



Human Resources Outsourcing (HRO) Annual Report 2006 – Preview

Our analysts produce “best-in-class” data and insight to assist members with important business decisions



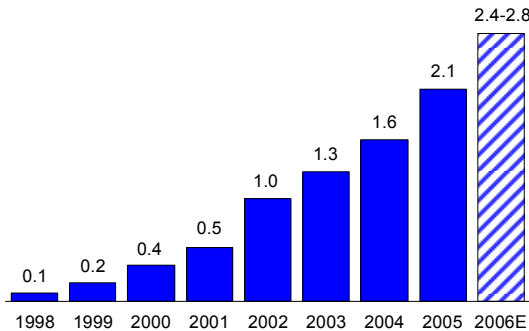
- Conduct fact-based research and analysis
 - Data-gathering
 - Proprietary research
 - Rigorous trend and segment analysis
- Identify key trends and develop initial hypotheses
 - Create models and databases
 - Segment data to determine key trends, emerging trends, and “game changers”
 - Conduct offshore analysis to determine key areas of penetration and changes in economic trends
- Develop implications and tailor research
 - Specific members (buyers, suppliers, investors, technology providers)
 - Specific processes (HRO, FAO, PO, ITO, ADM, Call Center)
 - Specific target buyer segments (large cap, small cap, single process, multi-process, local, regional, global, others)
- Communicate insights
 - Research products tailored for specific processes and vertical function
 - Word-of-mouth (conferences, strategy day, webinars, phone)
 - Web site (www.everestresearchinstitute.com)

The HRO market report has over 100 slides of insightful information

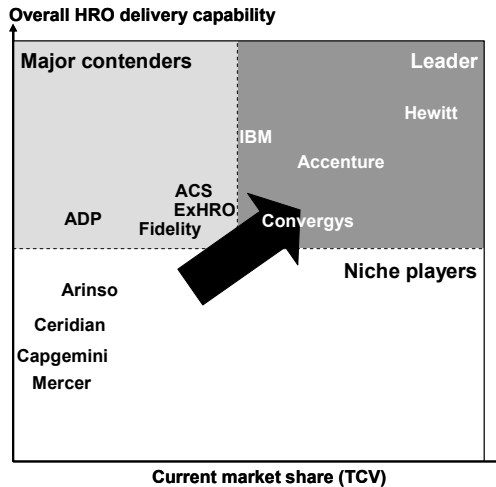


Market size

Annualized Contract Value
1998-2006; US\$ billion



Supplier capabilities

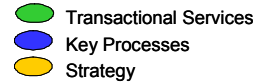


Source: Everest Research Institute

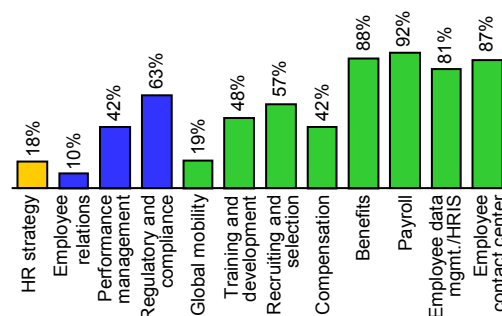
Functional composition

Measure of Scope of Services of HRO Deals

HR function



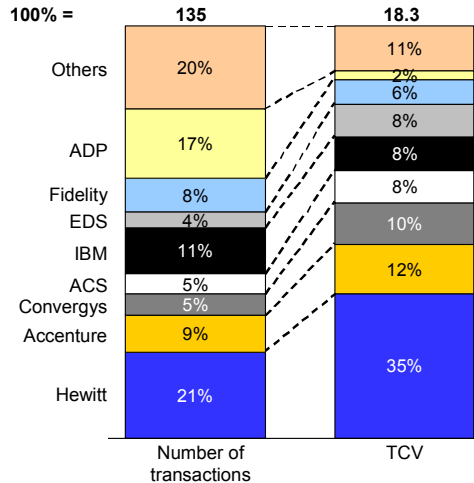
Overall Measure of the services outsourced



