



SOFTWARE AS A SERVICE UPDATE

SPURRING INNOVATION, ENHANCING BUSINESS VALUE
AND ENABLING BUSINESS PROCESSES

A TripleTree Industry Analysis

SPOTLIGHT REPORT

WWW.TRIPLE-TREE.COM

7601 FRANCE AVE S, STE 150, MINNEAPOLIS, MN 55435

12526 HIGH BLUFF DR, STE 300, SAN DIEGO, CA 92130

952.253.5300

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INTRODUCTION

Software as a Service (SaaS) has grown beyond a mega-trend to cause major disruptions to the status quo in the software industry. TripleTree has built a reputation as a leading investment banking firm in the Software as a Service sector dating back to the first-generation Application Service Providers (ASPs) and application maintenance/outsourcing firms of the late 1990s. Our commitment to publishing industry research, participating in key industry events, facilitating webcast sessions and setting new valuation standards for software firms is unmatched. This updated perspective builds on our 2004 report and underpins Software as a Service as a key driver of change in a consolidating software and technology industry.

The report, *Software as a Service Update - Spurring Innovation, Enhancing Business Value and Enabling Business Processes*, addresses the current evolution of Software as a Service relative to the technology industry, macroeconomic events forcing change, and its "disruptive" impact. It also reviews the leadership qualities of emerging, privately-held Software as a Service firms that are defining early success in the sector to-date. Finally, the report considers ways that Software as a Service is impacting the entire technology landscape, from enterprise software to outsourcing and consulting sectors. Concluding sections include a capital markets overview and a range of key quantitative and qualitative factors that are components of successful leadership qualities in Software as a Service.

A Legacy of In-Depth Research on Software as a Service



In the past twelve months, TripleTree has led five of the 24 M&A transactions involving Software as a Service firms. In the process, TripleTree has helped define this new class of companies by raising growth capital long before Software as a Service began to reinvigorate the software sector. Today, we continue our leadership in the sector through our valuation-leading M&A, capital raising and strategic advisory services.

INTRODUCTION

A Legacy of Leadership in Strategic M&A and Financial Advisory Services for Software as a Service firms



- Coupling transaction successes and in-depth research insight has enabled TripleTree to author seven reports and facilitate nine webcasts on Software as a Service. The programs have been attended by over 3,000 business executives, venture capital investors and industry analysts.
- TripleTree participates in speaking and panelist roles at leading industry and vendor conferences such as SaaScon, the SIIA Enterprise Software Summit, Salesforce.com's DreamForce, ITA Software as a Service Roundtable, and has been cited in numerous trade and industry publications including the Wall Street Journal.
- TripleTree's insight is derived from primary research including coverage of over 550 Software as a Service firms. Virtually every legacy application category now offers an on-demand solution and many new categories are rapidly being formed to address evolving business issues like Sarbanes-Oxley compliance or industry vertical solutions. To rank our database of Software as a Service companies, TripleTree has developed a "**Qualitative SaaS Scorecard**" to measure intrinsic assets necessary for sector leadership. This scorecard affords primary insight beyond conventional metrics like annual revenue and profitability, which are critical to long-term value creation.
- Included in this report are the findings from comprehensive market surveys and interviews with key executives at 150 Software as a Service firms. TripleTree's research agenda for the foreseeable future will include further coverage on domains and executive specific issues surrounding Software as a Service.

EXECUTIVE SUMMARY

Software as a Service - along with outsourcing, offshore, wireless, and open source technologies - is one of the game-changing forces in the technology industry. Transformation brought about by Software as a Service is as far-reaching and significant as anything experienced in the last 20 years in the software industry.

Software as a Service is not just about a new way of creating, delivering, selling and utilizing applications, but a philosophical change for how to solve some of the biggest challenges faced by earlier generations of technology - cost, complexity, time-to-market, risk, and ease of use. These are the hallmarks of Software as a Service. Customers and end-users are seeking to eliminate costly, complex and time consuming technology decisions by lowering upfront costs, reducing overall risk, and ensuring a higher rate of success with each technology deployment.

As a result, Software as a Service and "utility-based" pricing models for enterprise applications and core infrastructure solutions will be more widely adopted over the next five years. Poised for high growth, Software as a Service will remain a disruptive influence on industry leaders for the following reasons:

- Software as a Service sits at the core of a movement towards "customer-centric" solutions whereby pricing, deployment, and ongoing technology usage is closely aligned with customer interests. With Software as a Service, the burden of technology purchases and its underlying risks shifts from the customer to the technology provider with the former demanding more accountability and higher service quality.
- The revolution in the technology industry is now being driven by new metrics for value creation. Customers are gaining more predictable costs combined with lower risks and shared incentives from each new technology investment. Software as a Service firms and their investors benefit from a predictable, recurring revenue stream, high margin potential through economies of scale and sustainable client relationships.
- Intensified macroeconomic trends and forces - including "maturing" growth cycles, pricing commoditization and margin pressure, a shift towards maintenance rather than new software licenses, industry fragmentation, intense competition and consolidating trends, and investors' proclivity for recurring revenue models - are all prompting firms into proactively evaluating positioning and responsiveness to new threats. Adding to these pressures are a new breed of innovators like *Amazon*, *eBay*, *Google*, *Salesforce.com*, *WebEx*, *Yahoo* and others who continue to outperform and receive attractive valuations.
- Software as a Service will be more profound than most industry observers currently assume. Projected to reach over \$10 billion in the next several years, the sector will have much deeper implications affecting virtually every legacy application category as well as sending disruptive "ripple effects" into multi-billion dollar software, outsourcing and consulting sectors.
- Software as a Service will continue to be shaped by emerging private companies replacing legacy on-premise applications as well as creating new application categories. Overcoming challenges like "discrete" business requirements within vertical industries or solving core infrastructure demands with "utility-based" on-demand alternatives will become the norm.

EXECUTIVE SUMMARY

- New metrics for measuring and assessing value will emerge. Gone are the days where value is determined by revenue growth, profit margins, or P&L analyses alone. Revenue growth and profit margins must now be measured alongside cash flow, backlog, bookings/billings and deferred revenue. Viability will be noted by a range of qualitative factors not necessarily disclosed on financial statements.
- Traditional barriers to entry associated with market presence and intellectual property will now include other limiting factors associated with successfully transitioning or supporting a services-based approach. These include a multi-tenant delivery infrastructure, re-tooled sales, marketing and distribution strategies, and effective alliance strategies. These and other factors will push established companies to make acquisitions rather than attempt an organic transformation to successfully support a 'hybrid' approach. One only needs to reflect on the challenges encountered by *Siebel* in its failed attempt to combat on-demand competitive pressures to acknowledge that the road to transition is difficult. These competitive forces as well as actions to assume early leadership positions will promptly drive M&A activity. Positioning Software as a Service firms ahead of this inevitable trend will be important.
- Capital market conditions are strong, with M&A representing the best exit strategy for capturing built-in Software as a Service value. Public market valuations for TripleTree's Software as a Service Index are trading at a healthy premium compared to traditional "license and install" enterprise software indices. Initial public offerings (IPOs) for Software as a Service firms with the size, scale and the necessary infrastructure to support being a public company have also been favorable. Private equity investment in the sector has rebounded from previous lows to now represent more than 10% of all venture capital investment in the software industry, up from 6% a few years ago. New leadership will be defined by M&A strategies of Tier I acquirers seeking entry into the sector, with most of the activity occurring with Teir II acquirers and private-to-private consolidation attempting to be ahead of the "next trend."

The technology industry sits at an inflection point where established players and emerging innovators will spend the next two years attempting to differentiate themselves as tomorrow's leaders.

THE NEXT CHANGE IN THE SOFTWARE INDUSTRY IS HERE

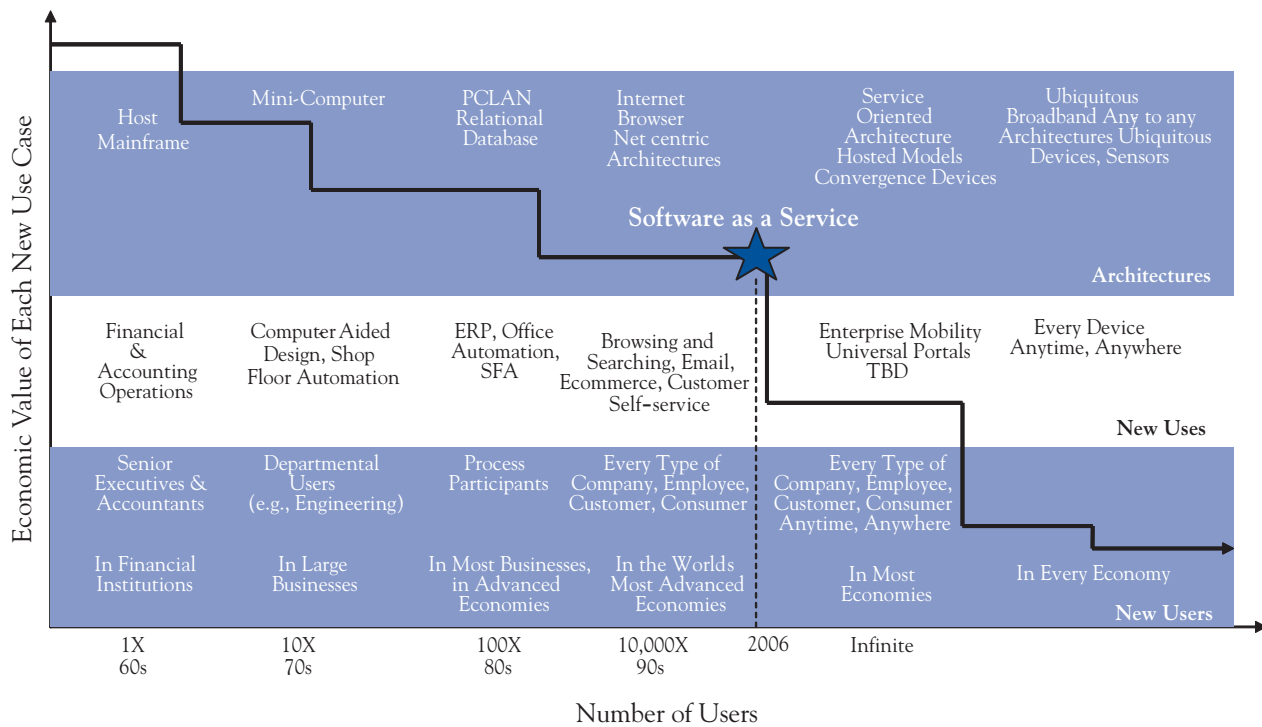
Software as a Service represents a bigger evolution in the technology industry than did distributed computing, desktop productivity or the Internet revolution. The enterprise software industry is at an important inflection point (see **Figure 1**).

The Internet opens the computing platform outside of conventional on-premise or "behind the fire-wall" deployments to a net-centric architecture with the introduction of a full lifecycle "customer-centric" model disrupting the status quo.

This current wave of Internet-enabled computing is

changing the paradigm by finding new ways for individuals and organizations to utilize, enable, interact and extend technologies led by innovators like *Amazon*, *eBay*, *Google*, *Salesforce.com*, *WebEx* and *Yahoo*. As a result, Software as a Service has become the biggest transformation and growth driver since the Internet and is "**changing the rules of the game.**" It is not just about a new way of creating, distributing, delivering, selling and utilizing applications, but a philosophical change about how to liberate some of the biggest customer challenges faced by earlier generations - cost, complexity, time-to-market, risk, and ease of use.

Figure 1: A Model for Enterprise Software Growth: A Major Inflection Point of Change



Source: TripleTree and Accenture

MACRO INDUSTRY FORCES

The rise of Software as a Service is the result of vendors responding to the need for improved customer satisfaction. While the perspectives vary, industry pioneers continue to opine about the momentum and rationale for the proliferation of Software as a Service (see **Table 1**).

Table 1: Growing Interest for Software as a Service:

Industry Analysts	By 2010, 30% of software revenue will be derived from software delivered via Software as a Service models. Gartner.
	"For every \$1 of software licenses, \$24 of additional expenses are generated." Gartner.
	"The end of software as we know it is not a matter of whether it will happen, but when. The debate is the rate." The End of Software, by Timothy Chou, Former President of Oracle On Demand.
Software as a Service Pioneers	"...this on-demand model will totally change the way technology is bought and sold. In other words, it's the end of software as we know it." Marc Benioff, Chairman & CEO, Salesforce.com.
	"The software industry is going through a transformation that is unlike anything it has seen in two decades, and the emergence of the PC itself. This transformation goes by many names: On-Demand, Web 2.0, Software as a Service. But they all point to the same conclusion: the era of the traditional software 'load, update, and upgrade business and technology model is over. It is time for 'The Business Web'." Marc Benioff, Chairman & CEO, Salesforce.com.
	"My prediction is within five to seven years the bulk, more than half, of all enterprise applications will be purchased through the on demand method." Greg Gianforte, CEO, RightNow Technologies.
Global Technology Firms	"Outsourcing will be the dominant form of computing in less than 10 years." Larry Ellison, Oracle CEO, CEO Executive Summit, 2003.
	"The thing I'm most interested in is software as a service. Companies should be experts in their business, and computing should be available on the Net as a service. That really is utility computing." Larry Ellison, CEO, Oracle.
	"This coming 'services wave' will be very disruptive...the next sea change is upon us." Bill Gates, Co-founder, Chairman & Chief Software Architect, Microsoft.
	"Software as a service has been moving along. We needed the Internet. We needed low-cost connectivity. We needed some data standards like XML." Bill Gates, Co-founder, Chairman & Chief Software Architect, Microsoft.
	"...respond to the core trend, move to a services approach – software as a service. If you do these things well, you compete well, and you win. The notion of all significant software evolving will have a service element." Steve Ballmer, CEO, Microsoft, at Gartner ITXpo October 2005.
Private Equity Investors	"Software-as-a-Service is an inevitable fundamental shift in enterprise software culture." Ray Lane, Partner, Kleiner Perkins Caufield & Byers and former President & COO of Oracle.
	"The on-demand computing model is real, and startups that offer software with friendly, consumer-like interfaces, but which scale up, are in a good position." Warren Weiss, General Partner, Foundation Capital.
	"Venture firms across the U.S. are spending less time looking at and funding companies with traditional software models. With that said, they are spending a lot of time looking at companies that are delivering services to enterprises in the form of [software as a service]." Gus Tai, General Partner, Trinity Ventures.

Source: TripleTree and various sources

Global firms are just beginning to awaken to new threats. Previously an "underground" activity consisting of only the most passionate early adopters, Software as a Service has now entered the mainstream and is prompting others into action. A number of large-scale macroeconomic factors are exerting additional pressures on software vendors:

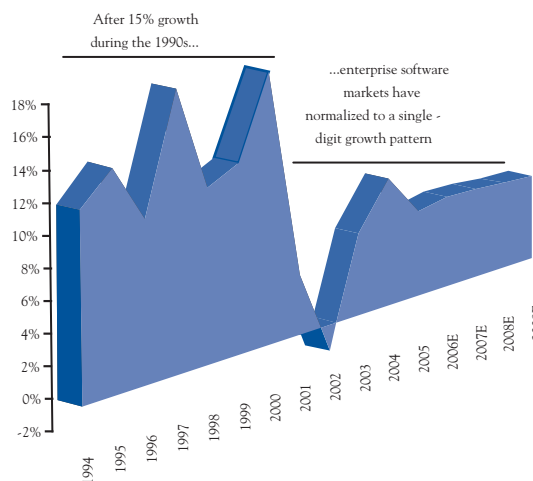
- **"Maturing" Software Industry Projected for Single-Digit Growth.** As depicted in Figure 1, the enterprise software industry has evolved with each new innovation triggering consolidation of earlier generations. The 1990s witnessed one of the most remarkable periods of growth. IT departments became strategic assets. Large and mid-size organizations made significant new technology investments. Year 2000 (Y2K) compliance and Internet/e-business development fueled record levels of spending and then the technology bubble burst. Today, the sector has resumed growth albeit a slower pace. The illusion of the next "killer application" has waned, maintenance of exist-
- ing investments has become top priority, and budgetary pressure has forced more diligence ahead of each new investment. The general consensus is that the software industry has matured to single-digit growth (see **Figure 2**).
- **Shrinking Profit Margins - Effects of Slower Growth and a Shifting Balance of Power.** Figure 3 is a historical review of the gross margins of the top 100 enterprise software firms. Longer sales cycles are giving clients more leverage in the negotiating process. Perceived value, multiple alternatives, and overall lower initial client investment have had a detrimental impact on top-line performance and profitability for software firms traditionally reliant on high margin from new product license sales.
- **"Services-Based" Enterprises with a Model Shifting from License to Maintenance and Support.** The business model for software firms has changed. Le-

gacy business models for software firms derive 70% of revenues from new product sales with the remainder coming from professional services, support and maintenance. Market conditions have shifted to more revenue (and growth) being derived by supporting implementations with professional services and maintenance now representing more than 50% of revenues (see **Figure 4**). Driven by market conditions, software firms are evolving into *service-based organizations* where incremental growth and profitability are more dependent on a revenue line item previously regarded as "lower value." The result is that many traditional software firms have been forced to embrace a Software as a Service model by virtue of a shifting revenue model without garnering any of its benefits or operational leverage.

- Value Disconnect between Software Providers and Customers - Stressing the "Lifetime" ROI Proposition.** A number of "hard" and "hidden" costs relative to software implementations including failed deployments, product delays, poor user adoption, and higher than planned total cost of ownership (TCO) have adversely impacted customer value and satisfaction. The reality is that only a small percentage of the capabilities delivered are actually utilized. Yet, software firms believe that "true" product value lies in the robustness of its features and functions rather than satisfied end-users throughout the full application lifecycle.

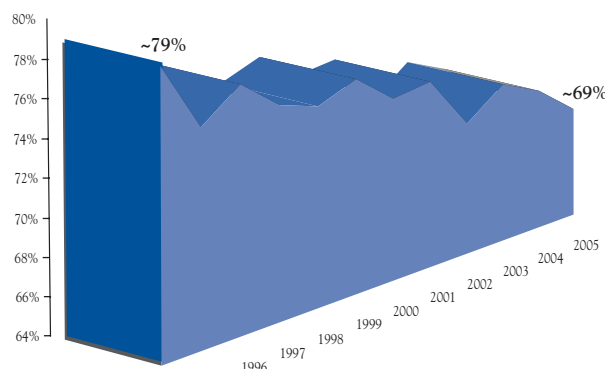
According to **AMR Research**, 12% of CRM projects failed to ever be implemented. An additional 47% of projects had significant end-user adoption problems even though the projects were successful from a technical standpoint. Another 25% of projects met technical and user standards but did not provide value because they were either only as good as the replaced systems or the benefits were difficult to define.

Figure 2: Changing Macro-Level Fundamentals in the Enterprise Software Industry



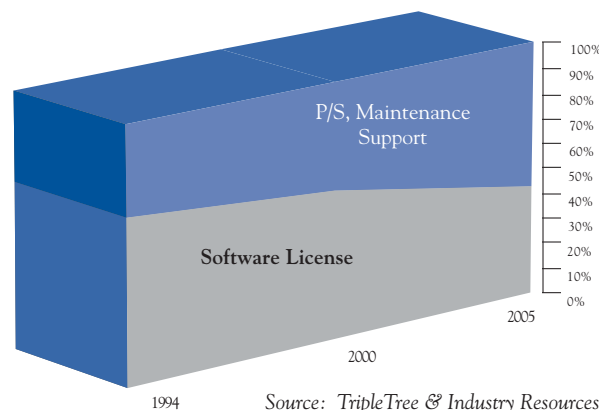
Source: TripleTree and IDC

Figure 3: Declining Gross Margin Trends (Based on Historical Analysis of the Top 100 Software Firms)



Source: TripleTree & Industry Resources

Figure 4: Software Firms are Becoming "Service-based" Enterprises with More Revenues Derived from Services & Maintenance, Rather than Product Licenses (Based on Historical Analysis of the Top 100 Software Firms)

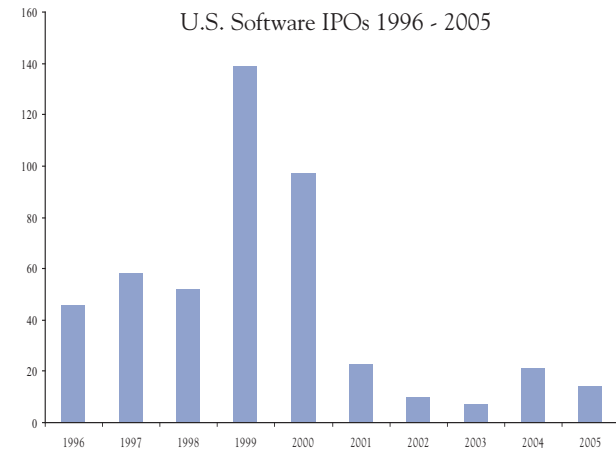
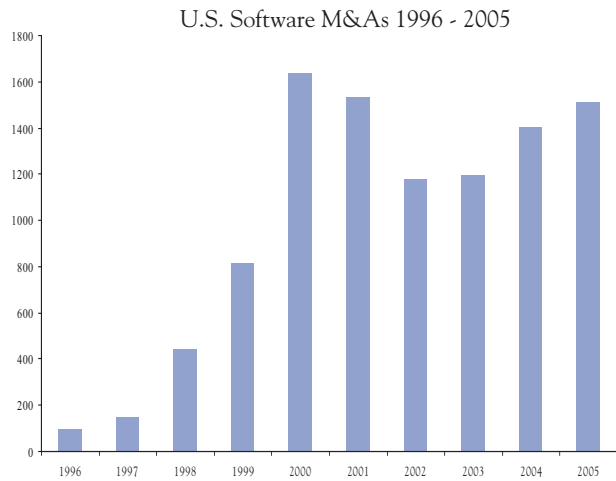


Source: TripleTree & Industry Resources

- Hyper-Competition Resulting from Pricing Pressures, Industry Fragmentation and Consolidation.** Competition is intense within the fragmented enterprise software sector. The top 25 enterprise software vendors control 50% of the market with the remaining share served by thousands of software firms. Since 2003, overcapacity and tighter budgets have prompted vendor consolidation and notable vendor break-out moves. Much of this consolidation has been impacted by Oracle's \$20 billion acquisition binge. Today, M&A remains the most viable exit strategy for many technology investors who recognize that IPO opportunities only offer liquidity options for unique firms with scalable operations and notable competitive advantages (see Figure 5).

