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Q2 2010: Technology Quarterly

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Second Quarter Highlights

- Technology M&A activity reached 117 deals in Q2 2010 with an average deal value of \$113M. Aggregate deal value rose by 38% from Q1 to Q2 in 2010.
- The national unemployment rate fell to 9.5% in Q2 2010.
- Worldwide IT spending is forecast to reach \$3.35 trillion in 2010, an increase of 3.9% from 2009 spending of \$3.23 trillion, according to Gartner, Inc.

Staying Strong

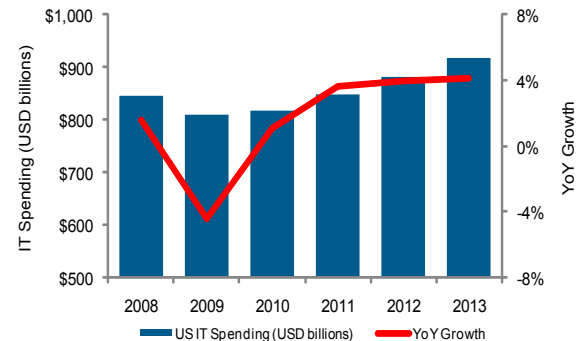
The marketplace is picking up interest from buyers regaining their appetite for technology companies. This revived appetite stems from shelving M&A activity a year ago, in order to preserve cash and restructure spending. Corporate cost cutting and inventory reductions even as profits recover have led to climbing cash balances upward of \$1.84 trillion, according to data from the Federal Reserve, the highest percentage since the 1960's. Private equity firms are re-emerging to the buyer marketplace as the debt markets continue to improve.

Companies are feeling the pressure to stay ahead of the competition and acquire into strong vertical markets or gather new technology. Buyers are paying more for small, innovative companies in high-growth areas with long-term potential, according to a report by Ernst & Young.

Software Watch

Two strong themes continued in the 2nd quarter; consolidation driven by leveraging distribution channels and the speed of acquiring new technology versus development. Oracle continues to lead in the consolidation strategy making multiple acquisitions of established vertical market leaders to leverage its superior distribution infrastructure, such as their Q2 acquisition of Phase Forward, a leading clinical research services firm with focus in pharmaceuticals, medical devices, and biotechnology. They and other major players in software will continue with this strategy.

US IT Spending



Source: Gartner

Google is quickly becoming the leading acquirer of technology. Its focus appears to be less on established players and more on small tech leaders with 9 transactions the first half of 2010, including On2. They will continue to be a major factor in driving competitive acquisitions and we expect Google's appetite to grow for larger deals.

Renewed Appetite

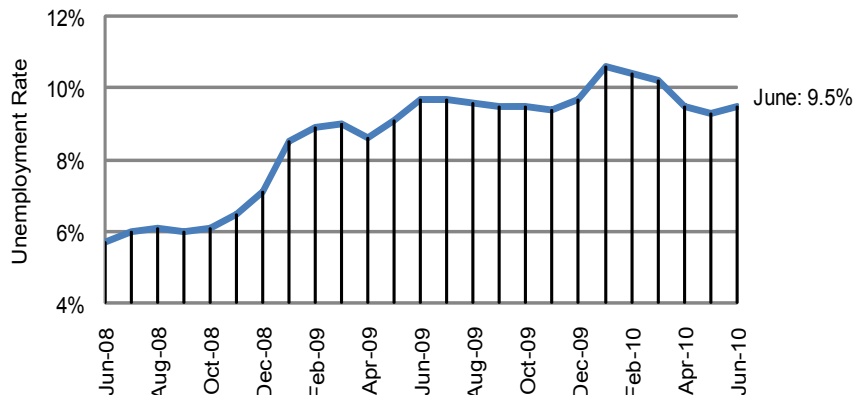
Private equity is starting to benefit from the continued recovery of the debt market and becoming more competitive. Private equity buyers are seeking small to mid-sized niche software and services companies. Some examples of relevant investments taking place in Q2 of 2010 are Apex Partners Worldwide majority purchase of Sophos Pic, an information technologies and business solutions company, and Oak Hill Capital Partners purchase of Viawest Internet Services.