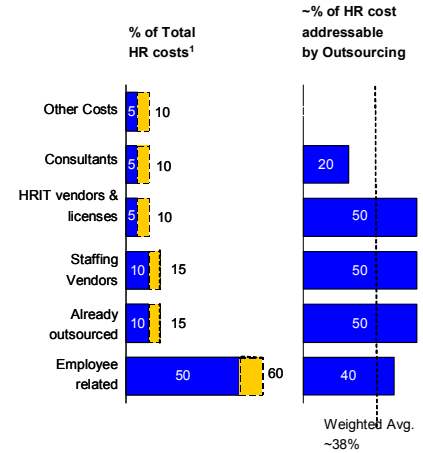
Supplier market share

Supplier share distribution of HRO Industry

Number of transactions, TCV in US\$ billion



Value drivers



Industry segmentation & trends

Geographic reach of HRO transactions
Proportion of transactions

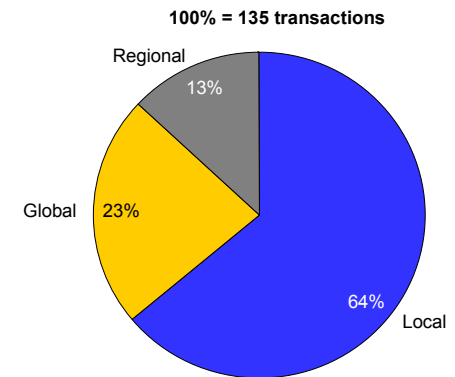


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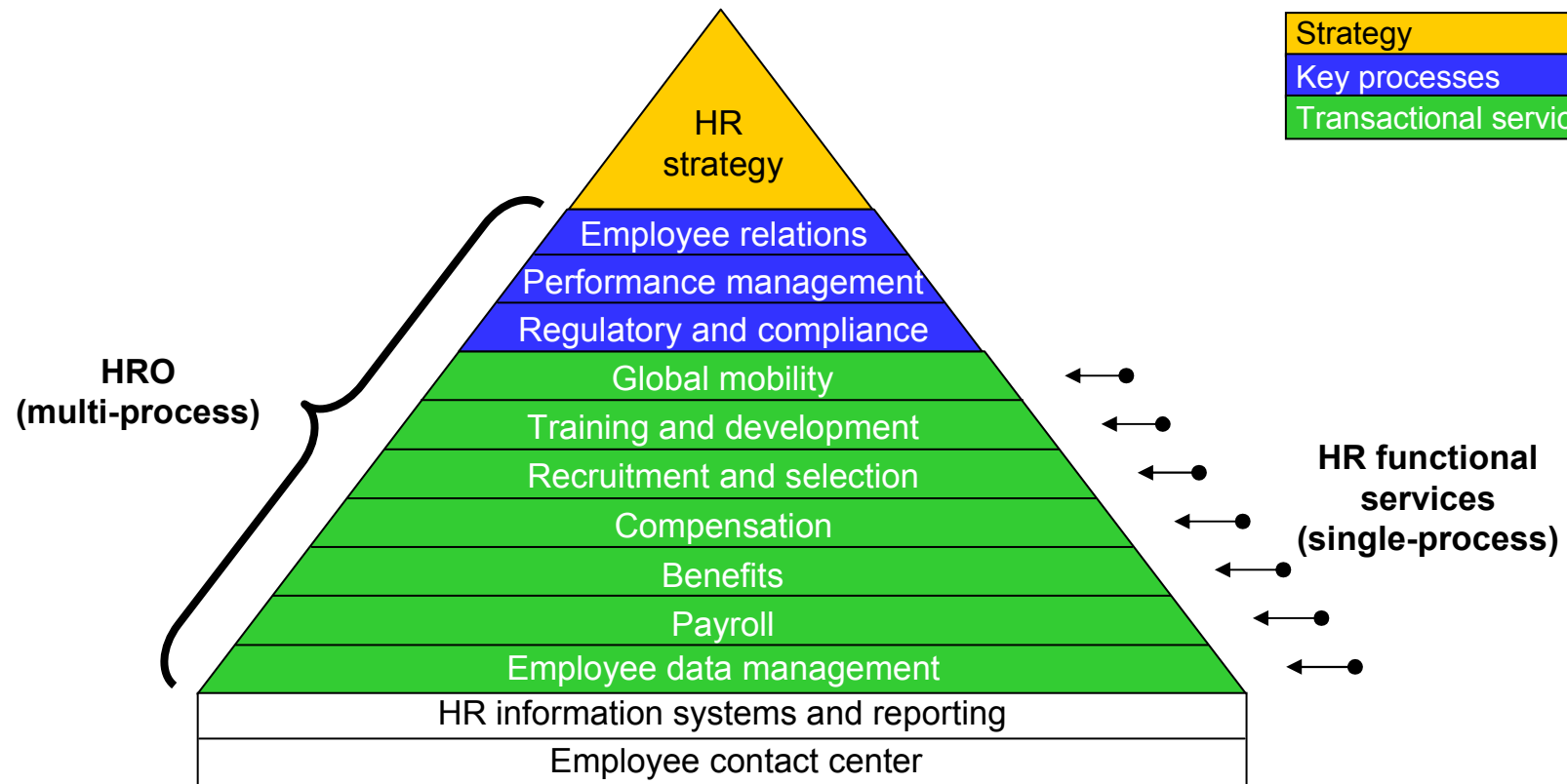
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The Everest Research Institute separates multi-process HRO from single-process HR functional services



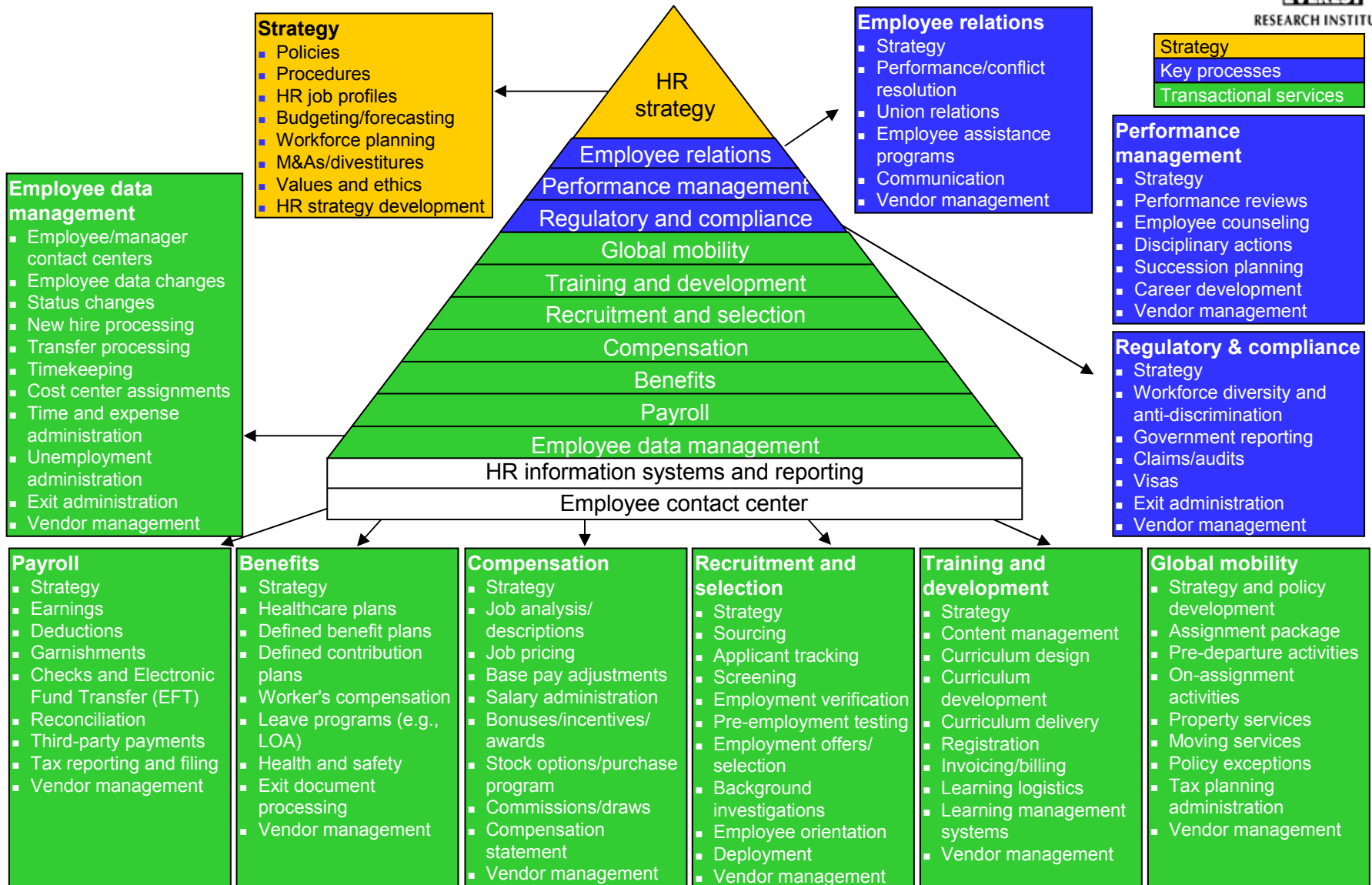
- Everest analysis includes all HRO transactions as of March 31, 2006
- HRO differs from its predecessor, HR functional services, by having a single supplier orchestrate a full (or fuller) suite of HR services
- HRO transactions include a minimum of three HR functions and service more than 3,000 employees

