting shall be allocated among the Key Management Holder and any other participating Key Management Holders in proportion, as nearly as practicable, to the respective amounts of Employee Registrable Securities held by such Key Management Holder and other securities held by other Key Management Holders at the time of filing the registration statement; provided, however, that the Employee Registrable Securities held by all such Key Management Holders shall be subordinate to all Registrable Securities held by the Preferred Holders and shall be excluded from such registration prior to the exclusion of any Registrable Securities held by the Preferred Holders.

3.4 Inclusion of Additional Shares. The Company may include in a registration pursuant to this Section 3 securities for its own account and by other third parties, in amounts as determined by the Company's Board of Directors. To the extent the Company includes securities for its own account or held by other parties in such registration statement, the Company shall take all actions it deems necessary or advisable in order to ensure that security holders of the Company, whether or not holding contractual registration rights, shall not have the right to exclude from any registration initiated pursuant to this Section 3 any Registrable Securities or Employee Registrable Securities with respect to which any Preferred Holder or Key Management Holder, as the case may be, has requested registration. If requested, and provided the underwriter or underwriters are reasonably satisfactory to the Company, the Company shall (together with all

officers, directors and other third parties proposing to distribute their securities through such underwriting) enter into an underwriting agreement in customary form with the representative of the underwriter or underwriters selected for such underwriting. Notwithstanding any other provision of this

Section 3.4, if the representative advises the stockholders registering shares of Common Stock in writing that marketing factors require a limitation on the number of shares to be underwritten, the securities of the Company, securities held by officers or directors of the Company (excluding such Registrable Securities or Employee Registrable Securities held by any Preferred Holder or Key Management Holder, as the case may be, subject to such registration) and the securities held by other third parties shall be excluded from the underwriting by reason of the underwriter's marketing limitation to the extent so required by such limitation. No securities excluded from the underwriting by reason of the underwriter's marketing limitation shall be included in such registration. If any officer, director or other stockholder (including Preferred Holders and Key Management Holders) who has requested inclusion in such registration as provided above disapproves of the terms of the underwriting, such person may elect to withdraw therefrom by written notice to the Company, the underwriter and the Preferred Holders and Key Management Holders requesting registration.

3.5 Termination of Demand Rights. The rights of any Preferred Holder and Key Management Holder to receive notice and to participate in a registration pursuant to the terms of this Section 3 shall terminate at such time as (i) such Preferred Holder or Key Management Holder could sell all of Registrable Securities or Employee Registrable Securities held by such Preferred Holder or Key Management Holder in any one three-month period under the terms of Rule 144(k) under the Securities Act and (ii) the Company has consummated an Initial Public Offering.

SECTION 4

FORM S-3 REGISTRATION

4.1 Registrations on Form S-3. Preferred Holders shall be entitled to request an unlimited number of registrations of Registrable Securities then owned by such requesting Preferred Holder on a Form S-3 registration statement under the Securities Act (a "SHELF REGISTRATION"); provided, however, that no more than one (1) such registration shall be effected in any twelve (12) month period (an "S-3 REGISTRATION REQUEST"). The S-3 Registration Request must be made in writing and the S-3 Registration Request shall (i) specify the number of shares intended to be offered and sold; (ii) express the present intention of the requesting Preferred Holders to offer or cause the offering of such shares for distribution; (iii) describe the nature or method of the proposed offer and sale thereof and (iv) contain the undertaking of the requesting Preferred Holders to provide all such information and materials and take all such action as may be required in order to permit the Company to comply with all applicable requirements of the SEC and to obtain any desired acceleration of the effective date of such registration statement. The Company shall, as soon as practicable, file a Shelf Registration and proceed to obtain all such qualifications and compliance as may be so requested and as would permit or facilitate the sale and distribution of all or such portion of the requesting Preferred Holder's Registrable

