PEROT SYSTEMS CORP
Form 10-K
March 09, 2005

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**

# FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For The Fiscal Year Ended December 31, 2004**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the Transition Period From to**

**Commission File Number 0-22495**
**PEROT SYSTEMS CORPORATION**
*(Exact Name of Registrant as Specified in its Charter)*

| | |
|---|---|
| **Delaware** | **75-2230700** |
| *(State of Incorporation)* | *(I.R.S. Employer Identification No.)* |
| **2300 WEST PLANO PARKWAY PLANO, TEXAS** | **75075** |
| *(Address of Principal Executive Offices)* | *(Zip Code)* |

**(Registrant s Telephone Number)**
**(972) 577-0000**
**Securities registered pursuant to Section 12(b) of the Act:**

| Title of Each Class | Name of Each Exchange On Which Registered |
|---|---|
| Class A Common Stock Par Value $0.01 per share | New York Stock Exchange |

**Securities registered pursuant to Section 12(g) of the Act:**
**Preferred Stock Purchase Rights**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes þ No o

As of June 30, 2004, the aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant, based upon the closing sales price for the registrant s common stock as reported on the New York Stock Exchange, was approximately $1,046,987,076 (calculated by excluding shares owned beneficially by directors and officers).

Number of shares of registrant s common stock outstanding as of February 28, 2005: 116,249,207 shares of Class A Common Stock and 1,633,352 shares of Class B Common Stock.

**DOCUMENTS INCORPORATED BY REFERENCE**

The following documents (or parts thereof) are incorporated by reference into the following parts of this Form 10-K: certain information required in Part III of this Form 10-K is incorporated from the registrant s Proxy Statement for its 2005 Annual Meeting of Stockholders, which is expected to be filed not later than 120 days after the registrant s fiscal year ended December 31, 2004.

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*This report contains forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, forecasts, expects, plans, anticipates, believes, estimates, predicts, potential, see, target, continue or the negative of such terms and other comparable terminology. These statements reflect our current expectations, estimates, and projections. These statements are not guarantees of future performance and involve risks, uncertainties, and assumptions that are difficult to predict. Actual events or results may differ materially from what is expressed or forecasted in these forward-looking statements. In evaluating these statements, you should specifically consider various factors, including the risks outlined below under the caption Risk Factors. These risk factors describe reasons why our actual results may differ materially from any forward-looking statement. We disclaim any intention or obligation to update any forward-looking statement.*

# PART I

## Item 1. *Business*

### Overview

Perot Systems Corporation, originally incorporated in the state of Texas in 1988 and reincorporated in the state of Delaware on December 18, 1995, is a worldwide provider of information technology (commonly referred to as IT) services and business solutions to a broad range of customers. We offer our customers integrated solutions designed around their specific business objectives, chosen from a breadth of services, including technology infrastructure services, applications services, business process services, and consulting services.

With this approach, our customers benefit from integrated service offerings that help synchronize their strategy, systems, and infrastructure. As a result, we help our customers achieve their business objectives, whether those objectives are to accelerate growth, streamline operations, or enhance customer service capabilities.

### Our Services

Our customers may contract with us for any one or more of the following categories of services:

- Infrastructure services
- Applications services
- Business process services
- Consulting services

*Infrastructure Services*

Infrastructure services are typically performed under multi-year contracts in which we assume operational responsibility for various aspects of our customers businesses, including data center management, web hosting and internet access, desktop solutions, messaging services, network management, program management, and security. We typically hire a significant portion of the customer s staff that have supported these functions. We then apply our expertise and operating methodologies to increase the efficiency of the operations, which usually results in increased operational quality at a lower cost.

*Applications Services*

Applications services include services such as application development and maintenance, including the development and maintenance of custom and packaged application software for customers, and application systems migration and testing, which includes the migration of applications from legacy environments to current technologies, as well as performing quality assurance functions on custom applications. We typically offer these services on a short-term basis.

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*Business Process Services*

Business process services include services such as claims processing, call center management, energy management, payment and settlement management, security, and services to improve the collection of receivables. In addition, business process services include engineering support and other technical services.

*Consulting Services*

Consulting services include strategy consulting, enterprise consulting, technology consulting, and research. The consulting services provided to customers within our Industry Solutions segment typically consist of customized, industry-specific business solutions provided by associates with industry expertise, as well as the implementation of prepackaged software applications. Consulting services are typically viewed as discretionary services by our customers, with the level of business activity depending on many factors, including economic conditions and specific customer needs.