Capital Spending Bouncing Back

Capital equipment and technology spending is recovering more quickly than expected. Companies are reaching maximum productivity with current resources and looking elsewhere to continue to improve and expand. This trend is expected to continue into the second half of 2010, as more firms make capital investments and acquisitions to increase revenues and productivity. According to Gartner, semiconductor spending in 2010 is expected to reach \$35 billion, a 113% increase over spending in 2009. We anticipate the semiconductor and networking sectors to benefit greatly as competition for new technology heats up.

Macroeconomic Factors

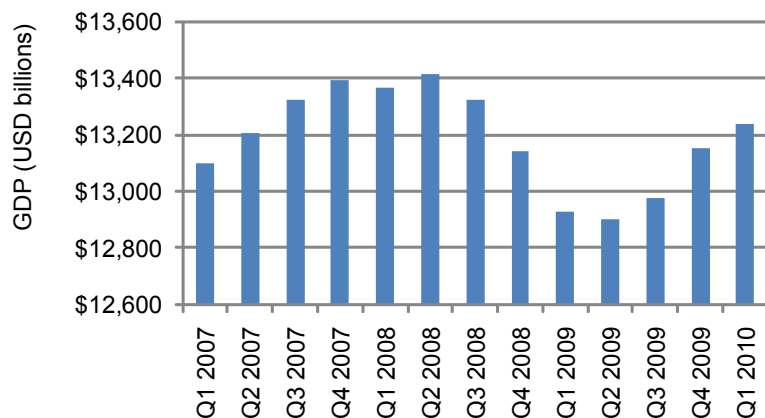
US Unemployment



Source: Bureau of Labor Statistics

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.

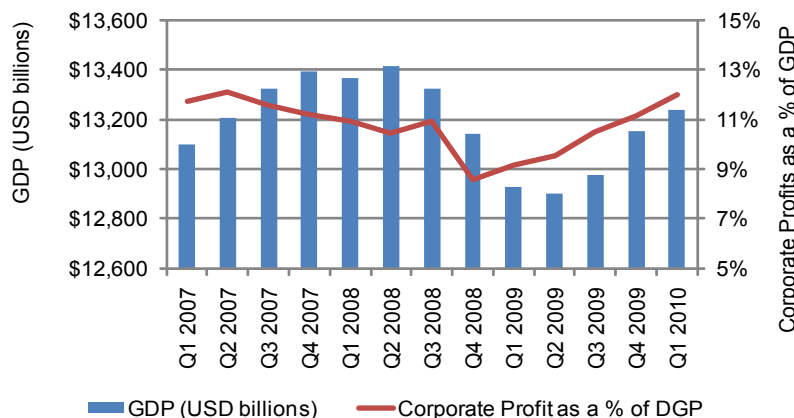
US Real GDP



Source: Bureau of Economic Analysis

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 vs. GDP



Source: Bureau of Economic Analysis

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.

Technology M&A Activity

	Deal Volume	Transaction Value (\$mm)	Median EV / Revenue	Median EV / EBITDA
Application Software	31	\$3,679	1.8x	7.4x
BPO	3	961	9.1	-
Consulting	6	132	0.6	11.5
Infrastructure Software	9	1,703	2.4	12.9
Internet & Digital Media	12	886	2.3	4.5
IT Services	18	1,171	0.6	9.4
IT Services - Government	2	87	1.8	-
Network Communications	16	1,860	1.1	7.0
SaaS	9	977	2.7	18.0
Semiconductor	8	1,366	9.2	-
Transaction Processing	3	411	-	-
Total	117	\$13,233	3.2x	10.1x

