

BACC Finance Newsletter

Spring, 1999

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Volume I, Issue 2

Welcome to the second edition of a financial news letter for CEOs and corporate development professionals in the Billing and Customer Care ("BACC") and Operations Support System ("OSS") industries. Each quarter we tackle valuation, merger and acquisition issues that affect our readers. **Peter A. Sokoloff & Co.** specializes in handling mergers and acquisitions in BACC and OSS. We welcome all inquiries.

Value Watch

(See the full Sokoloff & Co. Valuation Rankings on the last page of this newsletter.)

There were some significant changes in the rankings for the Spring 99 quarter, but overall the health and values of the BACC/OSS business remain robust. The combined market capitalization of the companies we follow increased by almost \$9 billion during the quarter. Even after backing out the addition of **Portal Software Inc.**, there was still a \$5.6 billion appreciation in values, representing about a 14% increase from 12/31/98 to 6/8/99. From the looks of 1st quarter revenue reports, the gain isn't being driven by market momentum but by solid performance. Following an increase in 1998 revenues for the group by some 49% over 1997, 1st quarter 1999 results show an average 31% increase over 1998 1st quarter reports.

LHS Group fell out of first place on the list as a long awaited correction, probably driven by founding investors plans to sell some shares, occurred. Falling to #5, LHS now follows #4 **Intasys Corp.**, #3 **AMDOCS Corp.** and #2 **Siebel Systems**. The leader, trading at an astounding 127x

1998 revenue is **Portal Software Inc.** Some naysayers claim that the **PRSF** stock price will prove to be unsupportable in the long term. **PRSF's 1st Q performance of 273% over last year's 1st Q and the truly rapid growth of the Internet space are some evidence to the contrary.** If **Portal** were to be valued over the next five years against the same multiple of revenue as **AMDOCS Corp.** (10.97x) and one assumed a 35% net present value discount rate, it would take a sustained cumulative growth rate of 120% per year over the next 5 years (Yr. 5 revenue grows to \$1.37 billion) to justify today's market cap. This is not an unreal expectation, but **Portal's** execs won't be allowed many mistakes by the market. More on **Portal** in the next article.

Top rated ranking *decline* in the Sokoloff Value Ratings was **Ace*Com (ACEC)**. We'll take a pat on the back for predicting this in our last newsletter when we indicated that ACEC was an anomaly and "the only company on the chart which had 1998 revenues below 1997 and was not severely punished by the market as a result." Retribution did finally come. ACEC dropped from 13th place to 25th losing 36% of its market capitalization since the first of the year. There are signs of a comeback, however. 1st Q revenue is up by 59%.

Still at the bottom of the barrel remains **Telesciences, Inc.**, formerly **Axiom Inc.** **TLSI** lost some 34% of its market cap since the beginning of the year and now trades at an absurdly low 0.26x 1998 revenue. **TLSI** 1st Q results are practically even with last year; one hopes that management succeeds in a turn around.

Others of note: **CSG Systems Int'l.** **CSGS** dropped from #4 (corrected), with a multiple of 8.49 to #8 with a multiple of 5.19. This is a 39% drop in market cap. Despite a 1st Q increase of 44%, the market may be perceiving that **CSGS** is like other service bureau oriented companies that might be expected to ultimately have slimmer earnings margins than pure software companies. Compared to **CSG**, competitors **Convergys** (1.93x) and **DST Systems** (2.99x) are probably undervalued.

Saville Systems tumbled from #7 to #12 on reports of problems with its newest generation product. This news was followed by disappointing 1st Q results.

Other significant demotions in the rankings were **Objective Systems Integrator Inc.** (from #15 to #24) and **Corsair Communications** (#22 to #30).

A big gainer was **Lightbridge, Inc.**, moving from #21 to #15 on the list. 1st Q revenue was up 45% and **LTBG** may be unstoppable in its bid to dominate the rapidly growing wireless fraud prevention market.

Finally, one of the more interesting stocks on the list is **American Management Systems**. The stock dropped in the rankings from #20 to #26 despite a 30.5% increase in 1st Q revenue. **AMSY** is an enigma. Amidst a broad base of products, professional services and consulting - telecom accounts for about 25% of the company's revenue. *That makes this division alone bigger than Saville and*

(Continued on page 2)

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(Continued from page 1)
about the same size as **Kenan Systems**, which sold this year to **Lucent** for about \$1.4 billion. Theoretically, the telecom division alone might be valued at more than the whole company, which makes this stock worth watching.

