

Technology Mergers & Acquisitions Review

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The Year in Review

– With the NASDAQ surging an impressive 46% in 2003, it is easy to forget that the first quarter of the year was shaping up to be another chapter in a nearly 3-year-old bear market. Uncertainty over the timing of the U.S. invasion of Iraq and its impact on the deficit and economic stability weighed heavily on the stock market and largely overshadowed the improving economic picture. Even though the first trading days of the year saw the NASDAQ set a blistering pace, these gains were quickly erased by mid-January as prewar fears and mixed visibility on economic growth stifled the stock market. The low point for the NASDAQ turned out to be March 11th when the index closed at 1114.1 (3 years and a day after the index hit its all-time high closing price of 5048.6). As the battle in Iraq ignited on March 19th, the NASDAQ began its unwavering ascent to over 2000 by the end of the year, representing an 80% gain off the March 11th low. For the entire year, NASDAQ rose 46%, essentially recouping all of its losses since the beginning of 2002. The broader markets also registered impressive growth as evidenced by the 26% gain in the S&P500 index for the year. 2003 marked the first time in three years that all major U.S. stock market indices showed year-over-year gains.

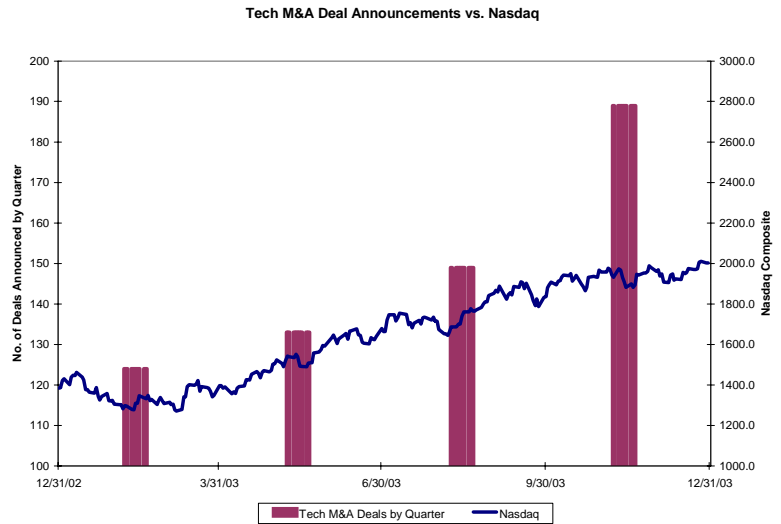


Figure 1

Strong GDP growth in the second half of 2003 provided the structural foundation for a Tech sector recovery. As business activity improved during the year, corporate IT departments released more of their budgets, and the long awaited upgrade cycle finally seemed to take hold. This IT spending recovery was rapidly reflected in stock prices as quarterly updates by industry CEOs suggested improving revenue prospects. The Tech IPO market returned with impressive showings from companies such as iPass, Tessera and Callidus, and venture capital activity showed improving momentum.

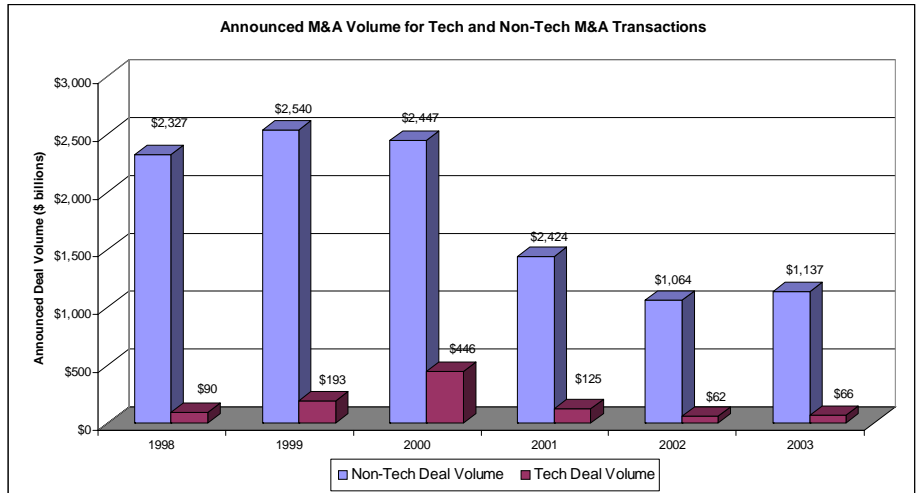
Rising stock values and improving business prospects fueled the beginnings of a rebound in the Tech M&A market as relieved sellers (relieved to see values finally move off the bottom) met anxious buyers (anxious to execute M&A deals before valuations moved too far ahead). The volume of announced deals accelerated consistently after a Q1 trough (see Figure 1). IT Security and Infrastructure Management Software were among the stronger Tech M&A sectors, with EMC offering an impressive \$3 billion+ for Documentum, Legato and VMWare.

We expect the Tech M&A market to continue its ascent in 2004 as stronger market valuations and recovery in IT spending create a solid base for executing strategic growth plans. Consolidation among maturing sectors (like ERP software) and overcrowded sectors (like Security software) will likely dominate Tech M&A activity.

2003 Tech M&A Overview

After a very slow start in the first half of 2003, announced M&A dollar volume increased steadily in the second half of the year, ending up at \$1.2 trillion for all sectors, including \$66 billion for Tech deals.

Tech M&A dollar volume was higher by 7.3% in 2003 over 2002 with the corresponding deal count higher by 14.9%. As was the case in 2002, Tech M&A deal announcements tended to follow the movement of the public stock markets, and as valuations rose in the public market, sellers and buyers became more aggressive toward deals. The fourth quarter saw a large increase in M&A deal announcements as the stock market continued its ascent, and buyers and sellers sought to close deals by year end (see Figure 1).



Source: Bloomberg
Announced Worldwide M&A Transactions with greater than \$10 million equity value

Figure 2

Financial buyers' interest in Tech companies waned throughout the year as the rising valuation tide began to price financial buyers out of the market. Nonetheless, a number of management led buyouts were attempted early in the year when many Tech companies traded at near cash per share values (i.e., insiders from both Resonate and Register.com announced attempts to undertake MBOs – although neither was successful). Strategic deals in 2003 fell largely into two camps: (i) those motivated by the need for consolidation in maturing sectors and (ii) those motivated by adjacent market moves.

The consolidation theme prevailed in the Enterprise Software sector with a large number of M&A deals completed during the year. Peoplesoft's acquisition of JD Edwards followed by the Oracle/Peoplesoft saga suggests that titans in this sector have acknowledged the maturation of their core product areas and are now seeking to establish themselves as long-term survivors. Other deals in the Enterprise SW space demonstrate this trend including: Chinadotcom/Ross Systems, Open Text/IXOS, Melita/Concerto, Sage/Accpac and others.

