



## STOCK WATCH

### DRIVING OSS CONSOLIDATION

This month Pete Sokoloff, MD, Peter A. Sokoloff & Co, reviews two trends that have arisen as a result of the retrenchment of OSS companies for long term survival and profitability.

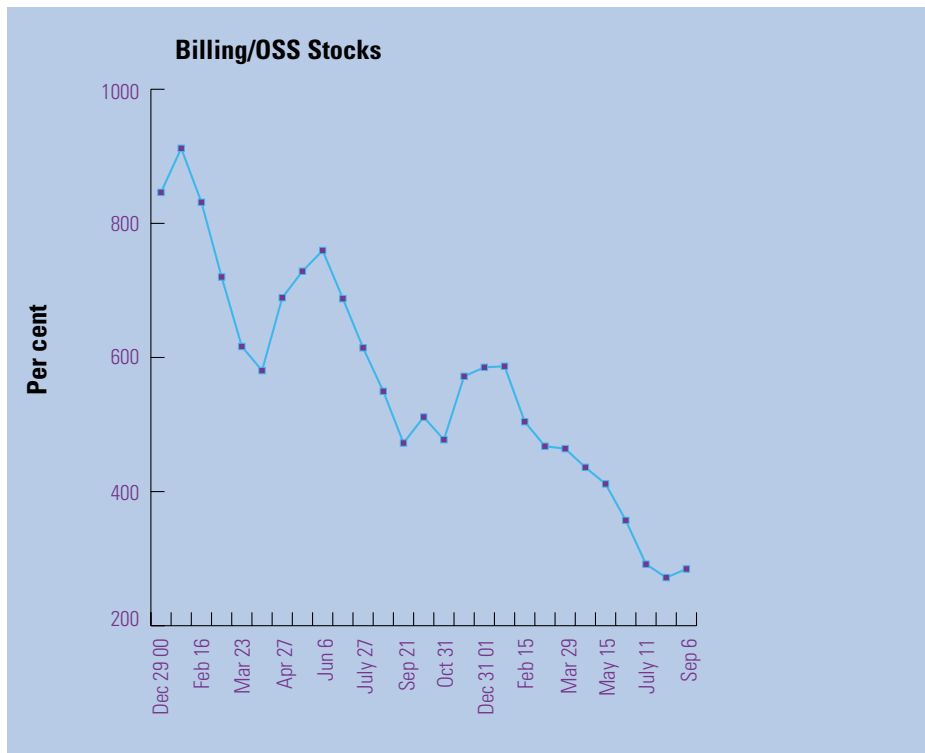
#### Trend #1: 'Bigger is Better'

Everyone's shortlist of who will shape the future of OSS and billing naturally includes three companies – Amdocs (DOX), Convergys (CVG) and CSG Systems. Each company has employed a similar strategy – forsaking huge one-time licence fees in favour of business models that lock in long-term revenues from tier one customers. But what else has differentiated them from the fallen giants of yesterday?

Each of the 'Big Three' has not hesitated to step up and make key acquisitions, even when they were dilutive. Done correctly, M&A activity stimulates a company and keeps its arsenal fresh for the future. DOX did not hesitate to spend over a billion dollars to buy small ISP biller Solect when it thought that Portal represented a real threat to its customer base. While most analysts looking backwards would suggest that Amdocs overpaid and did not get much of a return on its investment, the fact is that Amdocs' aggressive market-leading philosophy would not allow it to simply rest on its laurels while others took market share.

Similarly, CVG stepped in and paid enormously for Geneva. This was done courageously at a time when telecoms spending had clearly burst its bubble, but Jim Orr and other members of the Convergys team have steadfastly been committed to the investment needed to ensure its leadership position well into the future.

Most recently, CSG Systems has been stunning the investment community. Firstly,



note CEO Neal Hansen's bold move of acquiring turnaround candidate Kenan Systems from ailing Lucent. It turns out that Kenan really did not need that much of a turnaround effort – with the empathetic support of CSG's senior management, the remaining Kenan management team has retaken control of their unit's destiny. Quickly adding to the win was CSG's acquisition of IBM's ICMS Billing Unit. Relatively small, ICMS is installed in some thirty-five telecom operators around the world. Over several years, many of these telcos will choose to convert to Kenan's

Arbor/BP (now renamed CSG Kenan/BP). More importantly, CSG used the acquisition to get closer to IBM, which creates an important new channel for distribution.

What about the 'fallen giants?' Companies like LHS Group (subsidiary of oil services giant Schlumberger), Saville Systems (ADC), DST Innovis (DST) and Portal Software are still out there, but seem to be on a waning curve. Witness Kenan's sudden resurgence and one should not count any of these companies out. Their size and market penetration ensure they will be around in

some form for a long time to come. The right acquisition or movement to a new home could fundamentally change any of these companies and set them up to rapidly regain an ascendant position.