- Sustainable Shareholder Value - More Predictability and Recurring Revenue.** Revenue growth and consistent top-line performance remains a barometer for success, prosperity and shareholder value. Traditional metrics like profitability, margins and cash flows, and risk mitigation factors like higher level recurring revenue are also of particular interest. Table 2 illustrates a comparison of enterprise value (market capitalization plus debt less cash) to revenue for TripleTree's indices on Software as a Service, enterprise software, outsourcing, offshore services, and IT consulting. Investors are clearly placing higher value on sectors with visibility into future revenue and profitability performance (and presumably lower levels of operational and execution risk). While this may be an oversimplification, market performance over the past two years has rewarded these

Figure 5: Consolidating Software M&A Activity Overshadows the Level of Activity for Software IPOs



Source: TripleTree and Capital IQ

vendors. Private equity firms have also aggressively responded by investing in recurring revenue businesses. As evidenced by assuming controlling positions in multi-billion dollar franchises like Sungard and interests in firms like Computer Sciences Corporation (CSC)

Table 2: "The Software as a Service Premium": A Comparison of Enterprise Value-to-Revenue Across Sectors

TripleTree Sector & Index	Current EV / R ⁽¹⁾	12 Months Ago EV / R ₍₁₎	% Change	Examples of Companies in the Sector / Index
Software as a Service	5.0x	4.8x	4%	Salesforce.com, RightNow, WebSideStory, WebEx, etc.
Offshore IT Services	3.6x	3.9x	- 8%	Cognizant, HCL Infosystems, Infosys, Saytam, Wipro, etc.
Enterprise Software	2.0x	1.7x	18%	BEA, Lawson, Microsoft, SAP, Oracle, SSA Global, etc.
Outsourcing & BPO	2.0x	2.0x	0%	ACS, ADP, CSC, EDS, Perot Systems, etc.
Management & IT Consulting	0.9x	1.0x	- 20%	Accenture, BearingPoint, etc.

⁽¹⁾ Enterprise value is market capitalization (stock price multiplied by outstanding shares) plus debt less cash divided by trailing twelve month revenue.

Source: TripleTree

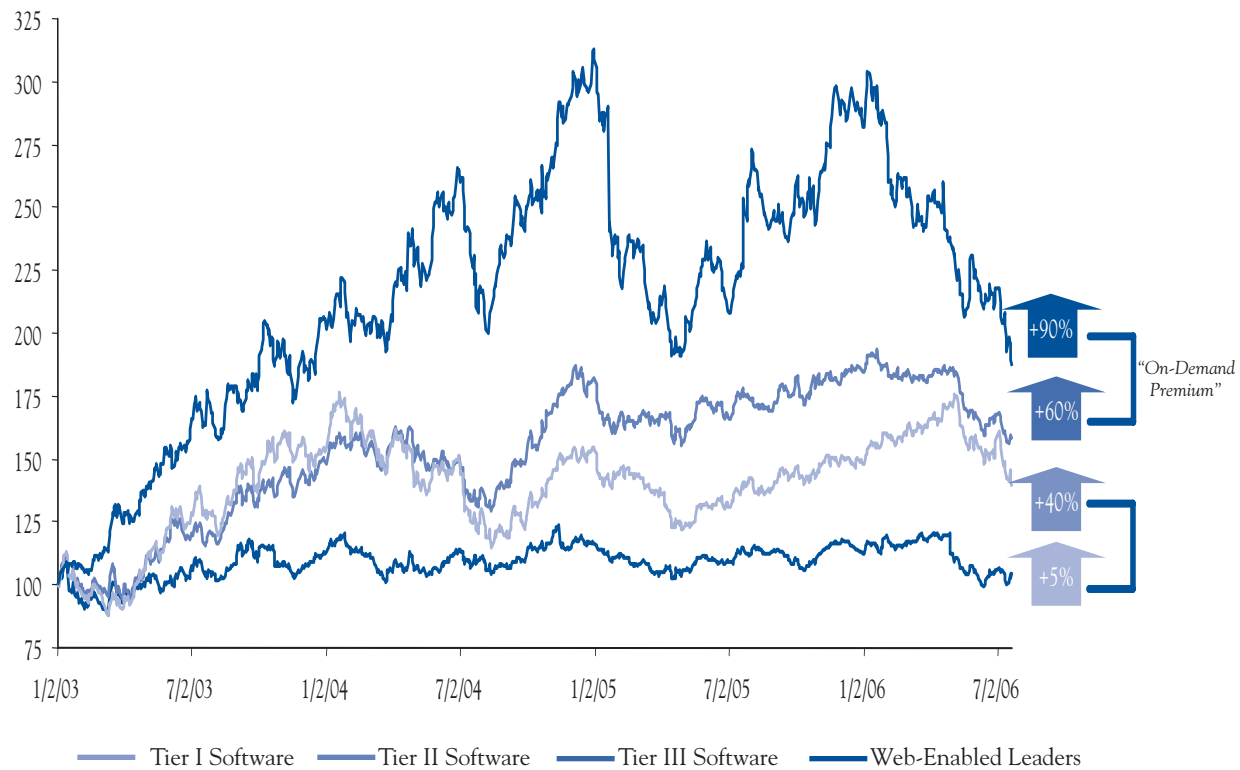
and *Affiliated Computer Systems (ACS)*, TripleTree expects private equity firms to continue aggressive positioning with firms with recurring revenue themes.

- The "Google Effect" - Premium Market Valuations for Internet-based Companies.** Reminiscent of the mid-1990s, market perceptions, high valuations and stock price performance of Internet innovators like *Amazon*, *eBay*, *Google*, *Salesforce.com* and *Yahoo* continue to gain momentum. **Figure 6** illustrates the performance of these stocks in relation to their software counterparts. At the extreme, *Google*

has amassed over \$100 billion in market capitalization and in the technology sector is only rivaled by the likes of *IBM*, *Microsoft*, *SAP*, and *Oracle* in this regard.

While TripleTree does not believe the entire software industry will radically change its game plan in response to these macroeconomic conditions, market pressures will only persist as Software as a Service becomes more commonplace and will thereby prompt a Darwinian re-direction towards Software as a Service in application delivery, product engineering, sales and distribution, and business model disciplines.

Figure 6: Web Innovators are Being Rewarded by the Public Capital Markets (Three-Year Relative Stock Performance)



Source: TripleTree

A WINNING FORMULA FOR ALL CONSTITUENTS

Perhaps the most compelling attributes of Software as a Service is the winning formula created by customers, suppliers and investors. Software as a Service creates a win-win-win scenario by inherently addressing challenges with deploying and utilizing technology, creating stronger economic incentives between end-users and vendors, and providing more financial predictability for investors and capital markets.

ON-DEMAND SHIFTS THE RISK OF TECHNOLOGY PURCHASES FROM CUSTOMERS TO SUPPLIERS

First, customers are seeking to eliminate costly, complex and time consuming technology decisions by incurring lower up-front costs and shifting the risk of technology purchases to its suppliers. Second, it has been well documented by many analysts that the software industry has suffered from customer dissatisfaction and frustration with upfront costs, costly and lengthy implementations, poor end-user adoption, and strained vendor relationships.

"There are so many enterprise customers who have all these licenses collecting dust and have spent all this money to achieve a certain ROI. But they're using as little as 10% of the functionality. They're beginning to ask: Why do we continue to do this?"

- Rick McGee, Vice President,
Software-as-a-Service, IBM.

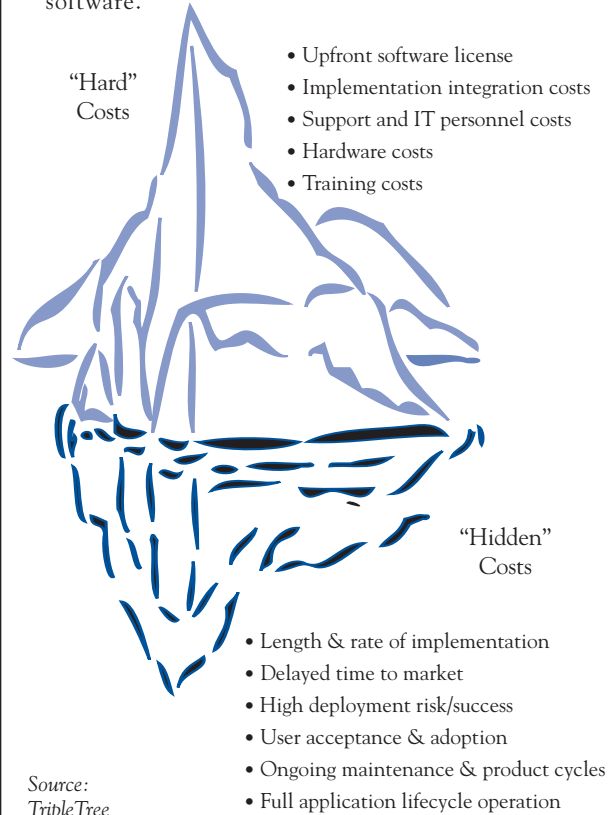
A classic approach with licensed software deployment has been to add more features and functionality instead of focusing on ease-of-use, quicker time-to-market, or lower cost of ownership, which are the hallmarks of Software as a Service. These traditional ways of selling and servicing enterprise software have been problematic for vendors and thus, a "customer-centric" approach has taken hold. Specifically:

- Software as a Service solutions are engineered to be simple to deploy, learn, use and customize. This begins with an approachable graphical user interface;

- Lower up-front and ongoing operational costs with no investments required in software, hardware and exhaustive internal IT resources;
- Eliminating the hidden costs of licensed software which are likened to an "iceberg effect" relative to customer ROI (see **Figure 7**) and realized value;

Figure 7: "Hard" & "Hidden" Cost Equation with Software Utilization

The software license is just the tip of the iceberg; it is not what is seen or known, but what is unseen or lies below the surface that is the source of the titanic problem with traditional software.



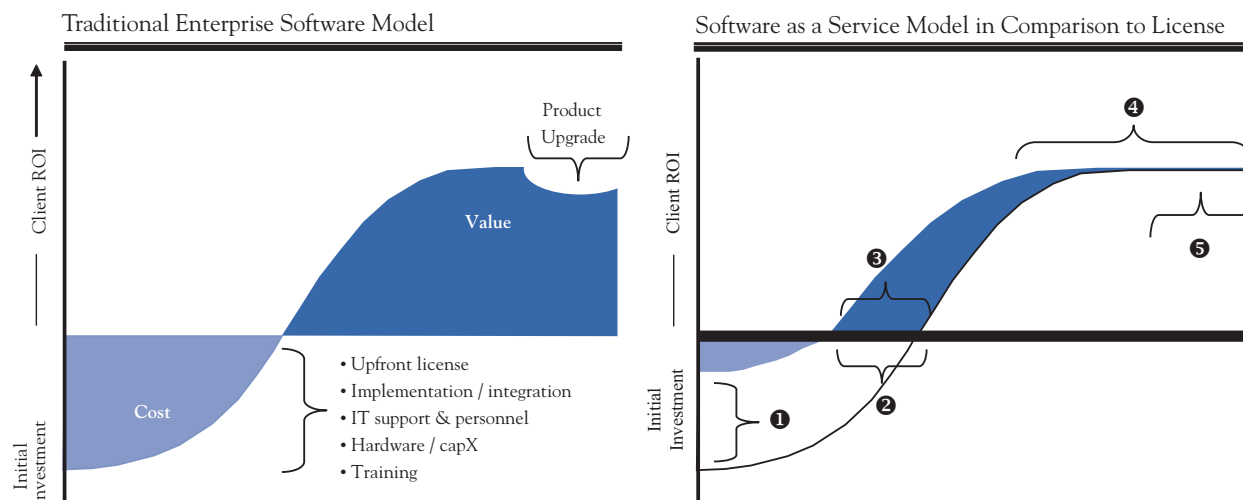
- Faster deployment and time-to-market that are fully operational in a few months (even weeks or days), rather than lengthy deployments ranging from six to 24 months;
- Accelerated payback and ROI effectively managing the total cost ownership (TCO) towards

continual value over the entire application life-cycle. A shift of the customer's cost equation from a capital expenditure to a predictable operating cost with identified and a known measurement being a powerful on-demand value proposition (see **Figure 8**);

"Customers can spend up to four times the cost of their software license per year to manage their applications."
- Gartner

- Ongoing customer service, support, and training emphasizing end-user acceptance, usage and productivity as much as it is solving technical issues, troubleshooting or providing help desk services; and
- Seamless product enhancements and upgrades that do not require overhauling prior versions, supporting legacy versions or re-writing system interfaces.

Figure 8: Compelling Total Cost of Ownership (TCO)



Differences between on-premise and on-demand changes customer dynamics and the selling proposition.

- 1 Pay-as-you-go lessens the severity and upfront cost/risk with each technology purchase.
- 2 Rapid deployment results in a quicker risk adjusted return.
- 3 Accelerates the time to market and use of the technology with deployments generally less than three months.
- 4 Predictable operating costs rather uncontrollable and costly maintenance and application performance.
- 5 Eliminates costly delays with future product version upgrades.

Source: TripleTree

SOFTWARE AS A SERVICE ADDRESSES KEY CHALLENGES FACING TECHNOLOGY PROVIDERS

The software industry has struggled to build sustainable client relationships which extend beyond the initial product sale and yield operational leverage that does not inhibit financial performance. Fundamental shifts in how the customer and vendor aligns both contractually and economically (pay-as-you-go), as well as ensuring on-going support and end-user adoption (perpetual accountability) all point toward the strengths of a utility-based model. Through this business partnership, the customer and vendor have their goals aligned which engender:

- More predictable recurring revenue and cash flows through annual or multi-year contractual relationships with high renewal rates, rather than relying on new product sales, upgrades or maintenance for growth and repeat business; and
- Manageable cost structures and higher margin potential with structural R&D and operational deployment leverage. This stems from shared resources and economies of scale derived from a consistent application framework and the elimination of redundancies in supporting different product iterations or architectures.

SOFTWARE AS A SERVICE PROVIDES INVESTORS WITH GROWTH AND MANAGED RISK

Investors and public markets have rewarded companies who have greater visibility into future performance and offer the operational leverage for higher margins and economies of scale. A persistent mantra among capital market investors is for recurring revenue-based business. Identifying new growth areas that can manage fluctuating business cycles are also in demand. Software as a Service firms provide:

- Projected growth at four to five times the rate of traditional software segments;
- Risk mitigation via "recurring revenue," pre-

dictable cash flows, increased visibility into performance through backlog, new bookings and future revenue recognition derived from deferred revenues; and

- Operational leverage and enhanced margin potential with efficiencies gained through a common delivery framework, repeatable processes, and resources.

THE HISTORY OF SOFTWARE AS A SERVICE

In reviewing the historical progression of the sector, three core questions are important to revisit:

- What is the history of Software as a Service? Will the sector survive, and in fact, prosper where its predecessors with similar philosophies and market advantages failed to fully succeed and live up to expectations?
- What is the fundamental difference between the current model and those of the past so it is not doomed to repeat past shortcomings? What is the fundamental difference between Software as a Service and other commonly used terms or delivery models like Application Service Providers (ASPs), Web / application hosting, managed services, utility computing, outsourcing, or Business Process Outsourcing (BPO)?
- What does the future hold for Software as a Service and where does it reside in the broad-

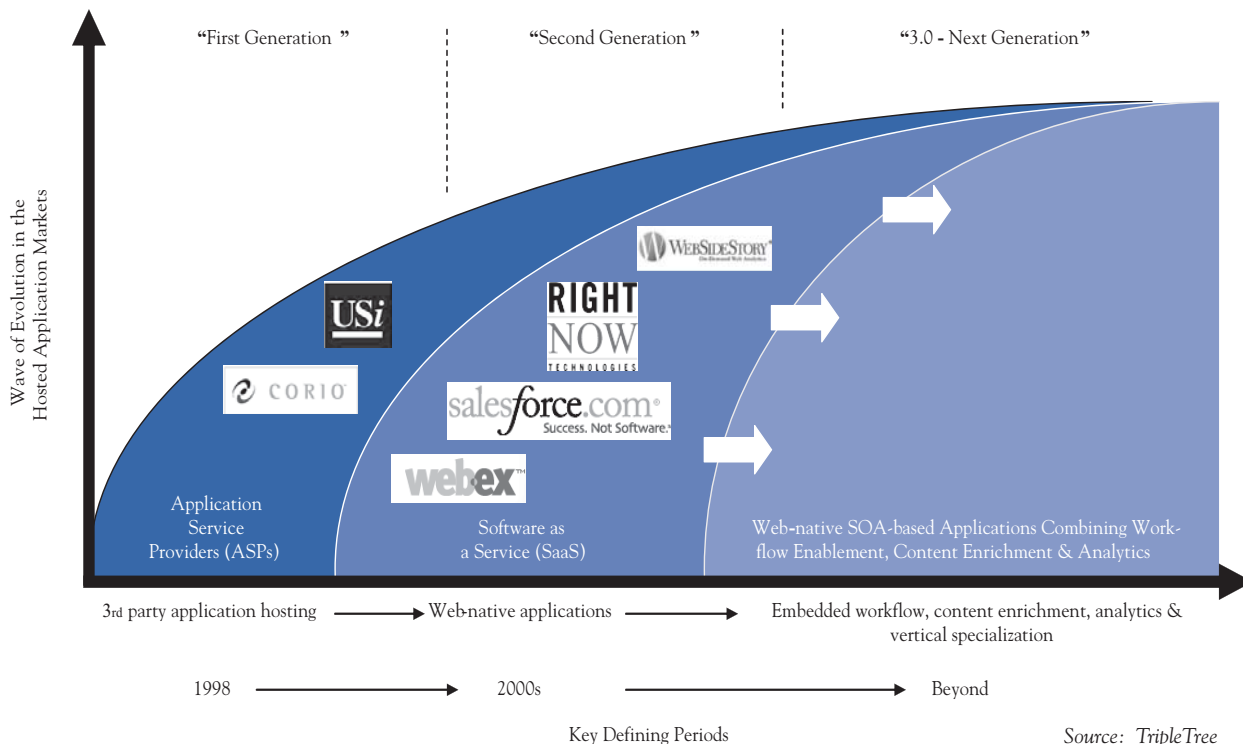
er ecosystem of software, outsourcing and consulting sectors?

SOFTWARE AS A SERVICE DEFINED

As discussed in our 2004 research publication on Software as a Service, the current model is evolutionary from prior generations (see **Figure 9**). Earlier versions were predicated on third-party application hosting of first generation ASP businesses that were most prevalent in the late 1990s with an earlier lineage dating back to mainframe, time-sharing models.

- **First Generation - 3rd Party Application Hosting.** First generation models (1998 - 1999 timeframe) were originally designed as a way for the small-to-medium size (SMB) market to use enterprise-class software functionality from Tier I & Tier II software providers like *Broadvision*,

Figure 9: Wave of Evolution in the Hosted Application Market



Source: TripleTree

Early pioneers set the stage for the "next generation" where on-demand services will not be simply viewed as easy to use application service rendered accessible over the Internet, but instead as a set of integrated, mission critical services delivering real-time content, analytical insight, and a highly specialized vertical industry framework that is unprecedented from today's software.

Lawson, Microsoft, Peoplesoft, SAP and Siebel without requiring large upfront license payments and implementation fees.

These models ran into operational challenges. Successfully scaling third-party application services that were not ready for Internet delivery in a "one-to-many" or multi-tenant basis proved to be difficult. Instead, many of the ASP offerings were patched together with thin client technical architectures that were deployed behind the client's firewall or lacked the ability to be replicated across multiple client instances. Likewise, customization and back-end integrations defeated the purpose of growing profitable ASP operations. Consequently, a first pass at hosted applications failed to live up to its expectations. The result is that many firms failed or morphed into today's managed services, application maintenance, Web hosting, and outsourcing providers.

- **Transformation to the Second Generation - On-Demand Application Services.** A new generation of businesses and models emerged seeking to rectify prior shortcomings with applications developed "in the cloud." The principal difference being the development of its own Web-native applications specifically designed for delivery over a standard Internet web browser. Many began to surface in the 1999 - 2001 timeframe with the first few years being missionary for these early pioneers. Challenges associated with the prior ASP model, a need to resolve end-user concerns about security, reliable application performance, back-end integration, and customization in addition to managing through one of the worst periods for start-up technology firms, all presented difficult hurdles to overcome. Despite this, early pioneers like *Salesforce.com*, *WebSideStory*, *WebEx*, *RightNow* and others emerged victorious and in the past

18 months have become recognized as the sector's innovators.

- **Software as a Service 3.0 - "The Next Generation."** TripleTree is watching for firms to deliver a more tightly integrated set of application services (both on-demand and on-premise) and embedded workflow with underlying business logic built on a Services Oriented Architecture (SOA), Web Services and AJAX technologies that are all deployed across a Web-enabled framework. Software as a Service 3.0 will evolve from an "adoption" to "addiction" phase with the four principal contributors listed below as the drivers:

- **On-Demand Application Delivery is the only Option with Little Consideration for a Traditional Enterprise Software Approach.** The customer actually prefers the application services to be deployed outside of its firewall. For instance, anti-spam and web analytics are good examples of remotely hosted application services that are desirable and, in many cases, preferred as a Web-based offering. Another facet here is where a services role is a more important facet than the product itself. ADP is the pioneer of this concept with its employer payroll services. In either case, these allow for an accelerated adoption cycle in effect becoming "viral" moving from one department or business unit to another in an addictive pattern.

- **Enriched Workflow Becoming Intrinsic to End-Users' Daily Working Habits.** Continuously adding depth to the underlying workflow, business logic, and configurability is inherent with on-demand applications. A pinnacle is reached when it is entirely unwanted by existing Software as a Service users to switch over. Custom development tools enable user level customization and communi-

ty tools. AppExchange from *Salesforce.com* democratizes how applications are assessed, purchased, and integrated; while, in another example, *Intuit's* Quickbase provides a robust application platform for the small business user. The net result is that adding workflow to a broader suite and customization features lends itself to longer-term, sustainable client relationships lowering any rate of attrition.