**Our Contracts**

Our contracts include services priced using a wide variety of pricing mechanisms. In determining how to price our services, we consider the delivery, credit and pricing risk of a business relationship. For the year ended December 31, 2004:

- Approximately 31% of our revenue was from fixed-price contracts where our customers pay us a set amount for contracted services. For some of these fixed-price contracts, the price will be set so that the customer realizes an immediate savings in relation to their current expense for an operation we are assuming. On contracts of this nature, our profitability generally increases over the term of the contract as we become more efficient. The time that it takes for us to realize these efficiencies can range from a few months to a few years, depending on the complexity of the operation.

- Approximately 27% of our revenue was from cost plus contracts where our billings are based in part on the amount of expense we incur in providing services to a customer.

- Approximately 27% of our revenue was from time and materials contracts where our billings are based on measurements such as hours, days or months and an agreed upon rate. In some cases, the rate the customer pays for a unit of time can vary over the term of a contract, which may result in the customer realizing immediate savings at the beginning of a contract.

- Approximately 14% of our revenue was from per-unit pricing where we bill our customers based on the volume of units provided at the unit rate specified. In some contracts, the per-unit prices may vary over the term of the contract, which may result in the customer realizing immediate savings at the beginning of a contract.

We also utilize other pricing mechanisms, including license fees and risk/reward relationships where we participate in the benefit associated with delivering a certain outcome. Revenue from these other pricing mechanisms totaled 1% of our revenue.

Depending on a customer s business requirements and the pricing structure of the contract, the amount of cash generated from a contract can vary significantly during a contract s term. With fixed-price contracts or when an upfront payment is required to purchase assets, an infrastructure services contract will typically produce less cash at the beginning of the contract with significantly more cash being generated as efficiencies are realized later in the term. With a cost plus contract, the amount of cash generated tends to be relatively consistent over the term of the contract.

**Our Lines of Business**

We offer our services under three primary lines of business Industry Solutions, Government Services, and Technology Services. We consider these three lines of business to be reportable segments and include financial information and disclosures about these reportable segments in our consolidated financial statements. You can find this financial information in Note 13, Segment and Certain Geographic Data, of the Notes to

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Consolidated Financial Statements below. We routinely evaluate the historical performance of and growth prospects for various areas of our business, including our lines of business, vertical industry groups, and service offerings. Based on a quantitative and qualitative analysis of varying factors, we may increase or decrease the amount of ongoing investment in each of these business areas, make acquisitions that strengthen our market position, or divest, exit, or downsize aspects of a business area. During the past five years, we have used our acquisition program to strengthen our business in the healthcare market, consulting markets, and to expand into the government market. At the same time, we have divested, or exited, certain service offerings and joint ventures that did not meet our criteria for continued investment.

***Industry Solutions***

Industry Solutions, which is our largest line of business and represented 79%, 86%, and 97% of our total revenue for 2004, 2003, and 2002, respectively, provides services to our customers primarily under long-term contracts in strategic relationships. This line of business was formed in December 2004 when we integrated Perot Systems Solutions Consulting and our management consulting practice into our former IT Solutions line of business. The primary services that we provide to the majority of our customers include the following:

*Technology infrastructure management* includes data center management, web hosting and internet access, desktop solutions, messaging services, video, voice, and data services, process and change management, hardware maintenance and monitoring, network management, including VPN services, service desk capabilities, physical security, network security, and risk management.

*Applications services* includes application assessment and evaluation, hardware and architecture consulting, systems integration, custom application development, system testing, application management and maintenance, business intelligence, and web-based services.

*Business process services* includes claims processing, call center management, energy management, payment and settlement management, security, and services to improve the collection of receivables.

*Consulting* includes strategic consulting, technology consulting, and enterprise solutions and applications, including Perot Systems Solutions Consulting and our management consulting practice.

*Program management* includes project assessments, project management, transition and contingency planning.

Within the Industry Solutions line of business, we face the market through our two vertical industry groups Healthcare and Commercial Solutions. Supporting these vertical industry groups is our Infrastructure Solutions group, the delivery organization for our technology infrastructure management services.

