



## RSA Security Not Secure

<http://www.fool.com/news/2001/rsas011012.htm>

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Electronic security provider **RSA Security** ([Nasdaq: RSAS](#)) announced yesterday that it had a lousy third quarter. Lousy? Very, very bad, actually. Revenue fell 13%. Operating income turned into a significant operating loss. The fourth-quarter forecast has shrunk to flat revenue and a \$0.14-0.17 per share loss, thanks to a blowup at RSA Capital.

And that was the good news. The bad news was that acquisitions and ill-advised put option contracts turned \$210 million in cash at the end of Q2 to \$21 million at the end of Q3.

The company asserted repeatedly that Sept. 11 put a serious hurt on the quarter. It makes sense that there was a powerful effect; as with most software companies, its sales are usually back-end loaded, and there is no doubt that a lot of deals supposed to go down in late September got shelved as representatives couldn't fly and companies froze spending. Management described the financial services sector as a "key vertical market" for the company, and it was in no mood to negotiate deals in September. Sales therefore took a bath. Public key infrastructure sales -- formerly a [key metric](#) for success -- were \$7.7 million, down 43% sequentially. Sequential sales dropped 23%. Sequential inventory swelled by 25%. There just wasn't much good.

RSA is trying to deal with the problems. It is cutting 15% of its workforce, beyond the 8% cut in the third quarter. It is reducing expectations for the future, dropping estimates to flat revenue and break-even operating results in Q4. It is projecting \$285-\$295 million in revenue in 2002, versus previous estimates of \$345 million. It estimates that it will earn \$0.09-\$0.19 per share in 2002, down from previous average estimates of \$0.39.

### Lots of bad decisions

All right, it was a bad quarter. There was a terrorist attack, and it hurt. Management is setting realistic expectations accordingly. That's good. But let us not ignore the fact that RSA has made a series of boneheaded moves that have cost it a lot of money and a lot of creditability.

- **The creation of RSA Capital.** The company attributed a lot of operating expenses to RSA Capital, and gave itself immunity from those costs, because it has decided to close the investment and venture-capital arm. Don't let them off so easily. This was an insane venture. In February 2000, RSA doubled its funding of RSA Ventures I to \$100 million. RSA Security had \$218 million in revenue and \$7 million in operating income in 1999, and it invested \$100 million -- 14 times trailing operating income -- in a venture capital fund. It is far too polite to say that it was not prudent to do so. Now this fund is just a series of write-offs.
- **Making a \$130 million cash acquisition at a time when business is terrible and cash is tight.** When the deal was negotiated, RSA may not have known how bad things would get, but the company was devoting half of its cash to an acquisition when it was clear the economy was souring. Again, management clearly lacked prudence.
- **The issuance of put option contracts as part of its share buyback plan.** It is almost never advisable for a company to buy back shares with something other than free cash flow, of which RSA never had a dime. It is even dumber to sell puts -- contracts to buy back

shares at a certain rate -- on your own stock in that case. The company did just that from February 2000 to May 2001. Sure, it got a commission, but RSA was forced to buy back 1.875 million shares at an average of \$23.90 per share at the end of September, when its stock was trading around \$13.00. The lost cash per share is damaging; the fact that these costs came when cash was already low was devastating. And it's not over yet; the company has three more put contracts outstanding. We'll see how much those cost it.

The fallout from all of these terrible decisions from management is that a company that should have had \$300 million and little cash burn instead has \$21 million, operating losses, and a bunch of bills coming up. The company says it will be able to raise cash from financing and/or the capital markets to continue operations. It says it will turn those operations around in 2002.

Liquidity is an important issue. With a management history like RSA's, I'll believe it when I see it.

*Brian Lund doesn't feel secure, and he can't count on RSA to help him. He does not own the stock. The Motley Fool is investors writing [for investors](#).*

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