

## IT Services M&A Update

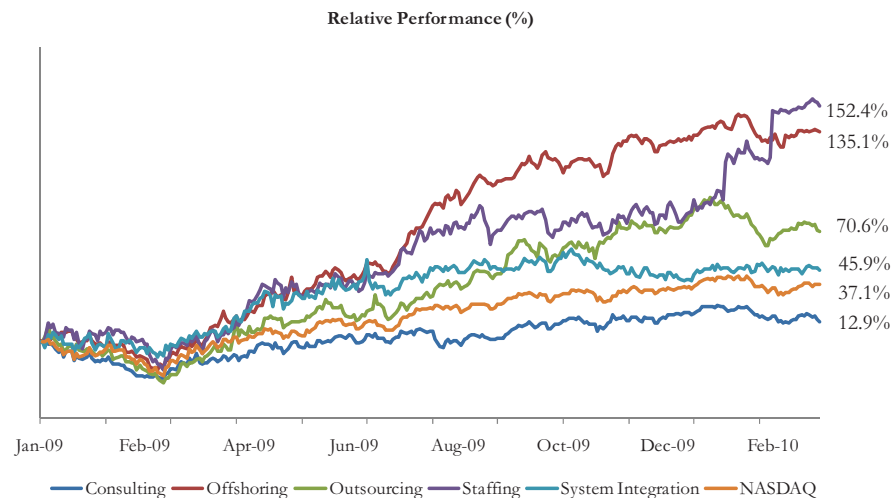
### IT Services...Showing Renewed Signs of Life

2010 has so far been a period of recovery in the IT Services industry. In 2009, most companies were forced to contain spending as a result of the recession, and IT budgets were slashed significantly. Last year, funding that was earmarked for IT capital expenditure was funneled to lower-cost outsourcing and offshoring. Commercial IT Services<sup>1</sup> vendors responded to pricing pressure by providing an increased offshore mix, fixed pricing, and rate cuts in exchange for greater volume commitments from clients. However, the macroeconomic environment has since turned the corner, leading to a more optimistic IT spending environment. Businesses have once again started to invest in discretionary IT projects, particularly in outsourcing and consulting. Staffing firms are experiencing an uptick in activity. Offshoring providers have started realizing increased activity from the Banking, Financial Services, and Insurance sectors, as confirmed by Infosys' 3Q 2010 earnings release.

With the exception of the Consulting sector, all of the KippsDeSanto IT Services indices have outperformed the NASDAQ (which has increased by over 37%) since the beginning of 2009. Staffing is surprisingly leading the way with a ~152% improvement, fueled by an increase in temporary hiring as providers such as CDI Corporation reported that clients have begun to position themselves for a turnaround in the economy. In addition, Manpower's recent announcement that it will acquire Comsys IT Partners for \$431 million marks a sizable transaction in the staffing sector and has driven up the target's share price, which is reflected below. The offshoring index has increased by over 135% with providers such as Syntel and WNS Holdings reporting strong earnings, an improved outsourcing market, and stabilizing billing rates. A number of services providers have revised their earnings outlook upwards in anticipation of the end of the global recession and firms such as Infosys and Accenture have recently made mention of increasing headcount to meet an expected increase in demand for IT services globally.

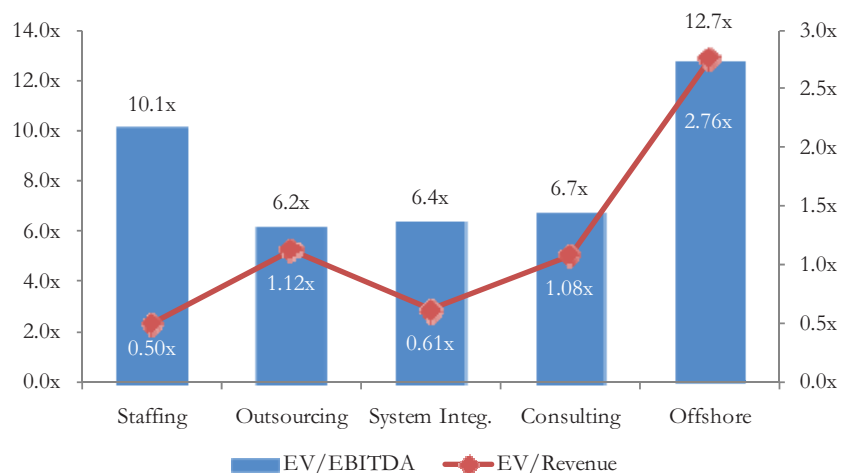
#### **KippsDeSanto IT Services Index Relative Pricing Performance**