Internet Envy

Not so surprisingly, the hottest area in the BACC merger and acquisition market is the Internet. *Virtually every acquisition-minded company we talk to has circled IP (Internet Protocol) products and companies at the top of their wish lists.* And not just ISP billing companies. Anything with Internet in it is cool - Bill presentment, e-commerce, OSS software for ISPs. Paraphrasing what one executive of a major firm told us, "We'll look at anything Internet. We want a foothold on IP and make the public market recognize we are undervalued."

As most public BACC and OSS companies watch their stocks languish at moderate levels, the desire to jump on the Internet bandwagon increases. Fueling this notion was May 6th's IPO of **Portal Software, Inc.** (PRSF) that was priced at nearly 35x trailing 12 months revenue (Year Ending 1/31/99), and then promptly quadrupled in price overnight. As of the writing of this newsletter in early June, Portal continues to trade in a market capitalization range of \$3.0 - \$4.0 billion. Even after moving the "Year Ahead" forward to include Portal's first quarter revenue of \$15.165 million, the company trades in a range of 85x to 114x trailing revenue!

By the way - watch for BACC behemoth **Convergys Information Management Group, Inc. (CVG)** to provide a major challenge to **Portal**. It just acquired St. Louis based, **Technology Applications, Inc.** TAI was the original market leader in ISP billing and customer care, providing early systems for **Bell Atlantic, Ameritech, Cincinnati Bell, Witel** and

others. **TAI** chose to grow as a private company without the help of a venture capitalist and was out-spent into relative

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obscurity by **Portal**. **TAI** was able to continue strong development of its "**CIM**" IP billing system and has remained technologically competitive with **Portal**. That technology coupled with **Convergys's** legendary sales and marketing clout should

now, you might want to take another look. Rivaling the many smoke-filled claims of "Convergent Billing," most companies that claim to be able to handle "Internet Billing" really mean that they can put flat-rate \$19.95 per month Internet access on their bills. Reality is, the bells and whistles of usage-based billing, Internet mediation and real-time processing are still as foreign to their software systems as hens teeth.

If they can't acquire, companies are partnering in reseller relationships or buying royalty-laden software licenses to fill in the holes. Venture capital is backing companies like **Xacct Technologies** (IP mediation), who has signed agreements with **Amdocs, CableData, Geneva, Danet, Smarten, Cap Gemini, Daleen, DMR, Solect, Portal** and others. It is interesting to note that **Portal** and **Solect**, who are the #1 and #2 IP BACC market leaders have themselves had to turn to **Xacct** for a mediation solution. Another company, **Novazen Software, Inc.** (bill presentment) has signed an exclusive agreement with **ITDS**.

Spreading the Risk in an Acquisition

How do you value a small private company that appears to have lots of upside potential but does not have the revenue history to merit paying a high price today? The public market tends to be less discerning, setting the price of the stock by simply punishing past performance or rewarding future expectations.

But an undercapitalized or technology-in-development private company typically has a minimal or checkered revenue and earnings history. A potential acquirer may agree that there is potential for terrific future growth, but can't justify to its board why it should take the risk of realizing that future potential by paying a big number up front.

The real assets being sold in this kind of

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"We



perform marriages between great BACC and OSS Companies."

Specializing in mergers and acquisitions for BACC and OSS

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make for a very interesting "battle of the titans" as **Portal** and **Convergys** rush to achieve market share.

A recent front page article in **USA Today** exclaimed that CEOs in any industry that do not have a strong Internet vision and strategy are liable to find themselves pushed out by nervous boards. The same could be said to be true in spades for BACC.

If you're reading this and wondering what the whole brouhaha is all about, because your company is billing for Internet right

(Continued from page 2)

situation are usually a) technology, b) management and employee resources and c) field experience and customer base. Much of the value to be realized by the acquirer will come from the acquirer itself as it overlays its own sales and marketing channels, development resources, administration and management to ultimately make the acquisition a success.