◦ **Intertwine Content Enrichment and Rich Analytics Beyond What is Permissible with On-Premise Software Deployments.** On-demand web analytic providers like *WebSideStory* or *Omniure* or industry specialists like *DealerTrack* are examples that bring content and analytics from third-party sources together. TripleTree believes the "stickiness" of analytics is the "holy grail" in the on-demand sector, due to the unprecedented capabilities to leverage best practices and apply key performance indicators across a large user base - "the network effect".

◦ **Industry-Specific Functionality Leading the Way to Deeper Services Specialization.** Most of today's Software as a Service firms opt for solving "horizontal" business issues. However, many successful Software as a Service firms are focused on narrow industry sub-segments and their representative business challenges. In sectors like construction, real estate services, automotive retailing, mortgage lending and others, automating business rules and services via Software as a Service is a defining strategy for many new market leaders. Vertical specialization with specific business process regime and services rendered to industry needs will define tomorrow's on-demand leaders from the rest of the pack.

In the future, on-demand application services will not be viewed simply as an easy-to-use application service accessible through the Internet, but instead as a set of integrated, mission-critical services delivering a level of real-time content and analytical insight on a specialized vertical industry framework

that is unprecedented and not possible with today's traditional software. Value drivers for the next generation topic will be addressed in the section titled, "Intrinsic Value Lies in the Qualitative Factors" on page 37.

THE FUNDAMENTAL DIFFERENCE OF SOFTWARE AS A SERVICE

Increased media attention, a growing analyst following, and favorable capital markets have attracted the attention of many. In fact, this level of activity rivals the hoopla of the Internet dot-com days. However, a growing amount of confusion remains, despite all the discussion and attention devoted to Software as a Service. We attempt to distill Software as a Service to its essence:

"Software as a Service represents a Web-centric application service designed, delivered and accessible through a standard Web and Internet browser with the application residing outside of the customer's firewall and offered through a flexible, recurring ("pay-as-you-go") pricing structure for end-users. This model supports a multi-tenant application architecture allowing operation from a shared, single instance of the application service and delivery platform."

- TripleTree

Partly confusing the matter are the wide variety of terms used simultaneously including Software as a Service, on-demand application services, application service providers, Web / application hosting, utility computing, managed services, outsourcing, business process outsourcing (BPO), among many others. Throughout this report we interchange the terms *Software as a Service* and *on-demand application services*. See **Table 3** for additional perspectives on the subtleties of Software as a Service in relation to other sectors frequently discussed.

Table 3: Fundamental Differences Between Software as a Service and Other Related Sectors

	Enterprise Software	Application Service Provider (ASP)	Software as a Service	Managed Services / App. Maintenance	Outsourcing / BPO
Type of relationship & what is being delivered?	Technology / product relationship; selling packaged software products	Service provider of third-party software; remote access to Web-enabled or 3 rd party enterprise applications hosted & maintained by the provider	Service model with applications created and designed for Internet delivery and hosting by the provider	External service provider that is continuously managing and supporting third-party or internally developed applications	External service provider assuming full responsibility for technical functions (IT hardware, etc.) or a specific business function (HR, customer service, back-office, etc.) that may or may not include application services
What is being provided?	Packaged software products	Hosted application services	Hosted software with services	Customized services	Customized services
Where is the solution provided?	"On-premise" software application that is deployed behind the customer's firewall and resides within the client's own IT infrastructure	Installed & managed in-house or deployed as a remotely hosted application	Internet application service delivered and accessible over a standard Web browser	Managed & delivered service either on- or off-site	Internal and external resources supporting the process; typically on-site combined with remote management
What is the nature of the client relationship?	Client buys a software application; typically under a perpetual license with ongoing maintenance	Client rents or leases the use of a 3 rd party application with off-site hosting services provided	Client rents or leases the use of the software application with hosting services all performed by the technology/services provider	Client buys the software application from a 3 rd party or internally develops; contracts with an external service provider to manage, support and maintain	Client contracts with an external service provider to fully manage, support, maintain and deliver a specific business function or technical need
What is the type of expenditure for the client?	Upfront, one-time capital expenditure for a perpetual license with ongoing maintenance and periodic upgrades	Pay-as-you-go, recurring operating expense; can be multi-year arrangement	Pay-as-you-go, recurring operating expense; can be multi-year arrangement	Periodic payments; multi-year agreement generally up to three years	Long-term, fixed contract with periodic payments and identified costs; usually from three to twelve years in length
What are the components of the expenditure incurred by the client?	<ul style="list-style-type: none"> •Software license & upgrades •Implementation & integration •Maintenance •Hardware •Training •IT support 	<ul style="list-style-type: none"> •Software license & upgrades •Implementation & integration •Hosting and maintenance charges 	<ul style="list-style-type: none"> Upfront professional services deployment Periodic payments including subscription, data hosting, support, etc. all lumped into one payment 	<ul style="list-style-type: none"> •Software license & upgrades •Maintenance •Hardware •Managed services fee 	Fixed price contract and periodic payment, but could also include cost-plus or shared savings fees
What is the level of flexibility?	Packaged with customization, if needed	Customized deployment with limited application flexibility	Application configurability but limited customization	Customized	Customized
What is the targeted market?	Fortune 1000 and mid-market	Small and medium size businesses	Small and medium size businesses	Fortune 1000 and mid-market	Global and Fortune 1000
Who are examples of companies fitting this description?	Microsoft, Oracle, SAP, among others	Corio, USInternetworking, among others	Salesforce.com, RightNow, WebSideStory, WebEx, among others	ACS, EDS, Cognizant, Wipro, among others	Accenture, ACS, CSC, EDS, IBM, Cognizant, Wipro, among others

Source: TripleTree

A few defining characteristics comprising the DNA of Software as a Service firms include:

- A core shift in the underlying relationship, from product-based to service-based;
- Web-based application with delivery of the application service over a standard Internet browser that is specifically designed and developed by the Software as a Service provider, not another technology firm;
- No end-user investment required in software, hardware, implementation and integration services, or use of additional IT staff;

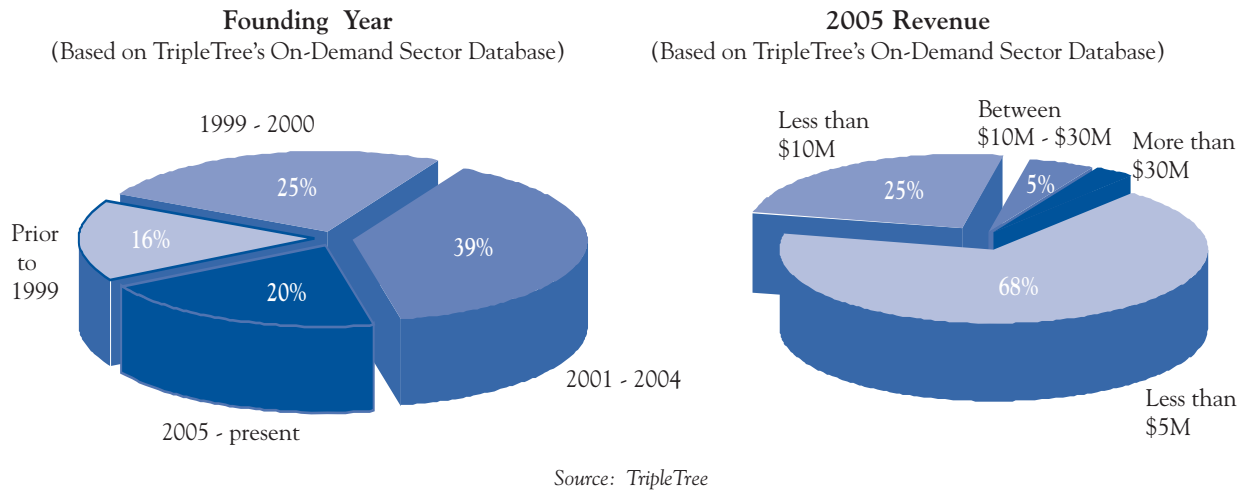
- | | |
|--|--|
| <ul style="list-style-type: none"> <input checked="" type="checkbox"/> No software/no hardware installed; remotely delivered and managed applications from a single or multiple centralized locations, but not residing on the client's site or within its underlying IT structure; <input checked="" type="checkbox"/> Rapid and simple deployment, configuration and training (typically less than three months); <input checked="" type="checkbox"/> Single application code base (Java, J2EE, .NET, or open source) and single platform and database selection that is used across the entire customer base allowing for significant product development and R&D efficiencies; <input checked="" type="checkbox"/> A "one-to-many" application delivery model that is often defined as a multi-tenant architecture, which is a scalable, secure, and replicable application architecture capable of supporting thousands of concurrent customers on a single instance of the application; <input checked="" type="checkbox"/> Frequent upgrade cycles occurring multiple times per year in addition to minor product enhancements on a routine basis that are all seamlessly deployed over the Web; <input checked="" type="checkbox"/> "Pay-as-you-go" pricing with a wide variety of models (i.e., subscription, transaction, etc.) and terms ranging from monthly to multi-year contractual agreements and various collection terms ranging from payments received upfront, to pre-pay, to as incurred; <input checked="" type="checkbox"/> Ability to customize and configure the appearance, policy settings, workflow and other characteristics to meet the diverse needs of a large customer base; <input checked="" type="checkbox"/> Ability to integrate using APIs and Web Services with other existing third-party and internally developed enterprise applications and databases; | <ul style="list-style-type: none"> <input checked="" type="checkbox"/> Back-end application hosting from remotely managed/owned facilities, or provided by a third party; <input checked="" type="checkbox"/> 24x7x365 perpetual account responsibility with on-going customer services supporting end-user adoption, use / training, and troubleshooting. |
|--|--|

A SECTOR OF GROWING IMPORTANCE

TripleTree tracks more than 550 Software as a Service firms, the vast majority of which have less than six years of operating history with an on-demand model and less than \$15 million in annual revenue (see **Figure 10**). While these points are noteworthy, most of these businesses are now reaching an important inflection point in their ma-

turity. The conceptual selling required during the early years of on-demand have been replaced by a growing level of customer familiarity among all market segments. As a result, 2006 - 2007 has become a watershed year for these firms to add size and critical mass and compete aggressively for meaningful market wins versus incumbent players.

Figure 10: Most On-Demand Firms Began in the Past Five Years with 95% Having Revenues Less than \$15 Million



Software as a Service is a high growth sector, outpacing the software industry growth rate by 5x. Still, it remains relatively small representing less than 2% of the total technology market and won't likely grow to more than 5% for the foreseeable future. Analysts project the Software as a Service segment to grow 20% and reach \$11 billion by 2009, up from approximately \$4 billion today (see **Figure 11**). Two important points are worth addressing:

Figure 11: Software as a Service is More Profound than Projected

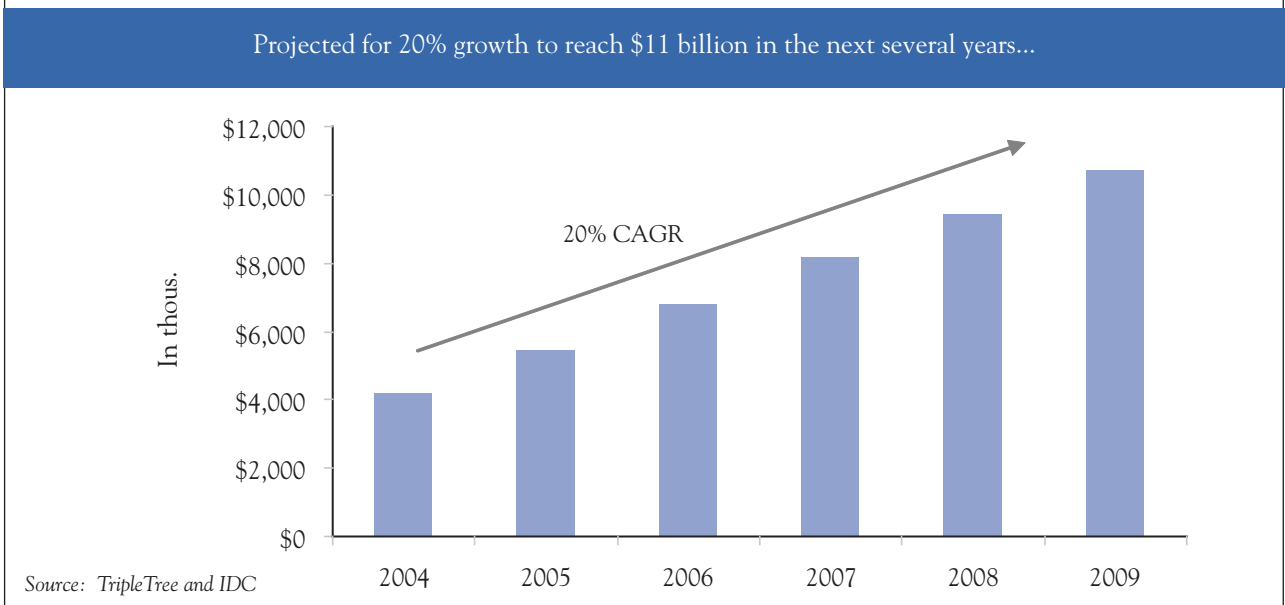
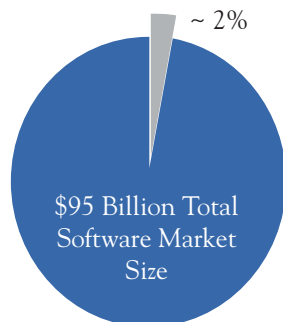


Figure 11: Software as a Service is More Profound than Projected (continued)

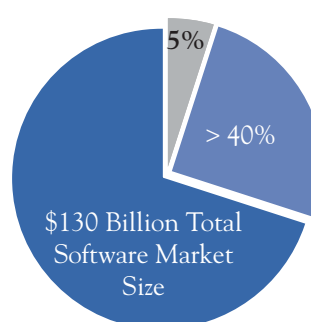
...with current projections underestimating the size and significance by as much as 80%;
a \$50 billion plus market opportunity

2005 Software as a Service Market Compared
to % of Total U.S. Enterprise Software



■ IDC's 2005 SaaS market penetration estimate

2009 Software as a Service Market Compared
to % of Total U.S. Enterprise Software



■ IDC's 2009 SaaS market penetration estimate

■ TripleTree's 2009 SaaS market penetration estimate

Source: TripleTree and IDC

1. Market statistics **underestimate the size of the Software as a Service sector by as much as 80%**. For the following reasons, TripleTree's analysis forecasts that the Software as a Service market potentially exceeds 40% of the total software market - or \$50 billion by 2009 (see **Figure 11**):

- Many analysts focus on first-generation ASP and related hosted application management rather than Web-native Software as a Service. Granted, the latter is difficult to fully quantify since many firms are privately-held providing limited public information. TripleTree's direct interactions within this segment underpin our viewpoints.
- Revenue recognition policies spread on-demand revenue out over time which downplays the near-term size of the market based on reported revenue in a given period. Reported revenue taking into account backlog is a more meaningful measurement. Factoring in high retention with contract renewals provide yet another gauge reflecting a larger market than originally projected.
- Generally, Software as a Service offerings are priced anywhere between two to ten times less expensive than the traditional packaged software solutions, thus impacting the immediate

market size.

- Popular market niches like CRM are growing at a fast rate and are quickly transforming on-demand standardization. Analysts estimate that on-demand CRM will grow at 40% CAGR reaching nearly \$4 billion by 2008, representing 36% of the total CRM market; while, comparatively the on-premise CRM market is estimated to grow at less than 6% during this same period. These projections alone imply that the on-demand CRM sector represents approximately 40% of the total on-demand market, which significantly underestimates the success of other Software as a Service sectors.

2. **Going forward, Software as a Service and "on-demand" will become synonymous descriptions for a business or delivery model whether addressing CRM, supply chain, compliance, collaboration, HR, and others.** Today, there is a finite universe of public companies committed to on-demand but more companies are beginning to adopt its disciplines. In the past 18 months, *Agile Software*, *Ariba*, *Business Objects*, among others have announced on-demand offerings. However, relying only on an index of public companies downplays much of the activity in the on-demand sector.

MICRO-SEGMENTATION

Software as a Service poses new threats to legacy on-premise offerings by reshaping application domains, creating new application categories, and leveraging new vertical solutions. Completely new classes of companies - designing Web-based offerings principally for on-demand delivery - have been the trailblazers and early leaders of the Software as a Service evolution. While Software as a Service is largely attributed to firms like *NetSuite*, *RightNow*, *Salesforce.com*, and *WebEx*, there are hundreds of other similar success stories. These firms are all participating in six evolving trends:

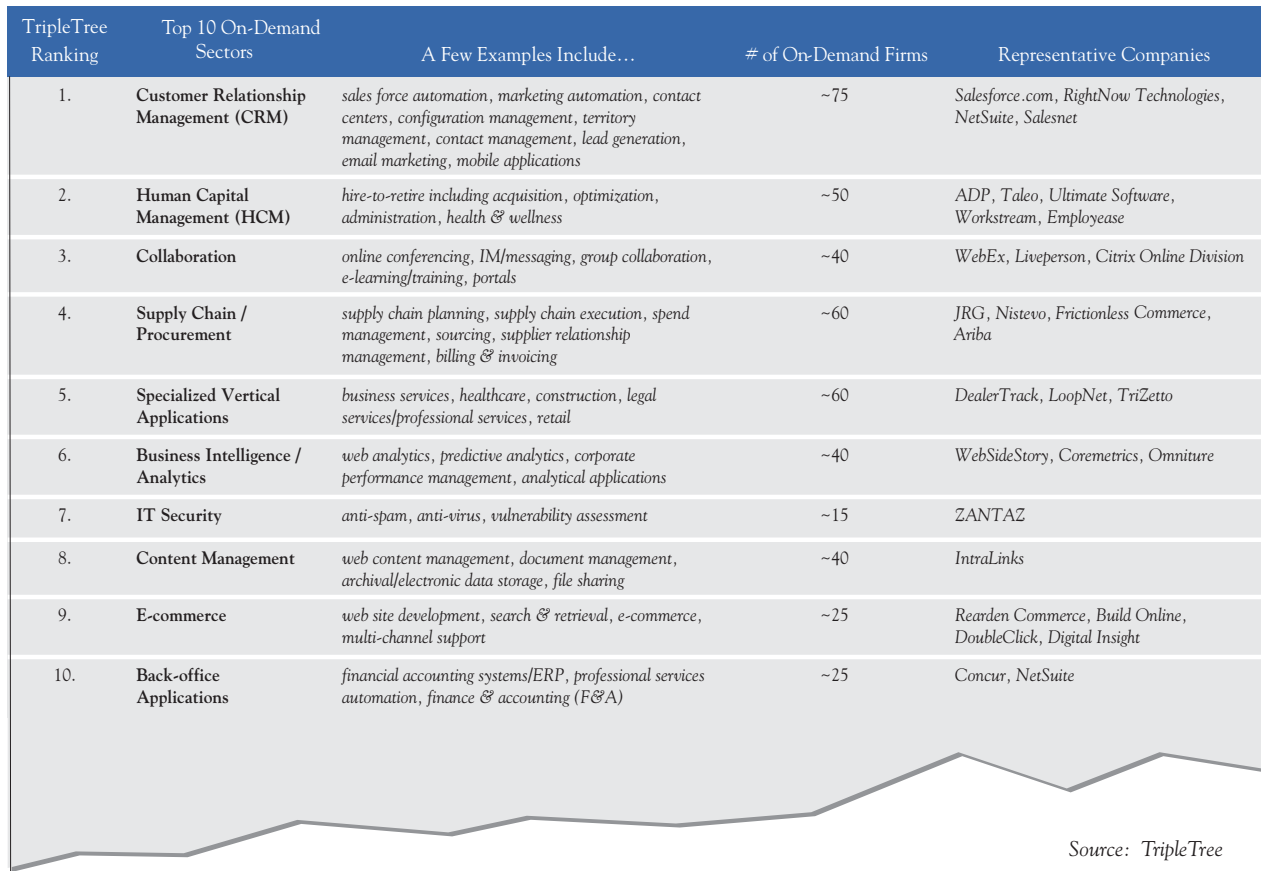
1. **Legacy replacement** where traditional on-premise enterprise applications are being displaced by on-demand offerings. The best examples are CRM and HR, where on-premise applications are quickly being supplanted by a new delivery model. Public firms like *Salesforce.com*, *RightNow Technologies*, and over 75 private firms like *NetSuite* compete in CRM sectors with public firms like *ADP*, *Taleo*, *Ultimate Software*, *Workstream*, and over 50 private firms like *Employease* competing in HR sectors.
2. **New category definitions** like web analytics, anti-spam, public relations, partnership relationship management, compliance and others are forming as a result of a great fit with a Software as a Service delivery approach. Or, category re-definitions like spend management, procurement or supply chain management are re-surfacing by the arrival of best-in-class, on-demand firms. *Vocus*, is a public on-demand firm focused on a newly formed public relations function. *Concur*, which is a public on-demand Corporate Expense Management firm, is another example and discussed later in this report.
3. **Infrastructure** with back-end data systems, basic productivity tools, and operating systems being deployed in a hosted model or collaboration applications including messaging and back-office productivity. Public firms like *Citrix Online*,

LivePerson and *WebEx* have been leading the transformation in collaboration categories.

4. **Vertical-specific offerings** architected specifically to meet market needs in large segments like financial services, healthcare, education, government, retail or in narrower market niches like legal services, real estate, construction, automotive retailing, hospitality and fast food restaurants. Amazingly, on-demand adoption is strong in sectors like Healthcare - which have traditionally been laggards when it comes to new innovations. Public firms like *DealerTrack*, *Kintera* and *LoopNet* are examples in automotive retailing, non-profit, and commercial real estate segments.
5. **ISV migration** includes traditional on-premise enterprise software firms pursuing a 'hybrid' delivery model through either internal product development or acquisition. *Click Commerce* and *Ultimate Software* are lesser known examples that are doing well with the transition, while *Siebel* was a glaring example of the challenges encountered by a traditional enterprise software firm attempting, and not truly succeeding, in the transition.
6. **On-demand enablers and infrastructure providers** are back-end tools and resources to assist in developing, delivering, migrating and supporting on-demand offerings noted above. More commonly known are data center, application hosting, co-location/redundancy, and disaster recovery services from firms like *IBM*, *EDS*, *Sungard*, and *Savvis*. Best-in-class companies like *Jamcracker* and *OpSource* are examples of Software as a Service enablers.