For the Period Ended February 26, 2010



## KippsDeSanto IT Services Index Public Company Pricing Multiples

For the period ended February 26, 2010



**Consulting:** ACN, DTPI, FCN, HURN, NCI, RECN, SAPE.

**Offshoring:** CTSH, EXLS, G, HCL, INFY, SYNT, Tata, Wipro, WNS.

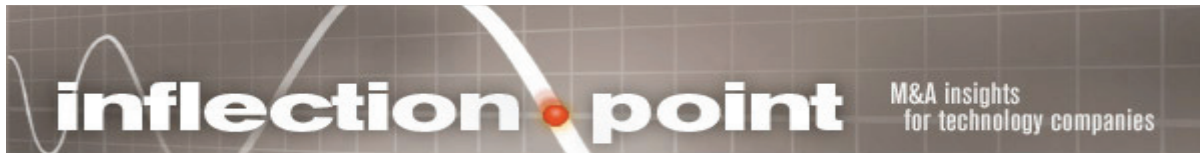
**Outsourcing:** ADP, CSC, MMS, PER, TEAM, TYL, UIS.

**Staffing:** CDI, CFS, CITP, CTGX, KFRC, NTSC.

**Systems Integration:** CBR, OTCBB:BGPT, EDGW, ELOY, TSX:GIB.A, MPS, PRFT.

Global IT services expenditure is expected to reach \$816 billion in 2010, a modest increase from the \$781 billion spent in 2009<sup>2</sup>. A significant driver of increased spending will be clients' continued desire to lower labor costs, a theme that will lead to the increased penetration of offshore services as clients seek to benefit from cost arbitrage. A Wall Street survey of 50 global organizations<sup>3</sup> indicated that the majority of CIOs expected to have their preliminary budgets completed in 4Q 2009, helping services projects flow into the market at a more normal pace as opposed to the delay seen in 2009. The survey also revealed that CIOs expect a 2.2% year-over-year budget increase versus the 2.3% decline in the prior year. IT consulting providers will benefit from customers' needs for security assessment, as well as the potential for infrastructure virtualization / cloud computing programs. Industry experts expect the continual proliferation of clouds, with private clouds gaining more attention. Systems integration expenditure will be driven by the continuous need for clients to drive more value from packaged applications.

IT expenditure will also grow as a result of the ever-increasing demand for information security. The IT security software and services market is estimated to have reached \$55 billion in 2009 (a year-over-year increase of over 11%). The rising use of the internet as a tool to transact business means an upsurge in the number of access points within an organization, leading to increasing amounts of critical information being vulnerable to a cyber attack. This is a problem not just for businesses – the U.S. Government has become ever more aware of the susceptibility of national security data to cyber attacks. As a result of these concerns, expenditure on IT security is expected to reach \$63 billion in 2010, with the Federal Government accounting for over \$8 billion. Managed security services providers ("MSSP") are expected to be big beneficiaries as organizations realize the cost effectiveness of MSSPs in relation to other security solutions. In the



governance, risk, and compliance (“GRC”) arena, spending will be driven by factors such as the automation of compliance processes in order to leverage IT investments to meet regulations.

### **IT Services M&A Still Very Active**

M&A activity was slow out of the gate in 2009, with momentum gradually building as the year progressed; Q4’09 deals accounted for 40% of the year’s IT services transactions, which bodes well for a positive 2010. We have tracked almost 250 IT Services transactions, with approximately 70 deals apiece in the systems integration, IT consulting and outsourcing categories. Despite a cautious but clear re-entry into the market by private equity groups, strategic acquirers accounted for approximately 94% of 2009 transactions. It remains to be seen if this trend holds true in 2010, but given the recent uptick in high yield capital market activity, we may see more financial buyers looking to make acquisitions in 2010.

