Q2 2010: Business Services Quarterly

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Second Quarter Highlights

- **Business Services M&A activity reached 41 deals in Q2 2010 with an average deal value of $120M. Aggregate deal value rose by 11% from Q1 to Q2 in 2010.**
- **The national unemployment rate fell to 9.5% in Q2 2010.**
- **According to the Bureau of Labor Statistics, Business Services employment levels increased by 141,000 in Q2 2010.**

Trends Continue from Q1 2010

The M&A activity in the Business Services sector has seen growing deal values in the second quarter with an average deal size of $120 million. Deal volume and value are expected to accelerate as the debt market improves and competition grows. Private equity is playing a bigger role in the market with firms like Apax Partners, Kohlberg Kravis Roberts & Co., and Vector UK making large investments in business process outsourcing and consulting services companies in the second quarter.

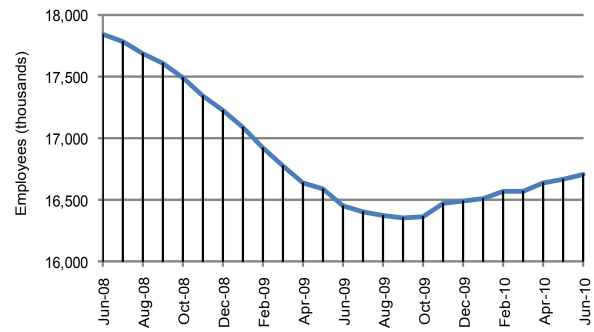
As the second half of 2010 begins, the expectations are that the current trends will hold steady. Deal volume is anticipated to remain in a steady growth pattern, while the next phase of the market recovery is the increase in valuation which will be driven by more players entering the market and creating competition for transactions.

Employment vs. Productivity

The focus on productivity seen in the first quarter of 2010 is tapering off as firms are reaching high levels of productivity with their current available resources. The Business Services sector added 141,000 positions in the second quarter of 2010 indicating stabilization in productivity levels.

For companies to continue to drive productivity and growth they will need to seek acquisitions. The acquisitions will likely be focused toward the small to midsized public and private firms, or to divisions of larger companies. Companies are turning focus to vertical markets for acquisition opportunities, such as Honeywell International announcing the purchase of Matrikon for $138M. Honeywell is the maker of controls for planes and buildings and is well recognized by consumers for their heating control units. The acquisition of Matrikon will provide access to software applications that monitor oil- and gas-well performance and mining equipment.

Business Services Employment



Source: Bureau of Labor Statistics

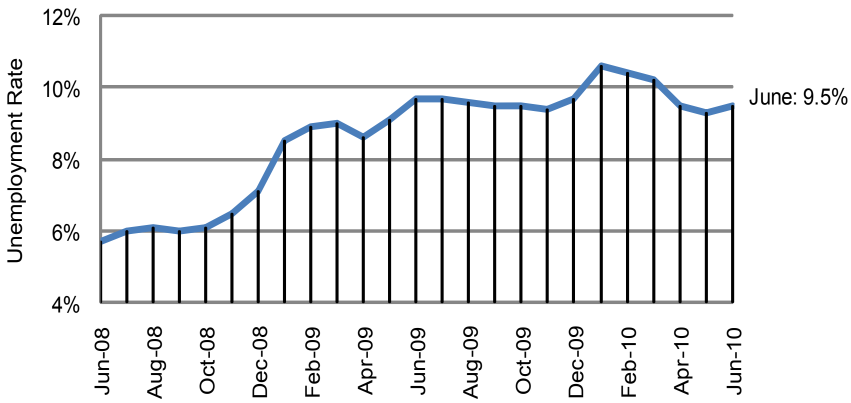
BPO Growth Anticipated

As we enter the next phase of corporate growth, an increase in business process outsourcing is expected. Companies are reaching the maximum productivity levels possible with internal resources. The next phase is to shift to outsourcing, as is illustrated through several deals announced and completed in Q2 2010. Some of these deals include acquisitions made by Hearst Corporation and URS Corporation. Hearst is a media conglomerate that acquired iCrossing Inc which is a global digital marketing agency. URS, an engineering services organization, won the bidding war to purchase Scott Wilson Group, a global engineering consulting firm.