*Healthcare*

Our Healthcare group, which represented 46%, 45%, and 44% of our total revenue and 58%, 52%, and 46% of revenue for the Industry Solutions line of business for 2004, 2003, and 2002, respectively, provides infrastructure, applications, business process, and consulting services in four industry markets:

*Providers* including integrated health systems, free standing hospitals, and physician practices;

*Payers* including national insurers, Blue Cross and Blue Shield plans, and regional managed care organizations;

*Healthcare Supply Chain* including medical/surgical suppliers and distributors; and

*Life Sciences* including research-based pharmaceutical and contract research companies.

The services that we provide in the Healthcare group that cross all markets include Health Insurance Portability and Accountability Act compliance and remediation consulting and training, and full and unbundled IT outsourcing. In addition, our Healthcare group provides numerous services and solutions tailored to each industry market.

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For customers in the provider market, we offer revenue cycle solutions, clinical solutions, health information management, Digital Access, and ERP solutions. Combined, these services are targeted to improve quality outcomes and patient safety, increase cash flow, and improve hospital efficiency and cost control.

For our payer customers, we offer a comprehensive solution that incorporates our PERADIGM™ suite of products with our global business process services capabilities. The Payer PERADIGM suite includes the evolution of our DIAMOND® 950 product to a service oriented architecture (SOA) framework. Payer PERADIGM combines this SOA enterprise framework with new web services interfaces, significantly enhancing productivity and ease of system integration. In addition, we provide claims processing outsourcing services for customers of any size or complexity, and our multiple locations in the U.S. and India allow us to provide flexible price and service alternatives to our customers.

For our customers in the healthcare supply chain and life sciences markets, we offer technology outsourcing services.

*Commercial Solutions*

Our Commercial Solutions group, which represented 33%, 41%, and 53% of our total revenue and 42%, 48%, and 54% of revenue for the Industry Solutions line of business for 2004, 2003, and 2002, respectively, provides infrastructure, applications, business process, and consulting services to customers primarily in four markets:

- *Financial Services* including customers in the financial markets, banking and insurance sectors;
- *Travel and Transportation* including hotel, food service, vehicle rental, and cargo companies;
- *Engineering and Construction* including customers in commercial and residential construction; and
- *Manufacturing* including automotive manufacturers and suppliers to these manufacturers, and publishers and providers of information products and services.

For customers in the financial services market, we provide application development and management services on both on-shore and offshore bases, computer and processing systems services, desktop services, outsourcing and applications services management. The substantial majority of the revenue from this market comes from our contract with UBS AG, our largest customer. As discussed below under Our UBS Relationship, our contract with UBS will end January 1, 2007.

For the travel and transportation market, our services are focused on solving business critical issues with technology solutions, including IT outsourcing, business process services, and application management. We also serve a limited number of customers in the communications and energy industries.

For the engineering and construction market, we provide solutions that help our customers reduce overhead cost, manage project risk, and increase return on assets. We provide these benefits to our customers primarily by applying our expertise in information technology and business processes to all aspects of their business, including the consolidation and integration of technology operations and the implementation of new technology to increase efficiency of their IT infrastructure.

For the manufacturing market, our services include business and technology solutions that improve the efficiencies of critical processes, including product design, supply chain execution, warranty systems, collaborative commerce, and manufacturing plant floor processes.

Also included in our Commercial Solutions group is Perot Systems Solutions Consulting and a team of management consultants, which provide consulting services ranging from strategy through full implementation of software solutions. These solutions include enterprise resource planning, supply chain management, eBusiness, customer relationship management, and related process and technology solutions.

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*Infrastructure Solutions*

Our Infrastructure Solutions group is responsible for defining the technology strategies for our Industry Solutions customers and us. This group identifies new technology offerings and innovations that deliver value to our customers. It manages, updates and maintains our technology infrastructure including networks, data centers, help desks, mainframes, servers, storage, and workspace computing. It also provides senior technology consultants to assist our customers with more complex technology transformations. It manages, resolves and documents problems in our customers computing environments. The group also provides comprehensive monitoring, planning, and safeguarding of information technology systems against intrusion by monitoring system and network status, collecting and analyzing data regarding system and network performance, and applying appropriate corrective actions. All of these activities are either performed at customer facilities or delivered through centralized data processing centers that we maintain.

***Government Services***

We formed Perot Systems Government Services in July 2002 through the acquisition of ADI Technology Corporation and then expanded it in February 2003 through the acquisition of Soza & Company, Ltd. This line of business, which represented 15%, 14%, and 3% of our total revenue for 2004, 2003, and 2002, respectively, provides consulting, engineering support, and technology-based business process solutions for the Department of Defense, the Department of Homeland Security, various federal intelligence agencies, and other governmental agencies.