Three large deals reshaped the IT Services M&A landscape in 2009 and will have a dramatic impact on this year’s acquisition activity. Xerox’s (rather surprising) acquisition of Affiliated Computer Services (ACS), Dell Corporation’s purchase of Perot Systems, and Adecco SA’s purchase of the MPS Group will have a reverberating effect on the market. None was larger than the \$7.5 billion ACS transaction, which underscores a trend in which IT product vendors are acquiring services platforms to diversify their revenue base and to obtain additional customers for cross-selling opportunities. In the staffing subsector, Adecco Group reached across the Atlantic and paid almost \$1.2 billion to acquire MPS Group, substantially strengthening its position in the North American market, in addition to bolstering its professional staffing business. While these transactions have taken a few buyers out of the market, deal volume is likely to increase as the reverberation of these big deals is felt throughout the IT services marketplace. The table below highlights some of 2009’s noteworthy transactions.

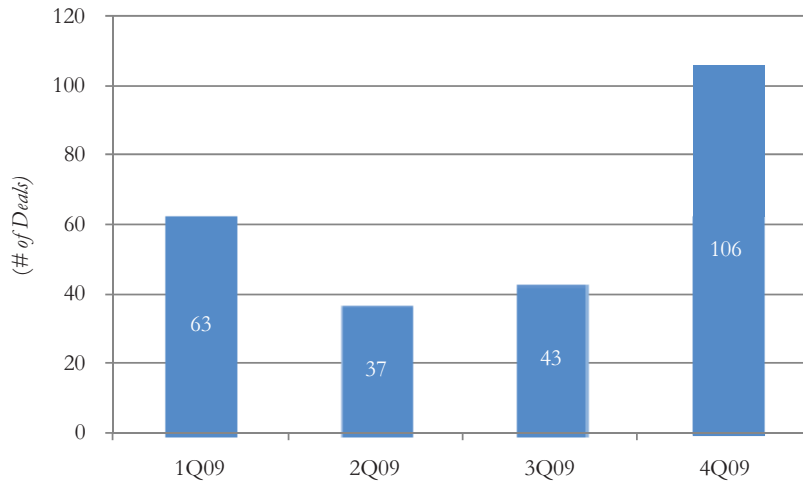
## 2009 Noteworthy IT Services Transactions

(\$ in millions)