Expansion into adjacent markets was an equally powerful theme in Tech M&A market 2003. EMC's acquisition strategy

allowed the storage hardware vendor to expand into the evolving content management software arena, leveraging its core offering. Using a strong share price as currency, EMC acquired Legato, Documentum and VMware in rapid-fire fashion to solidify its position in the content management space. Microsoft filled a gap in its product line with the acquisition of Placeware, Cisco re-entered the SOHO market through its acquisition of Linksys, and Network Associates moved into intrusion prevention with its acquisition of Enterscept Technologies. Some of the more notable deals of the year are highlighted in Figure 3.

Selected Tech M&A Transactions of 2003				
Announcement Date	Target Company	Acquirer	Transaction Value (\$ millions)	Form of Consideration
06/06/03	PEOPLESOFT INC	ORACLE CORP	6,298.3*	Cash
09/22/03	SCHLUMBERGERSEMA	ATOS ORIGIN	1,590.0	Cash and Stock
10/14/03	DOCUMENTUM INC	EMC CORP/MASS	1,541.7	Stock
06/02/03	JD EDWARDS & CO	PEOPLESOFT INC	1,349.9	Cash and Stock
07/14/03	OVERTURE SERVICES INC	YAHOO! INC	1,370.0	Cash and Stock
07/08/03	LEGATO SYSTEMS INC	EMC CORP/MASS	1,241.0	Stock
11/03/03	GLOBESPANVIRATA INC	CONEXANT SYSTEMS INC	896.0	Stock
07/18/03	CRYSTAL DECISIONS INC	BUSINESS OBJECTS	820.0	Cash and Stock
09/22/03	HOTWIRE.COM	INTERACTIVECORP	685.0	Cash
12/15/03	VMWARE INC	EMC CORP/MASS	635.0	Cash
03/20/03	LINKSYS GROUP INC/THE	CISCO SYSTEMS INC	500.0	Stock
01/06/03	PROBUBINESS SERVICES INC	AUTOMATIC DATA PROCESSING	518.0	Cash
10/06/03	NEOTERIS INC	NETSCREEN TECHNOLOGIES INC	265.0	Cash and Stock
01/21/03	PLACEWARE INC	MICROSOFT CORP	200.0	Not Disclosed
10/21/03	IXOS SOFTWARE AG	OPEN TEXT CORP	216.7	Stock
01/24/03	OKENA INC	CISCO SYSTEMS INC	154.0	Cash and Stock
09/23/03	POWERQUEST CORP	SYMANTEC CORP	150.0	Cash
04/04/03	ENTERCEPT SECURITY TECHNOLOG	NETWORK ASSOCIATES INC	120.0	Cash

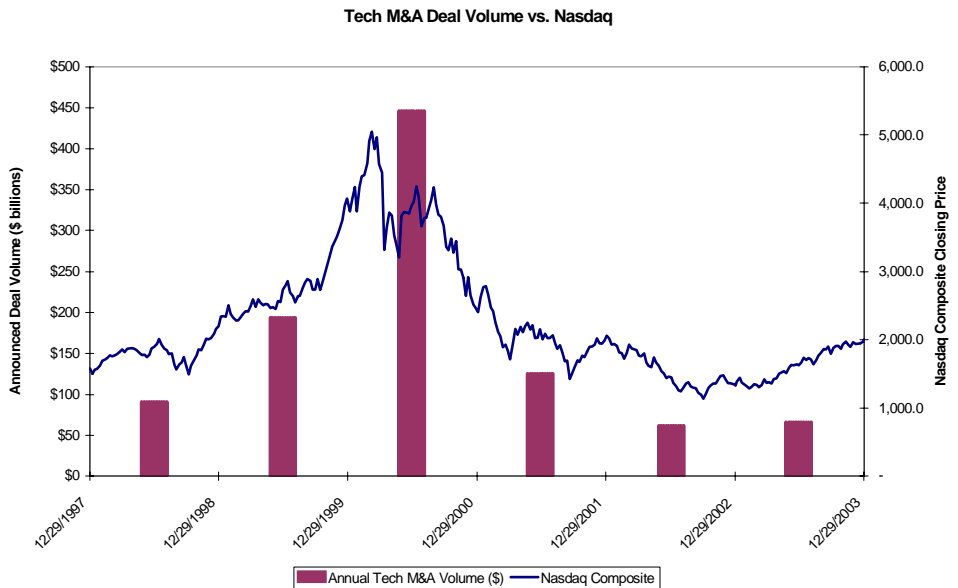
Source: Bloomberg and Update Capital
* Transaction value reflects Oracle's raised offer of \$26 a share.

Figure 3

2003 Tech M&A Overview (continued)

After peaking in 2000 at \$466 billion, Tech M&A deal announcements dropped to a low of \$62 billion in 2002 before showing a 7.3% improvement to \$66 billion in 2003. The improvement represented a welcome departure from the challenging environment of the past 2 years. Looking more closely at the data, smaller and mid-size deals continued to outpace larger deals (see Figure 5). Large Tech M&A deals (over \$500 million) actually declined in 2003 vs. 2002 (24 transactions in 2003 as compared to 29 such transactions in 2002). Industry fragmentation is reflected in the fact that the core Tech M&A market remains in the sub-\$250 million range, with deals in excess of \$500 million being the exception.

In 2003, average deal size for Tech M&A transactions declined slightly again. The average deal announced was \$111 million, a 7% drop from the 2002 level of \$119 million (see Figure 5).



Source: Bloomberg
Includes announced worldwide Tech M&A transactions of greater than \$10 million Equity Value

Figure 4

The trend to smaller deal sizes is best explained by (i) lower overall valuations and (ii) the large number of M&A deals coming from venture capital portfolios that were assembled in the 1998 – 2000 period. Many of these investments are being sold through the M&A process rather than through the IPO market.

Tech M&A Transactions by Deal Size						
Announced Transaction Value	2002 Tech M&A Deals			2003 Tech M&A Deals		
	Deals	Agg. Value (\$ mm)	Avg. Size (\$mm/deal)	Deals	Agg. Value (\$ mm)	Avg. Size (\$mm/deal)
\$1,000 +	7	\$15,170		12	\$18,918	
\$500 - \$1,000	22	15,840		12	7,624	
\$250 - \$500	25	8,420		35	12,257	
\$100 - \$250	57	9,040		81	12,081	
\$50 - \$100	78	5,550		98	7,106	
\$10 - \$50	329	7,620		357	8,126	
Totals	518	\$61,640	\$119	595	\$66,112	\$111

Source: Bloomberg
Includes announced worldwide Tech M&A transactions with greater than \$10 million Equity Value

Figure 5

Tech M&A vs. Total M&A (\$ billions)							
	Dollar Volume of Transactions (Equity Value)			Number of Transactions			Average Tech M&A Deal Size (\$ millions)
	Total M&A	Tech M&A	Tech as a % of Total	Total M&A	Tech M&A	Tech as a % of Total	
1998	\$2,418	\$90.5	3.7%	5,395	232	4.3%	\$390
1999	2,733	193	7.1%	6,023	453	7.5%	\$426
2000	2,892	446	15.4%	7,304	1,117	15.3%	\$399
2001	1,563	125	8.0%	5,683	792	13.9%	\$158
2002	1,125	62	5.5%	5,214	518	9.9%	\$119
2003	1,203	66	5.5%	5,663	595	10.5%	\$111

Source: Bloomberg
Includes all worldwide M&A transactions of \$10 million Equity Value or greater

Figure 6

Compared to the overall M&A market, Tech M&A volume contributed a mere 5.5% of all M&A, substantially off its 2000 peak of 15.4% during the "Tech Bubble" (See Figure 6). This partly reflects more realistic deal valuations than was seen in 2000.