Securities as are specified in the S-3 Registration Request, within 30 days after receipt of such written notice by the Company; provided, however, that the Company shall not be obligated to effect any such registration, qualification or compliance, pursuant to this Section 4 if (i) Form S-3 is not available for such offering by the requesting Preferred Holders; (ii) the requesting Preferred Holders, together with the holders of any other securities of the Company entitled to inclusion in such registration, propose to sell Registrable Securities and such other securities (if any) at an aggregate gross price to the public of less than \$2,000,000; (iii) the Company shall furnish to Holders a certificate signed by the President of the Company stating that in the good faith judgment of the Board of Directors of the Company, it would be seriously detrimental to the Company and its stockholders for such Shelf Registration to be effected at such time, in which event the Company shall have the right to defer the filing of the Form S-3 registration statement for a period of not more than one hundred twenty (120) days after receipt of the request of any Preferred Holder under this Section 4; provided, however, that the Company shall not utilize this right more than once in any twelve (12) month period; or (iv) the Company has, within the twelve (12) month period preceding the date of such request, already effected a registration on Form S-3 for any Preferred Holder pursuant to this Section 4.

SECTION 5

OBLIGATIONS OF COMPANY

Whenever the Company is required by the provisions of this Agreement to use its best efforts to effect the registration of the Registrable Securities or Employee Registrable Securities, the Company shall (i) prepare and, as soon as possible, file with the SEC a registration statement with respect to the Registrable Securities or Employee Registrable Securities, and use its best efforts to cause such registration statement to become effective and to remain effective until the earlier of the sale of the Registrable Securities or Employee Registrable Securities so registered or ninety (90) days subsequent to the effective date of such registration; (ii) prepare and file with the SEC such amendments and supplements to such registration statement and the prospectus used in connection therewith as may be necessary to make and to keep such registration statement effective and to comply with the provisions of the Securities Act with respect to the sale or other disposition of all securities proposed to be registered in such registration statement until the earlier of the sale of the Registrable Securities or Employee Registrable Securities so registered or ninety (90) days subsequent to the effective date of such registration statement, (iii) furnish to any Preferred Holder or Key Management Holder such number of copies of any prospectus (including any preliminary prospectus and any amended or supplemented prospectus), in conformity with the requirement of the Securities Act, as such Preferred Holder or Key Management Holder may reasonably request in order to effect the offering and sale of the Registrable Securities or Employee Registrable Securities to be offered and sold, but only while the Company shall be required under the provisions hereof to cause the registration statement to remain current; (iv) use its commercially reasonable efforts to register or qualify the Registrable Securities or Employee Registrable Securities covered by such registration statement under the securities or blue sky laws of such states as the Preferred Holder or Key Management Holder shall reasonably request, maintain any such registration or qualification current until the earlier of the sale of the

Registrable Securities or Employee Registrable Securities so registered or ninety (90) days subsequent to the effective date of the registration statement, and take any and all other actions either necessary or advisable to enable Preferred Holders or Key Management Holders to consummate the public sale or other disposition of the Registrable Securities or Employee Registrable Securities in jurisdictions where such Preferred Holders or Key Management Holders desire to effect such sales or other disposition; and (v) take all such other actions either necessary or desirable to permit the Registrable Securities or Employee Registrable Securities held by a Preferred Holder or Key Management Holder to be registered and disposed of in accordance with the method of disposition described herein.

SECTION 6

EXPENSES OF REGISTRATION

The Company shall pay all of the reasonable out-of-pocket expenses incurred in connection with any registration statements that are initiated pursuant to this Agreement, including, without limitation, all SEC and blue sky registration and filing fees, printing expenses, transfer agent and registrar fees, the fees and disbursements of the Company's outside counsel and independent accountants including expenses incurred in connection with any special audits incidental to or required by such registration. The Company shall also be required to pay the expenses of one special counsel to represent all Preferred Holders and Key Management Holders to be selected by a majority of the Preferred Holders and Key Management Holders participating in the Registration. Any underwriting discounts, fees and disbursements of counsel to the Preferred Holders and the Key Management Holders, selling commissions and stock transfer taxes applicable to the Registrable Securities registered on behalf of Preferred Holders and Key Management Holders shall be borne by holder of the Registrable Securities or Employee Registrable Securities included in such registration.