Virtually every application category now has on-demand solutions, including Customer Relationship Management (CRM), Human Capital Management (HCM), Collaboration, Supply Chain / Procurement, specialized vertical applications, Content Management, infrastructure services (IT Security), and back-office applications. Per TripleTree's research, database, and survey results, the following are the top ranking categories (**Figure 12**):

Figure 12: On-Demand CRM is the “Beyond CRM” - Most Application Categories Have On-Demand Offerings



LOOKING AHEAD...FUTURE ALIGNMENT

A transformational shift to Software as a Service will not be an overnight phenomenon in global markets. The formally separate sectors of software, technology, outsourcing, and consulting-based businesses are now in fact **converging**. Software as a Service is one game-changing force redefining how these sectors will seek to fill gaps, identify new growth sectors, solve inherent challenges and differentiate, and respond to new competitive pressures.

Along with outsourcing, offshore, wireless, and open source, Software as a Service is a mega-trend that firms will be forced to respond to. In fact, eventually it will be very difficult for established, legacy software firms to get off the "perpetual license drug" by themselves. In addition, strategic decisions will be more complex and limited than in the past. No longer will established companies be able to weigh all the pros and cons associated with buy, build/internal development, partner or leave alone options. ***More than ever, options will be limited to "buy" or "do nothing" as internal development or partnering don't pose viable options (this is especially true for public companies under the scrutiny of Wall Street and investors).***

Many enterprise software firms will first attempt to straddle 'hybrid' offerings - packaging licensed software applications and on-demand solutions as compelling offerings conveying the advantages of both. In the end, these firms will learn that a 'hybrid' model is not a panacea and many will face the difficult decision of either committing to Software as a Service in whole, or simply not participating.

OVERWHELMING CHALLENGES TRANSITIONING FROM A PERPETUAL LICENSE MODEL

Due to the challenges inherent in offering a 'hybrid' solution and the difficult "mutation," global players will need to make acquisitions to successfully compete in the Software as a Service sector.

- **Difficult Cultural Issues.** On-demand applica-

tion providers completely redefine the relationship from product-based to service-based applications. This is a "culture shock" for traditional software firms with every layer of the organization being effected. Implications are far more pervasive impacting the very essence and culture with how these organizations operate, interact and behave among its own internal employees, customers, partners, and investors.

Concur is the first traditional software company to successfully transition to an on-demand model. With over 2,000 accounts and more than 4 million users, about five years ago *Concur* successfully made a transition introducing on-demand offerings to its legacy on-premise product versions. The Company now offers on-demand Corporate Expense Management solutions and counts a diverse range of customers and industries as its end-users including *AT&T*, *Dell Computer*, *Cingular*, among other mid- and small-market companies.

The fourth quarter of fiscal 2005 was *Concur's* strongest quarter in its history having achieved record levels for revenue, subscription revenue, annual recurring revenue, operating margin and earnings. However, its transformation was not easy. The road to success was long and costly including a complete overhaul of the organization. With the completion of its acquisition of *OutTask's* on-demand travel capabilities, the Company currently reports \$80 million trailing 12-month revenue and has quietly amassed a \$500 million market capitalization.

- **Significant Sales & Marketing Challenges.** Sales and marketing organizations and channels are redesigned with many of the best Software as a Service firms excelling with a low-cost sales and marketing approach that leverages remote/telesales, selling over the Web, "test

drive" pilot programs, "guerrilla" marketing tactics and so on rather than relying on highly compensated sales teams with a classic "feet on the street" approach.

- **Customer Service is a Strategic Asset.** Customer service and support are no longer a "cost center," but a "profit center" viewed as a mission-critical asset essential for successful on-demand operation. The technical/help desk roles are redefined to include technical engineering and network operators, account management and end-user training all weaved into one.
- **Underlying Technology Architecture Dedicated to a Single Code Base.** Supporting multiple product iterations on different technologies is no longer a possibility with the on-demand model. To scale operations and prevent the pitfalls of prior generations, firms need to support a Web-enabled, single application code base rather than support multiple instances of the application or different delivery environments (e.g., mainframe, client/server, Web-based) or back-end databases (e.g., *Oracle*, *IBM*, *Microsoft*). Without this as a core tenant, one of the most important points of operational leverage in an on-demand model is jeopardized and can single-handedly deteriorate many of the best attributes of an on-demand delivery model.
- **Disrupting and Redefining a Valuable Partner Ecosystem.** Traditional sales alliances and the partner ecosystem are minimally re-invented, which further complicates a successful transition without disruption to a valuable software alliance network. Rapidly deployed on-demand application services with very little implementation fees completely change the economic reality since deployment services are generally less than three months. This forces new sales partnerships to be formed and threatens existing ones where software firms have historically prospered.
- **Resetting Investor and Wall Street Expectations.** For public software firms, perhaps the most dis-

ruptive forces are the damaging implications to the P&L and resulting valuation in the capital markets. New revenue, profit and cash flow metrics create a paradigm shift for Wall Street. Growth from the upfront software license model is replaced by more predictable (but comparatively more modest growth) for revenue, profits, and cash flows that are gradually spread out over time. Substituting upfront revenue recognition for longer-term recurring revenues can have a detrimental impact on the income statement and require investment to support delayed revenue and collections with periodic costs that are incurred and expensed upfront. Revenue recognition policies, billing, contract renewals and cash flow practices are also more complex when compared to traditional product licensing. The net result can be catastrophic, especially for unknowing or impatient investors.

With 4,800 employees and over a decade of CRM leadership serving nearly 4 million users, *Siebel* was a market leader of comprehensive CRM solutions. In the quarter before its announced acquisition by *Oracle*, *Siebel* reported approximately \$350 million revenue, a 10% year-over-year increase, on operating income of \$36 million, or a 10% margin. In the quarter, the majority of its revenues were derived from maintenance and services revenues with approximately 32% of revenues from software license revenue, which is consistent with the year ago period. At the time of the announced acquisition by *Oracle*, we estimate less than 15% of revenues were derived from *Siebel OnDemand* after two years since its re-launch and spending over \$100 million on strategic development, technology, channel formation, etc.

• **Background.** *Siebel CRM OnDemand* (www.crmondemand.com) was re-introduced in the fourth quarter of 2003, after an earlier failed attempt during the late 1990s.

The Company's on-demand initiatives were first aided by an alliance with IBM and two acquisitions - *UpShot* and *Ineto Services*. In October 2003, *Siebel* and IBM inked a multi-year joint development, marketing, selling, delivering and servicing arrangement for *Siebel OnDemand* to provide its enterprise-class CRM applications over the Web. Following a successful alliance dating back to 1999, the two organizations extended their relationship to *Siebel OnDemand* initiatives. IBM provided *Siebel OnDemand* with back-end infrastructure and support running hosted CRM applications on *DB2*, *WebSphere*, and utilizing back-end data and Web hosting services provided by IBM. At the time of the announcement, this combination created an impressive and powerful alliance to combat an emerging newcomer, *Salesforce.com*.

Later that same month, *Siebel* acquired *UpShot* for \$70 million in total consideration, which included \$20 million in contingency payments. *UpShot* accelerated *Siebel's* penetration into the hosted CRM market by acquiring an early innovator having started its on-demand business in 1999 and at the time was regarded as one of the "up and coming" leaders having quickly reached over 1,000 customers. In February 2004, *Siebel* acquired *Ineto Services*, a pioneer of hosted call center services, for \$5 million. This acquisition provided *Siebel* with an early entry into the hosted contact center functionality and incubated *Siebel Contact OnDemand*.

These acquisitions combined with its internal development provided customers with the freedom of choosing to run CRM systems in a hosted environment, on-premise, or a combination.

- **Results.** The results were marginally successful. Despite more recent success, *Siebel* failed to generate the same results of fast-growing on-demand leaders. Comparatively, *Salesforce.com* grew its subscribers by 370,000, a 70% year-over-year increase. As disclosed in *Siebel's* third quarter earnings ended in September 2005, the number of *Siebel OnDemand* subscribers increased by 80% to 44,000, as compared to 24,000 in the year ago period. For many aforementioned issues, *Siebel* faced challenges with both supporting a 'hybrid' model and transitioning to an on-demand player, in addition to other internal growth and management challenges.

With the entry of established players, three long-term trends will emerge:

1. **Business model evolution for enterprise software firms to include Software as a Service.**
2. **Outsourcing/Business Process Outsourcing (BPO) leaders will gain operational leverage through Software as a Service.**
3. **Major consulting firms align with Software as a Service providers as a means to introduce unique business process methodologies and vertical industry specialization.**

BUSINESS MODEL EVOLUTION FOR ENTERPRISE SOFTWARE FIRMS INCLUDES ON-DEMAND

- **Seeking Specialized Application Service Offerings in New Growth Markets.** Enterprise software firms will seek to enrich existing product offerings with highly specialized on-demand application services that complement or bolt-on to existing offerings but, more importantly, add new gained strengths and growth market opportunities that previously did not exist.

Long forgotten by the enterprise software industry is the SMB and mid-market. To the contrary, Software as a Service firms have been very successful in penetrating these markets where others historically failed. Ultimately demonstrated success in the SMB and mid-market will be rewarded by enterprise software firms that have struggled with effective solutions and go-to-market pursuits in these untapped, high-growth sectors.

WebEx has established a \$300 million (revenue) franchise serving as an on-demand Web conferencing tool for over 11,000 large companies conducting 10,000 daily meetings. *WebEx's* \$45 million acquisition of *Intranets.com* in August 2005 is an example of how *WebEx*, a Tier II technology company sought to gain a new market extension in the SMB market with Software as a Service.

With more than 10,000 customers and 300,000 users, *Intranets.com* was the world's largest on-demand 'asynchronous' collaboration service offering small-to-mid-size businesses, project teams, and other groups a private workplace for group communication and collaboration. *Intranets.com* flourished selling to companies with less than 100, a highly coveted segment that has been underserved by the enterprise software vendors. *Intranets.com* filled two key voids for *WebEx*:

1) A proven approach for penetrating

an attractive SMB market and subsequently forming a separate division called *WebExOne*, with *Intranets.com* as its platform; and

2) A broader set of applications with asynchronous collaboration including groupware, scheduling, calendaring, document management, contacts, and task management moving *WebEx* beyond its web conferencing niche.

- **Pursuing the Envable Position of Sustainable Client Relationships.** One of the many challenges faced in the perpetual software license model is the lack of long-term client relationships outside of software maintenance. Application performance, change management and maintenance cost 4x the initial license investment for most implementations, yet enterprise software firms have not captured the economics tied to the full application lifecycle. Software as a Service deepens and lengthens a client relationship beyond the initial contractual signing throughout this lifecycle.
- **Defensive Maneuvers Triggers Action.** A Darwinian "survival-of-the-fittest" mindset is gripping enterprise application vendors with respect to the rate of displacement and pressures from Software as a Service competitors. In the spirit of protecting market share, enterprise software firms will be compelled to make acquisitions yet it is unclear whether many of these first mover strategies will come predominantly from Tier I or Tier II vendors.

In less than six years, on-demand Customer Relationship Management (CRM) solutions pioneered by *Salesforce.com* have quickly emerged as a viable alternative to client/server solutions from *Siebel/Oracle*, *Sage/SalesLogix*, *SAP*, *Microsoft* and others. *Siebel's* demise and sale to *Oracle* at 17% premium (less than half of comparable premiums) was a direct result of their inability to

transition to Software as a Service. Now, SAP and Microsoft are intent on offering on-demand CRM alternatives to *Salesforce.com*, *NetSuite*, *RightNow*, *Entellium* and dozens of others. TripleTree anticipates more consolidation as the CRM market dynamics are re-defined and as global firms continue to support a dual solution of licensed software and Software as a Service.

- Intoxicating Effects of Recurring Revenue.** Purchasing power has shifted to the customer. At the same time, Wall Street and analysts are demanding more predictable financial performance from technology companies. Software firms seeking to smooth out the cyclical nature of their business as well as appease investors will make acquisitions of recurring revenue Software as a Service firms sporting compelling fundamentals to build shareholder value.

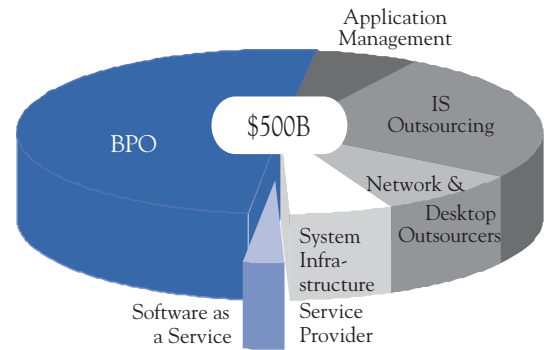
BUSINESS PROCESS OUTSOURCING (BPO)/ OUTSOURCING LEADERS GAINING LEVERAGE

Software as a Service will have profound implications across all major areas of both IT and Business Process Outsourcing (ITO and BPO). According to *IDC*, BPO is the transfer of management and execution of one or more complete business processes or entire business functions to an external service provider. Placing a greater emphasis on process alignment and business process re-engineering, Software as a Service shifts outsourced deployment services away from legacy technical deployment skills to replicable, service-based automation. While Software as a Service is part of a broader outsourcing trend, it represents a very small portion of the \$500 billion global outsourcing market (see **Figure 13**).

Outsourcing firms will seek "discrete" on-demand offerings and rely upon business process knowledge as a strategic asset and a point of significant operational leverage when securing and delivering outsourcing contracts. Interest by outsourcing firms will be motivated by:

Figure 13: Software as a Service is a Strategic Component for Outsourcing

With a small segment of the projected \$500 billion outsourcing market, Software as a Service will have more profound implications across the segment in the coming years.



Source: TripleTree and IDC

- "Trojan Horse" Strategies Leading to Full-Scale Outsourcing/BPO.** Large outsourcing firms like *Accenture*, *ACS*, *CSC*, *EDS*, *IBM*, as well as international and offshore providers have been successful at assuming control of non-core functions ranging from information technology and call centers to HR and finance and accounting. Price and cost are important factors on these contracts yet providers don't want to isolate their value proposition on these variables alone. Identifying *logical points of entry* in pursuit of an outsourcing contract to increase win rates has become an important consideration.

"Discrete" Software as a Service solutions provide such a point of entry by addressing a tactical component for outsourcing a domain like those listed above. Isolating a specific role allows on-demand firms a point of entry ahead of full-scale outsourcing and represent a "Trojan Horse" for broader contracts.

Founded in 1999, *Silver Oak Solutions* is a professional consulting and outsourced managed services firm that quickly grew to become the market leader of Spend Management solutions for the public sector. Spend Management is used to identify, create and sustain measurable cost savings in procurement spending, with each dollar of savings resulting in profitability improvements

(for more information on this topic, please visit www.triple-tree.com to read our Spotlight Report "Spend Management, One of the Best but Least Known ROI Stories in the Technology Industry").

In June 2005, CGI Group, one of the largest IT and business process services firms in the world, acquired Silver Oak Solutions to leverage its Spend Management and procurement expertise in outsourcing sectors. This acquisition represented a cornerstone of CGI Group's global outsourcing and BPO vision as a valuable point of entry for securing full-scale procurement BPO and other outsourcing contracts.

- **Filling the Void in the Middle Market.** Many of the world's largest outsourcing firms remain fixated on Fortune 1000 (Tier I) accounts. However, the mid-market (Tier II and Tier III) have just as strong of a business need for outsourcing. A challenge serving the mid-market has been effectively re-designing a high-caliber outsourcing service capable of supporting a profitable engagement with replicable terms. On-demand firms with embedded workflow capabilities and a proven methodology for serving the mid-market will be sought as compelling acquisition targets to fill this gap.

ADP's acquisition of *Employease*, an on-demand provider of HR solutions, is an example of a strategic move to bolster an outsourced offering for the mid-market with Software as a Service. Adding to the *Employease Services Division*, ADP gains a strong on-demand player serving 1,500 mid-market companies on a platform consisting of one million employees.

- **Services-Enabled Automation Replicated Across Accounts.** A higher quality of service through a consistent delivery framework reduces the "human cost factor" and optimizes operational efficiencies. Because some outsourcing contracts are priced on a "shared savings" model, outsourcing vendors will likely seek replicable services-based automation across functional domains to maintain higher margins.
- **Defensible Competitive Positioning.** Global outsourcing firms are seeking long-term, defensible outsourced relationships that first secure new deals then provide a conduit for cross- and up-selling other outsourced functional roles, and lastly support contract extensions when up for renewal. Differentiation is sought by bundling multiple outsourced business functions into one, fully-integrated offering. One by-product of Software as a Service is that outsourcing firms will distinguish from an increasingly competitive landscape by gaining invaluable intelligence on the client's current operating infrastructure and the necessary delivery requirements thereby prompting other outsourcing discussions not presently being explored.

COMPETITIVE POSTURING - THE PLAYERS

The Software as a Service movement will continue to be championed by privately-held companies in the near term. As shown below, many leading vendors can be quickly categorized as not a participant, slowly participating, transitioning, 'hybrid', or out-of-industry participant.

TIER I TECHNOLOGY PLAYERS

MICROSOFT

The most noticeable move by *Microsoft* relative to Software as a Service is the addition of Ray Ozzie to its senior leadership team. Ozzie was the founder of *Lotus Notes* and *Groove Networks* (*Groove* was acquired by *Microsoft* in March 2005). Mr. Ozzie is now Chief Technical Officer and is chartered with identifying new opportunities for *Microsoft* relative to positioning around Software as a Service.

Microsoft is expected to offer hosted applications via its hosting partners including collaboration (*SharePoint*), CRM and ERP to small and mid-size organizations. With recent announcements on *Windows Live*, *Office Live*, *Dynamics CRM* as hosted applications, a \$500 million marketing blitz around "People Ready" tools, all supporting the core theme of Ray Ozzie's memo titled, "The Internet Services Disruption," *Microsoft* appears to be getting serious.

Windows Live lets consumers manage email, instant messaging, blogs, photos, and podcasts in one site. *Office Live* enables small businesses to set-up Web sites and email systems and to provide simple collaboration sites for teams. *Office Live* offerings are targeted at the approximately 28 million small businesses worldwide that have fewer than 10 employees. *Windows Live* and *Office Live* are supported by advertising but subscription and transaction-based fees will also be available. *Dynamics CRM* is slated for release in 2006 and will be offered as both a licensed software and a hosted application. The hosted version does not support multi-tenancy

but is *Microsoft's* first serious play in the hosted CRM application sector.

Today, *Microsoft's* Software as a Service initiative is geared towards consumers and small businesses, not enterprise markets. *Microsoft's* leadership is just now acknowledging the services-based movement and under Ozzie's direction will unquestionably go further by offering components of *Office* as Web Services. Since its application architecture supports either a licensed or hosted model the company will continue to rely on a partner-centric channel strategy but modify it in a way that does not undermine the revenue models for these partners. Look for such a model to alter many of *Microsoft's* underlying technology, licensing, partnering and service parameters.

ORACLE

Oracle has been an aggressive consolidator of enterprise applications across numerous sectors spending over \$20 billion since 2003. These acquisitions have included *PeopleSoft*, *Retek*, *Siebel*, *ProfitLogic*, *Demantra* and many lesser-known properties. *Oracle* espouses a vision for a common, standards-based platform called *Fusion* upon which its applications (both on-premise and on-demand) will be developed and supported. Regarding Software as a Service, it's notable that *Oracle* CEO Larry Ellison was an early supporter and significant investor in both *Salesforce.com* and privately-held *NetSuite* (formerly *NetLedger*).

Oracle's involvement in the on-demand sector to-date has been as a hosted application management and infrastructure enabler to *Oracle* application hosting providers and Software as a Service firms. *Oracle On Demand* allows clients the option of hosting their applications at *Oracle's* data centers or alternative facilities.

Since its launch, *Oracle On Demand* has evolved to more of a specialist, automating processes and moving beyond managing the data center to man-

aging software applications. Serving 250,000 users across 25 countries, it has since become the fastest growing business inside Oracle but remains small at less than \$100 million in reported quarterly revenue.

"Oracle On Demand is the future of how Oracle will develop, deliver, and support technology: a service that eliminates the challenge of managing IT."

- Chuck Phillips, President, Oracle

Oracle's \$6 billion acquisition of Siebel overtook the CRM sector leadership from SAP and prompted Oracle to evaluate its commitment to the on-demand sector given the significant growth prospects. While it remains committed to Siebel's vision, it is unclear if this will impact the direction of Oracle On Demand. Most recently, Oracle announced severing its ties with IBM as a partner for Siebel On Demand. This was an expected announcement.

SAP

Contrary to its business application counterparts, SAP has elected to proceed fairly cautiously with on-demand offerings. Recently SAP has begun to announce a handful of on-demand solutions tailored to the mid-market. In early 2006, SAP announced the availability of its first on-demand application - SAP CRM On-Demand with Sales On-Demand, which is a sales force automation tool to manage customers, contacts and sales pipelines. Following this release, SAP intends on offering on-demand marketing and customer service modules in 2006 as well. Options to configure the application on-premise and on-demand are available, based on the business need of the customer, with the flexibility to switch to an on-premise model if the on-demand version does not meet more robust CRM needs. Also, in May 2006, SAP announced the acquisition of Frictionless Commerce, a supplier relationship management provider with sourcing capabilities.

