

Oracle-PeopleSoft: Big Turf Battles Ahead

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UPDATA CAPITAL

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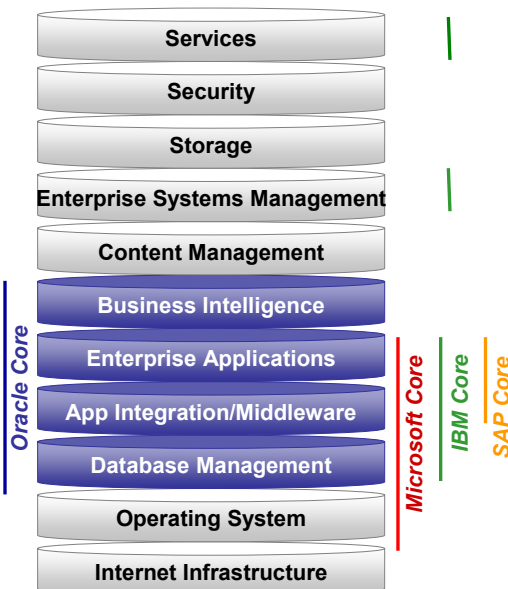
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Oracle Raises "Best and Final" Offer

PeopleSoft's acceptance of Oracle's bid will hasten ongoing consolidation in the maturing enterprise software industry. Modest demand growth, converging functionality and a landscape that is highly fragmented except at the very top are generating great pressure to do deals.

Deal Highlights. Oracle first offered to buy PeopleSoft for \$16 a share in cash, \$5.1 billion, on June 6, 2003, four days after PeopleSoft announced it would buy rival J.D. Edwards for \$1.7 billion. Oracle had been evaluating BEA, Siebel and other large M&A candidates to strengthen its presence in the enterprise "stack" – the layers of integrated software that businesses use (Figure 1 below) – but chose PeopleSoft for its significant share of the market for enterprise applications (customer, financial, HR and supply chain management) that sit atop databases. PeopleSoft/J.D. Edwards have 13,000 corporate customers and \$2.7 billion of annual revenues.

Figure 1: Enterprise Software Stack



Oracle modified its initial offer several times, making a "best and final" \$24 per share bid on November 1, 2004. By November 19, 61% of PeopleSoft's shares were tendered. Given Delaware court dismissal of the Department of Justice's antitrust suit in October 2004, the PeopleSoft board remained Oracle's last hurdle.

The Board unanimously rejected \$24 a share as low, based on management's bullish growth projections and valuation multiples paid on deals deemed comparable (Figure 2 below). However, on December 13, 2004, PeopleSoft's board approved a revised \$26.50 a share, or \$10.3 billion, bid. Excluding cash and investments, enterprise value of the deal is \$8.6 billion. Board approval precludes what would have been an almost certain proxy battle at PeopleSoft's next board meeting late Q1 2005.

Figure 2: Precedent Transactions

(Dollars in Millions)			Enterprise Value	LTM Results		Enterprise Value/	
Date Ann'd	Seller	Buyer		Revs.	Oper. Income	Revs.	Oper. Income
Dec-04 *	PeopleSoft	Oracle	\$8,643	\$2,674	\$148	3.2x	58.5x
Jun-03 **	PeopleSoft	Oracle	\$7,504	\$2,674	\$148	2.8x	50.8x
Oct-04	Netegrity	CA	\$340	\$90	\$5	3.8x	72.6x
Jan-04	FreeMarkets	Ariba	\$388	\$138	NA	2.8x	NA
Dec-03	SCT	Sungard	\$491	\$270	\$33	1.8x	14.9x
Oct-03	Documentum	EMC	\$1,542	\$275	\$13	5.6x	115.8x
Jul-03	Legato	EMC	\$1,241	\$280	-\$22	4.4x	NA
Jun-03	J.D. Edwards	Peoplesoft	\$1,350	\$886	\$46	1.5x	29.1x
Dec-02	Precise	VERITAS	\$433	\$72	-\$1	6.0x	NA
Dec-02	Rational	IBM	\$1,549	\$657	\$37	2.4x	41.6x
May-02	Navision	Microsoft	\$1,209	\$204	\$42	5.9x	28.7x
Apr-02	HNC	Fair, Isaac	\$623	\$226	NA	2.8x	NA
Jun-01	Remedy	Peregrine	\$980	\$291	\$27	3.4x	36.2x
Dec-00	Great Plains	Microsoft	\$916	\$250	\$14	3.7x	64.0x
Oct-99	Vantive	PeopleSoft	\$337	\$182	\$2	1.9x	187.2x
Mar-98	Scopus	Siebel	\$381	\$93	\$7	4.1x	53.5x

*Deal data reflects \$26.50/share bid announced December 2004.