Source: Everest Research Institute

In contrast to HR functional services, HRO includes outsourcing of multiple HR functions



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Source: Everest Research Institute

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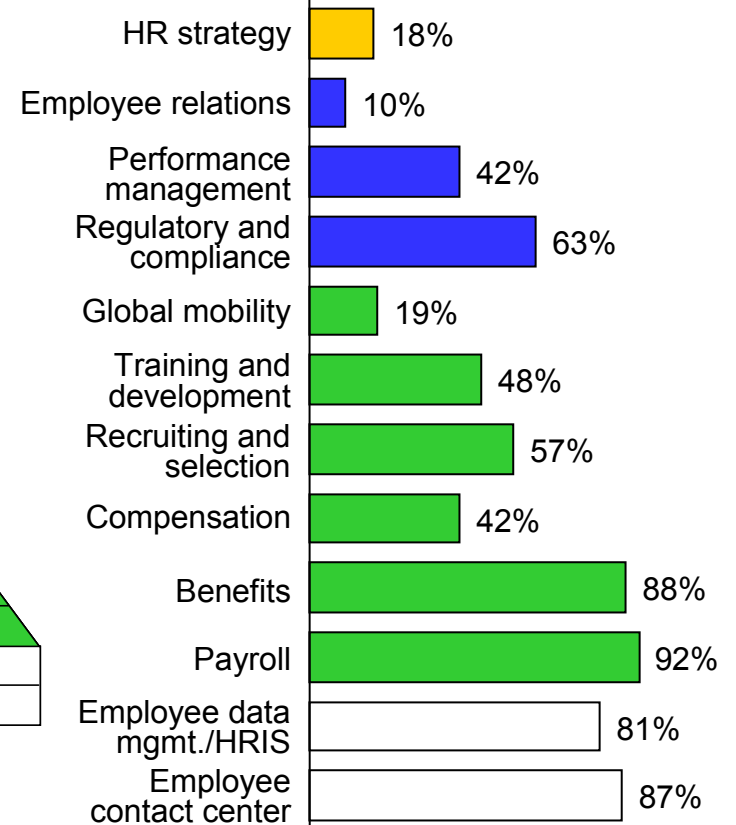
Payroll, benefits, employee data management, HR information systems, and contact centers are most commonly outsourced



1. As in other outsourcing arrangements, HRO buyers generally retain the strategy function
2. Some provide input on policy and performance management
3. Most HRO transactions provide services across multiple functional HR components



Frequency of inclusion within HRO transactions



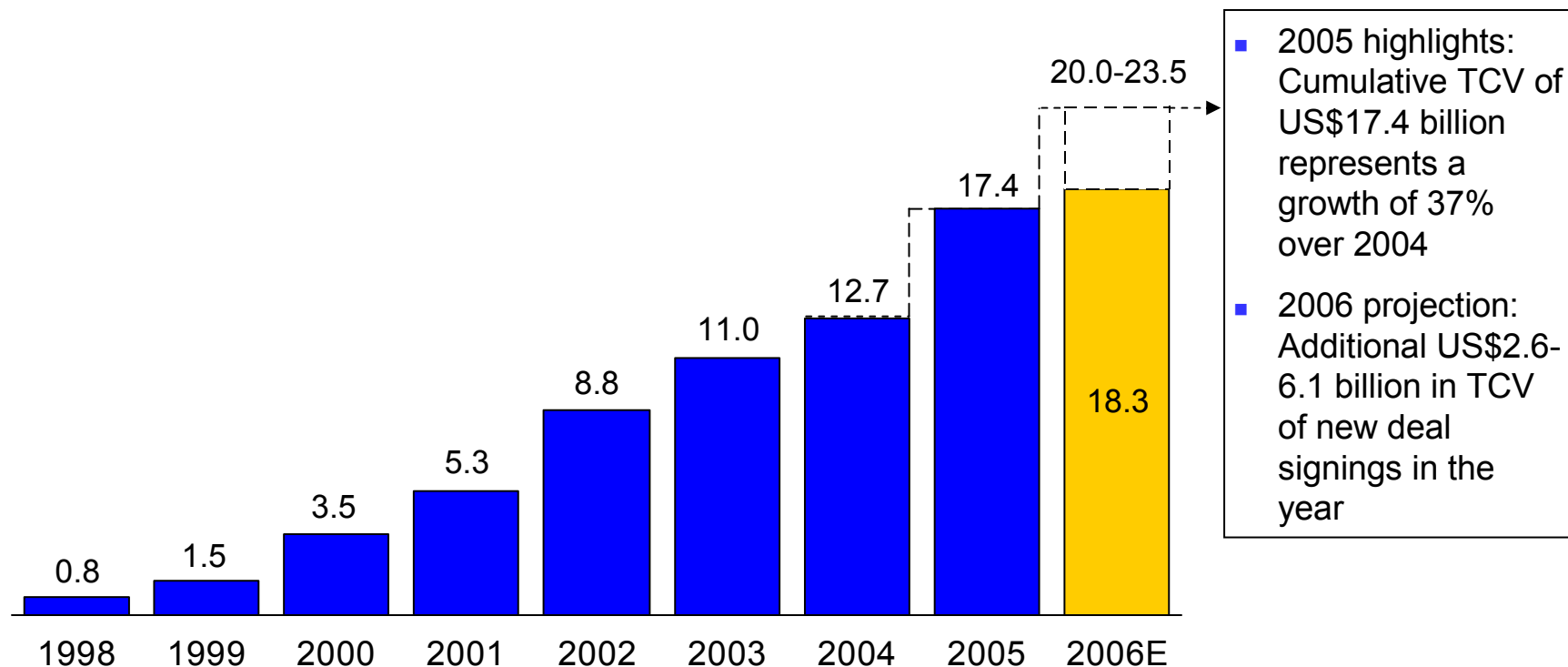
Sample size: 135 transactions signed as of Q1 2006
Source: Everest Research Institute