Thus, future success is a shared vision that might work better as a shared risk. A deal structure that is a mix of payment at closing and an incentive package for owners and employees can accomplish this. Here are a few of the tools that serve to spread the risk:

Earnout: All agree on a projection of revenue, earnings or other criteria for a typical period of 1-3 years after the acquisition and a schedule of payments is created that rewards target attainment. Earnouts become especially tricky if the acquired company's operations will be absorbed into the buying company and tracking results of a discrete subsidiary is not practical. There are other variables that also should be considered. This covers items like the after closing budget, management style, utilization of shared resources and arbitrary changes by the parent. Each earnout situation must be specifically crafted to meet the needs presented by each acquisition. Poorly structured earnouts become divisive, creating resentment and an "us against them" attitude which is harmful to all.

Stock Options: A public acquirer can provide a package of stock options. Typically, these options vest over several years and encourage management and employees to remain after the closing. The value logic is simple – If the acquired company can make a significant contribution, the value of the stock is very likely to go up. This is also an excellent vehicle to create a team environment after merger.

Stock Grants: If a primary objective in the acquisition is to bolt the management and employee team to the ship, a generous stock grant program which vests over several years should be considered. Typically, the grant is tied simply to continued employment, with full vesting if the employee is terminated without cause.

Contact Sokoloff & Co.

Please contact Pete Sokoloff for a confidential consultation about your company's merger and acquisition strategies. Mr. Sokoloff has guided hundreds of M&A transactions during a 19 year career in the telecommunications field. *Pete Sokoloff, (818) 952-3183, gosoko@aol.com.*

"Always do right. This will gratify some people and astonish the rest."

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June, 1999



has been acquired by

CONVERGYS

Information Management Group Inc.

**The undersigned represented
Technology Applications, Inc.**

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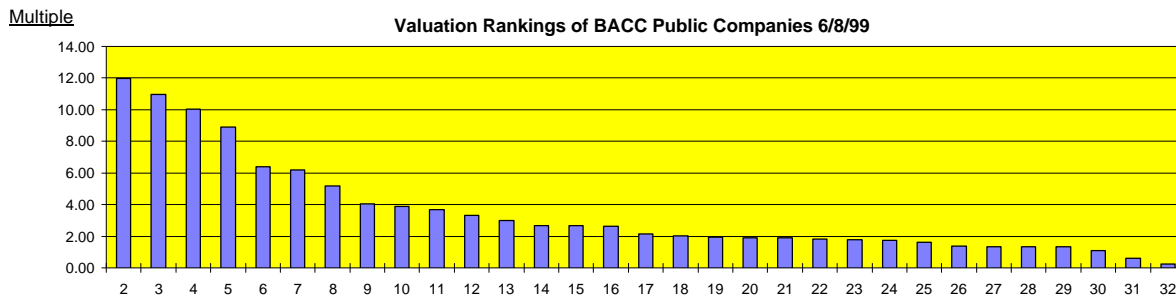
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SOKOLOFF & CO. VALUATION RANKINGS OF PUBLIC BACC COMPANIES

Sokoloff & Company compiles a quarterly review of the public BACC companies and compares how each is valued by the public marketplace. Since many of the companies on the list do not yet have earnings to report, we chose *total market capitalization divided by annual revenue (price to sales)* as a valid basis for comparison. Actual Y/E 1998 revenue has been corrected to actual and varies somewhat from the winter newsletter report which extrapolated the Y/E figures from available reports. A corrected ranking list for the Winter newsletter is also published herein. First quarter 1999 information is included for comparative purposes, but the yardstick for determining rankings remains the reported 1998 fiscal year. We apologize for any significant errors. The following was deleted from this quarter's list: **USCS International** (Acquired by **DST**). Added to the list: **ASYCF, CKEY, PRSF, DSET**. Note: The 1st Q 99 percentage column is the increase from 1st Q 98.