One key difference is its delivery approach in an "isolated tenancy" model allowing for individual customization. SAP announced that it will work with IBM's Applications On-Demand Platform for hosting services based on IBM DB2 database, eServer hardware, and IBM Global Services consulting. This approach and alliance suggests that SAP intends on delivering in single-tenant approach, as opposed to a single instance of the application delivered in a multi-tenant architecture. Another point of distinction is the application delivery in a 'hybrid' model that is pre-configured in a "one-to-many" model but transferable to an on-premise solution. The viewpoint is that this type of application delivery might only be relevant for SMB accounts where pre-defined business process standardization is more permissible than it is with enterprise accounts demanding higher levels of customization and an on-premise solution. SAP has long had the viewpoint that customers - especially in the enterprise markets - require the flexibility to customize the application to its liking and unique business demands.

SAP maintains its strong and growing CRM position, but its announcement is likely motivated by competitive pressures from on-demand players quickly grabbing market share rather than a broader services-based strategy. SAP has indicated no other plans for other on-demand offerings like ERP and suggested no market pressures or customer interactions requiring SAP to change its stance. While hearing mixed points of view in the marketplace, it appears for the time being that SAP will remain focused on its next platform offering - Enterprise 3.0 - which builds out a services-based architecture. Longer-term, it is our viewpoint that SAP will reconsider its strategic position when larger enterprises exhibit more interest.

TIER II TECHNOLOGY PLAYERS

AUTODESK

Autodesk has amassed a strong franchise that first revolutionized the drafting industry with its *AutoCAD*® software product 25 years ago. In March 2006, *Autodesk* completed a \$46 million acquisition of *Constructware*, a privately-held company specializing in on-demand communication and collaboration solutions used during design, construction, and facility management processes. The acquisition extends *Autodesk Buzzsaw's* on-demand collaborative project management solutions with cost, bid and risk management capabilities and positions it as the world's leading on-demand collaborative project management solution with nearly 140,000 users from mid-size to Fortune 500 companies. Adding to *Autodesk Buzzsaw's* customer base in home building, retail and hospitality segments of the commercial real estate market, the acquisition establishes a presence in the general and sub-contracting segments of the construction industry, especially in the government and education sectors.

BMC SOFTWARE

BMC Software is one of the few global software firms to successfully launch a meaningful pursuit of an on-demand business alongside its traditional licensed model. With over 25 applications across its value chain, *BMC* staffs an on-demand market development team dedicated to build-out Software as a Service applications and tools.

CLICK COMMERCE

A leading provider of on-demand supply chain management solutions enabling millions of users in 70 countries with real-time collaboration to business partners, *Click Commerce* has done a remarkable job of repositioning the company with its on-demand strengths. Public markets have rewarded this strategy with a \$260 million market capitalization that is trading at approximately 4x its trailing twelve months revenue. In the meantime, *Click*

Commerce has been among the most active acquirers of Web-based firms with on-demand attributes including *Elance*, *Requisite Technology*, *Xelus*, and *Optum*, all within the last 24 months.

OUTSOURCING PLAYERS

ADP

ADP provides automated transaction processing, data communication and information services worldwide for employer services, brokerage services, dealer services, and insurance services with over 90% recurring revenue from its business units. *ADP's* Employer Services Division is an example of a traditional service bureau that offers on-demand Web-based options. Representing over 60% of *ADP's* revenues and earnings, this division has experienced rapid growth of hosted Web-based solutions across product lines - HR, payroll, benefits administration, screening and selection services, time and labor management. *ADP Brokerage Services* and *ADP Dealer Services* are two other business units offering Web-based on-demand solutions.

Recently, *ADP* has been making significant strategic moves including the \$975 million divestiture of its Claims Services and spin-off of Brokerage Services Group into an independent publicly traded company, while investing in Software as a Service models for its Employer Services Division. In August, *Employer Services Division* announced the acquisition of *Employease*, a leading on-demand provider. The acquisition expands upon *ADP's* presence in the mid-market and bolsters its offerings with an on-demand solution, which is projected to represent more than half of HR purchases by 2008.

ADP is a prime example of a services-based organization that offers highly automated application services delivered on-demand. And, in many cases, *ADP* has become a poster child for Software as a Service. *ADP* is also an illustration of where non-traditional companies will become acquirers of asset-rich, Software as a Service firms capable of combining replicable services-based automation with intellectual capital assets.

IBM

"An enterprise whose business processes - integrated end-to-end across the company and with key partners, suppliers and customers - can respond with flexibility and speed to any customer demand, market opportunity or external threat."

- IBM, The New Agenda,
IBM and the New On Demand Era

Defined as Business Performance Transformation Services (BPTS), this represents a new market opportunity for IBM, which is pegged at about \$1.4 trillion (roughly, as large as the global IT industry), according to analysts. IBM's strategy in the BPTS sector is keen on addressing a \$500 billion sub-segment. In essence, BPTS allows clients to optimize operations with new business designs and processes, by turning over its operations to be managed by IBM experts.

IBM has invested in Software as a Service since 1999; principally as a hosted application management provider and infrastructure enabler through product and service offerings including *DB2*, *WebSphere*, back-end data center and Web hosting, and business consulting provided by *IBM Global Services*. IBM remains consistent to adhering to a strategy as an infrastructure provider, but longer-term, *TripleTree* sees IBM driven by a broader combination of On Demand Business and BPTS strategies, of which Software as a Service represents just one component.

OUT-OF-INDUSTRY PLAYERS

GOOGLE

Amassing a \$100 billion-plus market capitalization that has now surpassed *Caterpillar*, *Coca-Cola*, *General Motors*, and *Walt Disney*, *Google* is one of

the most remarkable growth stories in recent history and clearly one of the few Internet dot-com companies to successfully deliver upon the promise of an advertising-based revenue model.

Building on the successes of organically developed tools like *gMail*, *AdWords* and *AdSense* and through acquisitions like *Urchin* (low-cost web analytics), it is within reason to state that *Google* has the underpinnings for a "platform or directory of offerings" which could threaten to commoditize legacy desktop and enterprise application franchises. Since *Google's* revenues and profits are derived from advertising and paid-search, *Google* has a very different motivation to offering affordable (or free) Internet-based, on-demand applications to a wide user audience or businesses. Also, one only has to read its SEC filings to note that the ad-only revenue model has risk, and that the company could benefit from diversifying with break-out moves in the Software as a Service sector.

INTUIT

With more than 20 years of business and financial management for small businesses, accounting professionals and consumers, *Intuit* is an example of a traditional packaged software company with a consumer-based focus that has added Software as a Service offerings to its portfolio. With a target market of fewer than 200 employees, *Intuit* has successfully rolled out Web-based, on-demand offerings meeting the small business user. *QuickBooks® Online Edition* provides on-demand financial management services and tools to small businesses. *QuickBooks® Enterprise Solution* is growing more than 100% year over year with over 30,000 accounts and 90,000 users. The division has been a huge success and is expanding rapidly. *QuickBase* is a Software as a Service solution that allows corporate workgroups to easily create applications for managing business processes from over 60 pre-built applications including sales and customer support, project management, operations, IT, HR, or building custom applications. In the announcement of its spring 2005 edition, *Intuit* announced a 130% increase to its customer base.

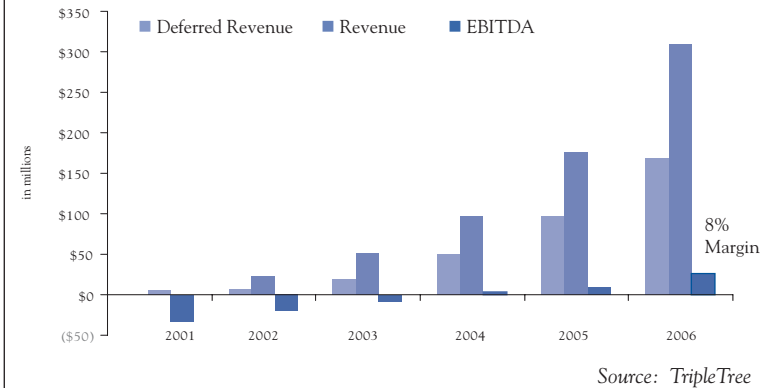
KEY QUANTITATIVE DRIVERS MEASURING SUCCESS

Within the past 18 months, several Software as a Service firms have become public companies providing investors, analysts, Wall Street, and investment bankers with public information to track developments, financial results, stock price performance and to assess underlying value for a new breed of companies. **With two models emerging, a key question is whether firms will be held to the same "tests" of growth as prior software generations:**

1. Hyper-Growth with Capital Resources to Support Delayed Profitability.

Salesforce.com, the largest and best-known on-demand company, is a great rapid growth story. Reaching \$350 million in revenue and over 440,000 subscribers, *Salesforce.com* has ascended from start-up to an on-demand powerhouse with a meteoric rise to the number three player in the overall enterprise CRM sector. Along the way, *Salesforce.com* utilized investments of over \$100 million before finally attaining P&L breakeven, reaching the public markets with its IPO and being rewarded by the capital markets with a multi-billion dollar valuation. Since its inception, *Salesforce.com* has reported 13 consecutive quarters of revenue growth averaging above 15%. More recently, it has reported eight consecutive quarters of profitability (see **Figure 14**).

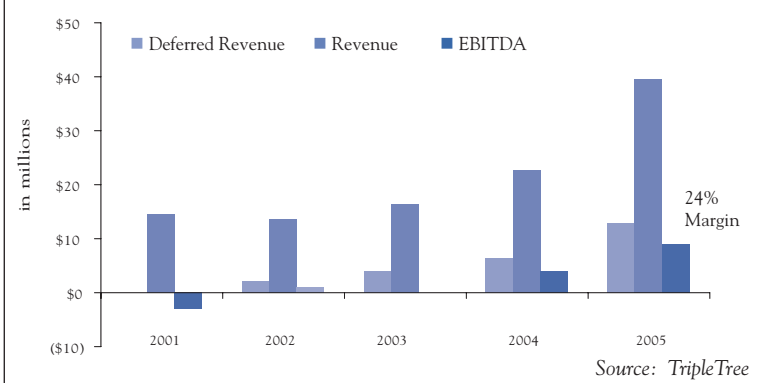
Figure 14: *Salesforce.com*: A Hyper-Growth Story



2. Attaining Nearer-term Profitability & Positive Cash Flow with Modest Growth.

Conversely, while recurring models provide more predictability with revenues spread ratably over its term, periodic costs are paid when incurred thereby resulting in growth constraints and investments required to accommodate for growth. Changing its focus to on-demand web analytics in 2001, *WebSideStory* has since grown to nearly \$50 million in revenue and reached profitability by its second year. The last nine consecutive quarters have been profitable with consistently improving margins, while reporting sixteen consecutive quarters of revenue growth averaging above 10x during this time period (see **Figure 15**).

Figure 15: *WebSideStory*: A Balanced Growth & Profitability Story



In contrast, *Omniture*, which is *WebSideStory*'s closest competitor, has adopted the *Salesforce.com* strategy by investing aggressively in its sales and marketing infrastructure.

A qualitative driver not to be lost in the on-demand discussion is the leverage associated with delivery and operations. **On-demand combines long-term, recurring revenue and the predictable cash flow attributes associated with outsourcing with high margin potential and operational leverage associated with enterprise software firms.** Along this journey, the genetic composition for how firms operate has changed. **Figure 16** compares discrepancies with traditional enterprise software and Software as a Service benchmarks by analyzing key financial data from the Top 25 enterprise software firms against TripleTree's on-demand index:

Figure 16: The Changing Genetic Make-Up and DNA of Technology / Software Companies

% Total Revenue	Enterprise Software ⁽¹⁾	Key Measurement	Software as a Service ⁽²⁾	% of Total Revenue
REVENUE COMPOSITION				
	Upfront payment Cash flow immediately	Business Model	Periodic subscription payment Delayed cash flow	
	Perpetual license	Pricing	Subscription service	
	40% license 30% maintenance 30% professional services	Revenue Mix	80% subscription 20% professional services	
COST OF REVENUE COMPOSITION				
	-	License / Subscription	-	
	Partnership with top SIs Large, multi-million dollar projects (> 2:1 ratio)	Professional Services	In-house services & training Small projects; either performed by provider	
25% - 40%	6 - 24 month deployments		Less than 3-month deployments	18% - 35% ↓
	Technical help desk Cost center Do not 'own' NOC or 'manage' app	Customer Service	Technical + customer service Profit center Manage uptime, availability, performance	
OPERATING EXPENSES COMPOSITION				
	Multiple code base "On-premise", single-tenant delivery "Pay for" maintenance (~20% license) "Pay for" upgrades over 2 - 3 year cycle Software releases / re-deployment	R&D	Single code base; Web-native "On-demand", multi-tenant architecture "Free" maintenance & support "Free" upgrades provided seamlessly Continuous feature updates	10% - 25% ↓
30% - 40%	Direct sales Partnerships with SIs and consulting firms	Sales & Marketing	Multiple direct/indirect sales channels Account management in service relationship	30% - 60% ↑
5% - 10%	-	G&A	-	5% - 12%
5% - 25%	Operating Margins		Operating Margins	BE - 30%+ ↑

⁽¹⁾ Includes a composite of the top 25 enterprise software firms that is based on last 12-months of operating performance.

⁽²⁾ Based on TripleTree's Software as a Service Index and the composite average of the last 12-months of operating performance.

Source: TripleTree

- General Business Model Characteristics.** Traditional enterprise software firms divide revenue between software license, professional services, and maintenance. Software as a Service firms derive revenue from subscriptions, which includes the price of the application usage, hosting charges, customer service, upgrades, and its professional services. Approximately 80% of revenues are derived from recurring revenues with the remainder coming from one-time professional services.

- Cost of Revenues.** Customer service is an essential, core operational component for ongoing operations and ensuring high customer satisfaction, training, end-user adoption and help desk support. With a high proportion of revenue derived from annual subscriptions and investments made in customer service, Software as a Service firms generate gross margins in the 65% - 80% range, which is generally lower than its licensed software peers.

- **Operating Expenses.** A key point of leverage is R&D, aligned around a single instance of the application. Since Software as a Service firms gain efficiencies from a single code base, database, and architecture delivered via the Web, Software as a Service vendors drive significantly lower product development and ongoing R&D costs compared to traditional, on-premise providers. R&D efficiencies have resulted in expenses as low as 5% of revenues. In contrast, higher sales and marketing costs hit Software as a Service firms hard as they must go to market without a proven alternate channel.

Profitability boundaries will be pushed to new levels - above 30% operating margins - as the sector matures, companies add critical mass to a recurring base, and economies of scale from shared operation infrastructures drive down fixed operational costs. This is one of the most exciting attributes with Software as a Service, but also one of the least well known or discussed. Interestingly, on-demand vertical specialists are the early leaders.

INTRINSIC VALUE LIES IN QUALITATIVE FACTORS

Wall Street and the analyst community remain fixated on the *quantitative* factors on the income statement - revenue growth, subscription services momentum, gross and operating margins, and profits - and uses these measurements as barometers for Software as a Service success. We point out that the balance sheet - deferred revenue in particular, carries a new level of meaning - with cash flow statements being of higher importance than conventional methods would suggest. **These quantitative factors are important, but it is critical to note that a range of qualitative factors or "intrinsic assets" are equally if not more important for long-term success.** These factors are not necessarily reflected on any financial statements nor have they become a focal point among the analyst community thus far.

Our special thanks to the over 150 interviews and company briefings with CEOs of emerging Software as a Service firms that supplied the market and financial data comprising TripleTree's analyses. Over the past 18 months, TripleTree conducted extensive interviews and surveys and leveraged over seven years of proprietary data to form our **Qualitative Software as a Service Scorecard** measuring the "hidden" assets important in this burgeoning sector.

The following includes excerpts from our 40-factor Qualitative Software as a Service Scorecard:

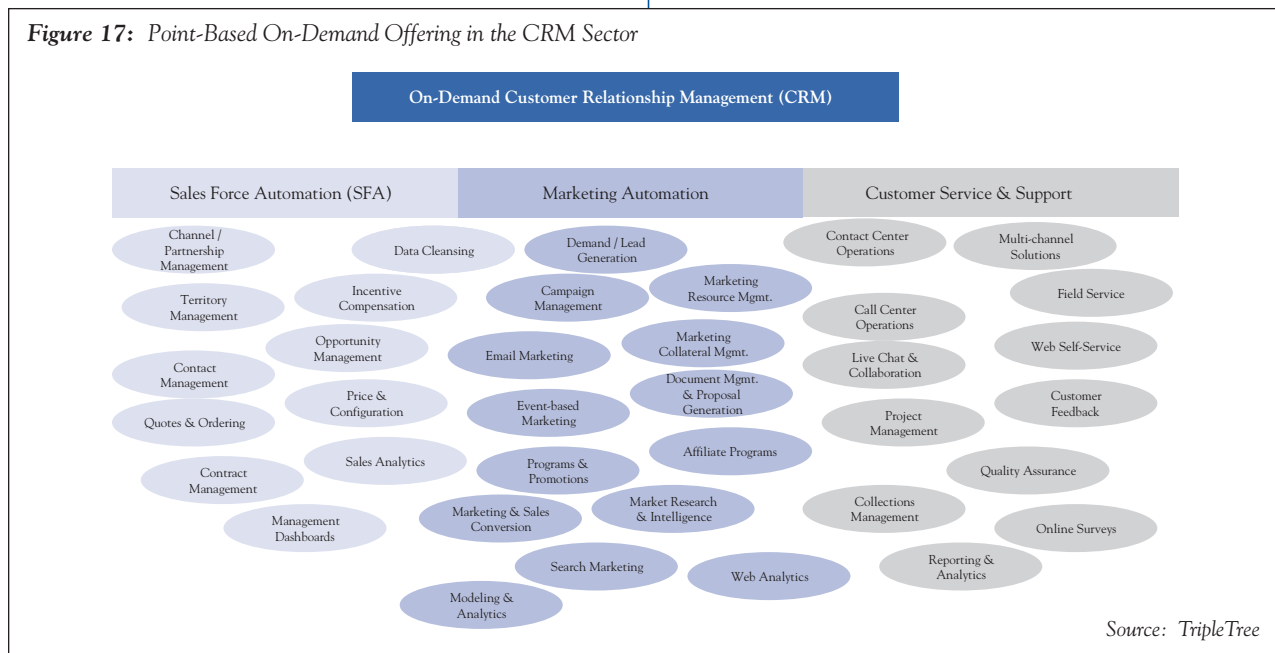
POINT-BASED SOLUTIONS TRANSITION TO PLATFORMS

By design, the vast majority of today's Software as a Service firms are narrow, best-of-breed vendors solving a specific market need (sales force automation, HR applicant tracking, professional services automation, facilities maintenance, etc). Financial returns for on-demand investments require a higher capital commitment and a longer time horizon for a return on capital. This timeline is compounded when the solution becomes a "platform."

Considering the introduction of *Salesforce.com's AppExchange* as an example of a platform play across CRM, **Figure 17** illustrates how a fragmented sector can benefit from such an approach.

Over 90% of the firms in TripleTree's database fit a point-based Software as a Service definition. Longer-term, the need to become part of a broad based platform within a domain will be essential as larger competitors with more resources emerge.

Figure 17: Point-Based On-Demand Offering in the CRM Sector



Source: TripleTree

SOFTWARE AS A SERVICE MARKET SEGMENTATION

TripleTree's research has characterized the market as such:

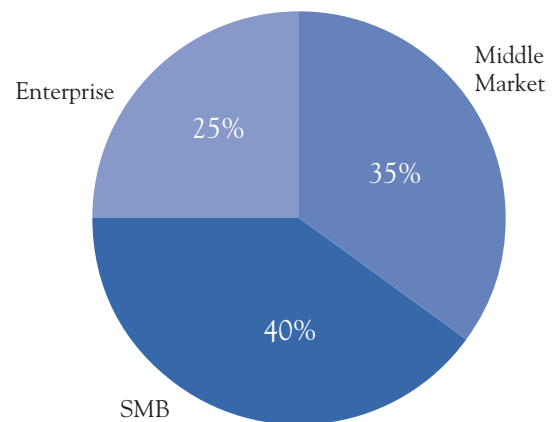
- **Small-to-Medium Size Businesses (SMB):** Less than \$100 million revenue and less than 250 employees;
- **Middle Market:** Less than \$1 billion in revenue and less than 5,000 employees; and
- **Enterprise Businesses:** Over \$1 billion in revenue.