Private equity firms are taking advantage of the improving debt market to invest in outsourcing services firms. KKR purchased Intelligence Ltd., a BPO firm. Natixis PE purchased Alloy Inc, a BPO firm focused in media and marketing services. And Apax Partners Worldwide purchased a majority share in TIVIT, a Brazilian based IT outsourcing firm.

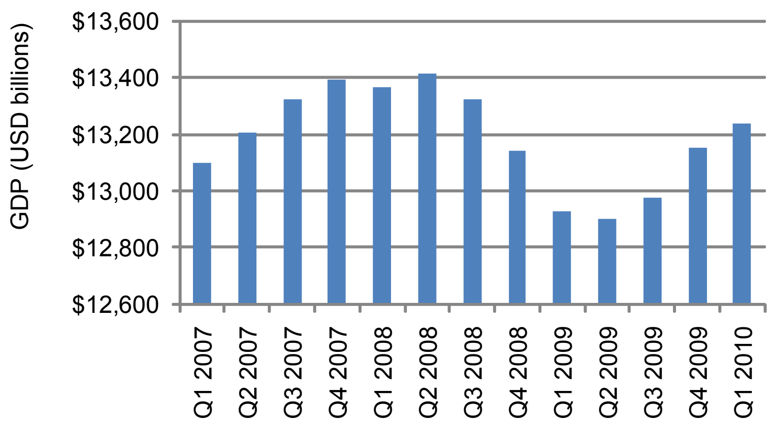
Macroeconomic Factors

US Unemployment



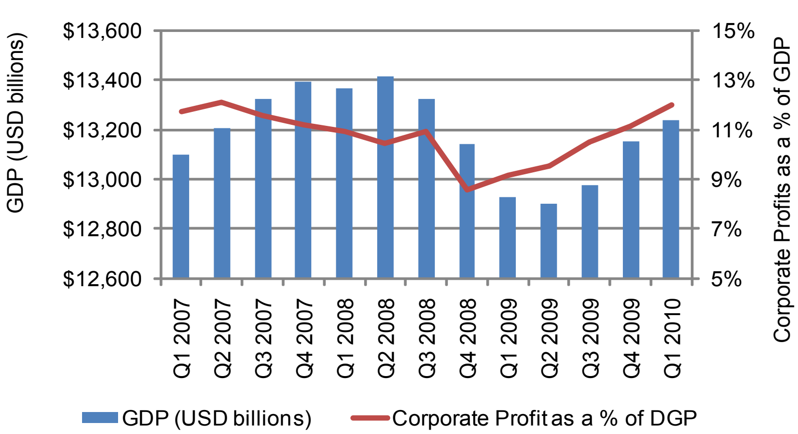
Source: Bureau of Labor Statistics

US Real GDP



Source: Bureau of Economic Analysis

Corporate Profits vs. GDP



Source: Bureau of Economic Analysis

The national unemployment rate edged down to 9.5% in June 2010, from 9.9% in April 2010. Employment rose 596,000 throughout the second quarter. Hiring of temporary workers for the Census 2010 strongly influenced the Q2 2010 employment numbers. The Census Bureau added 410,000 jobs in May and concluded 225,000 of those temporary positions in June, thus ending June 2010 with a decline of employment by 125,000 overall. Private-sector employment increased 357,000 this quarter, according to the Bureau of Labor Statistics. Over the past 12 months, the Healthcare sector gained 217,000 jobs. The professional and business services employment rose by 18,000 positions in June and added 379,000 temporary jobs over the past 9 months.

Real GDP continued to show moderate growth in the first quarter of 2010. According to the latest estimates released by the Bureau of Economic Analysis, real GDP increased 2.7% in Q1 2010 after increasing 5.6% in Q4 2009. The latter 2009 growth was attributed to increased private inventory investments, an upturn in nonresidential fixed investments, and an acceleration of exports. The moderation in real GDP growth primarily reflects a slowdown in inventory investment, exports and business investment in equipment and software, and a down turn in housing investments. These slowdowns have been offset by a strong pickup in consumer spending, especially for durable goods.