We expect the current Tech M&A trends to continue into 2004. Consolidation will remain a central theme particularly in the more mature sectors such as Enterprise Software and the over-crowded areas such as Security.

2003 Technology Equity Capital Markets Review

IT stocks rebounded sharply in 2003, outperforming other industry sectors (see Figure 7) in a year where capital markets broadly benefited from improved economic fundamentals, notably steep GDP growth in second-half 2003. While the S&P tech sector posted a 47% rise, the increase is much higher when small cap stocks are included: Morningstar's index of 1,150 technology stocks rose 137% and Updata's 12-month universe of 190 software stocks rose a mean 179%. Attesting to the IT recovery's breadth, 96% of software stocks in the Updata index posted gains during the year, and a full 94% of the S&P 500 finished the year in positive territory.

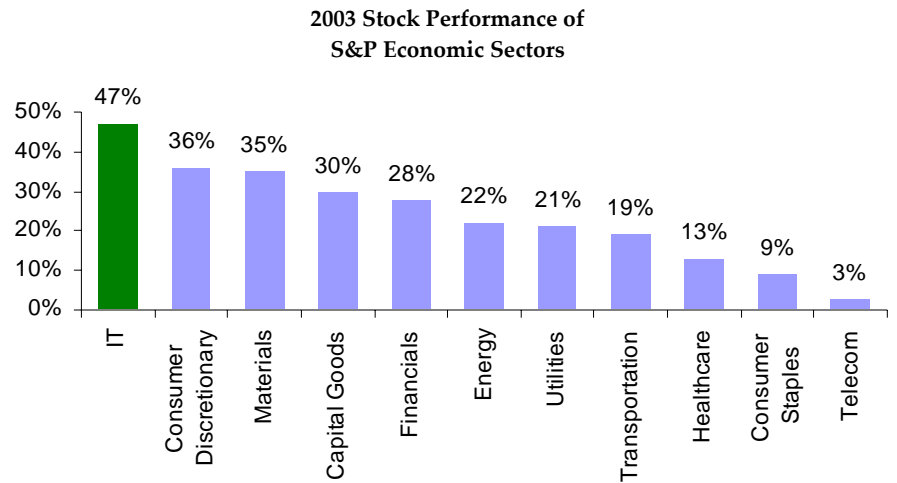


Figure 7

Improved profits drove much of the price gains, with IT firms registering the highest average earnings increases among industry sectors, according to Thomson Financial/First Call. While revenues also grew, aggressive cost-cutting drove a major portion of 2003's earnings growth. Although future IT demand growth remains a key question heading into 2004, institutional investors appeared comfortable with equity gains at year-end, as demonstrated by stable S&P put/call ratios through the end of 2003.

On the IPO front, 17 technology companies went public in the U.S. in 2003 (see Figure 8), up from 15 in 2002; IPO proceeds totaled \$1.9 billion, slightly below 2002's \$2.1 billion. While this data suggests a delayed tech IPO recovery, building momentum points to a much stronger 2004. Tech IPOs performed much better in 2003 than in 2002, finishing the year up 21% on average, versus 9% in 2002. Also, 2003 saw consecutive quarterly increases in overall venture-backed IPOs, to 21 in Q4, the best quarter since Q4 2000 according to the National Venture Capital Association.

Class of 2003 Technology IPOs						
Offering Date	Issuer	Shares Offered (millions)	Offering Price	Aggregate Proceeds (millions)	December 31 Closing Price	Price Performance
05/12/03	iPayment Inc.	5.0	\$16.00	\$80	\$33.89	111.8%
06/12/03	FormFactor Inc.	6.0	\$14.00	84	\$19.80	41.4%
07/10/03	Digital Theater Systems Inc.	3.8	\$17.00	65	\$24.69	45.2%
07/17/03	Intervideo Inc.	2.8	\$14.00	39	\$11.75	-16.1%
07/24/03	iPass Inc.	7.0	\$14.00	98	\$16.01	14.4%
07/30/03	Path 1 Network Tech	1.3	\$10.80	14	\$6.80	-37.0%
07/31/03	NETGEAR Inc.	7.0	\$14.00	98	\$15.99	14.2%
09/19/03	SigmaTel Inc.	10.0	\$15.00	150	\$24.68	64.5%
09/24/03	AMIS Holdings Inc.	30.0	\$20.00	600	\$18.28	-8.6%
10/10/03	DigitalNet Holdings Inc.	5.0	\$17.00	85	\$19.52	14.8%
11/13/03	Tessera Technologies Inc.	7.5	\$13.00	98	\$18.81	44.7%
11/20/03	Callidus Software Inc.	5.0	\$14.00	70	\$17.69	26.4%
11/25/03	SYNNEX Corp.	5.4	\$17.00	92	\$13.76	-19.1%
11/26/03	Open Solutions Inc.	5.0	\$17.00	85	\$17.60	3.5%
12/11/03	NPTest Holding Corp.	14.6	\$12.00	175	\$11.04	-8.0%
12/16/03	Webzen Inc.	8.7	\$11.17	97	\$10.39	-7.0%
12/19/03	Kintera Inc.	5.0	\$7.00	35	\$12.40	77.1%
Total IPO Volume				\$1,964.7		