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Current Rank	Previous Rank	Company	Symbol	Stock Price 6/8/1999	Market Cap 6/8/1999	1997 Revenue	1998 Revenue	First Q 99	1st Q 99 %	Multiple of 1998 Rev.
	(corrected)				(000's)	(000's)	(000's)	(if available) (000's)	Incr. (decr)	
1	NA	Portal Software Inc.	PRSF	45.125	3,395,000	9,416	26,669	15,165	272.9%	127.30
2	2	Siebel Systems	SEBL	51.5625	4,695,000	118,775	391,531	134,050	80.7%	11.99
3	3	AMDOCS Corp.	DOX	22.5	4,428,000	290,102	403,767	147,830	57.3%	10.97
4	6	INTASYS Corp.	INTAF	5.625	40,388	1,527	4,030	NA	NA	10.02
5	1	LHS Group	LHSG	7.4375	1,453,000	105,400	163,182	49,328	48.7%	8.90
6	5	Wiztec Solution	WIZTF	21.375	129,746	12,000	20,298	NA	NA	6.39
7	8	Clarify, Inc.	CLFY	35.5625	809,829	88,200	130,510	43,455	74.5%	6.21
8	4	CSG Systems	CSGS	23.75	1,227,000	171,800	236,640	71,087	44.2%	5.19
9	NA	DSET Corporation	DSET	12.1875	118,828	19,365	29,291	7,476	40.5%	4.06
10	10	Alltel Corp.	AT	71.5	20,116,000	3,263,563	5,194,008	1,368,362	15.5%	3.87
11	12	Remedy Corp.	RMDY	20	580,480	129,200	157,420	42,399	38.6%	3.69
12	7	Saville Sys.	SAVLY	14.25	557,203	107,000	167,705	30,168	-0.21%	3.32
13	9	DST Systems	DST	51.875	3,276,000	650,678	1,096,100	292,800	10.0%	2.99
14	16	Billing Concepts	BILL	11.5625	430,067	122,800	160,762	45,700	3.4%	2.68
15	21	Lightbridge	LTBG	10.4375	168,482	40,500	63,351	19,343	45.4%	2.66
16	14	Veremark Tech	VERA	5.96875	45,308	12,408	17,120	5,043	39.9%	2.65
17	18	ITDS	ITDS	14.3125	248,260	23,400	115,460	NA	NA	2.15
18	NA	Architel Systems	ASYCF	8.125	103,675	33,034	50,775	NA	NA	2.04
19	19	Convergys Corp.	CVG	18.3125	2,787,000	987,500	1,447,200	399,800	29.6%	1.93
20	17	Boston Comm.	BCGI	10	165,940	68,100	86,482	24,164	18.6%	1.92
21	NA	Crosskeys Tech.	CKEY	3.9375	73,430	21,465	38,680	13,530	37.1%	1.90
22	23	Vantive Corp.	VNTV	11.0625	295,202	117,346	163,100	44,800	23.5%	1.81
23	25	Affiliated Comp Service	ACS	43.0625	2,116,000	928,925	1,189,123	435,884	42.9%	1.78
24	15	Objective Sys.	OSII	2.9375	105,350	51,700	60,575	11,038	-38.8%	1.74
25	13	Ace Comm	ACEC	4.0625	36,046	33,700	22,465	7,254	59.0%	1.60
26	20	American Sy	AMSY	33.875	1,439,000	872,000	1,057,800	290,900	30.5%	1.36
27	24	TCSI	TCSI	2.59375	58,559	39,600	43,320	10,069	-0.09%	1.35
28	27	Astea International	ATEA	2.75	38,255	60,934	28,941	7,738	-42.0%	1.32
29	26	T-Netix Inc.	TNTX	5.8125	50,278	26,980	38,213	8,709	-6.0%	1.32
30	22	Corsair Comm.	CAIR	3.9375	69,969	53,044	65,218	15,278	-18.9%	1.07
31	28	Cellular Tech Serv	CTSC	3.25	7,416	30,255	11,955	2,764	-19.2%	0.62
32	29	Telesciences, Inc.*	TLSI	1.09375	8,333	33,000	32,141	5,488	-0.128	0.26
		*Formerly Axiom								
		Total			49,073,044	8,523,717	12,713,832	3,549,622	Average 31.24%	Average 7.41
					Increase from Y/E 1997-1998:		49.2%		Previous	Current
		Average Multiple without PRSF							3.55	3.54
		Mean Average Multiple for the Group							2.38	2.49



Note: #1 Ranked PRSF is not on the chart above.