SECTION 7

INDEMNIFICATION

7.1 The Company. The Company will indemnify the Preferred Holders and Key Management Holders and each person controlling the Preferred Holders and Key Management Holders within the meaning of Section 15 of the Securities Act, and each underwriter if any, of the Company's securities, with respect to any registration, qualification or compliance which has been effected pursuant to this Agreement, against all expenses, claims, losses, damages or liabilities (or actions in respect thereof), including any of the foregoing incurred in settlement of any litigation, commenced or threatened, arising out of or based on any untrue statement (or alleged untrue statement) of a material fact contained in any registration statement, prospectus, offering circular or other document, or any amendment or supplement thereto, incident to any such registration, qualification or compliance, or based on any omission (or alleged omission) to state therein a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances in which they were made, not misleading, or any violation

by the Company of any rule or regulation promulgated under the Securities Act applicable to the Company in connection with any such registration, qualification or compliance, and the Company will reimburse the Preferred Holders and Key Management Holders and each person controlling the Preferred Holders and Key Management Holders, and each underwriter, if any, for any legal and any other expenses reasonably incurred in connection with investigating, preparing or defending any such claim, loss, damage, liability or action, provided that the Company will not be liable in any such case to the extent that any such claim, loss, damage, liability or expense arises out of or is based on any untrue statement or omission or alleged untrue statement or omission, made in reliance upon and in conformity with written information furnished to the Company by such Preferred Holder or Key Management Holder or controlling person or underwriter seeking indemnification.

7.2 Holders. Each Preferred Holder will, if Registrable Securities held by such Preferred Holder are included in the securities as to which such registration, qualification or compliance is being effected (the "INDEMNIFYING HOLDER"), indemnify the Company, each of its directors and officers, each Key Management Holder and each underwriter, if any, of the Company's securities covered by such registration statement and each person who controls the Company or a Key Management Holder within the meaning of Section 15 of the Securities Act, against all claims, losses, damages and liabilities (or actions in respect thereof) arising out of or based on any untrue statement (or alleged untrue statement) of a material fact contained in any such registration statement, prospectus, offering circular or other document, or any omission (or alleged omission) to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, and will reimburse the Company, such directors, officers or control persons, Key Management Holders or underwriters for any legal or any other expenses reasonably incurred in connection with investigating or defending any such claim, loss, damage, liability or action, in each case to the extent, but only to the extent, that such untrue statement (or alleged untrue statement) or omission (or alleged omission) is made in such registration statement, prospectus, offering circular or other document in reliance upon and in conformity with written information furnished to the Company by such Indemnifying Holder, provided that in no event shall any indemnity under this Section 7.2 exceed the gross proceeds of the offering received by such Indemnifying Holder.

7.3 Key Management Holders. Each Key Management Holder will, if Employee Registrable Securities held by such Key Management Holder are included in the securities as to which such registration, qualification or compliance is being effected (the "EMPLOYEE INDEMNIFYING HOLDER"), indemnify the Company, each of its directors and officers, each Preferred Holder and each underwriter, if any, of the Company's securities covered by such registration statement and each person who controls the Company within the meaning of Section 15 of the Securities Act, against all claims, losses, damages and liabilities (or actions in respect thereof) arising out of or based on any untrue statement (or alleged untrue statement) of a material fact contained in any such registration statement, prospectus, offering circular or other document, or any omission (or alleged omission) to state therein a material fact required to be stated therein or necessary to make the statements therein not misleading, and will reimburse the Company, such directors, officers, control persons, Preferred Holders or underwriters for any

legal or any other expenses reasonably incurred in connection with investigating or defending any such claim, loss, damage, liability or action, in each case to the extent, but only to the extent, that such untrue statement (or alleged untrue statement) or omission (or alleged omission) is made in such registration statement, prospectus, offering circular or other document in reliance upon and in conformity with written information furnished to the Company by such Employee Indemnifying Holder, provided that in no event shall any indemnity under this

Section 7.3 exceed the gross proceeds of the offering received by such Employee Indemnifying Holder.