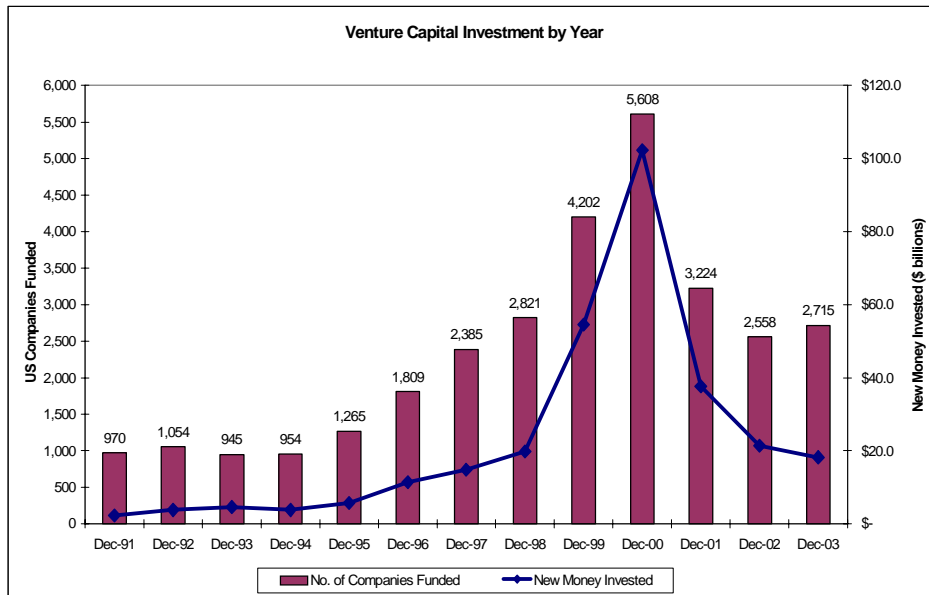
Source: Bloomberg and Updata Capital

Figure 8

registration pipeline and widely anticipated IPOs, e.g., from Google and Salesforce.com, also point to a robust 2004 tech IPO recovery.

Fueled by the rising equity market, technology secondary offerings in 2003 more than doubled to 55, from 23 in 2002, and raised \$9.6 billion in support of operations and acquisitions. Eighty-two percent of tech follow-on offerings occurred in the second half of 2003, with activity growing in direct relation to the rise in the NASDAQ.

2003 Technology Venture Capital Review



Source: PriceWaterhouseCoopers/Thomson Venture Economics/National Venture Capital Association MoneyTree™ Survey and VentureWire

Figure 9

The number of U.S. venture investments grew 6% in 2003 to 2,715 companies funded, according to Thomson Venture Economics (see Figure 9). This growth, while modest, marks the first time since 2000 that venture investing activity has grown. Although the amount of new investment dollars declined 15% last year to \$18.2 billion, this decrease is much smaller than the 2002 and 2001 declines of 43% and 63% respectively, and supports the widely shared view that VC activity troughed last year and began to pick up steam in late 2003. Large new fund closings in Q4 (see Figure 11) attest to this building momentum.

IT continued to command the lion's share of investment dollars in 2003, 64% versus 68% in 2002, based on data in The Deal's venture database (see Figure 10). The biggest sector changes were a 50% decline from 2002

to 2003 in the proportion of new VC investments in Internet infrastructure, commerce and service investments, and a 14% rise in software and hardware investments.

IPOs began returning as a liquidity option for venture-backed companies during 2003, with volume building each quarter. According to Thomson Venture Economics, 29 VC-backed companies – including nine in the tech sector – completed IPOs in the U.S. in 2003, up 32% from 2002. More than half, or 17, occurred in the fourth quarter, a level unseen since Q4 2000 and equaling the number of IPOs priced in the prior five quarters combined. M&A liquidity events for VC-backed firms declined slightly in 2003, to 252 M&A exits versus 290 in 2002. However, within IT sectors M&A activity has firmed. For example the number of Financial Technology and IT Security Transactions grew in 2003 over 2002. Overall, M&A valuations have started increasing in sympathy with the equity market.

U.S. VC Investments by Sector

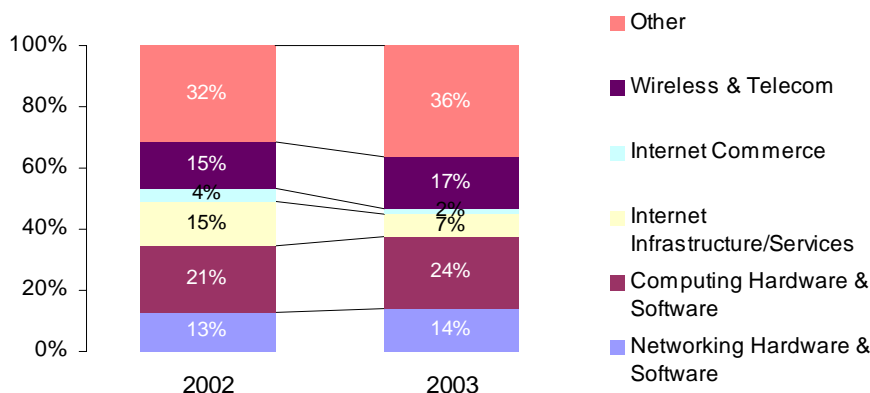


Figure 10

Top Five New Funds Closed in Q4 2003

	(\$ millions)
NEA Fund 11	\$945
Tech. Crossover Ventures V	814
Venrock Associates IV	550
Domain Partners VI	500
Three Arch Partners IV	450
Total Funds Raised	\$3,359

Figure 11

2004 Market Outlook

On balance, the global economic outlook continues to improve, and evidence supports further strengthening of the IT industry in 2004, barring surprise negative external events such as an energy price spike or major global unrest.

A CIO survey undertaken by Morgan Stanley in late 2003 predicts 5% IT budget growth in 2004. This is reaffirmed by Gartner, which also forecasts 5% growth, as well as by other analysts. The rate understates higher growth in certain key tech sectors, notably software and outsourcing-related services, which are expected to grow in the range of 10% or more in 2004. Street estimates indicate certain IT sub-segments, such as security and storage among other infrastructure areas, are expected to post even higher growth.

In the technology equity markets, the consensus view is that 2004 price gains will moderate versus 2003, but that the market will continue to remain positive. From an historical standpoint, overall P/E ratios remain defensible (see Figure 12). At the same time, most of the cost reductions that enhanced earnings growth last year have been taken, and many tech companies will run up against challenging comparisons in late 2004, as earnings from last year's second half were particularly strong. It should also be noted that financial results of large bellwether companies with heavy international exposure (e.g. Microsoft, IBM, H-P, Oracle) were helped in 2003 by currency fluctuations that are unlikely to recur in 2004. This does not ignore significant performance improvements during 2003, which continue to date and will likely drive further gains in the primary and secondary equity markets. Growth in tech M&A activity, widening of the IPO window and new technologies will also support improved equity market performance in 2004. This in turn will help drive the rebound in VC investment levels, a trend that began taking root late last year. Within IT, expect sector investment rotation to drive varying performances by IT sector.

Product development demand drivers to be watched include: (1) increased wireless and broadband penetration in the home and small-business markets. This will help drive adoption of subscription software models and strengthen demand for mobile applications and commerce solutions; (2) expanded demand for all types of outsourcing solutions, which will benefit BPO and IT services firms, as well as hosted businesses such as managed security; (3) convergence of infrastructure software functions, placing a premium value on big-ticket network, storage, identity and security management applications, multifunctional appliances and embedded functionality; and (4) emerging applications within such areas as VOIP, Linux and web services.