We provide mission and program support services predominantly to organizations with stringent quality, safety, technical, engineering, and regulatory requirements. Our services include the direct support of engineering, safety, quality assurance, logistics, environmental, and program management for federal managers across a broad spectrum of critical programs.

We also provide infrastructure support to the federal government through management consulting services, information technology and system support, application design and development, government financial services, business process outsourcing, and outreach, media and communications services.

Our major customers in the Department of Defense are the U.S. Navy and U.S. Air Force. In the Department of Homeland Security our customers include U.S. Citizenship and Immigration Services and the U.S. Coast Guard. Other government customers include the Departments of Agriculture, Commerce, Education, Health and Human Services, Housing and Urban Development, Interior, Transportation, and Treasury. We also serve various federal intelligence agencies, the Government Services Administration, and the Federal Deposit Insurance Corporation.

Despite the fact that a number of government projects for which we serve as a contractor or subcontractor are planned as multi-year projects, the U.S. government normally funds these projects on an annual or more frequent basis. Generally, the government has the right to change the scope of, or terminate, these projects at its convenience. The termination or a major reduction in the scope of a major government project could have a material adverse effect on our results of operations and financial condition. Approximately 99% of the revenue from the Government Services line of business in 2004 is from contracts with the U.S. government for which we serve as a contractor or subcontractor.

U.S. government entities audit our contract costs, including allocated indirect costs, or conduct inquiries and investigations of our business practices with respect to our government contracts. If the government finds that we improperly charged any costs to a contract, the costs are not reimbursable or, if already reimbursed, the cost must be refunded to the government. If the government discovers improper or illegal activities in the course of audits or investigations, the contractor may be subject to various civil and criminal penalties and administrative sanctions, which may include termination of contracts, forfeiture of profits, suspension of payments, fines and suspensions or debarment from doing business with the U.S. government. These government remedies could have a material adverse effect on our results of operations and financial condition.

*Technology Services*

Our Technology Services line of business represented 6% of our total revenue for 2004, net of the elimination of intersegment revenue. In December 2004, we integrated Perot Systems Solutions Consulting and our management consulting practice, which were previously included in our former Consulting line of business, into our Industry Solutions line of business. The remaining delivery unit in our former Consulting line of business, Perot Systems TSI B.V., which was acquired on December 19, 2003, when we purchased our joint venture partner s interest in HCL Perot Systems B.V., now operates as our Technology Services line of business. Technology Services specializes in application development and management, including the development and maintenance of custom and packaged application software for customers, and application systems migration and testing, which includes migrating applications from legacy environments to current technologies and performing quality assurance functions on custom applications. UBS is Technology Services largest customer.

**Perot Systems Associates**

The markets for IT personnel and business integration professionals are intensely competitive. A key part of our business strategy is the hiring, training, and retaining of highly motivated personnel with strong character and leadership traits. We believe that employing associates with such traits is and will continue to be an integral factor in differentiating us from our competitors in the IT industry. In seeking such associates, we screen candidates for employment through a rigorous interview process. In addition to competitive salaries, we distribute cash bonuses that are paid promptly to reward excellent performance, and we have an annual incentive plan based on our performance in relation to our business and financial targets. We also seek to align the interests of our associates with those of our stockholders by compensating outstanding performance with stock option awards, which we believe fosters loyalty and commitment to our goals.

As of December 31, 2004, we employed approximately 15,900 associates. A limited number of these associates located in the United States are currently employed under an agreement with a collective bargaining unit. In European countries, our associates are generally members of work councils and have worker representatives. We believe that our relations with our associates are good.

**Our UBS Relationship**

UBS AG is our largest customer. We earned 15.6%, 16.6% and 18.7% of our revenue in connection with services performed on behalf of UBS and its affiliates for 2004, 2003, and 2002, respectively. We perform most of our services for UBS under our IT Services Agreement, which is formally known as the Second Amended and Restated Agreement for EPI Operational Management Services and will end January 1, 2007. During the three years ended December 31, 2004, the amount of annual gross profit that we have earned from UBS and its affiliates under the IT Services Agreement has ranged from $44.2 million to $51.2 million. We also provide project services directly and through Technology Services through several separate contractual relationships with UBS, which are not described below.