**While announced in June 2003, deal data reflects most recent \$24/share bid.

Boxed outliers are excluded from summary calculations.

Enterprise Value = offer value + debt - cash/marketable securities.

mean	3.6x	42.6x
median	3.5x	38.9x

Sources: FactSet, Update.

Once Oracle-PeopleSoft closes, it will be the software industry's third largest M&A deal to date, its largest hostile bid, and the largest paid for in cash (Figure 3 below). Oracle/PeopleSoft/J.D. Edwards will own 13% of the enterprise applications market, creating a real competitor to market leader SAP's 18% share. Revenues among the top 5 enterprise application vendors would still remain below 40%, less than concentration levels of other stack sectors (Figure 4 next page), leaving room for further consolidation.

Figure 3: Largest Software Deals

(Dollars in Millions)			Enterprise Value	LTM Results		Enterprise Value/	
Date Ann'd	Seller	Buyer		Revs.	Oper. Income	Revs.	Oper. Income
Oct-98	HBO	McKesson	\$13,780	\$1,368	\$366	10.1x	37.7x
Mar-00	Aspect	i2	\$9,339	\$95	\$4	98.3x	NM
Dec-04 *	PeopleSoft	Oracle	\$8,643	\$2,674	\$148	3.2x	58.5x
Aug-00	Software.com	Openwave	\$6,752	\$76	NM	88.8x	NM
Mar-99	Platinum	CA	\$3,637	\$968	\$98	3.8x	37.1x
Feb-00	Sterling	CA	\$3,512	\$840	\$193	4.2x	18.2x
Feb-04	NetScreen	Juniper	\$3,486	\$275	\$44	12.7x	79.2x
Oct-99	Clarify	Nortel	\$2,032	\$171	\$17	11.9x	119.5x
Oct-98	Seagate	VERITAS	\$1,669	\$199	\$39	8.4x	42.8x
Dec-02	Rational	IBM	\$1,549	\$657	\$37	2.4x	41.9x

*Deal data reflects final December 2004 \$26.50/share bid.

Enterprise Value = offer value + debt - cash/marketable securities.

Purchases for cash (as opposed to stock) are in italics.

Sources: FactSet, Update.

Figure 4: Enterprise Software Market Segment Size, Growth & Leaders

Enterprise Infrastructure & Application Software	Operating System*	Database Management	Application Integration & Middleware**	Enterprise Applications***	Business Intelligence	Enterprise Content Management	Enterprise Systems Management	Storage	Security	Services
2004e Revenues	\$13.1B	\$8.7B	\$6.4B	\$55.0B	4.0B	1.1B	\$5.9B	7.8B	9.6B	607.3B
Projected Growth CAGR	11%	4%	2%	6%	8%	11%	6%	10%	16%	6%
Top 5 Market Share	93%	87%	80%	37%	47%	54%	65%	67%	41%	19%
Top 5	Microsoft IBM Sun HP Other	IBM Oracle Microsoft NCR Other	IBM BEA Oracle Sun Microsoft	SAP PeopleSoft Oracle Siebel Microsoft	Busin. Obs, Cognos SAS Hyperion MicroStrategy	IBM Filenet EMC OpenText Interwoven	IBM CA BMC HP Quest	EMC Veritas CA IBM HP	Symantec CA Cisco McAfee Trend	IBM EDS Fujitsu CSC HP

*Server-based **Market share is for app server vendors ***Including SMB market. Sources: Gartner, IDC, Street research, Updata.

Oracle's Rationale. Oracle's database business made it the world's largest pure-play enterprise software company (**Figure 5** below), and one of the most successful. Reliance on database sales (76% of revenues, 90% of profits in Q3) also made Oracle vulnerable to slowing demand growth and to inroads from Microsoft and SAP (**Figure 6** below). The company's application revenues declined 36% from the year-ago August 31 quarter, and new software license revenue declined 10%, reflecting what CEO Larry Ellison called a competitive "onslaught".