7.4 Defense of Claims. Each party entitled to indemnification under this Section 7 (the "INDEMNIFIED PARTY") shall give notice to the party required to provide indemnification (the "INDEMNIFYING PARTY") promptly after such Indemnified Party has actual knowledge of any claim as to which indemnity may be sought, and shall permit the Indemnifying Party to assume the defense of any such claim or any litigation resulting therefrom, provided that counsel for the Indemnifying Party, who shall conduct the defense of such claim or litigation, shall be approved by the Indemnified Party (whose approval shall not unreasonably be withheld), and the Indemnified Party may participate in such defense at such party's expense; provided, however, that the Indemnifying Party shall pay such expense if representation of the Indemnified Party by counsel retained by the Indemnifying Party would be inappropriate due to actual or potential differing interests between the Indemnified Party and any other party represented by such counsel in such proceeding, and provided further that the failure of any Indemnified Party to give notice as provided herein shall not relieve the Indemnifying Party of its obligations under this Section 7 unless the failure to give such notice is materially prejudicial to an Indemnifying Party's ability to defend such action. No Indemnifying Party, in the defense of any such claim or litigation shall, except with the consent of each Indemnified Party, consent to entry of any judgment or enter into any settlement which does not include as an unconditional term thereof the giving by the claimant or plaintiff to such Indemnified Party of a release from all liability in respect to such claim or litigation. No Indemnifying Party shall be required to indemnify any Indemnified Party with respect to any settlement entered into without such Indemnifying Party's prior consent.

SECTION 8

RULE 144 REPORTING

With a view to making available the benefits of certain rules and regulations of the SEC which may at any time permit the sale of the Registrable Securities to the public without registration, the Company agrees to use its best efforts to:

- (a) Make and keep public information available, as those terms are understood and defined in Rule 144 under the Securities Act, at all times from and after ninety (90) days following the effective date of the IPO;
- (b) File with the SEC in a timely manner all reports and other documents required of the Company under the Securities Act and the Exchange Act at any time after it has become subject to such reporting requirements; and

(c) So long as a Preferred Holder owns any Registrable Securities, furnish to such Preferred Holder forthwith upon request a written statement by the Company as to its compliance with the reporting requirements of said Rule 144 (at any time from and after ninety (90) days following the effective date of the first registration statement filed by the Company for an offering of its securities to the general public), and of the Securities Act and the Exchange Act (at any time after it has become subject to such reporting requirements), a copy of the most recent annual or quarterly report of the Company, and such other reports and documents of the Company, and such other reports and documents so filed as a Preferred Holder may reasonably request in availing itself of any rule or regulation of the SEC allowing such Preferred Holder to sell any such securities without registration.

SECTION 9

STANDOFF AGREEMENT

In connection with the Company's Initial Public Offering, if requested by the Company and the managing underwriter, each Preferred Holder and Key Management Holder agrees that such Preferred Holder or Key Management Holder will not, directly or indirectly, sell, make any short sale of, loan, grant any option for the purchase of, or otherwise dispose of any Common Stock of the Company (other than those included in the Initial Public Offering, if any) without the prior written consent of the Company or the underwriters for such period of time (not to exceed one hundred and eighty (180) days) as may be requested by the Company and the managing underwriter, provided that all executive officers and directors of the Company enter into similar agreements.

SECTION 10

LIMITATIONS ON SUBSEQUENT REGISTRATION RIGHTS

From and after the date of this Agreement, the Company shall not, without the prior written consent of Preferred Holder(s) of at least a majority of the outstanding Registrable Securities, enter into any agreement with any holder or prospective holder of any securities of the Company giving such holder or prospective holder any registration rights the terms of which are more favorable than the registration rights granted to Preferred Holders hereunder or to require the Company to effect a registration earlier than the date on which Preferred Holders can first require a registration under Section 3.1.