Corporate profits increased by 8% in the first quarter of 2010 to nearly $1.6 trillion. Year-over-year growth of 34% from Q1 2009 to Q1 2010 further emphasizes the continued recovery of the overall economy. After hitting a low of 8.5% in Q4 2008, corporate profits reached 12% of GDP in Q1 2010. This is the highest percentage of GDP that corporate profits have represented since Q2 2007. As capital becomes more accessible and businesses resume expansion, GDP and corporate profits are expected to continue to trend upward.

Business Services M&A Activity

	Deal Volume	Transaction Value ($mm)	Median EV / Revenue	Median EV / EBITDA
BPO	12	$2,276	0.8x	10.0x
IT Services - Corporate	2	138	1.8	-
IT Services - Government	1	28	1.8	-
IT Services - General	19	1,110	0.6	7.3
Management Consulting	5	1,198	1.4	8.2
Semicondutctor	1	34	-	-
Technical Software	1	138	1.6	18.6
Total	**41**	**$4,923**	**1.3x**	**11.0x**

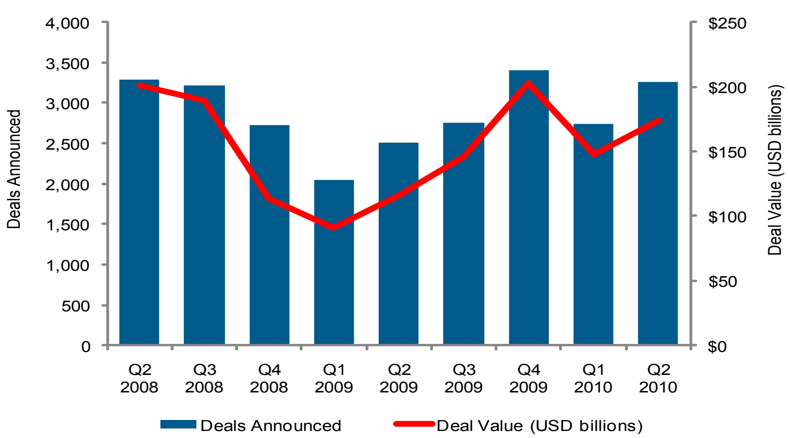
Sources: Capital IQ and 451 Group

Selected Business Services Transactions

Category	Announcement Date	Target	Acquirer	Enterprise Value ($mm)	Enterprise Value to LTM Revenue	Enterprise Value to LTM EBITDA
BPO	May-10	TIVIT Terceirização de Tecnologia e Serviços *Telecommunications IT services*	Apax Partners *Private Equity*	$907	1.8x	9.3x
BPO	Jun-10	iCrossing *Digital marketing*	Hearst Corporation *Media company*	425	4.3	NA
BPO	Jun-10	Intelligence *Human Resources Services*	Kohlberg Kravis Roberts & Co. *Private Equity*	358.1	0.5	NA
BPO	Jun-10	Alloy *Targeted media and marketing services*	Natixis, Hamilton Lane Advisors, GenSpring, ZelnickMedia, Rosemont Solebury *Private Equity*	139	0.5	10.6
Consulting	Jun-10	Scott Wilson Group *Property and transportation consulting*	URS Corporation *Technical consulting*	319	0.7	7.6
Consulting	Jun-10	Trafficmaster *Intellegent vehicle services*	Vector UK *Private Equity*	121	1.4	8.7
IT Services - Corporate	Apr-10	Reaktor *System development and consulting*	Know IT *IT consulting*	16	0.9	4.2
IT Services - Corporate	May-10	Fusepoint Managed Services *Managed IT and infrastructure services*	SAVVIS *IT services*	125	3.0	NA
IT Services - Government	Apr-10	Seismic *Cybersecurity and IT management*	Applied Signal Technology *Gov. defences intellegence products and services*	28	1.8	NA
IT Software	May-10	Matrikon *Industrial efficiency IT software*	Honeywell International *Diverse technology and manufacturing*	129	1.6	18.6
IT Services - Corporate	Jun-10	Portrait Software *Customer interaction solutions*	Pitney Bowes *Mail processing products and services*	63	2.7	23.1

Sources: Capital IQ and 451 Group

Overall Middle Market M&A Activity



In Q2 2010, IT Services led in deal volume with 22 deals combined across general, corporate, and government divisions. Business Process Outsourcing continued the trend from the first quarter leading in deal value.