The majority of today's Software as a Service solutions serve the SMB and Middle Market (see **Figure 18**). However, hosted applications in Enterprises Businesses are seeing strong adoption:

- A shift in the technology budget to solve the needs of the business users through the use of technology;
- A growing frustration by customers (business users) with deployment failures of enterprise software and disruptions created with product upgrades;
- Enterprise adoption that was first initiated within a specific department, unit or business segment. that was championed by a business leader authorizing the application's use based on their budgetary threshold, thereby avoiding resistance that can be associated with a full-scale enterprise-wide deployment;
- On-demand security and scalability issues being satisfied among an IT department that was previously leery of hosted applications;
- A shift in end-user attitudes towards on-demand applications as prior concerns for security, scalability, integration, customization and performance have been reasonably addressed by successful early pioneers popularizing the movement; and

- On-demand providers deploying an integration layer for legacy and package software applications that previously were not available or not well-understood by end-users;

Figure 18: Beyond SMB: Enterprise Firms Adopting "Point-Based" SaaS Solutions



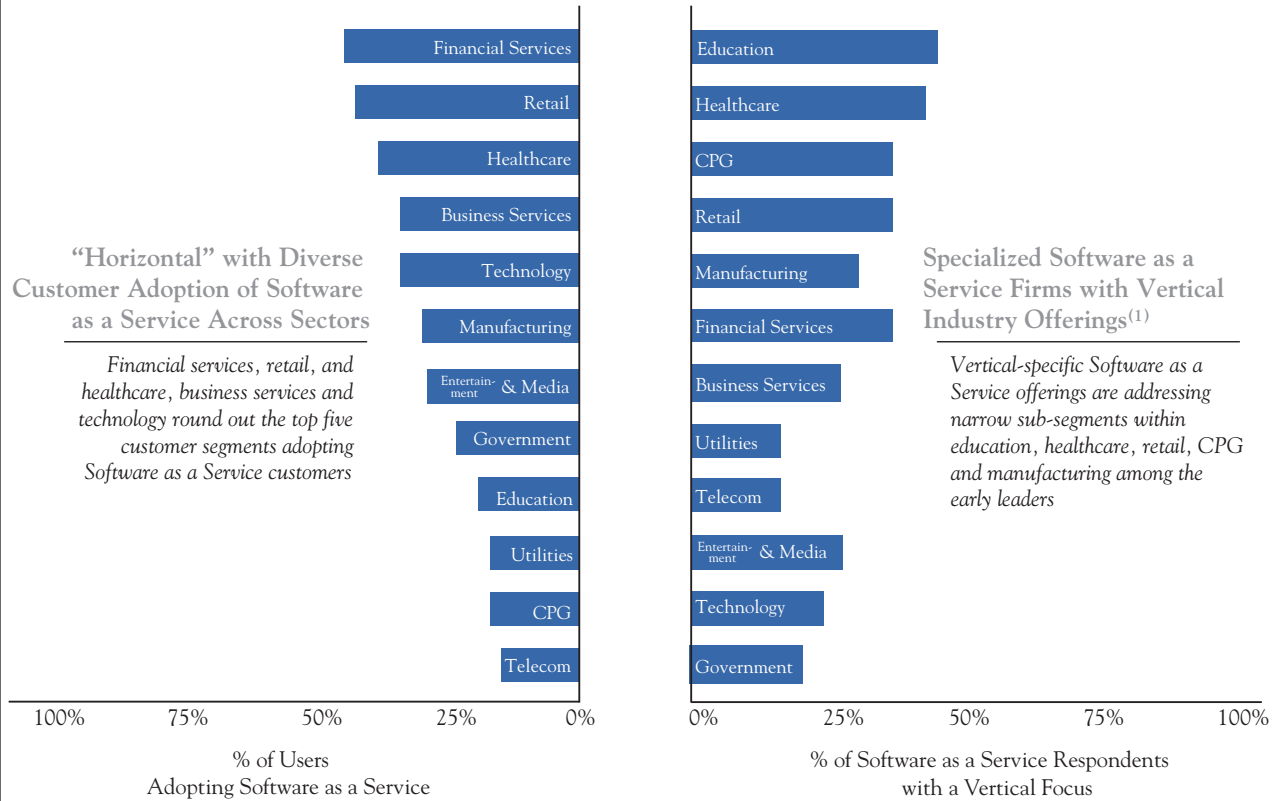
Source: TripleTree

Although the trend is already undergoing change, the enterprise market remains a division or a department rather than a full enterprise-wide deployment.

VERTICAL INDUSTRY SPECIALIZATION BACK IN VOGUE

Software as a Service is widely considered a "horizontal" solution that addresses a business need across any domain or industry vertical. The results of TripleTree's research confirmed this viewpoint with more than 85% of vendors serving multiple industries. In contrast, some of the most successful Software as a Service firms today are specialized applications (vertical merchandising solutions for retailers, profit optimization for industrial manufacturing, supply chain and materials management within hospitals, multi-family property management for the real estate industry, billing and document management systems for the legal industry, or facilities management and maintenance for education). Today, on-demand vertical specialization comes in two different varieties (see **Figure 19**):

Figure 19: Vertical Industry Specialization Comes in Two Varieties



⁽¹⁾ Most specialized vertical Software as a Service firms focus on narrow sub-segments within vertical industries. For instance, on-demand merchandising planning for chemical and electronics providers, which are subsets of the manufacturing industry.

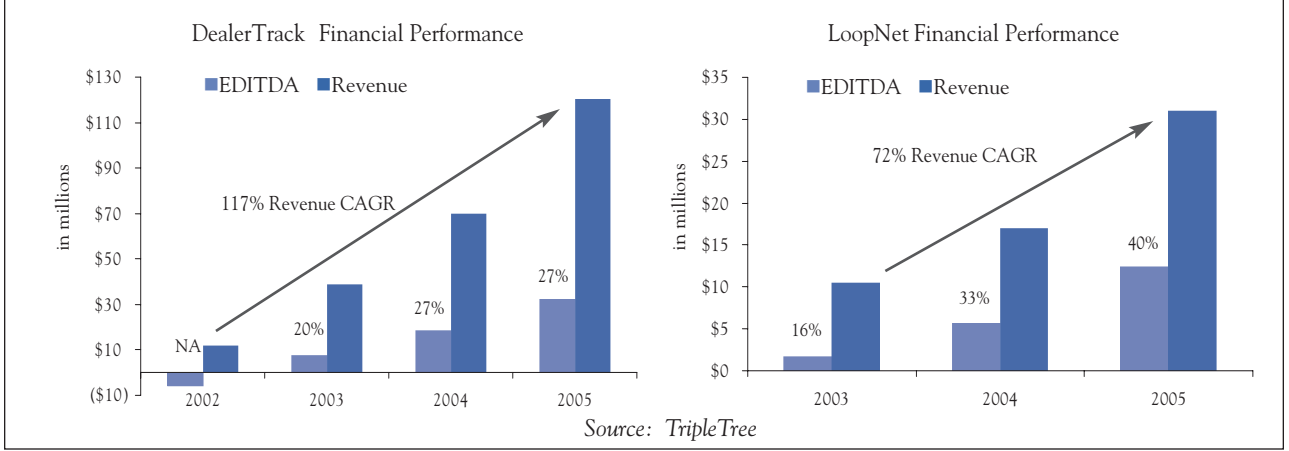
Source: TripleTree

- 1. On-demand firms find marketplace and customer success with hosted, on-demand applications, even if the application itself is delivered with deep vertical specialization or a "horizontal" offering.** Today, no vertically focused Software as a Service vendor monopolizes a single vertical. Software as a Service remains a horizontal play despite strong customer adoption by financial services, retail, healthcare, business services and technology end-users.
- 2. On-demand application services exclusively tailored to specialized industry needs.** Vertical specialization has been most successful in second-tier industries. For instance, physician services, hospitals, or payer sub-segments in Healthcare; or chemicals, processing, or electronics in Manufacturing. On-demand specialization has also taken root in capital intensive

industries like education, healthcare, retail, CPG and manufacturing where a unique approach for sales and delivery is necessary.

Vertical specialization is more of a rarity than the norm in Software as a Service. That being said, some of the best kept secrets and most successful stories reside in this domain. *DealerTrack* and *LoopNet* are two on-demand pioneers in their respective verticals (see **Figure 20**) that are growing and are highly profitable. Even though industry analysts state that "horizontal" is the preferred choice, vertical specialization is poised to become a differentiator with impressive winners.

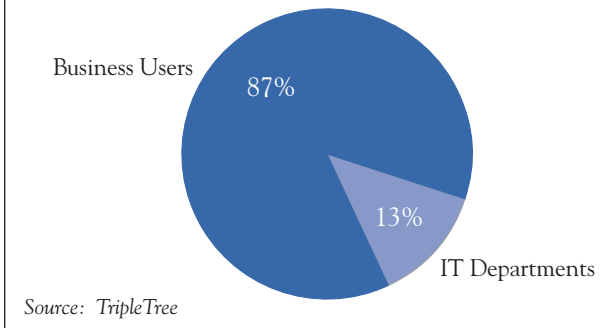
Figure 20: Superb Financial Performance of Two On-Demand Vertical Specialists: DealerTrack & LoopNet



BUSINESS USERS TRUMP IT WHEN DECIDING ON SOFTWARE AS A SERVICE

Vendors know that business users are making the majority of decisions regarding Software as a Services investment. As such, sales and marketing efforts focus on that constituency and IT department involvement is kept at a minimum.

Figure 21: Business Users Rather Than IT Departments are Software as a Service Champions

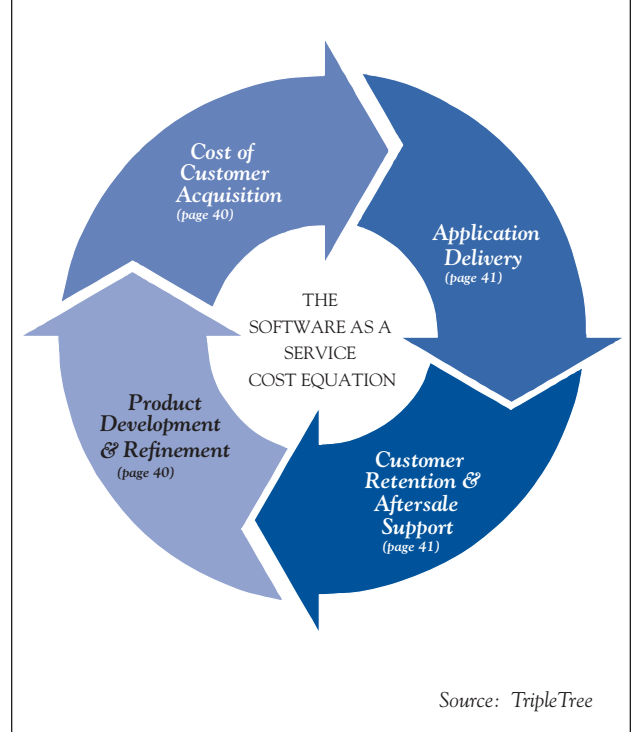


The internal champion for Software as a Service deployments is many times a line-of-business professional seeking to solve an immediate business need. While the IT department is typically involved in later stages of the implementation process (especially with infrastructure solutions like IT security), the business leader within various functional roles - sales, marketing, customer service, operations, supply chain and procurement, and finance - drives the decision.

THE ON-DEMAND COST EQUATION: DEVELOPMENT, ACQUISITION, DELIVERY & RETENTION

Four cost factors including product development and refinement, customer acquisition, application delivery, and customer retention are key contributors for the Software as a Service Cost Equation (see **Figure 22**). The subsequent sections address each component of the Software as a Service Cost Equation:

Figure 22: The Software as a Service Cost Equation

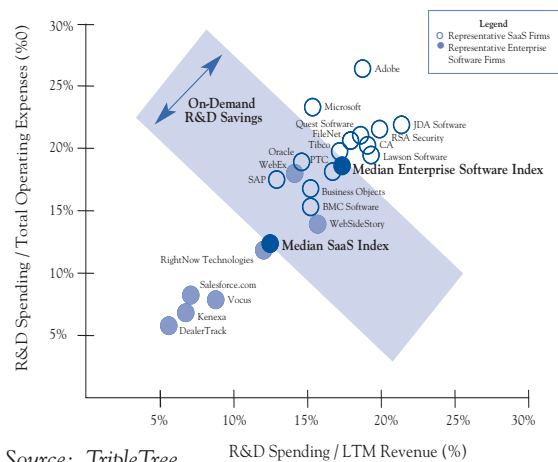


Structural Advantages & the Cost of Development

Product development is one component of the Software as a Service Cost Equation that can be controlled and managed with operational leverage. A critical characteristic within product development is the commitment to a scalable, secure multi-tenant application architecture engineered to offer a single instance of an application via a common technical architecture, operating system, back-end database and shared hardware infrastructure. Several points should be emphasized:

- **Economies of Scale Achieved by Lower Product Development and R&D Costs** - R&D spending for Software as a Service vendors is 11% of revenues and trending lower as tracked in TripleTree's Software as a Service Index. By contrast, SAP, Oracle and Microsoft spend 13% - 15% of revenue on R&D and other application vendors like BMC Software, Business Objects, CA, Intuit, Symantec spend upwards of 20% (see Figure 23).

Figure 23: R&D Operational Efficiencies Gained with SaaS



Source: TripleTree

Efficiencies are better gained by focusing resources on forward-looking product innovations and minimizing support for older, legacy products. **Product and R&D costs represent the single most controllable expenditure for impacting margins and gaining scalable efficiencies for Software as a Service firms.** Supplementing internal development with the use of external resources like off-shore programmers for code development, quality assurance and testing has further lowered costs. Lastly, the use of external emerging re-

sources, like off-shore development and open source technologies, will become more important as vendors attempt to lower the cost of development. TripleTree research suggests that vendor R&D can be reduced by 25% - 50% compared to traditional application development.

- **Frequent Upgrade Intervals and Seamless Application Enhancements** - Many on-demand providers update their applications frequently (two times to eight times annually.) Traditional enterprise software is usually upgraded every two to three years; Software as a Service releases happen simultaneously for all users, at no extra cost for deployment after hours to minimize potential productivity interruptions.
- **User Visibility is Inherent in On-Demand Applications** - Hosted applications provide visibility via systems login and performance dashboards that illustrates the features and functionality used most frequently. Additionally, account managers and online customer forums gain critical insight into user satisfaction through a continual stream of support requests and user interactions.
- **Closing the Functionality Gap** - One argument frequently cited in favor of legacy on-premise applications is that on-demand features and functionality lag behind on-premise alternatives. This will lessen over time with each new and more frequent upgrade narrowing the functionality gap that might exist today.

Sales, Marketing & Distribution Remains the Top Issue: Cost of Customer Acquisition

If R&D is a "controllable cost," sales and marketing is the largest and most unpredictable component in the Software as a Service Cost Equation. This expense category varies widely, ranging between 30% and 60% of total revenues. Included in this figure are salaries and related expenses with sales and marketing professionals, commissions, payments to partners and all product marketing and communication costs. Optimizing cost effective direct and indirect sales, marketing and distribution strategies is a key operational excellence.

1. Traditional Alliances with Large Systems Integrators

are no longer the only option. Enterprise software vendors have traditionally relied on successful partnerships with system integration firms like *Accenture*, *BearingPoint*, *CSC*, *EDS* and others who typically share in the economic incentives gained from packaged software implementations. Systems integrators provide a range of services including upfront strategic assessments, project planning, custom development, implementation services and training which translate into large fees. It is not uncommon for traditional systems integration projects to run two to ten times the initial cost of the software licensing and require several quarters to fully deploy. In return, software vendors benefit from direct sales resources and "solution selling" provided by its consulting and systems integration partners.

Traditional operating, partnering and sales models do not apply in the same manner for Software as a Service deployment to rapid implementation cycles. This leaves little, if any, economic incentive for large, one-time systems integration and consulting fees. The result is that Software as a Service firms have defined creative ways to leverage sales and marketing without reliance on alliances or channels with large systems integrators.

The announcement of *Accenture's* new partnership with *Salesforce.com* is an anomaly, since Tier I systems integration firms have largely remained absent in this sector. Since *Oracle's* acquisition of *Siebel* (a long-time ally and the flagship of *Accenture's* CRM practice), has forced a new direction, the results are yet unproven.

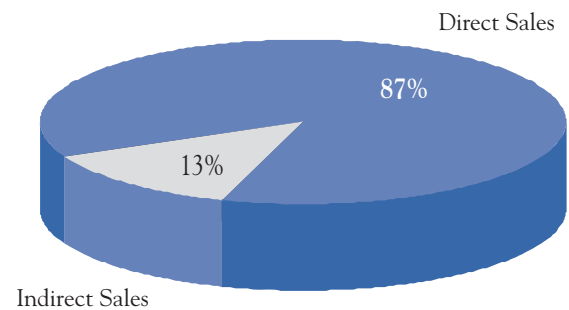
2. **Building market awareness and the continual need to educate users.** In the early days many Software as a Service firms opted to hide their "true identity" when talking to prospects, clients and analysts. While this has changed with broad market adoption, educating the market about ROI and TCO remain important messages to communicate when demonstrating customer value.

This rationale dictates that the best sales strategies include a mix of indirect and direct sales.

Direct Sales are the Cornerstone to Success

Controlling a sales process is a great way to ensure success and gather critical market feedback. Thus, a direct sales channel is preferred by nearly 87% of our survey respondents (see **Figure 24**).

Figure 24: Direct Sales Channel is the Preferred Method



Source: TripleTree

Many of the leading Software as a Service firms are redefining how they organize sales and marketing teams, including non-traditional "guerrilla marketing tactics" and creative sales channels. Typically, this includes a multi-faceted approach divided among a direct field sales team, an inside (telesales) team and a group of account managers with separate roles, responsibilities and target accounts. Usually the direct field sales team is focused on the middle market and enterprise accounts that require "customer touch" and solution selling; while inside/telesales teams target SMB accounts with little direct face time, instead selling online, through product demonstrations and over the phone. Some of the best firms have perfected the inside/telesales approach.

According to a study by *Aberdeen Group*, two-thirds of Software as a Service firms claim that the most critical first step to leverage the on-demand model is to run a pilot prior to deploying the solution in production mode.

A trend that is becoming more popular is what we call the "adopt-to-addiction" sales cycle whereby on-demand firms identify an initial, low cost of entry then "virally" grow across the organization to gain seats and create an enterprise-wide footprint.

Indirect Sales Have Proven To Be Challenging

Based on **Figure 24**, the majority of Software as a Service vendors surveyed by TripleTree rely on a direct sales approach. Conversely, on-demand providers targeting only segments of the SMB market (less than 50 employees) tend to rely on an indirect sales approach. **Table 4** outlines several tactics vendors are using to align indirect sales approaches and resources. The majority of these firms use referral programs and reseller arrangements, but our research shows this has been met with only marginal success.

Building an indirect sales channel is difficult and requires an unwavering attention to detail.

Below are three considerations:

- **Careful Selection of Indirect Partners.** If partners have an economic incentive tied to sales success, more traction has been gained. Clearly stated performance objectives based on a win/win scenario (for vendor and partner) has provided the best chance for success.
- **Committed Partnership Resources with a Vested Stake.** Consideration has been given to the level of dedicated resources, team and individual incentives and the measurement of key milestones. If performance objectives are well understood and measured, a successful long-term partnership has evolved.
- **Internal Resources Assigned to Solidify Relationships.** A program manager assigned by the vendor to guide the partners sales, marketing and delivery goals against a Service Level Agreement (SLA) has massively impacted the

Table 4: Indirect Sales Partnership Strategies

Characteristic(s)	Referral Programs	Reseller Programs	OEM/Private Labeling	Technology Alliance	Joint Venture
Type of Channel Partnership	Partners refer customers to the vendor with the vendor assuming responsibility for closing the sale & servicing the client	Applied discount granted to a partner to resell the on-demand application to its customers	Integrated and bundled offerings with other systems with marking up the offerings as desired. Sell more complete solution & services.	Co-brand offerings with the partner's solutions; bundled and integrated	Act as a single entity; typically associated with international markets
"Typical" Economic Relationship Received by the Indirect Partner	One-time fee based on the annual value of the contract	Applied percentage of the annual contract value; includes subscription royalties	Mark up the offerings as desired	Similar to reseller programs	Revenue sharing
Discount or % of Revenue from List Pricing	~ 5%	~ 10% - 20%	30% - 40%	-	Varies widely
Extent of the Joint Selling Relationship with End Users	Minimal involvement; source of new leads	Limited; direct involvement by selling to end users; partner typically provides some after-sale support	Limited; OEM partner sells directly into its prospects and clients; partner typically provides after-sale support & account management	Potentially market co-branded offerings	Limited; joint venture entity usually provides direct sales
Type of Partners	Regional IT service firms, consulting, VARs, infrastructure, among others	Regional IT service firms, consulting & advisory, VARs, infrastructure, among others	Telecommunication, vertical industry players, niche software firms, among others	On-demand firms, infrastructure providers, etc.	International companies

Source: TripleTree

effectiveness of an alliance.

OVERCOMING OPERATIONAL ROADBLOCKS WITH BEST PRACTICES: COST OF DELIVERY

Building a reliable infrastructure capable of supporting an application while responding to a growing end-user community is critical. A multi-tenant architecture, based on a single instance of the application, implies that the back-end IT infrastructure resources are shared for operational economies of scale across the network, servers, database and IT resources that is accessible from remote Web hosting facilities. This operational deployment approach has allowed for structural delivery and R&D advantages through shared costs that have resulted in on-demand alternatives that are 50%-100% less expensive than installed alternatives but at the same time have high service level demands with SLAs providing 24x7x365 support, five-9s application availability, and supplying redundant and dis-

aster recovery back-up plans.

Five primary operational issues which have historically been impediments to success are illustrated in Table 5.

While challenges persist (especially in light of recent downtime experienced by users of *Salesforce.com*), on-demand firms are excelling at dealing with objections and overcoming traditional roadblocks. In our survey, many on-demand firms downplayed traditional "points of resistance" - less than 50% cited physical and data security, application performance, ease of integration and customization as common challenges to overcome in the sales cycle. At the same time, there has been a rise in the number of Software as a Service infrastructure enablers like *Akamai*, *CollabNet*, *Jamcracker*, *OpSource*, and larger firms like *IBM* working to solve on-demand optimization.

Table 5: Operational Issues Posed with Software as a Service and Today's Responsiveness

Operational Challenge	Historic Observation	Today's Answer
1. Data Integrity & Reliable Security Standards	<i>Source data is compromised by residing outside the firewall thereby increasing the risk of possible security breaches and jeopardizing the integrity of source data. Also, physical security threats from a lack of appropriate back-up or disaster recovery plans.</i>	<ul style="list-style-type: none"> • High levels of data security protected by VPNs, firewalls, encrypted and access control technologies, etc. • 24x7 physical security standards with hosting facilities providing around-the-clock security, biometric access screening, on-site backup generators, regular tape backup, including centralized performance consoles, automated load distribution tools, self-diagnostics. • Disaster recovery for business continuity minimizing disruption during a transition to remote disaster recovery facility.
2. Ease of Integration	<i>Integration with existing legacy systems and workflow processes is a major barrier to adoption. According to IDC, integration is by far the largest barrier – cited by 70% of survey respondents – with only one in four claiming integrated on-demand offerings with internal IT systems.</i>	Web services and SOA frameworks allow on-demand application services to be addressable by other applications on the Internet and by applications behind-the-firewall in an integrated manner.
3. Consistent Application Performance	<i>Interrupted, inconsistent Internet and application services resulting from services glitches, denial-of-service, slow response times, application downtime and in accessibility.</i>	<ul style="list-style-type: none"> • Promise and typically deliver higher availability rates than in-house applications. • Service Level Agreements (SLAs) stipulate acceptable performance for system uptime and availability, user response times and resolution procedures to ensure minimally five 9s level performance. • SLAs provide minimum standards with penalties for non-compliance.
4. Flexible Customization	<i>On-demand applications are too limited and inflexible to meet the specific business needs and require a higher level of customization than is possible.</i>	<ul style="list-style-type: none"> • Templates have been developed to address industry-, user interface- or business-level functionality that are required to configure, rather than manipulate underlying code to meet customization issues. • Extend existing tables in the underlying database as well as create new tables without actually modifying the physical database schema. • Viewpoint that configurability, not customization addresses the core need.
5. Vendor Viability	<i>Risks associated with unproven, early-stage companies that do not have a long history of operation or a strong balance sheet.</i>	Recent successes have helped to validate the legitimacy of the sector, with now a new class of successful companies validating the sustainability of the model.