Figure 5: Ten Largest Software Companies

(\$ in billions)

Nov. 2004

Company	Market Cap.	12-Month Revenues	Net Profit Margin	Y-o-Y Qtrly Rev Growth	EPS Growth Next 5 Yr	2005e P/E
Microsoft	\$289.6	\$37.8	21%	12%	11%	21.3x
IBM	\$157.7	\$94.7	9%	9%	10%	19.0x
Oracle	\$65.6	\$10.3	27%	7%	10%	22.2x
HP	\$60.9	\$78.4	4%	9%	11%	15.6x
SAP	\$55.5	\$9.2	16%	15%	16%	34.3x
EMC	\$32.2	\$7.7	10%	34%	21%	38.0x
Symantec	\$20.3	\$2.2	22%	44%	17%	38.6x
CA	\$17.9	\$3.4	2%	3%	14%	38.0x
Sun	\$17.7	\$11.3	-2%	4%	14%	124.8x
Adobe	\$14.5	\$1.6	26%	27%	13%	34.0x

Sources: FactSet, Updata.

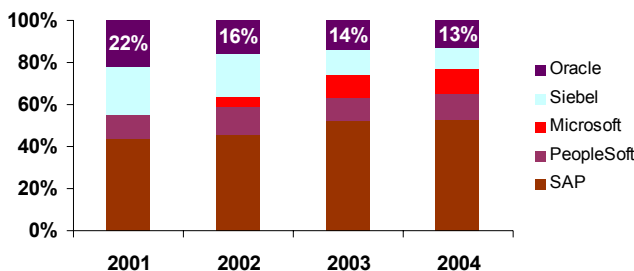
business application vendors, opening an avenue for higher growth. More importantly, the deal enlarges Oracle's captive revenue base, as the company obliges application customers to use its middleware and databases. This strengthens Oracle's position against Microsoft, IBM and SAP, which already tie applications and infrastructure sales together. Bundled sales, which improve integration and lower cost, are highly sought after by stack vendors to drive customer retention.

Forced Hand? By Oracle's lights, industry developments necessitated an acquisition of PeopleSoft proportions. Winning big deals has been increasingly hard – SAP and Oracle reportedly priced deals for large customers as much as 80% off list. Things may not get easier. Microsoft revealed during Oracle's antitrust trial that it had considered a potential acquisition of SAP. While that deal is off the table for now, Microsoft plans to invest \$10 billion to grow its business applications sales from under \$1 billion in revenues in 2004 to \$10 billion in 2007. At that expansion rate, Oracle could lose significant business.

IBM, which has acquired heavily in infrastructure software, also presents a looming competitive threat. Its partnerships with PeopleSoft, Siebel and other applications vendors drive strong middleware and database sales. In September, IBM and PeopleSoft jointly committed \$1 billion to increase interoperability. IBM plans to expand its footprint in the stack given the profitability of its software business, which generated 16% of 2003 revenues but over a third of total income.

Oracle's competitive landscape will further intensify as other giants battle for share in the stack. HP's application and business process management acquisitions suggest it will become a bigger force in enterprise software. As the CEO recently noted, "more and more of the value we deliver is in software." Mercury, which acquired Kintana to enter IT governance, has designs to transform itself from a

Figure 6: Relative Enterprise Application Market Share (Q1)



Source: Street research.

PeopleSoft's widely used enterprise application set gives Oracle needed traction against the sea of other

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tools vendor to a billion-dollar revenue enterprise software player. Seeing this, Compuware acquired ChangePoint and likewise sees opportunities to leverage its considerable customer base into the stack. EMC's serial big deals will enable it to exploit its position as lead storage management vendor to capture adjacent areas system and content management.

Oracle-PeopleSoft Fallout. Megadeals like Oracle-PeopleSoft create cascading dislocations that ripple through the competitive ecosystem, sparking further deal activity. Thus, PeopleSoft's J.D. Edwards offer may have influenced Oracle's bid timing. In turn, both Oracle's initial PeopleSoft bid and its victory in the antitrust suit appear to have raised share prices of other enterprise vendors in anticipation of further

consolidation in the space. SAP has observed that Oracle-PeopleSoft would make the market "hugely competitive." This could push SAP, which has \$3 billion of cash, to become acquisitive. BEA, battling for share against Oracle and IBM in application deployment software, may (unless itself acquired) also be pressed to expand its addressable market by buying, for example, an integration server or portal software company.