In connection with amending the IT Services Agreement in 1997, we sold UBS 100,000 shares of our Class B Common Stock for $3.65 a share and 7,234,320 options to purchase shares of Class B Common Stock for $1.125 an option. The options will finish vesting at the end of 2006. Shares of the Class B Common Stock are convertible, on a share for share basis, into our Class A Common Stock for the purpose of sales to non-affiliates of UBS. UBS can exercise these options at any time for $3.65 a share, subject to United States bank regulatory limits on UBS s shareholdings. UBS exercised options to purchase 700,008 shares of Class B Common Stock in 2004 and has exercised options to purchase an aggregate of 6,476,016 shares of Class B Common Stock since 1997.

*Our IT Services Agreement*

Prior to the amendment of the IT Services Agreement on September 16, 2004, it required that UBS obtain from us all of UBS Warburg s requirements for the operational management of its technology resources (including mainframes, desktops, and voice and data networks), excluding hardware, proprietary software applications development and general network services. The IT Services Agreement also generally entitled us to recover our costs plus a fixed fee, with a bonus or penalty that could have caused this annual fee to vary up and down by as much as 13%, which was the variable component of our annual fee, depending on our level of performance as determined by UBS.

On September 16, 2004, we entered into the EPI Transition Agreement to amend the IT Services Agreement. The Transition Agreement provides UBS with more control over the work performed by our associates working on the UBS account as part of UBS s efforts to integrate its global IT infrastructure and prepare for the transition of services back to UBS at the scheduled expiration of the IT Services Agreement at the end of 2006. The important non-financial terms resulting from the Transition Agreement are as follows:

Elimination of the requirement that UBS obtain certain services exclusively from Perot Systems.

Addition of a requirement that UBS extend offers of employment to a substantial majority of the Perot Systems associates working on the UBS account at the expiration of the IT Services Agreement.

Under the IT Services Agreement, as amended by the Transition Agreement, we will continue to be compensated for the services we provide using a cost plus fixed fee arrangement, and the following important financial terms will apply:

The variable component of the annual fee has been modified by eliminating the potential bonus in 2004, reducing the potential penalty from 13% to 3.5% for 2004, and by eliminating the variable component of the annual fee for 2005 and 2006. Therefore, we expect the annual fee (or profit) under the IT Services Agreement to be approximately $53.0 million in each of 2005 and 2006 (subject to adjustment for inflation in 2006). There was no penalty for 2004.

Forecast revenues, which as used in the IT Services Agreement excludes the Perot Systems fee and the bonus pool for associates working on our UBS account and are subject to adjustment for currency exchange rates, (i) for 2005, are $154.0 million and (ii) for 2006, will be 95% of the greater of 2005 actual revenue or 2005 minimum revenue.

Minimum revenues, which as used in the IT Services Agreement excludes the Perot Systems fee and the bonus pool for associates working on our UBS account and are subject to adjustment for currency exchange rates, are (i) $139.0 million for 2005 and (ii) 90% of the 2006 revenue forecast for 2006.

If actual revenues are greater than minimum revenues but are less than forecast revenues, Perot Systems would be entitled to receive 20% of the difference between the forecast revenues and actual revenues.

If actual revenues are less than the minimum revenues, Perot Systems would be entitled to receive a payment equal to 100% of the difference between the minimum revenues and actual revenues plus 20% of the difference between forecast revenues and minimum revenues.

We continue to expect that we will lose a substantial majority of our revenue and profit from UBS when our outsourcing agreement contract with UBS ends on January 1, 2007. The impact of the expiration of the outsourcing agreement on our profits will be based in part on our ability to reduce our costs. We expect that the expiration of the outsourcing agreement likely will have a disproportionately large effect on our profitability compared to the effect on our revenues. See the more detailed discussion of the expected effect of the end of our outsourcing contract with UBS below under Management s Discussion and Analysis of Financial Condition and Results of Operations.

**Competition**

We operate in extremely competitive markets, and the technology required to meet our customers needs changes. In each of our lines of business we frequently compete with companies that have greater financial resources; more technical, sales, and marketing capacity; and larger customer bases than we do. Because many of the factors on which we compete, as discussed below, are outside of our control, we cannot be sure that we will be successful in the markets in which we compete. If we fail to compete successfully, our business, financial condition, and results of operations will be materially and adversely affected.