Announced	Closed	Buyer	Seller	Sector	Description	Enterprise Value (EV)	Revenue	EBITDA	EV / Revenue	EV / EBITDA
12/31/2009	12/31/2009	Edgewater Technology, Inc.	Fullscope, Inc.	Systems Integration	Provides Microsoft Dynamics ERP systems integration and consulting services for the manufacturing sector	\$12.5	\$21.7	NA	0.58x	NA
12/21/2009	12/21/2009	Capita Group plc	Synetrix Holdings Ltd.	Systems Integration	Provides network and security design, integration, Web and email hosting, managed data backup, and recovery and Web content filtering services	120.5	NA	NA	NA	NA
11/14/2009	11/14/2009	Bain Capital, LLC	BellSystem24, Inc.	Outsourcing	Provides outsourced, marketing-related, call center-based customer care services	1,185.6	1,334.1	\$200.1	0.89x	5.9x
11/5/2009	Pending	TPG Capital / CPP Investment Board	IMS Health, Inc.	IT Consulting	Provides an online database of market research and analytical information related to diseases and treatments for the medical industry	5,071.9	2,171.0	489.0	2.34x	10.4x
11/2/2009	11/2/2009	Emst & Young, LLC	Capital City Technologies	Systems Integration	Provides ERP systems integration and consulting services for government agencies and educational institutions in the US	NA	NA	NA	NA	NA
10/30/2009	Pending	KPIT Cummins Infosystems Ltd	Sparta Consulting	Systems Integration	Provides SAP ERP, CRM, SCM and business intelligence (BI) systems integration, consulting, and software development for businesses in North America	34.0	25.0	NA	1.36x	NA
10/19/2009	1/20/2010	Adecco Group, Inc.	MPS Group, Inc.	Staffing	Provides staffing, consulting, and business solutions while operating through two divisions: Professional Services and IT Services	1,157.9	1,742.6	58.8	0.66x	19.7x
10/6/2009	2/2/2010	Sykes Enterprises, Inc.	ICT Group, Inc.	Outsourcing	Provides outsourced customer management and business process outsourcing solutions	220.7	404.3	25.9	0.55x	8.5x
9/29/2009	2/8/2010	Xerox Corporation	Affiliated Computer Services, Inc.	Outsourcing	Provides business process outsourcing, systems integration, software development, and document and human capital management	7,536.0	6,523.2	1,037.9	1.16x	7.3x
9/25/2009	11/12/2009	Platinum Equity	Pomeroy IT Solutions, Inc.	Staffing	Provides software development, systems and network integration, consulting, business process optimization, and managed services	42.5	455.9	(5.0)	0.09x	NMF
9/21/2009	11/3/2009	Dell, Inc.	Perot Systems	Outsourcing	Provides software development and testing, systems and network integration, business process outsourcing, consulting, and IT staffing	3,772.3	2,643.0	278.0	1.43x	13.6x
8/14/2009	10/1/2009	Stream Global Services	eTelecare Global Solutions, Inc.	BPO	Provides business process outsourcing services focusing on the voice and non-voice based segment of customer care services	105.4	290.9	26.3	0.36x	4.0x
8/11/2009	10/16/2009	Adecco Group, Inc.	Spring Group plc	Staffing	Provides recruitment, staffing, and related services in Europe, North America, and internationally	83.5	806.8	5.6	0.10x	14.9x
6/9/2009	7/1/2009	Capita Group plc	Carillion IT Services Ltd.	BPO	Provider of outsourced server and network management, tech support, managed hosting and consulting services for businesses in Europe	58.6	105.5	5.9	0.56x	9.9x
5/22/2009	6/12/2009	Affiliated Computer Services, Inc.	Anix Group	BPO	Provides a variety of managed services, including application hosting, security, storage, and network management for businesses in the UK	55.1	71.0	4.1	0.78x	13.4x
3/23/2009	5/8/2009	Deloitte LLP	BearingPoint (North American Public Services Business)	Consulting	Provides technology and consulting and systems integration services to the public sector	350.0	NA	NA	NA	NA
3/23/2009	6/16/2009	PriceWaterhouseCoopers	BearingPoint (North American Commercial Services)	Systems Integration	Provides technology and consulting and systems integration services to a broad range of sectors	44.0	618.0	NA	0.07x	NA
3/16/2009	3/24/2009	Affiliated Computer Services, Inc.	e-Services Group International, Inc.	Outsourcing (Help Desk Services)	Provides offshore call center and business process outsourcing solutions for companies in North America	93.8	65.0	NA	1.44x	NA
3/5/2009	6/1/2009	TriNet Group, Inc.	Gevity HR	BPO	Provides payroll management and HR administration outsourcing and consulting services to small and medium enterprises	67.9	544.8	26.6	0.12x	2.6x