Many Oracle and PeopleSoft partners stand to lose or gain business from the combination, which could also precipitate more deals. For example, IBM Global does hefty integration work around PeopleSoft's platform, but little with Oracle's. IBM could offset a loss of services business, key to driving deeper into the stack, with acquisitions of other consultancies or software vendors.

Figure 7: Acquisitions Made by the 25 Largest Software Vendors since 2003

Yellow boxes signify acquiror's core business. Bolded targets represent acquisitions > than \$1 billion.

Acquiror	Infrastructure Software	Internet Infrastructure	Operating System	Database Management	Application Integration/Middleware	Enterprise Applications	Business Intelligence	Content Management	Enterprise Systems Management	Storage	Security	IT Services
Adobe					Yellow Dragon				Qlink			
Altiris									BridgeWater Wise			
BEA					Enosys							CrossLogix
BMC				DGI		Magic			IT Masters Marimba			
Business Objs.							Crystal					
Cisco		Actona dynamicsoft Linksys Parc Pcube SignalWorks				Latitude			Jani Netsolve	Actona	Okena Perfigo Riverhead Twingo	
Cognos							Adaytum					
CA					Adjoin				Miramar SilentRunner	Netreon	Netegrity PestPatrol [1]	eSecurity Online
Compuware									ChangePoint [1]			
EMC								Documentum	VMWare	Astrum Dantz Legato [1] Softworks		Dolphin
HP					Talking Blocks PipeBeach				Consera Novadigm [1]	Persist	SelectAccess Truologica	CEC Europe Svs Extreme Logic FH Computer Svs IT Infrastructure Synstar Triaton Triext
Hyperion					QIQ Solutions		Alcar Brio					
IBM				CrossAccess	Rational Sector7 Trigo	Productivity Sol'ns Systemcorp	Alphablox	Apatrix Green Pasture Venetica	Candle Cyanea Infoblox Think Dynamics			Daksh Logicalis Maersk Data
Juniper		Unisphere										Netscreen
Mercury							Allerez		Appilog Kintana Performant			
Microsoft					Connectix	Encore Lookout Navision PlaceWare	ActiveViews				GeCad Pelican	
Novell			SuSE Linux Ximian									Salmon
Oracle					Collaxa	[Peoplesoft] SiteWorks		FileFish				
Peoplesoft						JD Edwards						
SAP						A2i						
Siebel						BoldFish Eontec Ineto Motiva UpShot						
Sun		Nauticus						Pixo	CenterRun Kealia			Waveset
Sybase					AvantGo	Dejima			Xcellenet			
Symantec									ONTechnology PowerQuest	Roxio	Brightmail Nexland SafeWeb Turntide	@Stake Lyric
Veritas									Ejasent Invio Jareva Precise	Kvault		

[1] = Update deals. Sources: Public information, Update.

Owning PeopleSoft does not end challenges to Oracle's franchise, or opportunities to expand further. Business intelligence for example is increasingly a driver of large enterprise application licenses. Thus far Oracle has built its own BI functionality. However, recent acquisitions by Microsoft and IBM in the space mean Oracle may seek to do the same. In enterprise systems management (network, application and configuration management, etc.), where Oracle's capabilities are limited to coordinating its own resources, it could develop or buy a more agnostic solution. H-P is working from the other direction, leveraging OpenView to build an infrastructure and applications platform.

Accelerated Consolidation Ahead. PeopleSoft's acceptance of Oracle's bid adds fuel to an industry ripe for consolidation. The absolute level of enterprise software M&A activity is already significant. Since 2003, the 25 largest enterprise software vendors announced at least 120 acquisitions (**Figure 7** prior page), equating to one acquisition per vendor every five months. Thirty percent of these deals had values exceeding \$100 million, and 6% exceeding \$1 billion. Aggregate estimated deal value of roughly \$33 billion (including Oracle-PeopleSoft), approximates the combined market capitalization of the next 100 largest software vendors.

On a relative level, such M&A activity by the largest players is less noticeable due to persistent market fragmentation below the top vendors. Microsoft, IBM, Oracle, SAP and CA comprised one-third of global software revenues in 2003, but beneath them remain 600 public software companies, two-thirds of which are unprofitable, according to a July Bain consulting report.