***Industry Solutions***

Our Industry Solutions line of business competes with a number of different information technology service providers depending upon the region, country, and/or market we are addressing. Some of our more frequent competitors include: Accenture Ltd., Affiliated Computer Services, Inc., BearingPoint, Inc., Cap Gemini Ernst & Young, CGI Group, Inc., Computer Sciences Corporation, Electronic Data Systems Corporation, Hewlett Packard Company, IBM Global Services (a division of International Business Machines Corporation), McKesson Corporation, Siemens Business Services, Inc., smaller consulting firms with industry expertise in areas such as healthcare or financial services, and the consulting divisions of large systems integrators and information technology services providers. In addition, we may compete with non-IT outsourcing providers who enter into marketing and business alliances with our customers that provide for the consolidation of services. As we enter new markets, we expect to encounter additional competitors. Our Industry Solutions line of business competes on the basis of a number of factors, including the attractiveness and breadth of the business strategy and services that we offer, pricing, technological innovation, quality of service, ability to invest in or acquire assets of potential customers, and our scale in certain industries. We also frequently compete with our customers own internal information technology capability, which may constitute a fixed cost for our customer. In addition, the market for consulting services is affected by an oversupply of consulting talent, both domestically and offshore, which results in downward price pressure for our services. All of these factors may increase pricing pressure on us.

***Government Services***

Our Government Services line of business competes with a number of different information technology service providers depending on the federal agency or department as well as the market we are addressing. Some of our more frequent competitors include: Accenture Ltd., Affiliated Computer Services, Inc., Anteon International Corporation, BearingPoint, Inc., Booz-Allen and Hamilton, CACI International, Inc., Cap Gemini Ernst & Young, Computer Sciences Corporation, Electronic Data Systems Corporation, General Dynamics, Lockheed Martin Corporation, Northrop Grumman Corporation, Science Applications International Corporation, SRA International, and Unisys Corporation. We compete on the basis of a number of factors, including the attractiveness and breadth of the business strategy and professional services that we offer, pricing, technological innovation, and quality of service. We must frequently compete in federal and defense programs with declining budgets, which creates pressure to lower our prices.

***Technology Services***

Our Technology Services line of business competes with a number of different service providers, including Accenture Ltd., Cognizant Technology Solutions Corporation, iGate Global Solutions Limited, Infosys Technologies Limited, Mastec, Inc., Patni Computer Systems Limited, Polaris Software Lab Limited, Tata Consultancy Services Limited, and Wipro Limited. We compete on many factors, including price, industry expertise, our process methodologies and intellectual property, and our past successes in executing assignments. Emerging offshore development capacity in countries such as India and China is increasing the degree of competition for our software development services.

**Financial Information About Foreign and Domestic Operations**

See Note 13, Segment and Certain Geographic Data, to the Consolidated Financial Statements included elsewhere in this report.

**Intellectual Property**

While we attempt to retain intellectual property rights arising from customer engagements, our customers often have the contractual right to such intellectual property. We rely on a combination of nondisclosure and

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other contractual arrangements and trade secret, copyright, and trademark laws to protect our proprietary rights and the proprietary rights of third parties from whom we license intellectual property. We enter into confidentiality agreements with our associates and limit distribution of proprietary information. There can be no assurance that the steps we take in this regard will be adequate to deter misappropriation of proprietary information or that we will be able to detect unauthorized use and take appropriate steps to enforce our intellectual property rights.

We license the right to use the names Perot Systems and Perot in our current and future businesses, products, or services from the Perot Systems Family Corporation and Ross Perot, our Chairman Emeritus. The license is a non-exclusive, royalty-free, worldwide, non-transferable license. We may also sublicense our rights to the Perot name to some of our affiliates. Under the license agreement, either party may, in its sole discretion, terminate the license at any time, with or without cause and without penalty, by giving the other party written notice of such termination. Upon termination by either party, we must discontinue all use of the Perot name within one year following notice of termination. The termination of this license agreement could materially and adversely affect our business, financial condition, and results of operations. Except for the license of our name, we do not believe that any particular copyright, trademark, or group of copyrights and trademarks is of material importance to our business taken as a whole.

