

## Increased Spending in Cybersecurity Drives Surge in Funding

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As funding from venture capitalists tapered off in the fourth quarter of 2015, investment in the cybersecurity sector continued to boom.

Venture capitalists invested \$675.43 million in the fourth quarter of 2015, up from \$522.41 million in the same quarter a year before, according to data from **Dow Jones** VentureSource. Total annual venture capital funding in cybersecurity increased 76 %, to \$3.34 billion, in 2015.

In the wake of high-profile hacks and increased activity from state actors, companies are increasing their spending on security. Gartner predicts the world-wide cybersecurity market will increase to \$170 billion by 2020, up from \$75.4 billion in 2015. Investors see that boom as an opportunity, despite public security stocks struggling since the start of the year.

U.S. VC investment in cybersecurity companies grew by 76% in 2015.

Experienced venture capitalist investors in security predict investment in the sector won't rise as rapidly in 2016 as market conditions cool. They view security as a viable sector largely insulated from the recent market turmoil, but say the sky-high funding rounds that became common in 2015 will be more rare. Investors predict a similar number of cybersecurity investments will occur in 2016, but the total dollars in the sector may not be as high because fewer large institutions will drive up funding rounds.

For many, a sign that valuations in the cybersecurity sector may have gone too far was **FireEye** Inc.'s acquisition of **iSight Partners Inc** . for as much as \$275 million, based on certain milestones. The company's sale, which security executives said was far below a sought-after higher valuation multiple, showed that even strong companies may not live up to the lofty valuations set in 2015.

Bob Ackerman, the managing director of Allegis Capital, said when everything is on the rise, investors tend to pile on. He expects firms that don't have a history of investing in security to pull back from the sector.

"In a market like this people talk about a flight to quality, but generally there's also a flight to comfort," said Mr. Ackerman. "Investors go back to the thing that they know best."

But funds are increasingly specializing in the sector. Mr. Ackerman's fund focuses on cybersecurity startups, as does TenEleven Ventures and Trident Capital Cybersecurity. **Menlo Ventures** plans to dedicate 25% of its latest fund to security companies.

Trident Capital's newest partner, Sean Cunningham , said he isn't worried about the increasing number of funds specializing in cybersecurity. Mr. Cunningham said that because there was so little investment in the sector for many years, venture capitalists are now playing catch up from when cybersecurity investment dropped between 2004 and 2010.

"The sector has actually been underfunded in some regards," Mr. Cunningham said. "You could argue that we're going to make up for some of that."

Mr. Cunningham said Trident passed on a number of deals in 2015 when term sheets came back with valuations the company felt were inflated. He said there will likely be a similar number of cybersecurity deals in 2016, but the total capital deployed in those deals may be lower.

In 2016, investors expect an increase in mergers and acquisitions within the sector. Mr. Cunningham expects traditional public security companies will likely be actively acquiring startups.

Investors predict that given current public market conditions, most companies that are ready to go public will wait it out. Public security companies' stocks took a beating in early 2016, with **FireEye** and **Imperva Inc** . down more than 40% since the start of the year.

Venky Ganesan, a partner at **Menlo Ventures** , said because so much capital flocked to cybersecurity in recent years, many "clones" were funded. He said time will tell which companies truly own their valuations.

"When the tide goes out, you can see who's wearing shorts and who is really naked," Mr. Ganesan said.

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