### Trend #2: VC-backed firms consolidating

During the OSS gold rush, over sixty start-ups received venture capital funding. Most of these companies were built on a premise of a single application, and many were devoted to just one industry segment. 'Broadband provisioning,' 'wireless data billing' and 'IP middleware' are just a few of the descriptions that have attracted VC money. Of course, each of these companies claim capabilities for many other applications; most have attempted to pitch their products into service provider domains outside their core market.

Reality is that the market has forced many of the VC-backed companies into specialised, vertical grooves. The results of this flawed strategy are firms that have had thirty to seventy million dollars of venture capital pushed into them only to achieve anaemic revenue results and little or no profitability. Management of these companies, especially in an environment of downtrending telecoms spending, have been challenged to find ways to grow.

One obvious solution would seem to be that VC-backed companies should merge with each other and form more viable enterprises that have a greater chance of flourishing and prospering in the years ahead. In fact, there have been many such discussions between these companies over the last few years but little to show for it. The many VCs and CEOs we have talked to tell the same story. After getting past the hurdles of business synergy, technology and how the management teams will combine, folks just can't agree on valuations.

The obstinate refusal of some to come to terms with their futures have sometimes led to no future at all. Most recently, AP Engines, a creative, promising broadband application company, was shuttered despite several attempts to merge or acquire it. The issue was valuation; attempting to improve its negotiating position, AP Engines just ran out of time.

While valuation issues will continue to haunt VC-backed firms, watch for common sense to eventually prevail. As this happens, we will see a number of fruitful combinations arise to deliver cheer while restoring confidence in the long-term prospects for independent OSS vendors. B

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### Index of Public Billing & OSS Companies

Company	Ticker	6 Sept 2002	31 Dec 2001	YTD % Change	52 Week High	Mkt Cap (000s)
Ace Comm	ACEC	0.75	1.14	-34.2%	1.75	6,988
Affiliated Comp Services	ACS	45.13	106.13	-57.5%	57.05	5,949,849
ADC Telecom	ADCT	1.12	4.6	-75.7%	5.97	891,996
American Mgmt. Sys.	AMSY	15.05	18.08	-16.8%	23.33	634,132
Alltel Corp.	AT	43.49	61.73	-29.5%	65.15	13,526,042
Astea International	ATEA	0.62	0.73	-15.1%	1.14	9,054
Boston Comm.	BCGI	9.21	11.35	-18.9%	15.71	159,701
Converse Technology Inc	CMVT	7.76	22.37	-65.3%	28.28	1,451,353
CSG Systems	CSGS	12.1	40.45	-70.1%	44.38	623,186
Cellular Tech Serv	CTSC	1.05	2.29	-54.1%	3.76	2,407
Convergys Corp.	CVG	17.94	37.49	-52.1%	38.5	3,107,100
Daleen Technologies	DALN	0.15	0.35	-57.1%	0.62	3,530
AMDOCS Corp.	DOX	6.82	33.97	-79.9%	39.25	1,518,323
DSET Corporation	DSET	0.2	1.15	-82.6%	1.78	1,032
DST Systems	DST	33.56	49.85	-32.7%	51.15	4,023,911
Evolving Systems Inc	EVOL	0.25	0.79	-68.4%	2.75	3,324
Fair Isaac	FIC	36.1	41.95	-13.9%	45.5	1,842,147
Lightbridge	LTBG	7.66	12.15	-37.0%	13.95	215,951
MDSI Mobile Data Solutions Inc	MDSI	3.2	3.51	-8.8%	5.08	26,208
Mind CTI	MNDO	1.079	1.67	-35.4%	2.05	22,299
MetaSolv Software	MSLV	2	7.85	-74.5%	9.1	75,390
Micromuse	MUSE	3.11	15	-79.3%	19	232,435
Peregrine Software	PRGN	0.238	14.83	-98.4%	33.55	64,000
Portal Software Inc.	PRSF	0.36	2.08	-82.7%	3.05	63,551
Siebel Systems	SEBL	8.43	27.98	-69.9%	38.38	4,028,823
TCSI	TCSI	0.35	0.76	-53.9%	0.98	7,194
Management Network	TMNG	1.45	6.9	-79.0%	7.66	48,281
T-Netix Inc.	TNTX	2.8	3.33	-15.9%	4	42,090
TTI Team Telecom	TTIL	8.931	25.02	-64.3%	35.09	104,966
Ulticom	ULCM	5.96	10.06	-40.8%	12.69	246,720
Veramark Tech	VERA	0.47	0.7	-32.9%	2.03	3,930
VeriSign	VRSN	7.19	38.04	-81.1%	53.45	1,701,542
Vertel Corp.	VRTL	0.075	0.67	-88.8%	3.25	2,562
Total Index		284.60	604.97	-53.0%		

Highlighted stocks are up from year-end 2001.

Fair Isaac acquired HNC Software.

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