The cumulative TCV of HRO transactions grew by 37% in 2005. The strong trend is expected to continue in 2006



Cumulative Total Contract Value
1998-2006; US\$ billion

Projected for Q2-Q4 2006¹
Data up to Q1 2006



¹ Projected based on 2002-05 CAGR
Sample size: 135 transactions signed as of Q1 2006
Source: Everest Research Institute

Total deal signings grew by 45% in 2005. It is expected that 48-59 new HRO deals will be signed in 2006



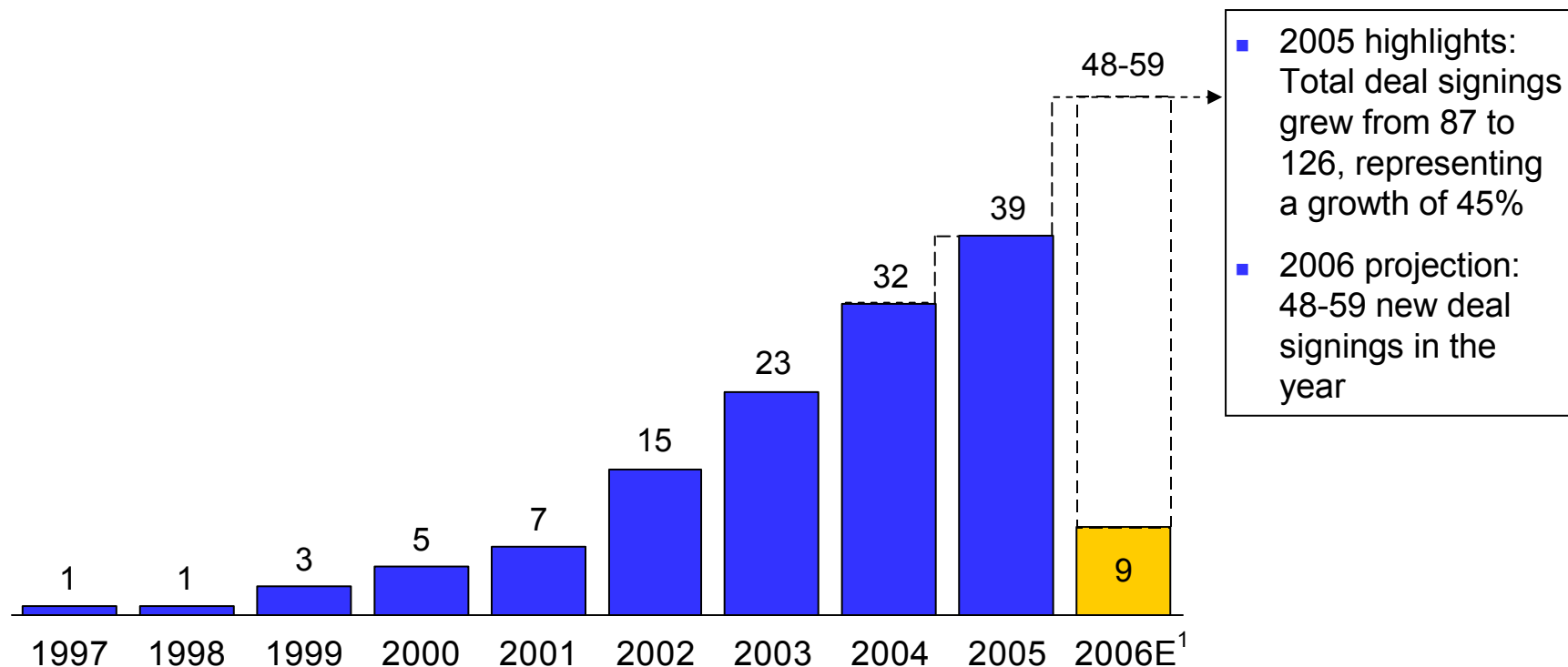
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Number of new HRO transactions