A key market dynamic in 2004 will be accelerated consolidation. Despite market concentration at the top of the technology industry, the landscape unquestionably remains highly fragmented. For example, 10 companies garner about 40% of security product spending, according to IDC. The remainder is split up among more than 500 companies, the vast majority of them VC-backed and private. Most of these are too narrowly focused to remain standalone long-term. While the IPO market is recovering, going public represents a realistic option for relatively few such companies. And with the impending recovery of the VC and IPO markets, more companies are receiving funding. The upshot is that most private technology companies will need to be acquired to remain viable long-term. On the supply side of the M&A market, larger and more diversified tech companies, encouraged by the bull market and strong balance sheets, are more aggressively seeking consolidation opportunities among smaller players to fill product gaps and broaden addressable markets. This is consistent with a growing trend among technology buyers favoring fewer vendors capable of providing fuller solutions.

In conclusion, in 2004 one may expect a sharp upturn in tech M&A volumes across most sectors, continued improvements in VC and secondary funding activity, and continued – though likely moderated – gains in overall public market valuations.

Forward P/E Indices over Time

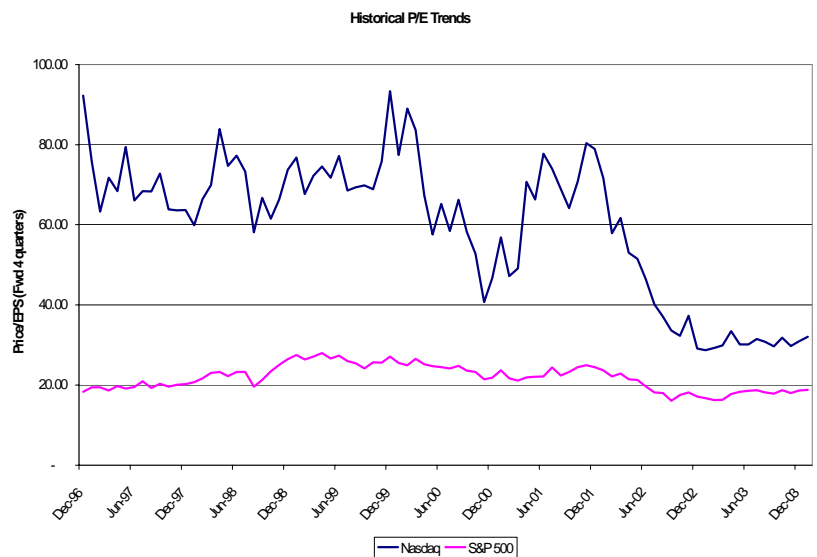


Figure 12

2003 IT Services Review

Udata tracks 69 commercial IT services firms grouped into 6 subsectors whose equity market performance is highlighted at right. Almost every subsector outperformed the NASDAQ in 2003, reversing a trend of several rough years. Interestingly, the sectors that performed best were those hardest hit during the recession, on belief that pent-up demand will release backlogged spending at higher rates than overall economic growth. Trading multiples for the systems

IT Services						
Year-End Net Enterprise Value Mean Multiples and Revenue Growth Rates (a)						
	Forward Revenue (b)		Forward EBIT (b)		Y/Y Rev Growth Rate	Share Price % of 52 Week High
	2003	2004	2003	2004	2003/2002	
IT Services Subsectors:						
Systems Integrators	1.0x	1.0x	17.6x	11.5x	3.0%	87.1%
IT Outsourcers	1.4x	1.3x	10.2x	8.3x	14.7%	94.5%
IT Consultancies	2.3x	2.1x	18.9x	39.1x	14.4%	86.5%
IT Staffing	0.4x	0.4x	10.0x	12.9x	5.4%	85.8%
Vertical Consultancies	1.9x	1.9x	19.8x	12.5x	12.1%	84.8%
Offshore Consulting	8.4x	6.1x	30.5x	26.0x	61.9%	78.6%

(a) Net Enterprise Value equals market value less cash, plus debt and preferred obligations
(b) Multiples for 2003 are based on expected results

integrators and the vertically-aligned consultancies more than doubled year-over-year, while trading multiples for the high-end IT consultancies quadrupled. What these sectors have in common are business models with the least commoditization from a client perspective, fusing technology, broad delivery capabilities and domain knowledge. The index of high-end consultancies in particular, now comprised post-shakeout of a reduced number of stronger firms, saw its market value rise 157% during the year. The index of offshore consultancies was the second-best performer, rising on average 74% during the year. The offshore firms trade at revenue multiples far in excess of most sectors, technology or otherwise, driven directly by their profit and growth. All IT services subsectors experienced year-over-year revenue growth, contrasted with 2002 when almost every sector shrank or remained flat. While recent quarters show a continuation of this important trend, recession-wizened customers continue to demand price concessions and competitive bidding, and competition is as intense as it has ever been. Furthermore, with customers continuing to pare their vendors lists, bigger remains better.

Top 2003 IT Services M&A Transactions by Deal Value						
Closing Date	Seller	Buyer	Enterprise Value (\$MM's)	LTM Revenue (\$MM's)	Multiple of Revenue	
01/30/04	IT services ops of SchlumbergerSema	ATOS Origin	\$ 1,590.0	\$ 2,680.0	0.6x	
Pending	Transciel SA	CGE&Y	523.0	616.6	0.8x	
02/25/03	Cognicase	CGI Group	215.5	336.2	0.6x	
08/01/03	Lockheed Martin (commercial)	Affiliated Computer Svcs	107.0	300.0	0.4x	
01/07/04	Patient Accounting Services Center	Affiliated Computer Svcs	94.0	68.0	1.4x	
01/12/04	Feld Group	EDS	89.0	ND	ND	
11/20/03	Ki Consulting & Solutions	TietoEnator	87.0	107.0	0.8x	
10/27/03	SCB Computer Technology	Ciber	80.4	107.6	0.7x	
07/31/03	APAR Infotech	Ness Technologies	78.0	85.0	0.9x	
Pending	Hall Kinion	Kforce	71.2	162.0	0.4x	

While sector IPO financing activity was non-existent other than few government IT services issues, the volume of M&A activity remained robust. There were 49 M&A transactions involving visible IT services names in 2003 (compared with 47 such transactions in 2002), in addition to a

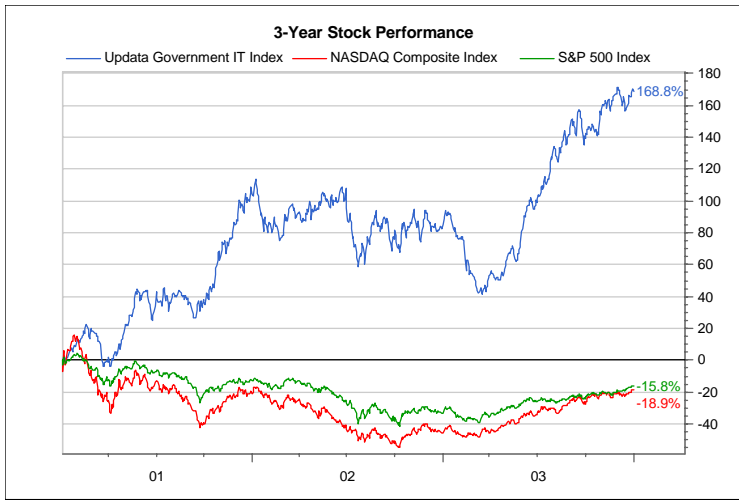
host of smaller deals which did not hit most radar screens. These prominent deals represented a publicly disclosed \$3.3 billion in aggregate transaction value (down from \$9.6 billion in 2002) on \$6.2 billion of revenue acquired (down from \$15.2 billion in 2002). The table above highlights some of the largest deals closed or announced during 2003. The blockbuster deal of the year was clearly Schlumberger/Sema's divestiture of its extensive international IT services business, which was itself the product of Schlumberger's and Sema's many acquisitions over the last decade. The second biggest, largely intra-European, was Cap Gemini's acquisition of French Transciel.