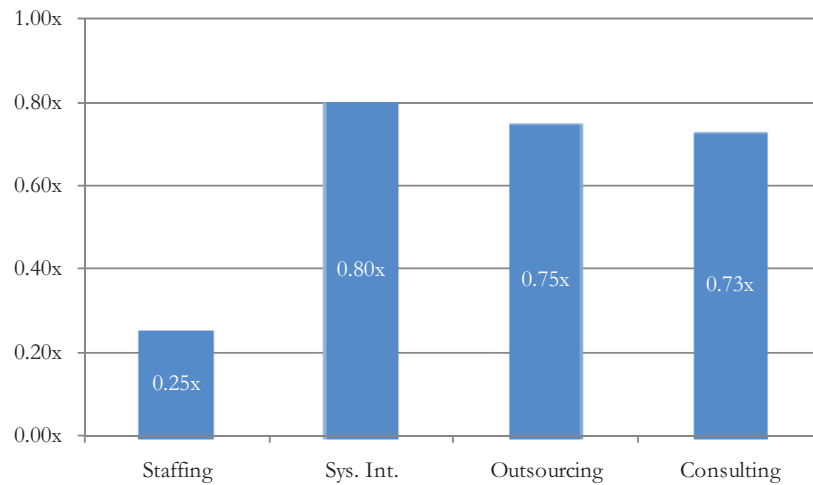
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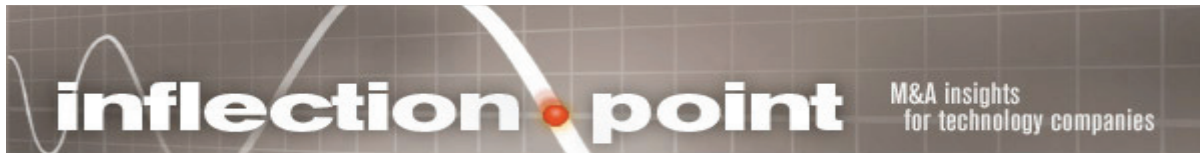
2009 Commercial IT Services M&A Volume



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2009 Median M&A Revenue Multiples by Sector<sup>4</sup>



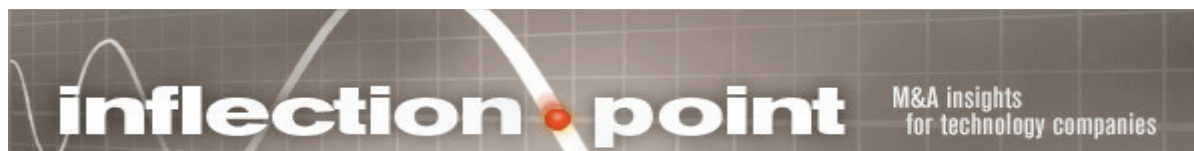


### **Federal IT Services Were Not Completely Immune To Economic Downturn...**

Overall technology M&A activity was slow in the first half of 2009, and the Federal IT services sector was no exception. Deal volume was particularly slow in the first quarter, with only 10 announced transactions, but did pick up by the fourth quarter. There were 76 announced deals in 2009, a decrease from an average of nearly 90 over the prior three years. Fourth quarter momentum has continued into 2010, evidenced by 19 announced deals through February. Repositioning in response to the Administration change; a dynamic Federal funding and contracting environment; the strong appetite for growing, well funded “hot” areas in cybersecurity, intelligence, C4ISR and healthcare IT, and; the continued investment by financial sponsors in the space have driven this renewed activity.

Notable priorities top-of-mind on Capitol Hill and amongst buyers included healthcare and cybersecurity. Soon after taking office, the Obama Administration championed a \$19 billion commitment to healthcare IT as part of the ARRA and has since continued promoting technology to help reduce healthcare costs, improve care quality and broaden coverage. Federal contractors have taken note, with many seeking acquisitions that support or deliver upon these initiatives. Two such examples were Harris’ acquisition of Patriot Technologies and private equity group Snow Phipps Groups’ acquisition of IT firm ITSolutions.

Cybersecurity remains the top Federal IT area of interest given mounting cybersecurity threats and the resultant Federal robust funding outlook and growth opportunity. For example, cybersecurity initiatives comprised over \$400 million of the Department of Homeland Security’s 2010 budget, including protecting critical infrastructure from cyber attacks, cybersecurity-related research, and U.S. Secret Service Security initiatives. Additionally, a portion of a \$900 million ARRA allotment for healthcare initiatives was dedicated to cybersecurity to ensure secure patient information transfer. With the overall Federal cybersecurity market expected to grow at an 8.3% CAGR over the next five years (reaching \$12 billion in 2014), Federal IT services firms were active acquirers of cybersecurity software and services companies in 2009. ICF International’s Jacob & Sundstrom buy and SAIC’s acquisition of Atlan (followed-up by Cloudshield in 2010) are representative examples. QinetiQ’s acquisition of venture-backed Cyveillance in July was also noteworthy given the \$80m valuation (\$40m in initial cash consideration plus the potential for an additional \$40m in earn-outs), representing a 7.7x multiple of 2008 revenue. While Cyveillance was predominately focused on the commercial market, QinetiQ sought to leverage Cyveillance’s cyber intelligence capabilities across its government customers and expand its own security offerings with complementary solutions. Continued consolidation in this segment is anticipated given the longer-term favorable funding outlook and mission need as larger players look to establish their platforms and supplement or replace in-house technology innovation and development.