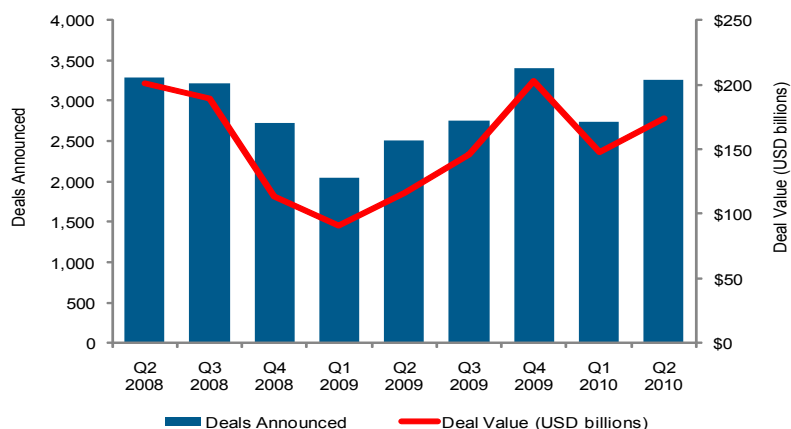
Sources: Capital IQ and 451 Group

Selected Technology Transactions

Category	Announcement Date	Target	Acquirer	Enterprise Value (\$mm)	Enterprise Value to Revenue	Enterprise Value to LTM EBITDA
Application Software	Apr-10	Phase Forward <i>Clinical research software</i>	Oracle <i>Enterprise software solutions</i>	\$591	2.7x	20.0x
Application Software	Apr-10	Symyx Technologies <i>Research data management software</i>	Accelrys <i>Software solutions for scientific development</i>	101	0.7	6.4
Application Software	Jun-10	TTI Team Telecom International <i>Operations support systems</i>	TEOCO <i>Network cost optimization solutions</i>	32	0.8	7.4
Infrastructure Software	May-10	Double-Take Software <i>Virtual infrastructure software</i>	Vision Solutions <i>Data management and recovery solutions</i>	154	1.8	11.1
IT Services	Jun-10	Intelligroup <i>Software applications, tools, and services</i>	NTT Data International <i>Research and facility management services</i>	174	1.4	10.7
IT Services	Apr-10	Morse <i>Application and infrastructure services</i>	2e2 Group <i>IT managed services and solutions</i>	81	0.2	3.1
Network Communications	May-10	Teleset Networks <i>Telecommunication services</i>	Volgatelecom <i>Telecommunication services</i>	137	4.4	7.5
Network Communications	May-10	AGC Networks <i>Business communication systems</i>	Essar Capital Finance <i>Industrial diverse investment firm</i>	75	0.6	6.4
SaaS	Jun-10	DivX <i>Media enhancement</i>	Sonic Solutions <i>Digital media management</i>	193	2.6	-
SaaS	May-10	Dynamic Change <i>Online governance software</i>	Allocate Software <i>Workforce management solutions</i>	13	2.8	18.0

Sources: Capital IQ and 451 Group

Overall Middle Market M&A Activity



Sources: Capital IQ and 451 Group

Note: Statistics include announced mergers and acquisitions with disclosed value of less than \$1 billion

Software continues to be the focus of Technology M&A activity in the second quarter of 2010, as Application Software leads in terms of deal volume. The Infrastructure Software sector posted an average deal value of \$189 million, with a median EBITDA multiple of 12.9x.

More than 3,200 deals were announced in Q2 of 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.