INFORMATION RIGHTS

11.1 Delivery of Financial Statements.

(a) The Company shall deliver to each Preferred Holder, as soon as practicable, but in any event within ninety (90) days after the end of each fiscal year of the Company, an income statement for such fiscal year, a balance sheet of the Company as of the end of such year, and a schedule as to the sources and applications of funds for such year, such year-end financial reports to be in reasonable detail, prepared in accordance with generally accepted accounting principles, and audited and certified by independent public accountants of nationally recognized standing selected by the Company.

(b) The Company shall deliver to each Preferred Holder:

(i) within thirty (30) days after the end of each month and forty-five (45) days after the end of each quarter, an unaudited income statement and schedule as to the sources and applications of funds and balance sheet and comparison to budget for and as of the end of such month or quarter, as the case may be, in reasonable detail;

(ii) as soon as practicable, but in any event thirty (30) days prior to the end of each fiscal year, a budget and business plan for the next fiscal year, prepared on a monthly basis, including balance sheets and sources and applications of funds statements for such months and, as soon as prepared, any other budgets or revised budgets prepared by the Company; and

(iii) such other information relating to the financial conditions, business, prospects or corporate affairs of the Company as each Preferred Holder; or any assignee of such Preferred Holder may from time to time request; provided, however, that the Company shall not be obligated to provide information which it deems in good faith to be proprietary.

11.2 Inspection. The Company shall permit each Preferred Holder, at such Preferred Holder's expense, to visit and inspect the Company's properties, to examine its books of account and records and to discuss the Company's affairs, finances and accounts with its officers, all at such reasonable times as may be requested by such Preferred Holder; provided, however, that the Company shall not be obligated pursuant to this Section 11.2 to provide access to any information which it reasonably considers to be a trade secret or similar confidential information.

11.3 Termination of Information and Inspection Covenants. The covenants set forth in Sections 11.1 and 11.2 shall terminate as to each Preferred Holder and be of no further force or effect immediately upon the consummation of an Initial Public Offering.

SECTION 12

ADDITIONAL COVENANTS

12.1 Confidentiality. Each of the Preferred Holders agrees to keep confidential and not to disclose to persons other than its employees, professional consultants and advisors any information concerning the Company which is confidential or proprietary ("CONFIDENTIAL INFORMATION"), except as otherwise required by law. No Confidential Information shall be used or disclosed by a Preferred Holder for any purpose except in connection with the transactions contemplated by the Purchase Agreement and the agreements executed and delivered in connection with the Purchase Agreement and in the enforcement of its rights thereunder. Each Preferred Holder shall use the same level of care with the Confidential Information as it uses with its own confidential information. Notwithstanding the foregoing, the restrictions set forth in this

Section 12.1 shall not be applicable to any information that is publicly available, any information independently developed by a Preferred Holder or its professional consultants, any information known to a Preferred Holder or its professional consultants before the disclosure thereof by the Company, or any information disclosed to a Preferred Holder by a person without any confidentiality duty to the Company.

12.2 Independent Accountants. Until the consummation of the Company's Initial Public Offering, the Company will retain independent public accountants of recognized national standing who shall certify the Company's financial statements at the end of each fiscal year. In the event the services of the independent public accountants so selected, or any firm of independent public accountants hereafter employed by the Company, are terminated, the Company will promptly thereafter engage another firm of independent public accountants of recognized national standing.

12.3 Internal Revenue Code ss.1202. The Company shall furnish to each Preferred Holder, and shall use reasonable commercial efforts to make such filings with the Internal Revenue Service, as shall from time to time be required pursuant to Section 1202(d) (1) of the Code. In addition, the Company agrees that it will not make any purchases of its stock within the meaning of and which would exceed the limitation contained in Section 1202(c)(3)(B) of the Code with respect to the Preferred Stock, unless such purchases have been consented to by holders a majority of the Preferred Stock or are required by contractual obligations entered into prior to the Closing. Any such information provided to the Preferred Holders under this Section 12.3 shall not be disclosed by any Preferred Holder to any party except as required and solely in order for such Preferred Holder to claim any benefits under Section 1202 of the Code.