**Select Recent Cybersecurity Transactions**

*(\$ in millions)*

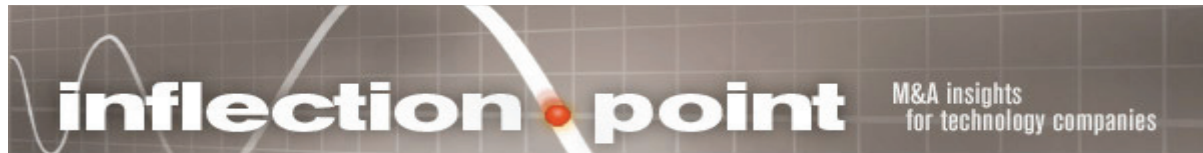
<b>Announced</b>	<b>Closed</b>	<b>Buyer</b>	<b>Seller</b>	<b>Description</b>
1/14/2010	2/9/2010	SAIC, Inc.	CloudShield Technologies, Inc.	Provides services management and infrastructure protection solutions to national governments and service providers.
1/12/2010	1/28/2010	Symantec Corporation	Gideon Technologies Inc.	Provides IT security and risk management solutions, including SCAP-validated configuration and vulnerability assessment, to federal customers.
12/23/2009	12/23/2009	SafeNet Inc.	Assured Decisions LLC	Provides information security consulting services and MDeX information sharing solution to IC and DoD. Acquisition complements SafeNet's existing data protection product offering.
12/1/2009	12/10/2009	ICF International, Inc.	Jacob & Sundstrom, Inc.	Provides cybersecurity and identity management services to DoD, EPA, SSA, and other civilliian and S&L agencies.
7/13/2009	7/13/2009	SAIC, Inc.	Atlan, Inc.	Provides cybersecurity product testing in addition to FIPS and SCAP certification for the federal government and commercial clients.
6/15/2009	6/22/2009	Boeing Co.	eXMeritus	Develops hardware and software to securely share information across federal government and law enforcement networks and systems.
5/6/2009	7/1/2009	QinetiQ Group PLC	Cyveillance	Provides continuous, comprehensive Internet monitoring and sophisticated intelligence analysis that proactively identifies and eliminates threats to information, and infrastructure.

Federal IT M&A multiples in 2009 tended to be deal-specific, generally experiencing downward pressures outside the aforementioned hot lanes that remain in high demand at premium valuations. Structured transactions and earn-outs were also more prevalent as buyers and sellers increasingly shared the post-deal performance risks associated with funding challenges, increased market competition and ongoing broader economic recovery. Broadly speaking, larger transactions received premiums; however, there was a notable market shift in buyers' openness to consider and pay-up for smaller deals (less than \$100 million in Enterprise Value). Buyers frequently prioritized and rewarded capability and customer focus over scale. Looking into 2010, Federal IT services M&A is expected to rebound from 2009 lows given the number of larger well capitalized strategic and financial buyers looking to reposition in growth areas, and the many smaller, and often faster growing entrepreneurial contractors looking to monetize their investments or become more competitive themselves.