1997-2006; Number of transactions

Projected for Q2-Q4 2006¹

Data up to Q1 2006



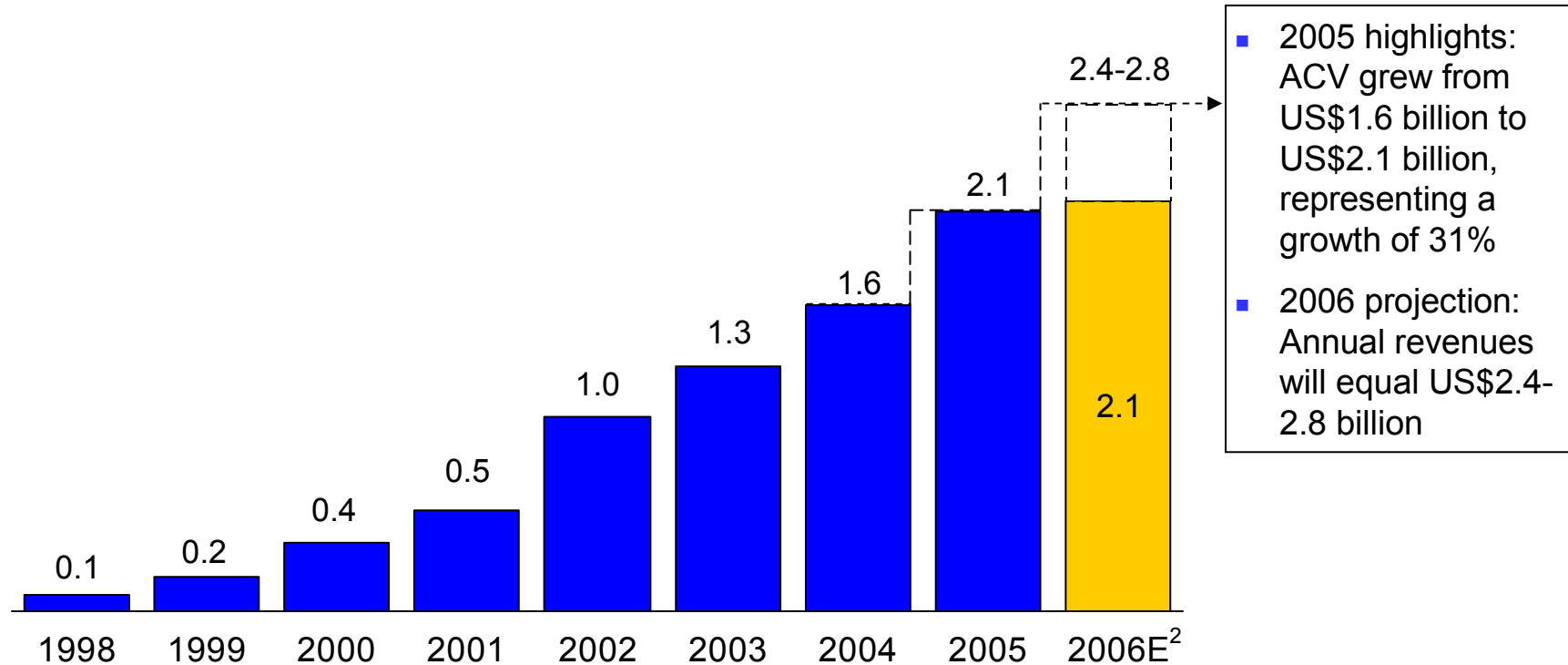
¹ Projected based on 2002-05 CAGR
Sample size: 135 transactions signed as of Q1 2006
Source: Everest Research Institute

The HRO market had annualized revenues of US\$ 2.1 billion in 2005. This is expected to reach US\$2.4-2.8 billion in 2006



