

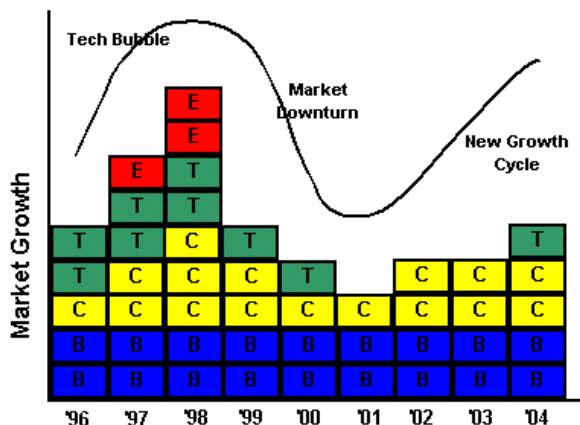
INTRODUCTION

The information technology (“IT”) services outsourcing industry continues to grow, as the inherent cost benefits leads to additional demands that will drive increased revenues upward. Many of the fundamental trends in this industry indicate that the growth in this sector is fueled by long-term information management growth and an increase data security increases. As a result, Victory Partners believes that this industry presents a viable long-term growth opportunity.

INDUSTRY OVERVIEW

The IT Service industry is in a state of flux as demand for IT Services demand can be broken into four components: Baseline/Maintenance, Cyclical/Economic, Technology Wave and Event-Based. Demand for IT Services have seen considerable destabilization in the last 3 years:

- Baseline/Maintenance*: Structural supply variations have weakened the pricing environment.
- Cyclical/Economic*: We are expecting good economic growth for 2005, however, market optimism still remains somewhat fragile
- Technology Wave*: However, certain vertical markets may hold pockets of lagging technology deployment.
- Event-Based*: With Y2K past, there are no significant anticipated industry wide events to drive near term demand, although certain industry verticals will be subject to occasional event driven cycles.



Source: Smith Barney, Viant Group, WP Capital Analysis

EMERGING TRENDS IN IT SERVICES

Some of the emerging trends in IT Services include Business Intelligence (“BI”), Off-shore IT services, SAP upgrade cycles and continued government IT spending.

BI is a key focus area for IT service providers in 2005 as many suppliers seek to differentiate its services. Small (\$10-40 million revenue) BI focused IT Services companies will experience increased competition, as 3rd party service providers must create or integrate into larger more robust platforms.

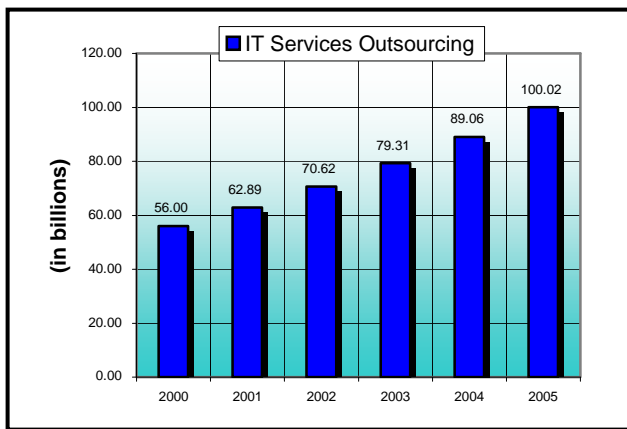
Offshore IT services delivery has become mainstream in the industry as the increased success of “Third Wave” offshore companies have been driven by clients needing to lower its IT spending budget. The offshore model has allowed its clients a 30-50% savings compared to traditional providers, displacing ~ \$30 billion in demand.

The SAP Upgrade Cycle and Software Suite will drive continued emphasis on SAP capabilities across all solution markets (SCR, CRM...). As many as 75% of existing customers may go through upgrade cycles in the next 36 months. Furthermore, SAP continues to gain market share in enterprise applications software.

Finally, the continued strength in government IT spending has been an emerging trend in the industry. Federal, state and local government agencies continue to make significant investments in IT. Homeland security and defense have received increased attention, as military and armed services continue to rise.

IT SERVICE OUTSOURCING OVERVIEW

Spending in information technology (“IT”) outsourcing is expected to rise as companies continue to exploit the cost benefit of outsourcing its information technology. Growing at a 12.30% CAGR, the Worldwide IT Services Industry Forecast and Analysis report that spending in IT outsourcing reached \$56 billion in 2000 and is expected to top \$100 billion by the end of 2005.



Source: *Worldwide IT Services Industry Forecast and Analysis*

The outsourcing market is growing as a viable alternative to in-house information systems management. Demand for outsourcing is being driven by globalization and technological innovations throughout the world. These factors have led to global competition, which is forcing companies to focus on cost cutting measures. According to Dataquest, outsourcing services are expected to grow at an annual rate of 15.8%. Outsourcing works out as a feasible cost effective solution for companies that are trying to cope with the rapid technological change but do not want to spend on maintaining an in-house technology office.

According to the Outsourcing Index, the IT outsourcing industry accounts for 28% of all outsourcing. It reports that outsourcing is currently growing at a 15% growth rate, compared to the U.S.'s 3.5% growth rate, of which 25% of its growth can be attributed to outsourcing.

WHY COMPANIES OUTSOURCE?

One of the main reasons why companies outsource its IT service is due to its reduced and controlled operation costs. According to Dr. Quinn, the William and Josephine Buchanan Professor of Management at the Amos Tuck School at Dartmouth College, sophisticated outsourcing supported by new electronic communications, modeling and monitoring techniques enables companies to reduce innovation cycle times and costs by 60% to 90% and decrease investments and risks by equal amounts.

As companies continue to grow, the large volumes of data compiled and complex security issues that accompany growing corporations will allow for enhanced growth in this sector. Dun & Bradstreet reports, "As companies continue to grow, the gathering and management of information will become more complex and costly for in-house operators, leading to the increased need to outsource storage and security.

Recognizing not only the need to guard against such attacks but also their lack of expertise to provide that protection, businesses have begun to outsource network

security. The Outsourcing Institute report that one sign of this growing security growth is that security and network management firms have been forming specific professional units targeted to providing such services.

Top 3 Reasons why Companies Outsource

- Reduce and control operational costs
- Improve company focus
- Gain access to world-class capabilities

Source: *The Outsourcing Institute*

RECENT M&A IN THE INFORMATION TECHNOLOGY SERVICES INDUSTRIES

M&A valuations in the IT Services industries have recently experienced upward trending growth as will continue to rise as, Victory Partners believes that growth in the industry is the result of increased competition and activity that will lead to rapid consolidation over the short term, resulting in higher valuations. For example, in July 07, 2003, an information technology service company was acquired for \$20.505M, that generated \$46.328M in revenues. The transaction sold for 0.444x revenue and 6.347x EBITDA. In July, 27, 2004, another information technology services company was purchased for \$12.480M. This company yielded \$3.410M in revenues, which resulted in 3.66x revenue and 13.229x EBITDA.

Based on the past three years, valuations have risen, indicating the expected growth and development in the industry. For example, in 2002, the mean transaction price to revenue multiple was 0.367. The multiple has steadily risen to 0.8758 and finally to 2.41 in 2003 and 2004, respectively. Furthermore, the average price/EBITDA multiple has been from 14.41 to 5.34 to 18.82, from 2002 to 2004.

Victory Partners, LLC is actively involved in analyzing and representing companies in the IT Services industry, having provided financial advisory services, performed recapitalizations, and completed M&A transactions for middle market companies.

For additional information, please contact Tony Neveling at tony@victorypartnersllc.com.