**Risk Factors**

*An investment in our Class A common stock involves a high degree of risk. You should carefully consider the following risk factors in evaluating an investment in our common stock. The risks described below are not the only ones that we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the following risks actually occurs, our business, financial condition, or results of operations could be materially and adversely affected. In such case, the trading price of our Class A common stock could decline, and you could lose all or part of your investment. You should also refer to the other information set forth in this report, including our Consolidated Financial Statements and the related notes.*

*Our outsourcing agreement with UBS, the largest of our UBS agreements, ends in January 2007, and we expect the end of this agreement to result in the loss of a substantial majority of revenue and profit from our UBS relationship.*

UBS is our largest customer. During 2004, our UBS relationship generated $276.7 million, or 15.6%, of our revenue. The amount of gross profit that we have earned from the IT Services Agreement with UBS has ranged from $44.2 million to $51.2 million per year during the past three calendar years. We continue to expect that we will lose a substantial majority of our revenue and profit from UBS when the IT Services Agreement ends on January 1, 2007. We expect that the expiration of the IT Services Agreement likely will have a disproportionately large effect on our profitability compared to the effect on our revenues. As discussed below in Management s Discussion and Analysis of Financial Condition and Results of Operations, the impact of the expiration of the IT Services Agreement will be based in part on our ability to reduce our costs.

*We may not be able to successfully implement planned operating efficiencies and expense reduction initiatives and achieve the planned timing and amount of any resulting benefits.*

As discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations, we have identified several operating efficiencies and expense reduction initiatives that we believe could reduce the expected negative impact on our operating income from the expiration of our outsourcing agreement with UBS on January 1, 2007. Our planned operating efficiencies and expense reduction initiatives are based on estimates and assumptions regarding costs and timing of activities to be undertaken as part of our long-range planning activities. These estimates and assumptions are subject to economic, competitive and other uncertainties that are beyond our control. If we are unable to successfully implement these operating efficiencies and expense reduction initiatives and achieve the planned timing and amount of any resulting benefits, our financial condition and results of operations could be adversely affected.

*We may bear the risk of cost overruns under custom software development and implementation services, and, as a result, cost overruns could adversely affect our profitability.*

We provide services related to the development of custom software applications and the implementation of complex software packages for some of our customers. The effort and cost associated with the completion of these software development and implementation services are difficult to estimate and, in some cases, may significantly exceed the estimates made at the time we begin the services. We provide these software development and implementation services under level-of-effort and fixed-price contracts. The level-of-effort contracts are usually based on time and materials or direct costs plus a fee. Under those arrangements, we are able to bill our customer based on the actual cost of completing the services, even if the ultimate cost of the services exceeds our initial estimates. However, if the ultimate cost exceeds our initial estimate by a significant amount, we may have difficulty collecting the full amount that we are due under the contract, depending upon many factors, including the reasons for the increase in cost, our communication with the customer throughout the project, and the customer s satisfaction with the services. As a result, we could incur losses with respect to these software development and implementation services even when they are priced on a level-of-effort basis. If we provide these software development or implementation services under a fixed-price contract, we bear all the risk that the ultimate cost of the project will exceed the price to be charged to the customer.

*Our largest customers account for a substantial portion of our revenue and profits, and the loss of any of these customers could result in decreased revenues and profits.*

Our 10 largest customers accounted for 47.9% of our revenue for 2004 and 49.4% of our revenue in 2003. UBS was the only customer that accounted for more than 10% of our revenue for 2004 and 2003. After UBS our next nine largest customers accounted for 32.3% of our revenue in 2004 and 32.8% of our revenue in 2003. Our primary relationship with each of our next nine largest customers consists of a long-term outsourcing contract with a term extending at least through 2007. One of these customers, in addition to UBS, has notified us that it intends to transition the services that we provide them to its new business partner over the next two to three years. This transition will decrease our revenues and profits, as described in Management s Discussion and Analysis of Financial Condition and Results of Operations. If we were to lose one or more additional large customers, our revenues would generally be materially decreased and our profits would be less.

Generally, we may lose a customer as a result of a merger or acquisition, contract expiration, the selection of another provider of information technology services, entry into strategic business and marketing alliances with other business partners, business failure or bankruptcy, or our performance. Our outsourcing contracts typically require us to maintain specified performance levels with respect to the services that we deliver to our customer, with the result that if we fail to perform at the specified levels, we may be required to pay or credit the customer with amounts specified in the contract. In the event of significant failures to deliver the services at the specified levels, a number of these contracts provide that the customer has the right to terminate the agreement. In addition, some of these contracts provide the customer the right to terminate the contract at the customer s convenience. The customer s right to terminate for convenience typically requires the customer to pay us fees to cover costs that we have incurred but not recovered and an amount that results in the recovery of a portion of profit we had expected to earn over the term of the contract. We may not retain long-term relationships or secure renewals of short-term relationships with our large customers in the future.