Annualized Contract Value¹
1998-2006; US\$ billion

Projected for Q2-Q4 2006¹
Data up to Q1 2006



¹ Defined in Appendix section

² Projected based on 2002-05 CAGR

Sample size: 135 transactions signed as of Q1 2006

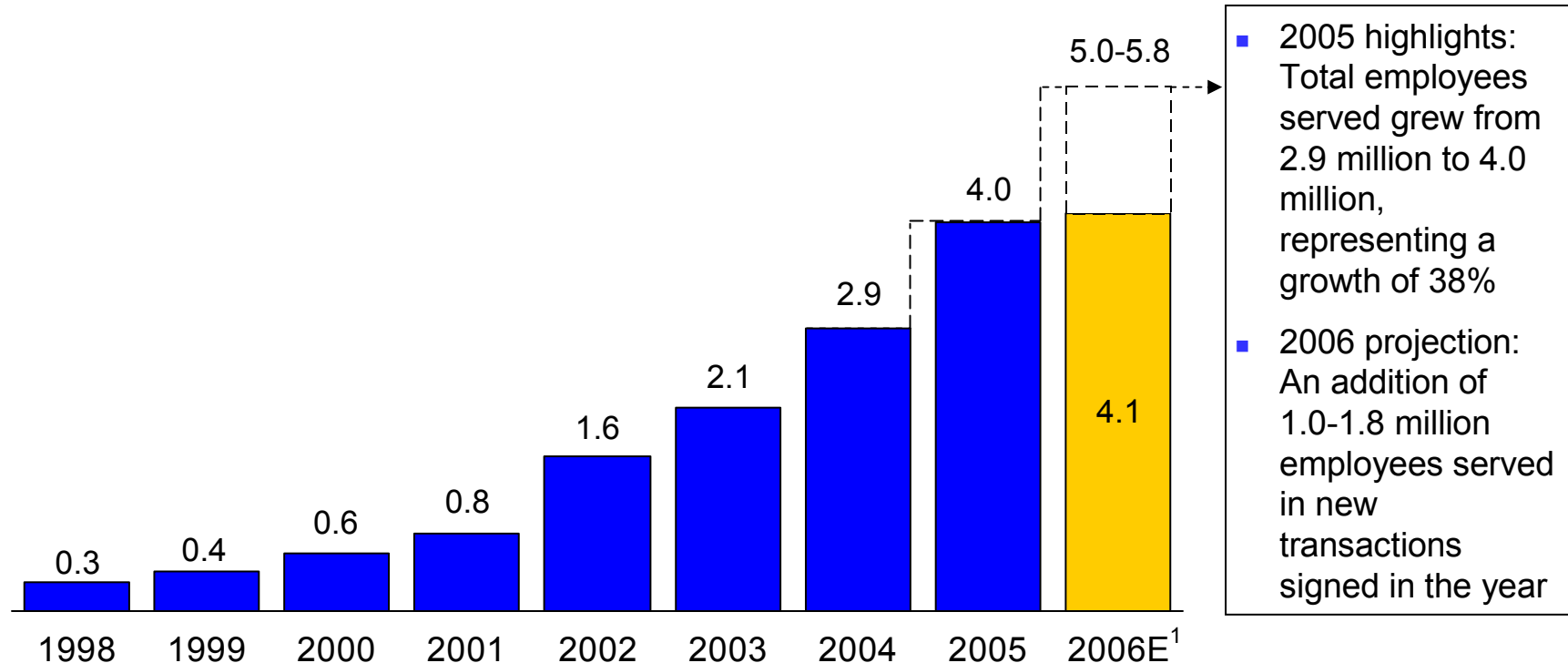
Source: Everest Research Institute

In 2005, there were four million employees being served in the HRO market. This is expected to reach 5.0-5.8 million in 2006



Number of employees served
1998-2006; Millions of employees

Projected for Q2-Q4 2006¹
Data up to Q1 2006



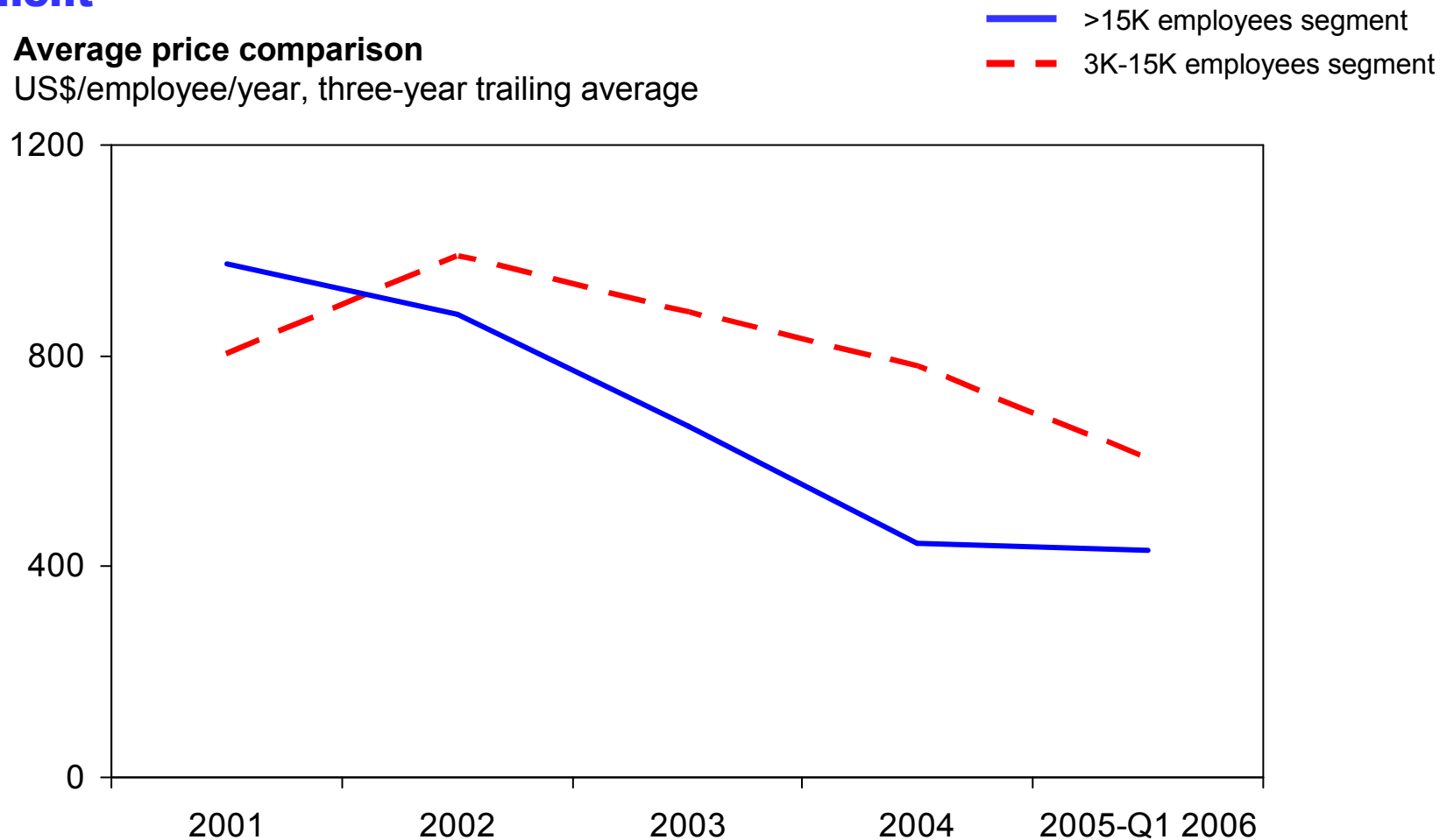
¹ Projected based on 2002-05 CAGR
Sample size: 135 transactions signed as of Q1 2006
Source: Everest Research Institute

Price points have declined significantly due to increase in competition. Prices seem to have stabilized for the >15K segment, although they are still declining for the 3K-15K segment



Average price comparison

US\$/employee/year, three-year trailing average



Sample size: 135 transactions signed as of Q1 2006

Note: Price has not been normalized for scope in this chart. Similar trend is observed with an adjustment of data for scope differences