More than 3,200 deals were announced in Q2 2010, representing $174 billion in value. This is a deal volume increase of 30% and deal value increase of 51% compared to the year-ago quarter M&A activity, and a 19% and 18% deal volume and value increase, respectively, from the first quarter activity in 2010.

Sources: Capital IQ and 451 Group
Note: Statistics include announced mergers and acquisitions with disclosed value of less than $1 billion

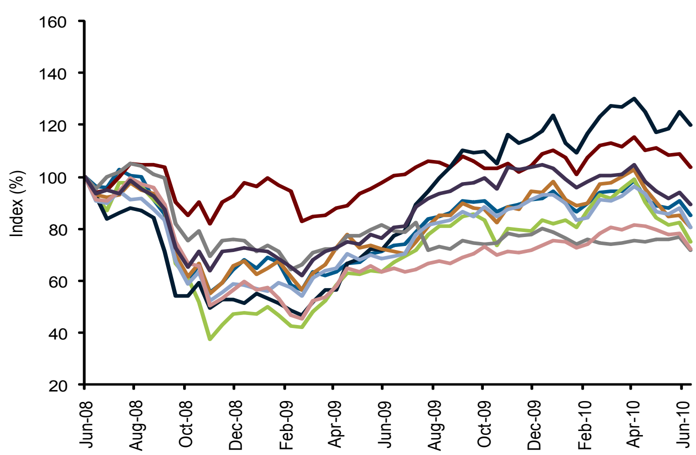
Public Trading Comparables

	Stock Price Change			EV / Revenue			EV / EBITDA			P / E		
	3 months	6 months	12 months	LTM	2009A	2010E	LTM	2009A	2010E	LTM	2009A	2010E
Business Process Outsourcing	(6.8%)	(8.7%)	13.6%	1.1x	1.1x	1.1x	8.4x	7.9x	8.2x	16.3x	16.5x	11.9x
IT Services - Corporate (Large Cap)	(11.5)	(2.7)	21.2	0.5	0.5	0.5	6.2	6.3	6.1	14.9	14.9	14.4
IT Services - Corporate (Mid Cap)	(11.7)	(12.2)	16.2	0.9	0.8	0.4	9.7	9.8	6.9	18.2	19.8	15.6
IT Services - Government	(10.5)	(11.6)	(0.5)	0.7	0.7	0.6	8.1	8.3	6.9	15.0	15.4	15.0
IT Services - Offshore	(9.3)	(1.4)	76.2	2.7	3.1	2.8	10.6	13.4	12.0	24.3	29.6	16.3
Management Consulting	(3.7)	(7.6)	(14.1)	1.0	1.0	1.0	7.3	6.9	7.0	14.6	14.2	12.4
Payment & Transaction Processing	(10.7)	(7.8)	13.6	2.4	2.4	2.3	8.3	8.7	7.6	16.2	17.5	13.9
Research Services	(4.5)	(3.4)	23.3	2.6	2.7	2.6	10.1	10.2	9.6	23.1	23.5	19.9
Staffing	(17.4)	(7.4)	15.7	0.3	0.3	0.3	8.3	11.3	8.4	24.5	20.7	23.4
Overall Median	**(10.5%)**	**(7.6%)**	**15.7%**	**1.0x**	**1.0x**	**1.0x**	**8.3x**	**8.7x**	**7.6x**	**16.3x**	**17.5x**	**15.0x**