SECTION 13

TERMINATION OF RIGHTS

Unless otherwise specified herein, this Agreement shall terminate on the fifth (5th) anniversary of the date of the Company's Initial Public Offering. Upon termination, no party shall have any further obligation or liability hereunder.

MISCELLANEOUS

14.1 Assignment. The rights to cause the Company to register securities granted to the Preferred Holders or Key Management Holders by the Company under this Agreement may be transferred or assigned by the Preferred Holders or Key Management Holders; provided that the Company is given written notice at the time of or within a reasonable time after said transfer or assignment, stating the name and address of the transferee or assignee and identifying the securities with respect to which such registration rights are being transferred or assigned, and, provided further, that the transferee or assignee of such rights assumes the obligations of such Preferred Holder under this Agreement. Subject to the preceding sentence, this Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns. Any transferee or assignee shall thereafter be treated as a Preferred Holder or Key Management Holder, subject to the limitations herein. Until the Company receives actual notice of any transfer or assignment, it shall be entitled to rely on the then existing list of Preferred Holders and Key Management Holders and the failure to notify the Company of any transfer or assignment shall not affect the validity of a notice properly given by the Company to the Preferred Holders and Key Management Holders pursuant to lists maintained by the Company.

14.2 Governing Law. This Agreement shall be governed by and construed under the laws of the State of California as applied to agreements entered into solely between residents of and to be performed entirely within, such state.

14.3 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

14.4 Titles and Subtitles. The titles and subtitles used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

14.5 Notices.

(a) All notices, requests, demands and other communications under this Agreement or in connection herewith shall be given to or made upon the Preferred Holder at the addresses set forth in the Company's records with a copy to Wilson, Sonsini, Goodrich & Rosati, P.C. at 650 Page Mill Road, Palo Alto, California 94304, attention: Steven E. Bochner, and, if to the Company, to: Internet Security Systems, Inc., 41 Perimeter Center East, Suite 660, Atlanta, Georgia 30346, with a copy to Brobeck, Phleger & Harrison LLP, 301 Congress Avenue, Suite 1200, Austin, Texas 78701, attention: Carmelo M. Gordian.

(b) All notices, requests, demands and other communications given or made in accordance with the provisions of this Agreement shall be in writing, and shall be sent by airmail, return receipt requested, or by facsimile with confirmation of receipt, and shall be deemed to be given or made when receipt is so confirmed.

(c) Any party may, by written notice to the other, alter its address or respondent, and such notice shall be considered to have been given three (3) days after the airmailing or faxing thereof.

14.6 Attorney's Fees. If any action at law or in equity (including arbitration) is necessary to enforce or interpret the terms of this Agreement, the prevailing party shall be entitled to reasonable attorney's fees costs and necessary disbursements in addition to any other relief to which such party may be entitled.

14.7 Amendments and Waivers. Any term of this Agreement may be amended with the written consent of the Company and the holders of at least sixty-six and two-thirds percent (66 2/3%) of the outstanding Registrable Securities; provided, however, that the holders of at least fifty-one percent (51%) of the Employee Registrable Securities held by Key Management Holders who are still employed by the Company is required if the registration rights of such Key Management Holders will be materially and adversely affected by such amendment. Any amendment or waiver effected in accordance with this Section 14.7 shall be binding upon the Preferred Holders, Key Management Holders and each transferee of the Registrable Securities, each future holder of all such Registrable Securities, and the Company.

14.8 Severability. If one or more provisions of this Agreement are held to be unenforceable under applicable law, portions of such provisions, or such provisions in their entirety, to the extent necessary, shall be severed from this Agreement, and the balance of the Agreement shall be interpreted as if such provision were so excluded and shall be enforceable in accordance with its terms.

14.9 Delays or Omissions. No delay or omission to exercise any right, power or remedy accruing to any party to this Agreement, upon any breach or default of the other party, shall impair any such right, power or remedy of such non-breaching party nor shall it be construed to be a waiver of any such breach or default, or an acquiescence therein, or of any similar breach or default thereafter occurring; nor shall any waiver of any single breach or default be deemed a waiver of any other breach or default theretofore or thereafter occurring. Any waiver, permit, consent or approval of any kind or character on the part of any party of any breach or default under this Agreement, or any waiver on the part of any party of any provisions or conditions of this Agreement, must be made in writing and shall be effective only to the extent specifically set forth in such writing. All remedies, either under this Agreement, or by law or otherwise afforded to any Preferred Holder or Key Management Holder, shall be cumulative and not alternative.