2004 Outlook

As public valuations in the IT services sectors rise, there will be a dual effect on consolidation trends. Public companies' stock is for the first time in many years a viable potential currency for acquisition strategies. On the other hand, M&A transactions by services firms will be closely scrutinized by the investment community for faultless logic and synergy, and sector liquidity is certainly not going to be flush. We may also experience a widening of the valuation gap between buyers' and sellers' expectations. This gap, which had narrowed among private sellers and public buyers -- somewhat painfully -- in the distressed markets of 2002 and 2003, now confronts much healthier public multiples. Private sellers may be less willing to accept trailing, distressed-environment M&A multiples as valid proxies for their business valuations. We also expect cross-border M&A activity to remain strong, and in particular we look for some prominent pairings between Indian and U.S. firms.

2003 Government IT Services Review

2003 has been another exemplary year for the government IT services sector. War, continued terrorist threats and the strong trends toward outsourcing all have continued to fuel the growth that government IT services companies have enjoyed for over 2 years. While the Udata Government IT Index reflects a 45% increase over the past year, the same index is up nearly 170% over the past three years. The robust valuations in this sector held their value over the past year, even as the struggling commercial sector began showing signs of life and offered other positive areas for investment. M&A activity also continued at a robust pace throughout 2003 with over 30 transactions and 2 mega mergers in the sector.



Public offerings

The Capital Markets continued to reward the government IT services sector in 2003. While the number of offerings was significantly down from 2002, each transaction represented a successful offering, demonstrating continued investor appetite. In June, SRA International raised \$91 million in a secondary offering to use for general purposes, including future acquisitions. Anteon completed its secondary in September and raised \$223 million, although all proceeds went to unnamed selling shareholders rather than to the Company. Ending the nearly year-long dry spell of IPOs in this sector, DigitalNet completed its IPO in October, raising \$85 million. After canceling the offering earlier in the year, the company had a successful IPO with the stock trading up more than 15% on the first day of trading.

Deals and Mega Deals

The completion of the CSC / Dyncorp transaction in early 2003 set the stage for a year of robust M&A activity. 2003 was the year of mega deal announcements with the Veridian / General Dynamics and Titan / Lockheed Martin transactions, which further solidified the acquirors in their dominant positions as top tier federal vendors. Together these two deals represented almost \$4 billion of deal value. These deals also further illustrate the premium associated with larger sized deals.

Selected Transactions	Enterprise Value	Revenue Multiple	EBITDA Multiple	1-Day Deal Premium
General Dynamics / Veridian	\$1,484	1.6x	17.8x	28%
Lockheed Martin / Titan	\$2,446	1.5x	19.2x	30%

The pace of consolidation remained strong with over 30 deals announced last year. Deal values ranged from .6x trailing revenue on the low end to 1.6x revenue on the high end. Companies focused on the faster growing DoD and intel markets continued to command a slight premium over civilian agency focused targets. Companies with high barriers to entry, such as security clearances, represented the highest deal multiples. Active acquirors in 2003 were the usual suspects such as CACI, Mantech and MTC, with three transactions each. Aerospace and defense companies also fueled consolidation as they sought to broaden their services offerings, while financial buyers continued to pick over the sector with a notable investment by Arlington Capital in ITS Services and New Mountain in PlanetGov.

2004 Outlook

In 2004, we will continue to see sector consolidation, including a couple mega deals, as the pure play government services companies look for new areas of growth. The President's FY 2005 budget for information technology contains only a 1% increase over the previous year, encouraging acquisition growth over organic growth.

With 7 IPOs and 5 secondary offerings in the past two years, this sector continues to show signs of investor enthusiasm. Maintaining this momentum will be difficult considering the pipeline of companies in the government sector. While the DigitalNet IPO was successful and demonstrated continued investor demand, the supply of good candidates with over \$100 million in revenue is still very uncertain.

2003 IT Security Review

Updata's security stock index leapt 116% in the 12 months ended January 31, 2004, double NASDAQ's rise. Twenty-eight of thirty public security firms tracked by Updata posted price gains in 2003, and trading multiples have rebounded sharply from historic lows. This performance has been fueled by strengthening company fundamentals – e.g., security firms posted 15% average quarter-over-quarter revenue growth in the most recent period – and by universal recognition of the need to harden IT infrastructures against cyber-attack. Within the sector, profitability, acquisitiveness, size and offering breadth all have correlated positively with higher valuations and share price gains.

IT Security Forward Trading Multiples*						
	Enterprise Value/Revs			P/E		
	2001	2002	2003	2001	2002	2003
Mean	5.0x	2.2x	3.7x	61.9x	32.3x	44.4x
Median	3.4x	1.7x	3.2x	60.8x	29.0x	37.7x

*Multiples are of 2002e as of year-end 2001, 2003e as of year-end 2002, and 2004e as of year-end 2003.

The year also saw resurgent M&A and venture investing activity. Updata counted at least 48 security acquisition announcements (including four Updata-managed deals) in 2003, valued at approximately \$2 billion, with average deal value/trailing revenue multiples of 8.2x. By comparison, 32 security deals were recorded in 2002, double that of 2001. Deals announced in 2003 included four acquisitions of public security firms: Rainbow, N2H2, Nexland and Valicert. (Four public security firms were also acquired in 2002: Cylink, Intertrust, McAfee and Visionics.)

Updata recorded 93 investments in private IT security firms in 2003 totaling more than \$810 million, including 24 A rounds. The pace of investments increased in the second half of the year, and informal feedback from investors and private security companies indicates that VC interest and capital availability in the sector has improved.