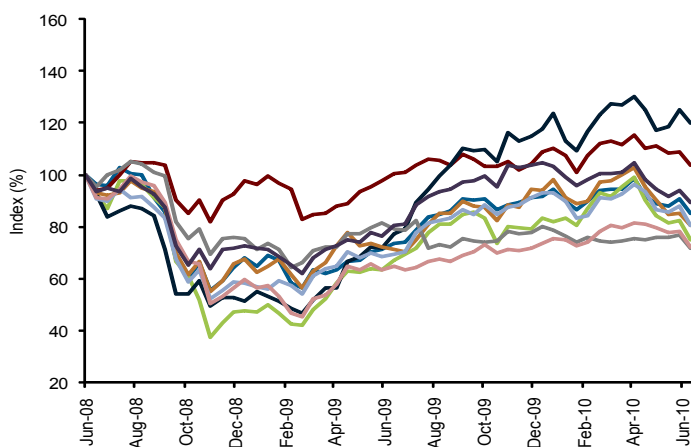
Public Trading Comparables

	Stock Price Change			EV / Revenue		EV / EBITDA		P / E	
	3 months	6 months	12 months	2009E	2010E	2009E	2010E	2009E	2010E
Application Software	(4.2%)	(2.9%)	25.8%	2.7x	2.5x	12.9x	8.3x	27.0x	16.8x
Infrastructure Software	(7.8)	(5.7)	20.1	2.1	2.0	9.4	8.3	15.2	14.1
Internet & Digital Media	(12.6)	(11.3)	2.7	1.7	1.7	11.7	6.6	21.2	23.8
IT Services - Corporate (Large Cap)	(11.5)	(2.7)	21.2	0.5	0.9	6.3	6.0	14.9	14.1
IT Services - Corporate (Mid Cap)	(11.7)	(12.2)	16.2	0.8	0.6	9.8	7.1	19.8	13.9
IT Services - Government	(10.5)	(11.6)	(0.5)	0.7	0.6	8.3	6.9	15.4	15.1
IT Services - Healthcare	(5.5)	(3.4)	10.8	2.1	2.4	11.1	10.4	28.2	25.5
IT Services - Offshore	(9.3)	(1.4)	76.2	3.1	2.8	13.4	13.4	29.6	14.4
Network Communications	(19.9)	(12.7)	1.2	0.9	1.0	8.2	7.2	24.6	14.7
SaaS	(10.5)	(8.8)	31.1	3.0	2.8	21.5	12.3	28.2	23.4
Semiconductor & Equipment	(12.7)	(8.4)	36.5	2.3	1.3	10.3	7.5	26.2	15.4
Overall Median	(10.5%)	(8.4%)	20.1%	2.1x	1.7x	10.3x	7.5x	24.6x	15.1x

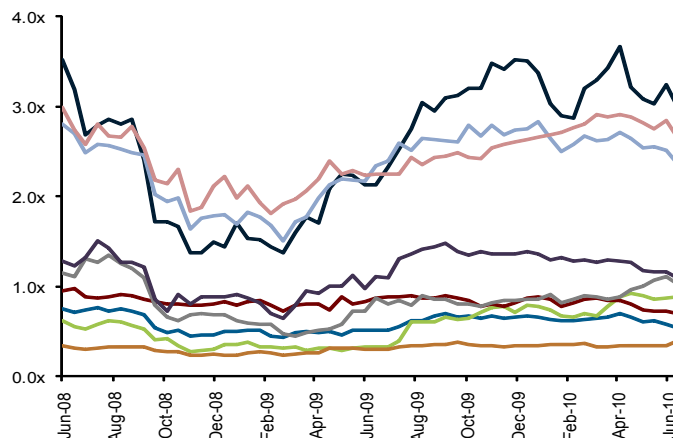
	Index Price Change		
	3 months	6 months	12 months
NASDAQ Composite Index	(12.2%)	(7.0%)	14.9%
Dow Jones Industrial Average	(10.6)	(6.3)	15.7

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

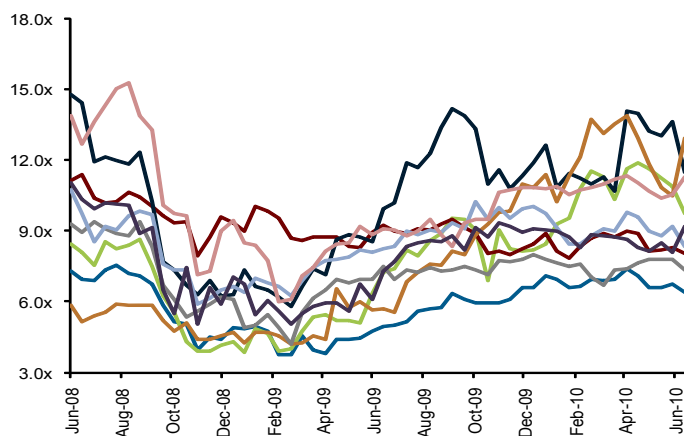
Stock Performance



EV/Revenue Multiples



EV/EBITDA Multiples


















Legend

- Application Software
- Infrastructure Software
- Internet & Digital Media
- IT Services - Corporate (Large Cap)
- IT Services - Corporate (Mid Cap)
- IT Services - Government
- IT Services - Healthcare
- IT Services - Offshore
- Network Communications
- SaaS
- Semiconductor & Equipment

Sources: Capital IQ and company filings

Covington Associates

Recent Transactions

 <p>acquired by</p> <p>NEW ENGLAND CAPITAL AND CLARKSTON MERCHANT PARTNERS</p>	 <p>has acquired</p> 	 <p>acquired by</p> 	 <p>entered into a development partnership with</p> 
 <p>acquired by</p>  <p>\$133,000,000</p>	 <p>acquired by</p> 	 <p>HEMODIALYSIS CATHETER BUSINESS</p> <p>acquired by</p>  <p>\$12,500,000</p>	 <p>acquired by</p>  <p>\$6,500,000</p>

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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