Source: TripleTree

MANAGING THE COST OF RETENTION IS A MUST

Superior customer service is an absolute necessity to maintaining, protecting and growing a client base of on-demand, "pay-as-you-go" subscribers.

The value of the ongoing customer service and account management has reached new heights. Customer service is no longer a toll-free number viewed as a "cost center," but rather is a core, strategic asset extending the full value of an application to its customers daily. Dedicated non-sales service managers carry daily responsibilities for ensuring that customers gain the full use of an application and are extracting maximum value from the service.

Processing 24x7 general customer inquiries, addressing technical questions, help desk and troubleshooting or other services over the phone, email or Web are basic free-of-charge offerings with advanced classes/training sessions on how to use, administer and customize forums for customer feedback, format customer satisfaction assessments, monitoring progress and application usage, providing "high touch" customer interfaces.

Excellent customer satisfaction and high retention rates remain the essential measure of success for Software as a Service vendors. Ultimate success is dependent on highly satisfied customers, repeat business, and an expanded client footprint. Without satisfied customers with retention rates above 90%, many will not succeed in scaling into larger organizations. As a result, firms are compensating sales representatives based on new sales and investing heavily in customer service and account managers by compensating them with strong incentives for customer retention upon renewal.

THE TECHNOLOGY PLATFORM IS MORE CRITICAL THAN EVER

The technology platform is an important decision faced early in the evolution of the Software as a Service firm. The implication is obvious as it impacts investments in R&D, product development, and delivery fulfillment. Less obvious but of growing significance is what implication the chosen technology platform could have on which strategic options remain viable as a vendor matures.

More so than in years past, the R&D/technology platform will have serious strategic consequences:

- **Underlying technology and infrastructure alignment are key strategic considerations.** Software as a Service firms will have a disproportionate influence over the long-term success of development and deployment frameworks such as J2EE and .NET, since these providers will select a single environment on which to base their hosted service. Consequently, the alignment of technical resources will define where and with whom strong partnerships and alliances will be formed. Finally, because scalability within multi-tenant architectures need to be addressed early in an applications existence, it is clear why many firms have opted to leverage cost-effective open source platforms and technologies.
- **In the long-term, to gain the structural operational and R&D advantages the Software as a Service model offers requires a commitment to a single platform on a multi-tenant architecture.** As the industry matures and consolidates, technology platform selection will be a key strategic decision impacting M&A exit options relative to how the platform aligns with an acquirers' strategy. This has been a nascent tactical issue during software M&A due diligence over the past 20 years but is now more important.

But, the technology platform selection will be a more influential and strategic issue considered

during M&A evaluations. Stated otherwise, if an acquirer is to gain the full benefit of leverage, efficiency and value derived from multi-tenant, on-demand models, technical synergies are key.

SHIFTING BUSINESS FUNDAMENTALS REDEFINE NEW VALUE METRICS

Software as a Service fundamentally alters the economic model with a new set of factors outside of conventional P&L metrics that are becoming more important to track and measure. This includes methods of customer acquisition and subscriber growth, underlying pricing metrics and sustainability of pricing with customer renewals, length of contractual relationships, payment terms, backlog and bookings, deferred revenue on the balance sheet, among many others. A new category of underlying financial metrics that are not necessarily disclosed on the P&L and financial statements become critically important to measuring the intrinsic value, health, and long-term prosperity for Software as a Service firms:

- **Consecutive Quarters of Revenue Growth & Breakeven Profitability.** With subscription and support revenues recognized ratably over the contract terms beginning on the commencement dates of each contract, some of the best Software as a Service firms have demonstrated the consistent and consecutive periods of revenue and profitability growth expected of a recurring revenue model.
- **Rate of Customer Acquisition & Growth of Net New Subscribers.** The addition of new customers offsetting any lost accounts is critical. Equally important is customer retention resulting from high customer satisfaction.
- **Annual Recurring Revenue (ARR) Per Account.** With a wide range typically between \$5,000 to \$100,000/per account, annual recurring revenue is an important metric scaling Software as a Service businesses.

- **Length of Contractual Relationships.** Over 35% of firms participating in our survey cited multi-year contracts ranging from 12 to 60 months, while the majority are 12 month subscription and support terms.
- **Customer "Lifetime" Value.** The combination of ARR, the length of contractual relationships with high customer retention provides a valuable gauge of forward-looking results for latter periods.
- **Escalating Number of Users per Account.** Not all Software as a Service firms support a per seat pricing model. However, this metric provides a gauge of how pervasive the on-demand offering is within its accounts. Current industry averages are 10 - 30 users per account.
- **Pricing Metrics / Structure & "Same Store Sale" Comparisons with Each Customer Renewal.** The ratio of current contract value compared to initial contract value is a key indicator of the ability to scale up within an account.
- **Backlog, Deferred Revenue, Bookings/ Billings and Cash Flows.** Backlog, bookings, deferred revenue and operating cash flows become good benchmarks since current period revenues and earnings are understated.
- **Cash Payment Cycles.** Collecting billings in advance of subscription services rendered, which adds deferred revenue to the balance sheet, is a key value driver. Some vendors enjoy payments from multi-year contracts in advance of service rendered.

This concludes our discussion on the intrinsic factors impacting new leadership. We briefly covered what is a much more expansive discussion spanning over 40 qualitative factors that TripleTree has refined over the past seven years of work in Software as a Service.

CAPITAL MARKETS UPDATE

Capital markets are strong. Public market valuations for TripleTree's Software as a Service Index is at an all-time high and at a significant premium compared to traditional "license and install" enterprise software indices. Initial public offerings (IPOs) for on-demand firms with the size, scale and infrastructure to support being a public company have been favorable. Of the 40 software IPOs that have occurred since 2004, ten have been on-demand IPOs. As a result, private equity investment in the sector has followed. After rebounding from previous lows, on-demand now represents approximately 10% of venture capital investment activity in the software and technology industry, with widespread anticipation that over 50% of new investments will be with on-demand firms. Attractive capital markets have not gone unnoticed as M&A activity in the sector has accelerated and represents what TripleTree believes is the best strategy to maximize and capture the intrinsic value created by Software as a Service leaders.

A NEW BREED OF PUBLIC SOFTWARE COMPANIES HAS EMERGED

Capital market conditions for on-demand public firms have been strong the past several quarters. Until recently, the public on-demand sector was sparsely populated. Several public firms like *Concur*, *Click Commerce*, *Ultimate Software*, and *Siebel* quietly operated in transition mode but were rarely acknowledged until new arrivals like *Salesforce.com*, *WebSideStory*, *WebEx* and *RightNow* began disrupting the landscape.

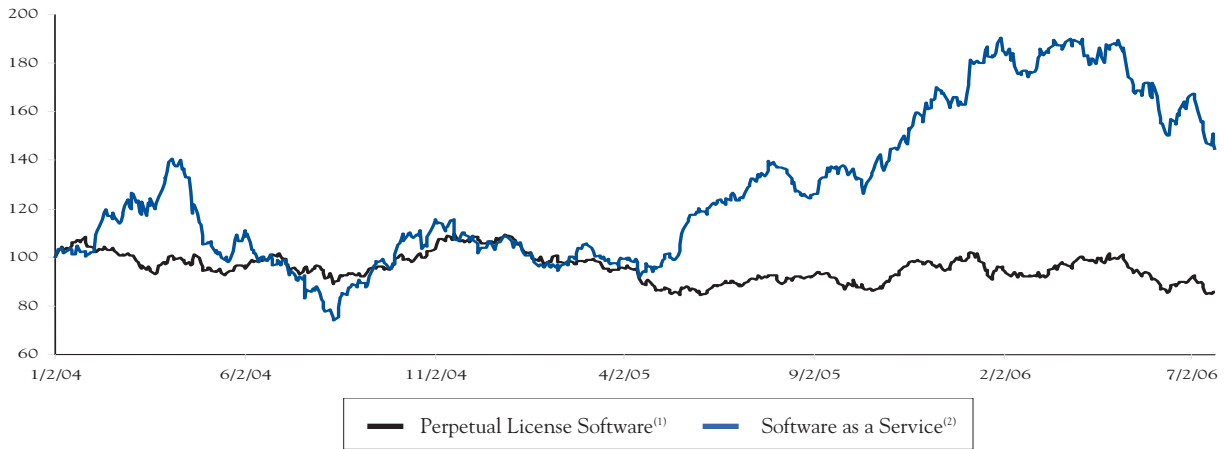
TripleTree's Software as a Service Index, which includes over 15 pure-plays as well as transitioning firms, cuts across a range of sectors like CRM, HR, BI/Web Analytics, Collaboration, and more as well as vertical segments like Healthcare (see **Table 6**). Below are some macro-trends followed by TripleTree regarding public on-demand firms:

Table 6: TripleTree's Software as a Service Index

Company	Current Stock Price	Market Cap	TEV	LTM Revenue	LTM EBITDA	LTM Net Income	TEV / Revenue	TEV / EBITDA	P / E
Blackboard Inc.	\$26.96	\$747	\$772	\$142	\$28	\$37	5.4x	27.3x	21.1x
Click Commerce Inc.	\$18.40	\$232	\$217	\$67	\$22	\$20	3.2x	9.7x	10.9x
Concur Technologies, Inc.	\$13.88	\$497	\$501	\$81	\$13	\$5	6.2x	38.5x	92.0x
DealerTrack	\$21.64	\$771	\$671	\$135	\$38	\$6	5.0x	17.5x	NM
Kenexa Corp.	\$28.00	\$567	\$488	\$74	\$13	\$16	6.6x	37.5x	30.0x
Kintera Inc.	\$1.82	\$66	\$39	\$42	(\$31)	(\$40)	0.9x	NA	NA
LivePerson Inc.	\$4.16	\$162	\$143	\$24	\$4	\$3	5.9x	32.8x	56.2x
LoopNet, Inc.	\$14.97	\$520	\$533	\$35	\$15	\$20	15.2x	35.8x	26.6x
Omniure Inc.	\$7.02	\$317	\$370	\$51	(\$5)	(\$18)	7.2x	NA	NA
Rightnow Technologies	\$15.41	\$497	\$427	\$93	\$9	\$6	4.6x	45.6x	66.2x
Salesforce.com	\$22.22	\$2,479	\$2,249	\$350	\$30	\$24	6.4x	75.7x	94.2x
Taleo Corp.	\$11.24	\$214	\$152	\$82	\$6	(\$2)	1.8x	26.7x	NA
TriZetto Group Inc.	\$13.58	\$583	\$612	\$306	\$49	\$25	2.0x	12.4x	24.9x
Ultimate Software Group	\$18.95	\$453	\$422	\$93	\$7	\$2	4.5x	57.3x	NM
Vocus Inc.	\$13.08	\$197	\$155	\$30	\$0	(\$4)	5.1x	NM	NA
WebEx Communications	\$32.95	\$1,561	\$1,330	\$326	\$98	\$49	4.1x	13.5x	27.0x
Websidestory Inc.	\$11.37	\$225	\$230	\$46	\$10	\$7	5.0x	23.2x	33.6x
Workstream Inc.	\$1.21	\$62	\$58	\$27	(\$9)	(\$17)	2.1x	NA	NA
	High	\$2,479	\$2,249	\$350	\$98	\$49	15.2x	75.7x	94.2x
	Median	\$475	\$425	\$77	\$11	\$6	5.0x	30.1x	30.0x
	Low	\$62	\$39	\$24	(\$31)	(\$40)	0.9x	9.7x	10.9x

Source: TripleTree

Figure 25: On-Demand Index & Software Index Stock Price Performance

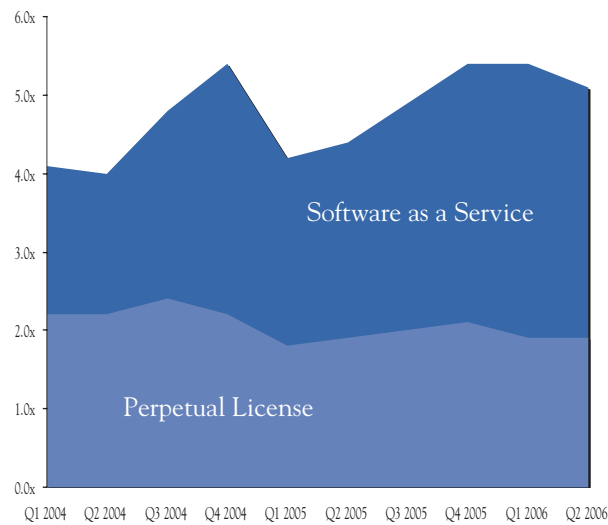


⁽¹⁾ Includes Top 25 Software Level K firm as measured by revenue. ⁽²⁾ Includes TripleTree's Software as a Service Index Source: TripleTree

- Software as a Service is Currently One of the "Hottest" Sectors in the Public Markets.** During the past year, TripleTree's Software as a Service Index has consistently outperformed the broader market. Prior to the recent downturn in the technology public markets, TripleTree's Software as a Service Index traded up 57%, significantly higher than the NASDAQ composite and a peer group of the top 25 software license firms (see **Figure 25**). For all of 2005, the NASDAQ and top 25 software firms eked out only marginal gains, up 5% and 0.5%, respectively, while the Software as a Service Index gained more than 40%.

- Premium Valuations Compared to Software Peers.** Investors are rewarding the recurring revenue models of Software as a Service firms with higher relative valuation metrics than traditional license-based software firms. Following *Google* and *Yahoo*, the Software as a Service sector is the most highly valued sector by investors (see **Figure 26**). Over the past several quarters this index has consistently traded at a 2x to 3x premium to the enterprise software and outsourcing sectors and significantly higher than IT consulting indices.

Figure 26: Historical LTM Enterprise Value-to-Revenue Multiples (Q1:04 - Q1:06)



Source: TripleTree

- Comparatively Strong Growth and Financial Performance.** One of the factors driving stock performance and valuation is the overall growth and anticipated future prospects for the sector (see **Table 7**). Companies comprising the Software as a Service Index have outperformed with 35% year-over-year revenue growth with many attaining important profitability milestones in 2005. Industry leaders like *Salesforce.com* and *WebSideStory* performed ahead of both indices with revenue growth of more than 75%. Albeit, on-demand firms clearly have benefited from a smaller revenue base. But, high-growth will continue in 2006 and beyond with many firms beginning to demonstrate exciting operational metrics, leveraging accelerated levels of profitability.

Table 7: Financial Performance of the On-Demand Sector

Company	LTM EBITDA Margin	1 Yr. Revenue Growth	3 Yr. Revenue Growth	1 Yr. EBITDA Growth	3 Yr. EBITDA Growth	1 Yr. Net Income Growth	3 Yr. Net Income Growth
Blackboard Inc.	20%	22%	NA	18%	NA	149%	NA
Click Commerce Inc.	33%	115%	62%	156%	NM	185%	NM
Concur Technologies, Inc.	16%	28%	16%	121%	143%	99%	NM
DealerTrack	28%	73%	NA	79%	NA	-51%	NA
Kenexa Corp.	18%	46%	NA	79%	NA	NM	NA
Kintera Inc.	NA	41%	148%	NM	NM	NM	NM
LivePerson Inc.	18%	32%	39%	52%	67%	49%	NM
LoopNet, Inc.	43%	NA	NA	NA	NA	NA	NA
Omniiture Inc.	NA	NA	NA	NA	NA	NA	NA
Rightnow Technologies	10%	39%	NA	42%	NA	55%	NA
Salesforce.com	8%	70%	NA	104%	NA	111%	NA
Taleo Corp.	7%	30%	NA	278%	NA	NM	NA
TriZetto Group Inc.	16%	9%	4%	16%	23%	44%	NM
Ultimate Software Group	8%	22%	17%	177%	NM	NM	NM
Vocus Inc.	0%	38%	NA	NM	NA	NM	NA
WebEx Communications	30%	24%	29%	14%	38%	-3%	32%
Websidestory Inc.	22%	87%	NA	132%	NA	157%	NA
Workstream Inc.	NA	13%	15%	NM	NM	NM	NM
High	43%	115%	148%	278%	143%	185%	32%
Median	18%	35%	23%	79%	52%	77%	32%
Low	0%	9%	4%	14%	23%	-51%	32%

Source: TripleTree

INSTITUTIONAL AND PUBLIC CAPITAL MARKET INVESTORS HAVE FLOCKED TO IPO ISSUANCES

Software Initial Public Offerings (IPOs) have remained quietly absent in the resurgence of the capital markets (see **Figure 5**) with fewer than 14 software IPOs in 2005 (of which five came from the Software as a Service sector). However, today Software as a Service has emerged as one of the top sectors worthy of IPO consideration. The challenge remains that many of these firms are relatively small (less than \$20 million in revenue) and need to reach a size suitable to support the addi-

tional costs (Sarbanes Oxley) of becoming a public company. In addition, point-based Software as a Service providers require more comprehensive build-out strategies to win favor on Wall Street. Lastly, as history has proven, an IPO is not always the best mechanism for unlocking and capturing shareholder value. Below are a few trends followed by TripleTree:

- **Active IPO market for Software as a Service.** Until recently, the Software as a Service sector was defined by emerging private companies or a sub-segment of transitioning public software firms. Within the past 24 months, the on-de-

mand sector has introduced eight new companies to the public markets spanning CRM, HR, web analytics, supply chain, healthcare, and so on. As a result, Software as a Service has become one of the most active for technology IPOs.

- **Post-IPO investor support has been strong.** Since the time of the IPO, many of the firms have traded at a significant premium to their initial public offering price. Cumulatively, the sector has increased 62% from its IPO pricing (see **Table 8**).
- **Key thresholds are reached to support being a public company and coping with delays from**

revenue recognition policies. Most of the early pioneers considering an IPO did so only after reaching critical mass. On average, Software as a Service IPO candidates reported \$60 million in revenues with measurable profitability and predictable cash flows (see **Table 9**). In the Sarbanes-Oxley era, the cost of being a public company for a firm with less than \$1 billion in revenue reached \$14 million annually, according to a study by *Foley & Lardner*. Significant costs of corporate governance including legal, accounting, financial compliance and organizational components (personnel) needed to manage internal controls and disclosure raised the question of whether an IPO is the best exit strategy for today's Software as a Service lead-

Table 8: Performance of Software as a Service IPOs

Source: TripleTree

Company	Date of IPO	Offering Amount	Offer Price Per Share	Stock Price as of 3/31/06	Trading Premium
Blackboard	6/18/04	\$77M	\$14.00	\$28.13	101%
DealerTrack	12/13/05	\$170M	\$17.00	\$20.18	19%
Kenexa	6/24/05	\$60M	\$12.00	\$23.43	95%
RightNow	8/5/05	\$44M	\$7.00	\$12.09	73%
Salesforce.com	6/23/04	\$110M	\$11.00	\$24.48	123%
Taleo	9/29/05	\$94M	\$14.00	\$ 7.91	44%
Vocus	12/7/05	\$45M	\$9.00	\$13.65	52%
WebSideStory	9/28/04	\$37M	\$8.50	\$12.25	44%
Median		\$69M	\$11.50	\$16.92	62%

Table 9: Financial Characteristics of Recent Software as a Service IPOs at Time of the Most Recent S-1 Filing

Source: TripleTree

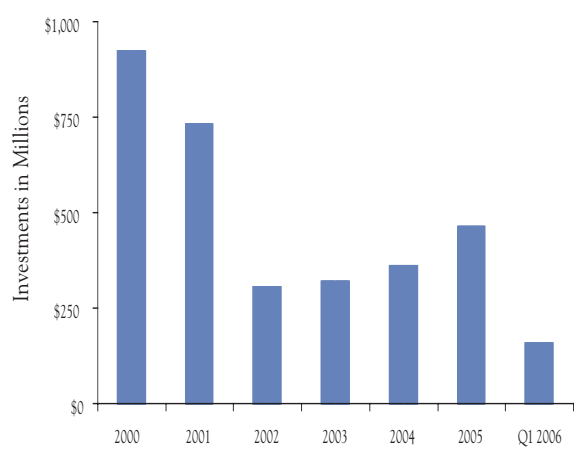
Company	Revenue	Gross Profit	EBITDA	Cash Flow from Ops.	% Software / % Services	Gross Margin	EBITDA Margin	Cash Flow Margin
Blackboard	\$98M	\$67M	\$13M	\$16M	90% / 10%	68%	13%	17%
DealerTrack	\$106M	\$61M	\$30M	\$26M	NA	58%	28%	24%
Kenexa	\$51M	\$37M	\$7M	\$11M	77% / 23%	72%	14%	21%
RightNow	\$47M	\$36M	\$2M	\$5M	81% / 19%	77%	4%	11%
Salesforce.com	\$112M	\$91M	\$3M	\$24M	89% / 11%	82%	3%	21%
Taleo	\$68M	\$43M	\$5M	\$4M	82% / 18%	63%	7%	6%
Vocus	\$26M	\$18M	(\$3M)	\$2M	NA	71%	NA	7%
WebSideStory	\$19M	\$16M	\$2M	\$3M	NA	83%	10%	18%
Median	\$59M	\$40M	\$4M	\$8M	82% / 18%	72%	10%	18%

REINVIGORATED PRIVATE EQUITY INVESTMENT & CAPITAL MARKETS

Similar to the entire technology industry, venture capital investments into the Software as a Service sector experienced a significant downturn after 2000. Since then however, venture capitalists have turned their attention back to the Software as a Service sector with a number of noticeable trends:

- Renewed venture capital interest in Software as a Service.** TripleTree has tracked a resurgence of interest and private equity investment into the sector (see **Figure 27**). In a two-year period from 2000-2002, venture capital investments dropped 67%, from approximately \$925 million to \$300 million. Driven by strong returns through IPOs and anticipation of increased M&A activity, private equity investments have poured back into the sector with over \$450 million invested in 2005 and nearing \$250 million year-to-date in 2006. In fact, several venture capital firms have emerged that are 100% focused on the sector with many others reporting multiple Software as a Service investments and a strong interest in the space.
- Strengthening fundamental investment metrics.** Despite the decline in total dollars invested, the number of investments made in Software as a Service firms has remained fairly stable over

Figure 27: Increasing Private Equity Investments into Software as a Service

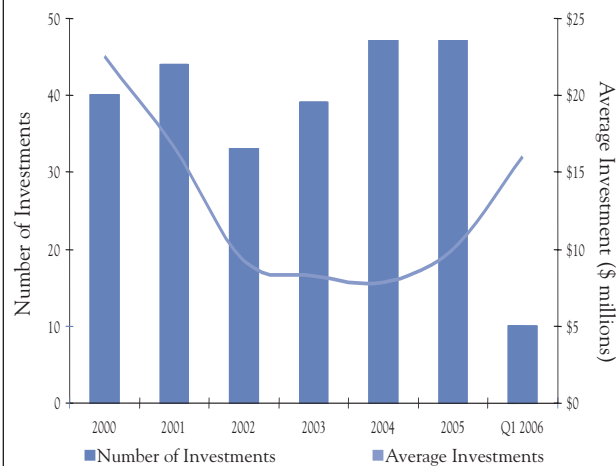


Source: TripleTree

the past six years while the average investment size fluctuated greatly (see **Figure 28**). Investors have supported firms with sizable investments averaging \$15 million plus over the past several years. For instance, *Omniture* received a \$40 million investment led by *BA Venture Partners* and *Hummer Winblad*, one of the largest on-demand investments ever recorded and months later announced their IPO filing. New investment in the sector also remains divided with investors equally supporting some of the early pioneers with later stage rounds as well as new start-ups.