Largest 2003 IT Security M&A Deals						
Ann't Date	Seller	Buyer	Value (\$ MM)	LTM Rev (\$ MM)	Mult of LTM Rev	Description
Dec-03	Guardent	VeriSign	\$140	\$24	5.8 x	Managed security services provider
Dec-03	Business Layers	Netegrity	\$43	\$10	4.3 x	Identity provisioning
Dec-03	Zone Labs	Check Point	\$205	\$28	7.3 x	Desktop firewall
Nov-03	Waveset	Sun	\$150	\$15	10.0 x	Identity provisioning
Oct-03	Rainbow (merger)	Safenet	\$457	\$136	3.4 x	Tokens, anti-piracy, SSL acceleration
Oct-03	Neoteris	Netscreen	\$265	\$32	8.3 x	Virtual VPNs
Apr-03	Entercept Security	Network Associates	\$120	\$8	15.0 x	Host-based intrusion prevention
Apr-03	Intruvert	Network Associates	\$100	\$2	50.0 x	Network intrusion prevention
Jan-03	Okena	Cisco Systems	\$154	\$5	30.8 x	Intrusion prevention management

2004 Outlook

Security is one of the most dynamic technology sectors. As threats and protection needs continually evolve, analysts broadly expect demand to increase at a faster pace than in other infrastructure areas. Within the \$14 billion security software market, growth opportunities include vulnerability/patch management, spam blocking (although dozens of players have entered the space or been funded in the past 18 months), intrusion prevention (see prior spam comment), security event management (including outsourcing of the monitoring function through MSSPs), compliance management, identity management, and high-assurance authentication (e.g., USB-based access tokens, where market demand is doubling each year).

We have long maintained, and continue to believe, that the security market remains overly fragmented and will continue consolidating. That pace is likely to accelerate in 2004 given a strengthened market, and growing preference among investors and customers alike for broad solutions delivered by companies with staying power and critical mass. Increasingly, likely acquirors will be large public companies, like CA, Cisco, Microsoft and Sun, seeking to embed security into their offerings.

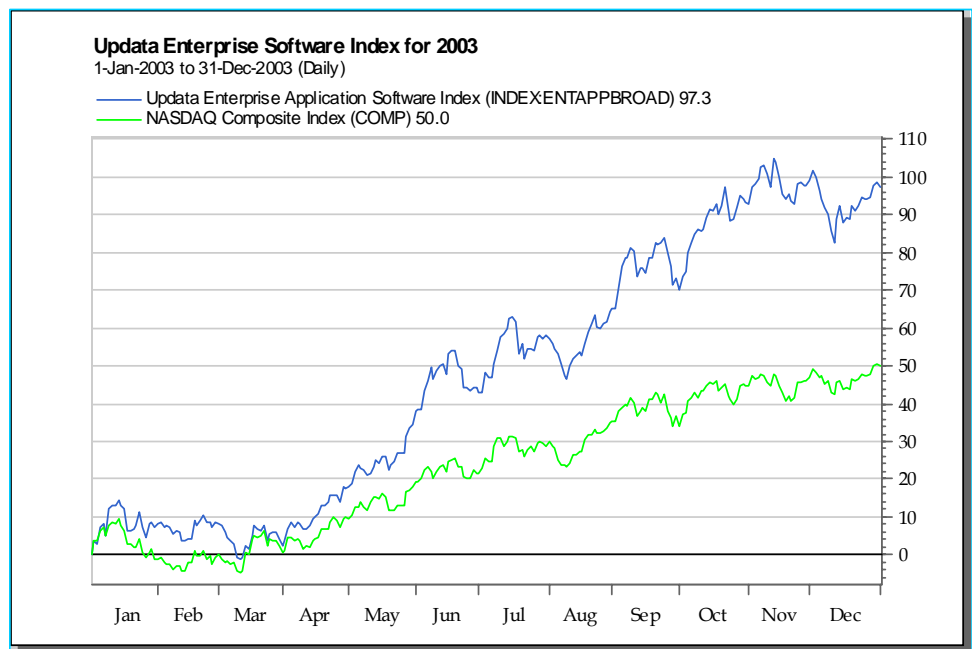
2003 Enterprise Application Software Market Review

Equity markets have staged a solid comeback after posting three years of disappointing performance. The NASDAQ was up an impressive 50% in 2003 but was dwarfed by the 97% increase in Udata's Enterprise Application Software Index. A combination of macro and micro economic factors contributed to the tremendous gains. The progress made in Iraq and the battle against terrorism has provided some positive momentum in the broader economy which we have not experienced since 9/11.

Gone from the Application Software market is the complete lack of visibility on the top-line which characterized late 2002 and early 2003. In its place are guarded optimism and a return to modest growth expectations.

As evidenced by our analysis of the sector, the average revenue growth was modest at 8%. This average is skewed by the leaders in Business Intelligence, particularly Cognos, Ascential and Hyperion (average growth of 28%) and the leaders in the middle market ERP sector such as Chinadotcom and Mapics. It should be noted that much of the growth exhibited by these companies has less to do with improving economic conditions and more to do with active M&A strategies.

The Business Intelligence sector finally started to consolidate in 2003 as many had been predicting and the activity was highlighted by a number of marquee deals, including the Business Objects/Crystal Decisions and Hyperion/Brio transactions.



After an active 2002, the middle market ERP sector also was active as the market further consolidated, highlighted by SSA/Baan, Epicor/Scala, and Frontstep/Mapics.

The long awaited consolidation in the supply chain space appears to have begun. With hundreds of small companies and no dominant pure play, we expect consolidation in the sector to accelerate in 2004. Most of the transactions in 2003 involved smaller private companies, but the most notable deal in the space was the acquisition of EXE by SSA.

2004 Outlook

The current rebound in the public markets and the broader economy are pushing companies to more aggressively pursue strategic opportunities. With a relatively tight public market over the past two years, access to new equity capital has been limited. As a result companies have taken a conservative approach to deploying capital towards strategic M&A. The opening of the public markets has allowed public companies access to new equity capital and consequently increased interest in pursuing strategic M&A opportunities. These dynamics will result in a more active M&A market and consequently an expansion of M&A multiples.

2004 should see particularly strong activity in Supply Chain Management and segments around the SMB marketplace. Strategic deals should be more prominent as purely financial buyers will find it difficult to compete as valuations creep up.

2003 Infrastructure Management Software Review

Udata's Infrastructure Management Software Index outperformed the NASDAQ by a wide margin in 2003, delivering price appreciation of over 76% for the year. Infrastructure management vendors benefited from an intense focus by enterprise customers on improving the efficiency of IT operations that grew increasingly complex during the bubble years.

To address this complexity, virtually every major infrastructure management software vendor has adopted a CIO-level marketing position emphasizing more efficient IT management. Examples include storage vendor EMC's Information Lifecycle Management marketing theme. BMC and Mercury Interactive have announced strategies around Business Service Management and Business Technology Optimization, respectively. Hewlett-Packard refers to its strategy as Adaptive Enterprise while Sun's N1 strategy targets data center automation.

The need to deliver on these marketing messages drove a very active M&A environment for vendors of infrastructure management software. Symantec continued its acquisition spree with the purchase of configuration management vendor ON Technology. Deals targeting private configuration management vendors included IBM's acquisition of Think Dynamics, Sun's transaction with CenterRun (following its late 2002 acquisition of Terraspring) and Hewlett-Packard's acquisition of web services management vendor Talking Blocks.