## What to Expect in 2010

In 2010, we expect to see the following themes:

- ***“Hot” Areas of the IT Sector continue to drive IT services spending:*** Cloud computing environments are expected to multiply in 2010, and as such, service providers will need to differentiate themselves in terms of expertise in security, optimal resource allocation, cost, performance, and flexibility. Security remains an attractive market for growth in 2010 as new and sophisticated threats continue to drive demand for a myriad of security solutions. We expect services spending around security to accelerate in 2010 and beyond. Healthcare IT is another area that is poised for considerable growth. Healthcare IT services providers were in high demand in 2009, and the on-going healthcare reform focus on Capitol Hill is likely to keep this demand steady, with vendors seeking to position themselves to benefit from the substantial allocation of Federal dollars to healthcare IT.
- ***M&A momentum continues in systems integration:*** 2009 witnessed a number of systems integration deals, as companies, faced with pressure to drive down costs, sought the aid of IT services vendors to gain incremental value from existing IT investments. SAP service providers saw strong interest in the M&A markets (e.g. Black & Veatch’s acquisition of Ariston Consulting & Technologies and Bunker Hill’s NSpro buy). However, towards the latter part of the year, service providers looked to build Microsoft (e.g. Edgewater’s acquisition of Fullscope and Synergy Business Solutions’ purchase of Congruent Software’s Microsoft Dynamics Practice) and Sage (e.g. BrainSell Technologies’ acquisition of Paradime Solutions) capabilities. Although cost containment pressures have eased, companies are still looking to derive value from current assets, and this will likely to continue to fuel systems integration activity. Activity in this subsector will also be stimulated by firms looking to business intelligence services providers to assist them in making sharp, actionable decisions and enhancing organizational effectiveness by efficient analysis and management of the substantial amounts of data that companies routinely collect during day-to-day operations.
- ***Heightened M&A interest in services from product vendors:*** The Xerox / ACS and Dell / Perot transactions are prime examples of this trend; however, there were a number of other transactions in the sector that also emphasized product vendors’ desires to strengthen their service offerings. TeleCommunications Systems’ acquisition of Sidereal Solutions, an IT support services provider, and Dell’s purchase of Allin Corporation’s Microsoft IT Consulting segment also support this view. As product vendors seek to gain more domain expertise, provide customers with more extensive offerings and acquire contracts with substantial recurring revenue, a number of high-end services providers, such as Unisys, could see significant interest.
- ***Possible increase in M&A valuations:*** A strong indicator of the return of M&A activity is the willingness of buyers to pay substantial premiums for key assets. Large providers of high-end service offerings enjoyed robust valuations (Perot was purchased at 13.6x LTM EBITDA and IMS Health was acquired for a valuation in excess of 10.0x LTM EBITDA), but even vendors of services viewed as commodity offerings were purchased at high EBITDA multiples (MPS Group was acquired for 19.7x LTM EBITDA). There were also a number of sub-\$1 billion transactions where acquirers showed a willingness to pay top dollar (such as Capita Group plc’s purchase of Carillion IT Services). These transactions suggest that buyers are becoming more comfortable that the economy is improving and see M&A as a viable path to build value.
- ***Staffing should attract a high degree of attention:*** As the global economy begins to recover at a measured pace, companies will gradually start ramping up staffing levels with temporary employees. Staffing firms will likely seek to gain scale in anticipation of meeting this growing demand. A number of high-profile staffing-related M&A transactions were announced in 2009 and early 2010 (Adecco / MPS Group, Platinum Equity /



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Pomeroy IT Solutions, and Manpower / Comsys IT Partners), and the trend is likely to continue with improving macroeconomic conditions.

<sup>1</sup> KippsDeSanto defines Commercial IT Services to include IT Consulting, Outsourcing, Systems Integration, Offshoring, and IT Staffing.

<sup>2</sup> Source: "Gartner Perspective: IT Spending 2010", Gartner Research.

<sup>3</sup> Source: Wall Street Research.

<sup>4</sup> Offshoring transactions have been included in included in the Outsourcing bucket.

Select KippsDeSanto & Co. IT Services Transactions



DAO TECHNOLOGY SOLUTIONS

a portfolio company of  
J.F. Lehman & Company

has been acquired by



January 2010



PERFORMTECH

has been acquired by



December 2009



has been acquired by




October 2009



has been acquired by



July 2009



has been acquired by




May 2009




has been acquired by



August 2008



has been acquired by



August 2008



has been acquired by



July 2008



has been acquired by



July 2008



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