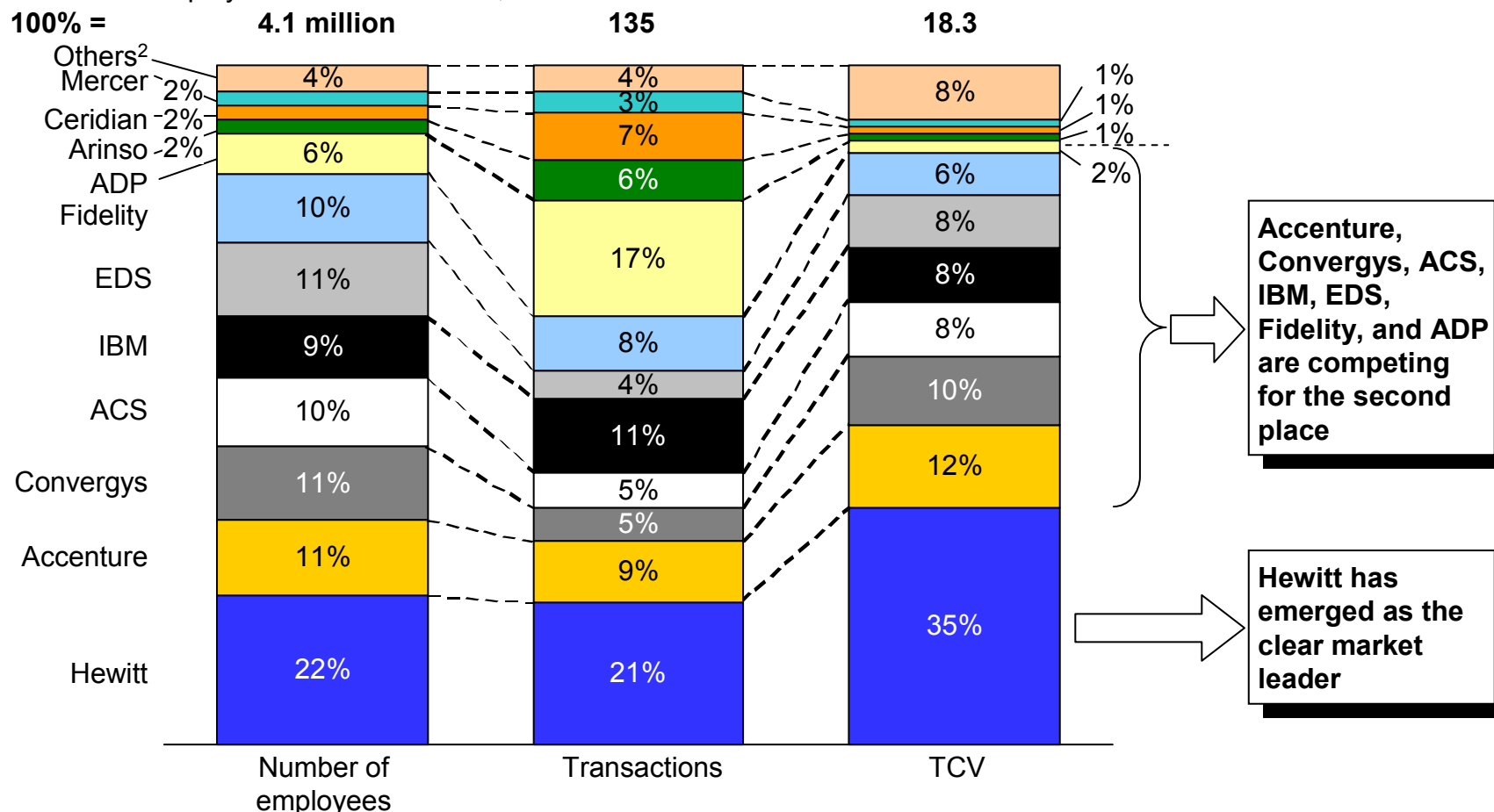
Source: Everest Research Institute

Hewitt remains the market leader, but several suppliers are competing for the number two position¹



Supplier share distribution of HRO Industry

Number of employees and transactions, TCV in US\$ billion



1 Based upon signed TCV of all current transactions (US\$18.3 billion in TCV)

2 Others include the following in order of their market share by number of transactions – Capgemini, AON, Xchanging, Capita

Sample size: 135 transactions signed as of Q1 2006

Source: Everest Research Institute

Suppliers are finding it challenging to make a profit in today's HRO market



Two examples reported by suppliers from their HRO businesses

Hewitt

- FY 2005 operating loss: -17%
- FY 2006 operating loss guidance revised from US\$128 million to US\$400 million, which includes non cash pre-tax charge of US\$249 million following review of HR BPO portfolio
- Higher than expected implementation and operational costs
- One-third of contracts signed in 2005 are expected to lose money over the lifetime of the project
- Underestimated complexity of taking on a large number of clients and contracts over a short period of time, post Exult acquisition

Convergys

- FY 2005 operating loss: -31%
- Q1-Q2 2006 operating loss: -17%
- Operating margin has been improving quarter-on-quarter since Q1 2005

Providers in the large employer segment have shown the propensity to lose up to 25-30% of annual revenues due to implementation costs on new clients and lack of leverage across clients

Source: Everest Research Institute

Consequently, suppliers are taking steps to tackle the profitability problem



Remedial steps being taken by suppliers to improve the financial performance of HRO:

■ Hewitt:

- Use of stronger analytical tools and processes to predict performance of existing and future contracts
- Adoption of a more disciplined approach to evaluating new contract opportunities and judiciously determining the number of parallel implementations. This should lead to pursuing only those deals which meet operational criteria and turning away those that do not meet financial objectives
- Systematic application of experience and analytics for new deal pricing
- Restructuring of organization to reduce fragmentation, increased role clarity and accountability, and leveraging key resources
- Use of third party consultant to monitor and advise on long-term contracts
- Announced Russell Fradin as the new CEO, who has successful HR outsourcing and consulting experience

■ Convergys:

- Planning to ensure that the various in-progress parallel implementations leverage standardized processes, so as to allow economies of scale across clients
- Operating margin has shown an improvement on a quarter-on-quarter basis since 2005. Improvements resulted from cost reductions initiated in 2005 and on-going operating efficiencies