14.10 Entire Agreement. This Agreement and the documents referred to herein constitute the entire agreement between the parties hereto pertaining to the subject matter hereof and any other written or oral agreements between the parties hereto are expressly canceled.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement of the day and year first above written.

COMPANY:

PREFERRED HOLDERS:

INTERNET SECURITY SYSTEMS, INC.

AT & T VENTURE FUND II, L.P.

By:

By:

Name:

Name: Richard S. Bodman

Title: General Partner

Title:

GREYLOCK EQUITY LIMITED
PARTNERSHIP

KEY MANAGMENT HOLDERS:

By: Greylock Equity GP Limited Partnership
Its General Partner

Christopher Klaus

By:

General Partner

Thomas Noonan

John P. Imlay, Jr.

Glenn McGonnigle

KLEINER PERKINS CAUFIELD & BYERS

By: KPCB VIII Associates

Kevin O'Connor

By:

Name:

Title:

RIGHTS AGREEMENT

**KPCB INFORMATION SCIENCES
ZAIBATSU FUND II**

By: KPCB VII Associates

By:

Name:

Title:

KPCB JAVA FUND

By: KPCB VIII Associates

By:

Name:

Title:

SIGMA ASSOCIATES, III, L.P.

By: Sigma Management III, L.P.

By:

General Partner

SIGMA INVESTORS III, L.P.

By: Sigma Management III, L.P.

By:

General Partner

SIGMA PARTNERS III, L.P.

By: Sigma Management III, L.P.

By:

General Partner

*****RIGHTS AGREEMENT*****

VENTURE FUND I, L.P.

By:

Name:

Title:

*****RIGHTS AGREEMENT*****

EXHIBIT 21.1

Subsidiaries of the Registrant.

1. Internet Security Systems, Inc. (Georgia).
2. Internet Security Systems Europe N.V. (Belgium).
3. Internet Security Systems K.K. (Japan).

EXHIBIT 23.1

CONSENT OF INDEPENDENT AUDITORS

We consent to the reference to our firm under the caption "Experts" and to the use of our reports dated January 13, 1998, in the Registration Statement (Form S-1) and related Prospectus of ISS Group, Inc. dated January 20, 1998.

/S/ Ernst & Young LLP

*Atlanta, Georgia
January 16, 1998*

ARTICLE 5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE AUDITED FINANCIAL STATEMENTS OF INTERNET SECURITY SYSTEMS, INC. AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

MULTIPLIER: 1

CURRENCY: U.S. DOLLARS

PERIOD TYPE	YEAR
FISCAL YEAR END	DEC 31 1997
PERIOD START	JAN 01 1997
PERIOD END	DEC 31 1997
EXCHANGE RATE	1
CASH	3,929,000
SECURITIES	0
RECEIVABLES	4,038,000
ALLOWANCES	255,000
INVENTORY	0
CURRENT ASSETS	8,248,000
PP&E	1,971,000
DEPRECIATION	402,000
TOTAL ASSETS	9,866,000
CURRENT LIABILITIES	5,976,000
BONDS	140,000
PREFERRED MANDATORY	8,878,000
PREFERRED	0
COMMON	132,000
OTHER SE	0
TOTAL LIABILITY AND EQUITY	9,866,000
SALES	13,467,000
TOTAL REVENUES	13,467,000
CGS	676,000
TOTAL COSTS	676,000
OTHER EXPENSES	16,938,000
LOSS PROVISION	195,000
INTEREST EXPENSE	17,000
INCOME PRETAX	(3,919,000)
INCOME TAX	0
INCOME CONTINUING	(3,919,000)
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	(3,919,000)
EPS PRIMARY	(0.28)
EPS DILUTED	0