Another prominent trend that continued from 2002 was the consolidation of application management vendors. Veritas closed its acquisition of sector leader Precise Software at mid-year, while Mercury Interactive acquired private firm Performant in addition to its acquisition of IT governance vendor Kintana. There was also substantial consolidation among private application management firms such as the combination of Tonic and Appliant.

In the storage management sector, Veritas broadened its offerings beyond storage management with the acquisition of Precise, while EMC buttressed its open systems credentials through the acquisition of Legato Systems, moved into content management with the Documentum transaction, and acquired virtualization vendor VMWare.

Values of selected transactions are shown below.

Date Ann.	Seller	Buyer	Enterprise Value*	Mult of Rev
27-Oct-03	ON Technology	Symantec	\$84.0	2.4x
14-Oct-03	Documentum	EMC	\$1,541.7	5.6x
08-Jul-03	Legato Systems	EMC	\$1,241.0	4.4x
10-Jun-03	Kintana	Mercury Interactive	\$225.0	5.1x
19-Dec-02	Precise Software	Veritas Software	\$394.4	5.5x

* \$ in Millions

2004 Outlook

Looking forward, there's no reason to expect M&A activity in the infrastructure management industry to subside. Already in February 2004 Hewlett-Packard announced simultaneous transactions with Novadigm and Consera. Quest acquired systems management vendor Aelita while Allen Systems Group acquired application server management vendor Dirig.

One potential 2004 development to watch for is consolidation between application management vendors that target production environments with those offering tools for pre-production environments, to create a complete Application Lifecycle Management solution. To date, IBM and Computer Associates offer the broadest product sets, while Mercury Interactive and Compuware also have a presence across pre-production and production environments. Change management vendors might be viewed as the bridge between the two environments, making them potential acquisition candidates.

In any event, we expect to see a vigorous M&A market in 2004. The pressure to reduce costs and improve performance of IT infrastructure continues, and the vendors that can deliver the broadest solutions will take mind share among CIOs and market share from their competitors.

2003 Financial Technology Review

Udata's Financial Technology Index turned in a stellar performance, almost doubling the NASDAQ Composite return with an 84% gain in 2003. This compares to a 24% loss in 2002 when the broader indices struggled that same year with the S&P 500 off 23% and the NASDAQ off 32%. Clearly, the Financial Technology companies that we track had a much improved year in terms of both stock price and fundamentals. With the NASDAQ vaulting to a 45% gain in 2003 and the S&P 500 up 22%, the equity markets clearly enjoyed their run after three years of losses. While it is not unusual to see disparities within the returns across the various sub-segments of Financial Technology, what was striking this year was the underperformance of the Transaction Processing companies. Historically, the Transaction Processors have led the group. With a 2003 increase of 37%, the Transaction Processing Index not only underperformed the composite Udata Capital Financial Technology Index, but also underperformed the NASDAQ. The leading sub-segment in 2003 was the Liquidity Providers with a 131% gain. Given the rise in the equity markets in the last half on 2003, this group of companies caught fire and delivered a very impressive rebound.

Valuations in the Financial Technology sector meaningfully improved in 2003. The median forward P/E increased from 19.4x at the end of 2002 to 27.8x at December 31, 2003. This 43% expansion of the P/E multiple is clearly responsible for a significant portion of this year's 84% gain in the Udata Financial Technology Index. Interestingly, the revenue multiple increased only 13% to 2.6x from 2.3x in 2002. Clearly, the data suggests that while the Financial Technology universe has recovered and had an impressive 84% gain, the profitability margins of those companies in the Index has slightly weakened. It appears the market is back to placing a premium on growth and is willing to tolerate diluted profit margins in the pursuit of top line momentum. This held true in each sub-sector that we track with the exception of the Liquidity Providers. The Liquidity Providers maintained their P/E levels from a year ago, but doubled their revenue multiples suggesting tremendous profitability gains. Given that there was increased volume processed by the group, it is evident that there is still substantive price pressure restricting top line revenue growth.

The Capital Markets activity in the Financial Technology sector was still relatively anemic in 2003. There were two IPOs: iPayment and Open Solutions. Together they raised \$165 million and were both very well received, pricing above the range for Open Solutions and trading up over 111% for iPayment at year end. The sector also saw \$1.1 billion in follow-on offering volume, with five deals involving three issuers. It appears as though 2004 is poised to see much improved activity in the Capital Markets with quite a bit of chatter in the markets about planned IPO filings, and several companies looking to capitalize on already strong stock prices as they seek capital and/or liquidity for some shareholder groups.

M&A activity has continued to accelerate in the sector with 102 transactions announced or closed in the markets we track in 2003. Forty transactions disclosed the deal value, which aggregated to almost \$12 billion. The First Data/Concord EFS announced deal represented over half of the total disclosed value. Excluding the First Data/Concord deal, the average disclosed deal size was \$133 million, which is slightly lower than in 2002. However, we saw 46% more transactions in 2003 than in 2002 and continue to believe that the pace of consolidation will continue to accelerate. Forty-five percent of the deals were done by buyers who made more than one acquisition in 2003, furthering the argument that financial institutions are seeking broader product offerings from their larger vendors. In addition to the robust M&A environment in 2003, we saw over \$600 million in venture capital/private equity invested into the sector. 2003 appears to have marked a return to renewed optimism in the Financial Technology sector. Investors, customers and company management are all taking steps to ensure their continued success and ability to prosper from appropriate strategic investments in the Financial Technology marketplace.

2004 Outlook

We believe that the Financial Technology sector in 2004 will continue the trend of increasing capital markets activity coupled with at least \$1 billion in private equity investments and an active M&A environment. More importantly, we believe there will be increased IT spending by large financial institutions as the year progresses, with both software and outsourcing models benefiting from the enhanced environment. Large technology vendors will continue their pursuit of broader product suites and extended customer sets. We believe the key themes in 2004 will include exuberance around Check 21, a drive toward effective business intelligence suites with actionable predictive analytics, the development of a more integrated and complete payments solution (paper, card, electronic, etc.), a final wave of consolidation around electronic trading, and finally, real revenue momentum and acceptance by the carriers for insurance application vendors should begin to materialize.

In summary, 2003 began what we expect to be an attractive period of growth and profitability in the Financial Technology sector for the next 24-36 months. We continue to believe that the sector offers unique investment opportunities, whether they are through early stage venture investing, mature buyouts or strategic acquisitions.

Updata Capital, Inc. is a leading investment banking firm specializing in mergers and acquisitions for the information technology industry. Since its inception in 1987, Updata has managed over 375 mergers and acquisitions for software, IT services, e-commerce, infrastructure, telecommunications, e-services, and security firms, representing an aggregate value over \$10 billion.

Our clients rely on our deep understanding of technological vision and financial expertise to assure the successful execution of their strategic initiatives.



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