Source: Everest Research Institute

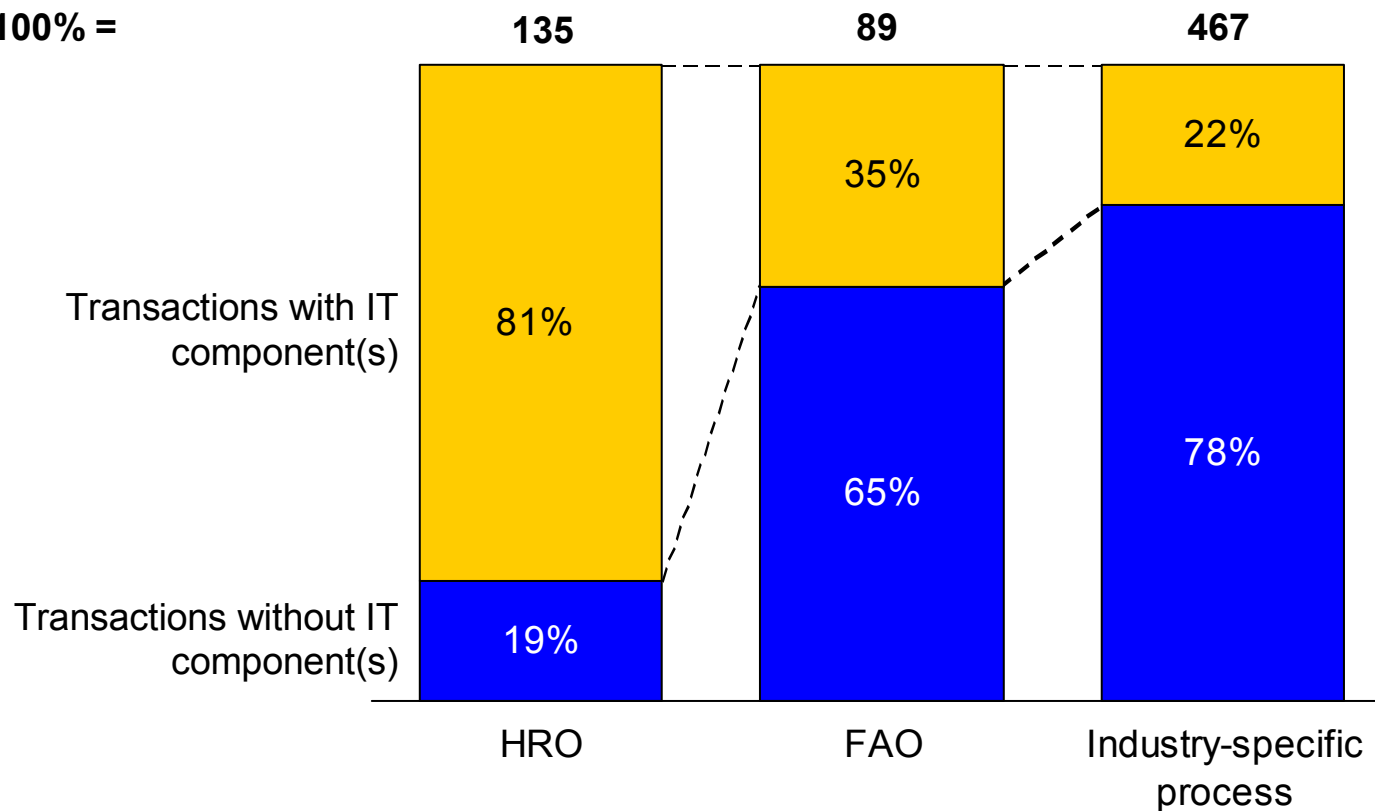
The bundling of full-service solutions with IT services is much higher in HR as compared to other functions



Frequency of combination of business process outsourcing with associated IT services

Number of contracts

100% =



Source: Everest Research Institute analysis

Offshore is expected to be a significant driver of value creation in the HRO market



Rationale

- There is a high relative share of HR functions that are labor driven and are inherently open to labor arbitrage
- Offshore is becoming more and more culturally acceptable; it's success in other BPO markets (e.g., FAO) supports this fact. There is expectation with senior management that offshore lever is pulled wherever possible
- Global solutions are more likely to need/require offshore centers of competence
- Key HR suppliers have invested in offshore and are poised to exploit it. This will force others to follow suit

Characteristics

- Expect varying degree of penetration by function with total sum being substantial. Amongst first movers will be benefits administration, followed by other functions (e.g., e-training, call-center) to a lesser degree
- A growing pool of HR subject matter experts in offshore locations will further drive adoption
- For voice-based work, cultural sensitivity and accent training will expand acceptability

Implications for buyers

- Offshore adoption will lead to downward pricing trend
- Potential quality implications during transition
- Change management will be critical. There will be a need for broader communication strategy, both external and internal, to overcome real as well as emotional issues
- Contractual flexibility will be required
- Will influence the functional scope
- For existing buyers, there will be price improvement opportunity

Implications for suppliers

- Pricing will be impacted
- Will influence competitive positioning
- There will be customer messaging implications
- Will potentially lead to consolidation

Implications for investors

- Will drive value creation

Our Mission



To serve the global outsourcing community as its central source of strategic intelligence, analysis, and insight that enables member companies to make more impactful business decisions.

“Everest Research Institute is what the outsourcing community has always needed, an idea whose time has come. We now have a premier research organization that specializes exclusively in outsourcing, and their research analysts know more about information technology and business process outsourcing than virtually anyone else. What’s more, they’re readily available to consult with Institute members on strategic business issues and market trends that impact their outsourcing investments and programs.”

*Rita Terdiman
Principal, Conscient Partners and former Gartner VP and Research Analyst, Sourcing*

Get the answers today that lead to tomorrow's success



Everest Research Institute has the resources, experience, and capabilities to provide companies with the strategic intelligence, analysis, and insight that are crucial to making the right decisions in today's outsourcing marketplace.

With the vision of our leadership team, the personal commitment, and indeed, the passion of our professionals to deliver real value to our clients, our organization is unsurpassed in its ability to guide your company's future success.

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