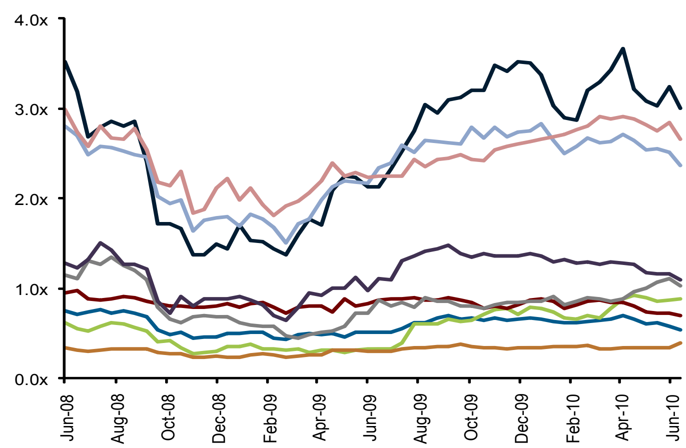
	Index Price Change		
	3 months	6 months	12 months
NASDAQ Composite Index	(12.2%)	(7.0%)	14.9%
Dow Jones Industrial Average	(10.6)	(6.3)	15.7
S&P 500 Index	(12.5)	(7.6)	12.1

Note: Large Cap defined as market capitalization of more than $1 billion as of March 31, 2010.

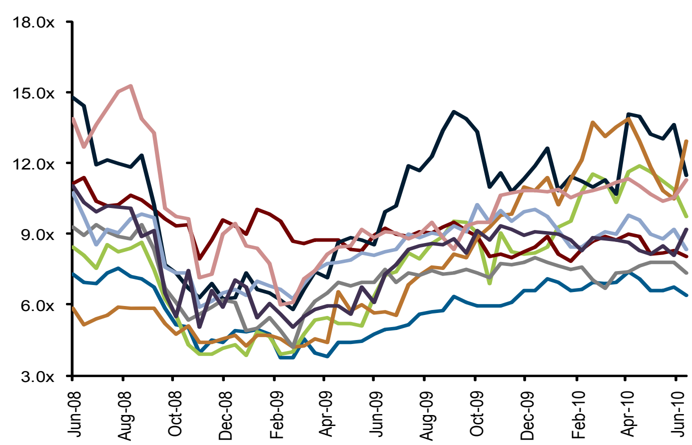
Stock Performance



EV/Revenue Multiples



EV/EBITDA Multiples



Legend

- BPO
- IT Services - Corporate (Large Cap)
- IT Services - Corporate (Mid Cap)
- IT Services - Government
- IT Services - Offshore
- Management Consulting
- Payment & Transaction Processing
- Research Services
- Staffing

Sources: Capital IQ and company filings

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Recent Transactions

METRIGRAPHICS® DIVISION OF DYNAMIC RESEARCH CORPORATION
acquired by
NEW ENGLAND CAPITAL AND CLARKSTON MERCHANT PARTNERS

OrthopaedicSynergy
has acquired
PRAXIM

NewtonPeripherals
acquired by
ID8MOBILE

AgaMatrix
entered into a development partnership with
sanofi aventis

on2 technologies
acquired by
Google
$133,000,000

ACROMETRIX
acquired by
life technologies

spire HEMODIALYSIS CATHETER BUSINESS
acquired by
BARD ACCESS SYSTEMS
$12,500,000

TS TOURTELLOTTE SOLUTIONS
acquired by
BIOCLINICA
$6,500,000

Industry Expertise

Business Services
- Consulting
- Government
- Payment & Transaction Processing
- Real Estate Services
- Research

Healthcare
- Clinical Trial Services
- Diagnostics
- Disease Management
- Healthcare Information Technology
- Medical Product Outsourcing
- Medical Devices
- Tools and Reagents
- Therapeutics

Consumer and Industrial
- Analytical Instrumentation
- Consumer Products
- Energy
- Manufacturing & Distribution
- Transportation & Logistics

Technology
- Communications
- Digital Media Technologies
- Enterprise Software
- Hardware
- IT Services
- Reseller/Distribution

About Covington

Covington Associates is a specialty investment banking firm founded in 1991 serving business services, consumer & industrial, healthcare, and technology companies throughout the country.

Focused on mergers and acquisitions, debt and equity capital raising, debt and equity restructuring, and strategic advisory assignments for middle market companies, Covington Associates has completed transactions ranging in value from $10 million to close to $2 billion for both private and publicly traded companies.

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