Slowing industry growth will be the main catalyst to intensifying consolidation ahead. Growth, which builds scale and profits, correlates with higher valuations (**Figure 8** below). However, in an environment of single-digit projected annual IT demand growth (2-3% according to Gartner and Goldman Sachs), meaningful expansion requires taking market share and adding strategic differentiation. As IDC noted in November, "double-digit growth rates experienced in the last

decade will not return in the foreseeable future." In such circumstances, M&A is the most direct path to growth, as more companies are realizing. Leading vendors have shown the ability to build success on a string of M&A deals (**Figure 9** below). Over half of EMC's Q3 multiplatform software sales of \$262 million came from its last 3 acquisitions, and 28% of BMC's revenues come from vendors bought in the last 2 years.

Consolidation Won't End Competition. Although software M&A volume is likely to materially rise over the next two years, IT will never become, as Oracle Chairman Jeff Henley predicted, like the auto industry. Barriers to entry remain relatively low, with large pools of venture funding available to fuel rapid growth of start-ups offering better solutions (e.g. Google). Further, the tech IPO market is rebounding. That and more M&A activity could even increase fragmentation in some sectors for a time as more exits draw greater venture investment – witness what has occurred in IT security.

Ongoing evolution of the software delivery framework will also keep things fluid, even as control over the infrastructure-application stack reduces the number of truly viable software vendors. Customers still prefer best-of-breed over bundles if integration, operation and maintenance are easy. Software as a service, standards like XML and, eventually, web services increasingly make this achievable.

Figure 9: Leading Vendors Build on String of Deals

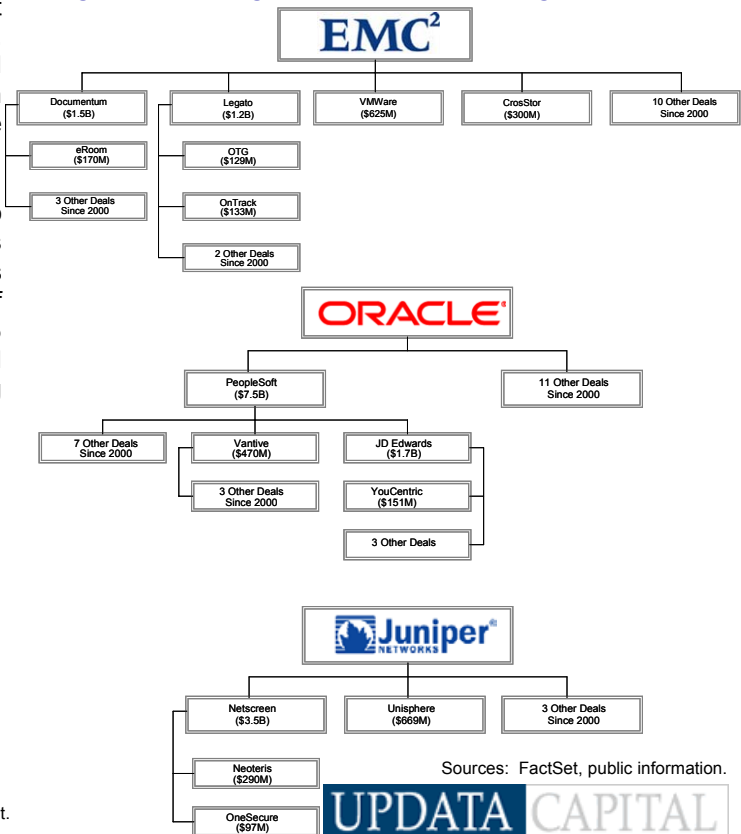
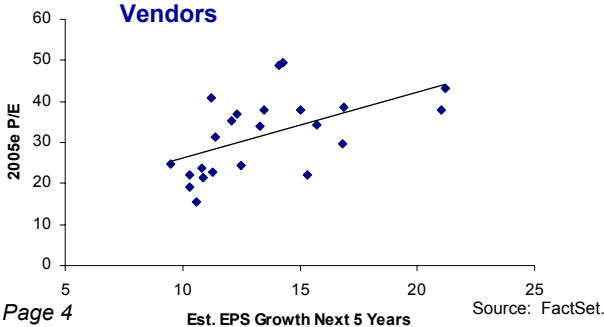


Figure 8: Growth vs. P/E for 25 Largest Software Vendors



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