- Software as a Service will receive new capital investments.** In the next several years, TripleTree anticipates that over half of private equity investments will be invested in the on-demand sector, up from 10% this past year. Furthermore, the remaining share will support existing portfolio companies with "license and install" businesses rather than new investments being made in traditional software models. There is a growing community of private equity firms that are beginning to act like "strategic acquirers" by aggregating best-of-breed on-demand providers in the hopes of a blockbuster IPO or game-changing M&A such as in the case of *SciQuest*, an on-demand supplier relationship management provider, and *Trinity Ventures*.

Figure 28: Improving Fundamentals with Increased Investment Size



Source: TripleTree

STRATEGIC M&A MOVES WILL REPRESENT THE BEST EXIT STRATEGY

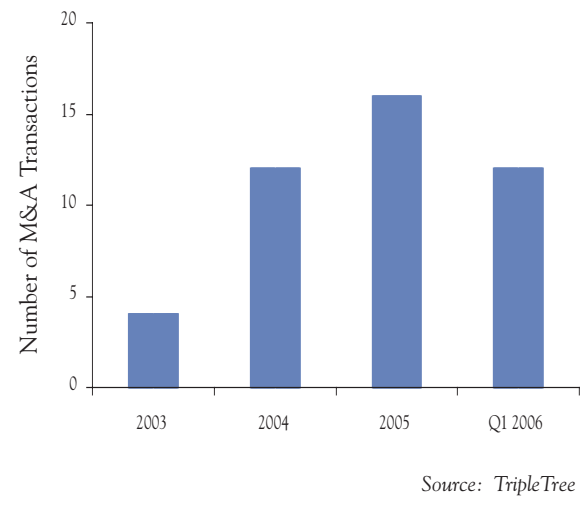
The sector's attractiveness is beginning to manifest itself as mergers and acquisitions occur. Previously, most of the M&A activity was confined to isolated merger-of-equal transactions between point-based providers. Until now, few companies met the qualifications of global acquirers and many of these same acquirers were skeptical of the on-demand model. Recently however, a major shift to this mind-set has occurred:

- **Accelerating M&A activity has 2006 - 2007 poised as a significant period for strategic acquisitions.** M&A activity in the sector has steadily increased but the deals have been small. In 2005, TripleTree tracked over 15 M&A transactions. During the first quarter of 2006 the pace accelerated. A few reasons: traditional software vendors will continue transitioning toward Software as a Service; large outsourcing firms will seek operational efficiencies; consulting firms will add highly specialized, repeatable IP-based service offerings; and non-traditional acquirers will continue to see on-demand as a new point of competitive leverage.
- **The preferred exit for most Software as a Service firms will be a strategic sale.** As stated earlier, many on-demand firms provide "discrete" business solutions and/or serve niche markets. Exit outcomes for these firms are best captured through M&A. In part, the sales cost model to grow a profitable Software as a Service firm is prohibitive. For many to attain 30%-50% growth rates, firms will need to alter traditional sales fundamentals. Secondly, public market hurdles have risen with an average software IPO at \$100 million in profitable revenue. Therefore, an IPO is not the best mechanism for capturing shareholder value.
- **Majority of the acquisitions remain under \$75 million.** Many on-demand firms have yet to surpass \$20 million in reported revenues and as a result, the majority of M&A transactions have

been at valuations below \$75 million. This trend will change as several firms emerge from the pack and gain scale beyond \$20 million in revenue.

- **Valuation multiples vary widely, but several transactions have been among the highest in the industry.** Following public comps, M&A transactions for Software as a Service businesses are trading at premium valuations. With the enterprise software sector consolidating 1x to 3x revenues, Software as a Service leaders have received premium valuations to their Software counterparts. Of the nearly 50 transactions that have occurred in Software as a Service, TripleTree has tracked valuations in excess (sometimes far in excess) of these figures. Because of the strong financial and business benefits of the Software as a Service model, this will continue.

Figure 29: Early M&A Consolidating Trends in Software as a Service



- **Private-to-private on-demand consolidations will begin to occur.** Combining best-in-class on-demand providers together will redefine certain domain and vertical industries. We fully anticipate that these events will begin to occur in 2006 and 2007. The resulting on-demand "platform" will have the size, scale and market force driving on-demand standardization, exerting more pressure on established firms to re-

spond. Private equity firms are increasingly showing an interest in these market-altering events, and in fact, we believe this could lead to better strategic possibilities for stand-alone firms than current M&A or IPO options.

PRIVATE COMPANIES REPRESENT SOME OF THE BEST SOFTWARE AS A SERVICE STORIES

TripleTree tracks over 550 privately-held Software as a Service firms. Virtually every application category and industry vertical has on-demand, multi-tenant solutions. In the past 18 months, TripleTree has interacted with scores of firms as we assembled research and findings for this report.

Since the universe of private firms is large (and growing), a simple index or listing of companies does not adequately account for the subtleties of each sector. Instead, general trends from the entire private company landscape are noted throughout the report and upcoming executive spotlight reports will expand upon in-depth, sector-specific viewpoints. Listed below are some of the topics we are currently exploring

Upcoming Research Topics

- *The Executive Suite & Board Room: Software as a Service - What Is My Position?*
- *The Next Sector to Follow CRM Towards On-Demand Standardization: Human Capital Management (HCM)*
- *On-Demand Application Services - Revitalizing Supply Chain Management (Procure-to-Pay) and Finance & Accounting (Order-to-Cash) Processes*
- *Some of the Best Kept Software as a Service Secrets: On-Demand Vertical Applications*
- *On-Demand Application Services as the Next Frontier in the Business Intelligence Sector*

STRATEGIC ALTERNATIVES AND POSITIONING

STRATEGIC ALTERNATIVES

Seek Growth Capital and Expand

For a significant number of market participants, the current environment represents a terrific opportunity for growth with additional capital financing. The key is determining whether your organization has what it takes to successfully expand.

Some factors to consider:

- *Is your operating model scalable?*
- *Do you have a seasoned management team?*
- *Is your on-demand suite competitively differentiated?*
- *Can your technology platform be leveraged with clients and partners?*
- *Where and at what cost can you access growth capital?*

Getting objective answers to these and other important questions is the key to determining whether to seriously evaluate growth opportunities in your market. It is advisable to get professional input when considering these and other questions.

Strategic Sale

In the current environment, many Software as a Service vendors should be considering a strategic sale. Many CEO's and investors are gaining confidence in an exit but realize their solution solves a narrow problem set. In the past, software firms needed to reach a certain threshold (\$50 million revenue) to become a viable acquisition candidate. These "rules" are being re-written with the on-demand model, including those defining relevancy for strategic acquirers.

TripleTree asserts that a \$5 - \$30 million Software as a Service firm can be highly relevant as a "growth platform" or important "tuck under" acquisition for an acquirer. Being able to effectively position an emerging firm with an acquirer requires

the ability to articulate on-demand synergies across both domains and technical ecosystems. TripleTree is setting the standard in this understanding with thought-leading research and by attaining premium valuations.

Our advice given the increased attention and growing competition is that investors should consider being proactive in the near term while market conditions favor best in class, on-demand firms. In preparation, here are a number of steps that can be taken to maximize value in preparation of a sale:

- **Effective Positioning/Packaging** - Key strengths of the organization need to be highlighted including proper evaluation of the relevant IT "ecosystem" and where IP can become an asset and leveraged within a larger organization.
- **Effective Process** - Getting the right players to the table, including some non-traditional strategic acquirers who might have an incentive to bid aggressively, ensures a competitive process.
- **Correct Timing** - Conduct the process when one or more purchasers have a strong desire to enter the market(s) or to defend an existing position. Carefully evaluate the organization's performance and company-specific market conditions and proceed accordingly.

Stay the Course

TripleTree will many times encourage an emerging company to stay the course and focus on organic growth, develop channels and refine a partner ecosystem. Nonetheless, as an advisor to numerous growth-oriented firms, regardless of which strategic alternative seems right for your company, all business leaders can benefit from an outsider's perspective. Ongoing dialogue with an advisor that possesses in-depth industry knowledge and insight can be a tremendous help as you focus on your goals.

CONCLUSION

A "game-changing" shift is underway regarding how on-demand application services are redefining the delivery of applications and changing the economic realities of the software industry. Predictable and recurring revenue, profits, and cash flows with shared operational risks are aligning vendor and customer interests.

Primarily focused on "discrete" business functions (sales, marketing, supply chain, collaboration, compliance, business intelligence), or vertically specific offerings (financial services, healthcare, professional services, education, construction), the on-demand sector is at yet another important inflection point. Longer-term, Software as a Service "platforms" will emerge with a broader suite of application services solving a deeper set of functional issues or vertical needs. This evolution will continue to be shaped by emerging private Software as a Service companies that comprise the vast majority of the market and its growth. Furthermore, this will be shaped around acquisitions by industry leaders seeking to establish an early but dominant position as top competitors. Software as a Service firms positioned ahead of these rapidly changing and evolving trends stand to benefit.

Having spent the last seven years advising emerging firms to consummate M&A transactions in this segment and helping market leaders with future positioning, TripleTree has assembled a vast body of knowledge and experience about the Software as a Service sector. We have noted a remarkable shift in the market attitude moving from Software as a Service "investment" to "acquisition" with a number of significant industry events, behind-the-scenes discussions, and first-person interactions with global companies. TripleTree anticipates that the balance of 2006 and into 2007 will see a whirlwind of M&A activity for Software as a Service and we have positioned our experienced technology team at the center of this activity. A number of mega-trends and events supporting our conclusions and providing a higher degree of confidence include:

Key Trends

- The proliferation and evolution of AppExchange will continue to position *Salesforce.com* as the leading innovator in the Software as a Service sector. Its first acquisition - *Sendia* - while not significant by its size or magnitude is a gesture that a platform build-out strategy is important.
- Oracle's acquisition of both *PeopleSoft* and *Siebel* thrust the database giant into the on-demand game in a much different way than its current application hosting and management infrastructure play. Support of *Siebel OnDemand* will be imperative to the growth and prosperity of Oracle's on-demand initiatives.
- *Microsoft*, which has traditionally been less successful with its application strategy in the enterprise markets, has become much more vocal about a services-based strategy. The software giant is becoming more active in the sector through its *Windows Live*, *Office Live* and CRM solutions.
- While *SAP's* entry into on-demand CRM provides validation for the sector, outwardly absent in its PR is a commitment to other application categories like ERP, supply chain and HR. *SAP's* stance on on-demand solutions will change with higher levels of enterprise adoption.
- Recent developments from a range of on-demand HCM players and acquirers looking to secure a strong HCM foothold suggest that it is the next sector in line to follow CRM towards on-demand standardization.
- New IPO issuances from *LoopNet* and *Omniture* affirm that Software as a Service is gaining popularity and interest of the public markets.

- On-demand acquisitions made in the past 18 months by SSA Global, UnitedHealth Group, Click Commerce, Microsoft, WebSideStory, Trinity Ventures, Autodesk, SAP and Sungard confirm a theme that the interest in Software as a Service is strong across all domains and industries.

Looking beyond 2006, TripleTree anticipates:

1. An increasing entry and transitioning of software firms to on-demand platforms with most of the activity being facilitated by M&A among the Tier II software sector;
2. Large outsourcing businesses will acquire specialized, on-demand companies to gain operational leverage and increase win rates in outsourcing deals;
3. Major consulting firms will reach a cross roads and acquire best-in-class domain and vertical-specific on-demand capabilities or risk being marginalized;
4. Non-conventional acquirers, those not classically regarded as technology acquirers, will seek best-of-breed on-demand firms; and
5. Private-to-private on-demand firms will merge together in an attempt to build a dominant category killer. We anticipate this theme with private equity sponsorship will gain momentum.

Persistent Q&A dominate our weekly discussions with executive teams of global, technology companies regarding their positioning and inorganic growth strategies:

- *Where will on-demand go from here?*
- *Is on-demand here to stay?*
- *What are the next "hot" sectors for on-demand opportunities?*

- *What is the viability and interest in on-demand applications across different customer segments - SMB, mid-market and enterprise? How far will it be adopted upstream in the enterprise?*
- *Can a 'hybrid' be competitive against pure-play, on-demand entities?*
- *What are the pitfalls and key operational, technical and financial considerations to building a winning on-demand presence?*
- *Where should our executive team and investors set our expectations relative to valuations and liquidity options?*
- *In what sectors should we be the most acquisitive...who are the market leading innovators?*

Tier I software firms and Tier II players have now realized that the disruptive impact of Software as a Service is not a passing fad. However, limitations exist. It is difficult to simultaneously assess, build, partner and acquire. Decisions and cultural challenges, including a complete redefinition of sales, marketing and distribution channels for services, a commitment to a single, multi-tenant architecture, and bridging the transition to delayed revenue recognition with subscription-based pricing are just a few of the obstacles prompting global companies to acquire Software as a Service firms.

To evaluate the relevance, TripleTree has designed an integrated engagement framework to help on-demand firms plan for the future and address these industry-defining events. In this new phase of growth for Software as a Service, less than 95% of the on-demand firms in our database will be viable candidates for IPOs. Many best-of-breed, point-based Software as a Service firms will be best aligned to capture shareholder value as acquired assets by companies who can broaden the reach in a Software as a Service model.

THE TECHNOLOGY TEAM

TripleTree today has 22 professionals with complimentary backgrounds as business builders, operators of public and private firms, lawyers, accountants, bankers, Wall Street analysts and investors. Within IT, we have a team with significant transaction and operating experience exceeding 75 years. Our team has completed dozens of technology transactions and we have helped our clients create hundreds of millions of dollars of value for their owners. Included below are the professionals focused within our Technology practice and who are the primary contributors to all Software as a Service related activities at TripleTree:

Kevin Green, Managing Partner. As Managing Partner, Kevin advises companies on maximizing the value of their firm by leveraging 25 plus years of operational, M&A, capital raising and board experience. His broad industry background and relationships, extensive transactional experience, and hands-on operating experience bring unique perspectives to each client engagement.

Prior to co-founding TripleTree, Kevin held several senior executive roles at private and public companies within the healthcare and technology industries. He served as CEO of both *Summit Medical* and *Integrated Medical Systems (IMS)*. During his tenure, IMS grew from a start-up company to a high growth business that was sold to *Eli Lilly*. Previously, he served as an executive at *Cycare*, which grew from a private firm to a NYSE company and was later sold to *McKesson*. Kevin started his career at *Westinghouse*. Kevin is actively involved in a number of industry associations. He currently serves on the board of the Software and Information Industry Association's Software Division and is a frequent speaker at technology conferences. He holds B.A. and M.B.A. degrees from the University of San Diego.

Dave Henderson, Managing Partner. Dave co-founded TripleTree with the vision of providing industry leading financial advisory services based on senior-level, hands-on involvement. He has assist

ed numerous business owners and executive teams in planning and executing successful transaction strategies to maximize the value of their firm. Dave brings a well-rounded perspective to investment banking.

Prior to TripleTree, Dave spent 22 years in venture capital, business development and as a senior operating executive, combined with seven years of public accounting experience at *Arthur Andersen*. His operating experience includes serving as CEO of a \$400 million asset bank holding company and COO of *Republic Telecom Corporation*. He has served on the Board of Directors of numerous public and private companies as a venture investor, working closely with CEOs to develop and implement successful business and financing strategies. Dave is a graduate of Moorhead State University and is a Certified Public Accountant.

Brian Klemenhagen, Senior Principal. Joining TripleTree in 1999, Brian has over ten years of combined investment banking and Wall Street equity research experience. He has been the primary engagement manager on 15 merger and acquisition, private placement, and strategic advisory engagements across technology, software and outsourcing sectors including engagements and consummating transactions with acquirers/investors like *IBM*, *John Wiley & Sons*, *Monitor Clipper*, *Brady & Co.*, *QUALCOMM*, and others. He is the principal author and architect behind TripleTree's sector research in Software as a Service and application software like *Spend Management/Procurement & Business Intelligence*.

Prior to joining TripleTree, he was an Analyst/Associate at *RBC Dain Rauscher Wessels* focused on medical devices and wireless, where he was directly involved in publishing buy/sell research. Previous experience also includes financial lending and wealth management at *American Commercial Bank*, *Craig Hallum*, and *Salomon Smith Barney*. He earned his B.A. in Financial Economics from Gustavus Adolphus College and his M.B.A. from the Carlson School of Management at the University of Minnesota.

Chris Hoffmann, Senior Principal/Research Director. Chris joined TripleTree in August 2005. Chris has over 17 years of experience as an operating executive, consultant and analyst in the technology industry. He is leveraging this experience at TripleTree in his role as Research Director as well as assisting on transaction activity in the areas of software and technology services.

Chris joins the firm from Tier1 Research where he was president and lead analyst for the enterprise software sector. At *Tier1*, Chris architected the growth of the firm toward a successful acquisition in June 2005 by The 451 Group. Prior to Tier1 Research, Chris held executive positions at *Zamba Solutions*, *Gartner*, *GE Capital Consulting*, *IBM Global Services* and a consulting firm which he founded. He has worked with the world's leading technology firms including *IBM*, *Microsoft*, *Accenture*, *EDS* and *HP*; has been quoted in numerous trade and industry publications including the *Wall Street Journal*, the *New York Times* and *Investors Business Daily*, and is a frequent presenter at industry events. He earned a degree in Marketing from the University of Minnesota-Duluth and has completed advanced studies through the University of Minnesota and Michigan State University.

Scott Donahue, Principal. Scott Donahue joined TripleTree in September 2006. For the past 14 years, Scott has delivered a wide variety of business and financial strategy analysis and business development consultation geared to many aspects of his client's business functions including marketing, operations support, and technical product development. Having served both in operational and advisory roles, Scott has built expertise in data center operations and services delivery approaches, including utility computing; server automation in heterogeneous environments; storage infrastructures; network management; and service-oriented architectures.

Prior to joining TripleTree, Scott established and managed the IT Management and Automation software research practice for Tier1 Research (a division of the 451 Group). There, Scott applied his

knowledge in influencing IT strategies across a range of industries; in helping companies better position existing solutions and identifying areas for portfolio expansion; and in advising public and private investors profitable financial strategies for their portfolio companies. Prior to Tier1, Scott served in both operations and managerial roles at software companies serving the telecom industry and at a telecommunications focused early-stage venture capital firm. Scott received his MBA with Honors from the University of Michigan and his Bachelors in Economics from the UC Santa Barbara.

Rob McCray, Managing Partner. Rob is Managing Partner of TripleTree's San Diego office. In advising healthcare and technology companies, Rob leverages over 25 years of experience as a business owner, senior operating executive, and legal and transactional advisor to private and public companies. Since joining TripleTree, Rob has dedicated much of his time to the convergence of technologies and services in the mobile wireless and life sciences industries. In addition to authoring published research on the topic, he is a founding member of the Wireless-Life Sciences Alliance.

Prior to joining TripleTree, Rob was President, COO and an early investor in Digital On-Demand, Inc., a retail services technology company that operates under the brand name RedDotNet in chains including Barnes & Noble, Circuit City, Best Buy, Blockbuster and Fred Meyer. Previously, he served as President and CEO of HealthCap, Inc., a venture capital-backed physician practice management company that returned 90% CAGR to its investors in a 1997 transaction. Rob also served as Managing Director of Caremark Physician Resources, directing its formation during its initial high-growth years prior to its sale to MedPartners, Inc. He also co-founded OnCall Medicine, Inc., a medical house calls company. Prior to his success as a business operator, he was a Managing Partner in his law firm and a partner in a predecessor firm, delivering healthcare and transactional legal and consulting services for over 20 years. Rob is a graduate of the University of California, Davis School of Law and the University of California, San Diego.



ABOUT TRIPLETREE

TripleTree is a leading investment banking firm dedicated to meeting the needs of technology, healthcare, and business services companies. Specializing in M&A, private placements and financial advisory services, the firm represents growth-oriented companies in pursuing strategic alternatives that drive premium valuations. Unlike most investment banking firms, TripleTree brings a unique approach to advisory services through the leverage of experienced executives, strict industry focus, and extensive commitment to research. Such a commitment has allowed us to build an investment bank focused on identifying and delivering strategic solutions that enable shareholders and business executives to maximize the value of their firm in a dynamic and rapidly changing marketplace.

For further information, visit our website at: <http://www.triple-tree.com>

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MINNEAPOLIS

T 952-253-5300

F 952-253-5301

7601 France Avenue South

Suite 150

Minneapolis, Minnesota 55435

SAN DIEGO

T 858-792-3406

F 858-792-3407

12526 High Bluff Drive

Suite 300

San Diego, California 92130