*If entities we acquire fail to perform in accordance with our expectations or if their liabilities exceed our expectations, our profits per share could be diminished and our financial results could be adversely affected.*

In connection with any acquisition we make, there may be liabilities that we fail to discover or that we inadequately assess. To the extent that the acquired entity failed to fulfill any of its contractual obligations, we may be financially responsible for these failures or otherwise be adversely affected. In addition, acquired entities may not perform according to the forecasts that we used to determine the price paid for the acquisition. If the acquired entity fails to achieve these forecasts, our financial condition and operating results may be adversely affected.

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*Development of our software products may cost more than we initially project, and we may encounter delays or fail to perform well in the market, which could decrease our profits.*

Our business has risks associated with the development of software products. There is the risk that capitalized costs of development may not be fully recovered if the market for our products or the ability of our products to capture a portion of the market differs materially from our estimates. In addition, there is the risk that the cost of product development differs materially from our estimates or a delay in product introduction may reduce the portion of the market captured by our product.

*Our financial results are materially affected by a number of economic and business factors.*

Our financial results are materially affected by a number of factors, including broad economic conditions, the amount and type of technology spending that our customers undertake, and the business strategies and financial condition of our customers and the industries we serve, which could result in increases or decreases in the amount of services that we provide to our customers and the pricing of such services. Our ability to identify and effectively respond to these factors is important to our future financial and growth position. Each of our three major lines of business has distinct economic factors, business trends, and risks that could have a material adverse effect on our results of operations and financial condition.

*If we are unable to successfully integrate acquired entities, our profits may be less and our operations more costly or less efficient.*

We have completed several acquisitions in recent years, and we will continue to analyze and consider potential acquisition candidates. Acquisitions involve significant risks, including the following:

companies we acquire may have a lower quality of internal controls and reporting standards, which could cause us to incur expenses to increase the effectiveness and quality of the acquired company s internal controls and reporting standards;

we may have difficulty integrating the systems and operations of acquired businesses, which may increase anticipated expenses relating to integrating our business with the acquired company s business and delay or reduce full benefits that we anticipate from the acquisition;

integration of an acquired business may divert our attention from normal daily operations of the business, which may adversely affect our management, financial condition, and profits; and

we may not be able to retain key employees of the acquired business, which may delay or reduce the full benefits that we anticipate from the acquisition and increase costs anticipated to integrate and manage the acquired company.

*Our contracts generally contain provisions that could allow customers to terminate the contracts and sometimes contain provisions that enable the customer to require changes in pricing, decreasing our revenue and profits and potentially damaging our business reputation.*

Our contracts with customers generally permit termination in the event our performance is not consistent with service levels specified in those contracts. The ability of our customers to terminate contracts creates an uncertain revenue and profit stream. If customers are not satisfied with our level of performance, our reputation in the industry may suffer, which may also adversely affect our ability to market our services to other customers. Furthermore, some of our contracts contain benchmarking provisions that could decrease our revenues and profitability. Some of our agreements contain pricing provisions that permit a customer to request a benchmark study by a mutually acceptable third-party benchmarker. Generally, if the benchmarking study shows that our pricing has a difference outside a specified range and the difference is not due to the unique requirements of the customer, then the parties will negotiate in good faith any appropriate adjustments to the pricing. This may result in the reduction of our rates for the benchmarked services and could negatively impact our results of operations or cash flow.

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*Some contracts contain fixed-price provisions or penalties that could result in decreased profits.*

Some of our contracts contain pricing provisions that require the payment of a set fee by the customer for our services regardless of the costs we incur in performing these services, or provide for penalties in the event we fail to achieve certain contract standards. In such situations, we are exposed to the risk that we will incur significant unforeseen costs or such penalties in performing the contract.

*Fluctuations in currency exchange rates may adversely affect the profitability of our foreign operations.*

Fluctuations in currency exchange rates may adversely affect the profitability of our foreign operations. For instance, with respect to most of our Indian operations, our customers pay us in their local currency (typically Euros or U.S. Dollars), but our costs are primarily incurred in Indian Rupees. Therefore, if the Rupee increases in strength against these local currencies, our profits from our Indian operations would be adversely affected. To attempt to mitigate the effects of significant foreign currency fluctuations, we use forward exchange contracts and other hedging techniques.

*Our international operations expose our assets to increased risks and could result in business loss or in more expensive or less efficient operations.*

We have operations in many countries around the world. In addition to the risks related to fluctuations in currency exchange rates discussed in the immediately preceding risk factor and the additional risk associated with doing business in India discussed in the immediately following risk factor, risks that affect these international operations include:

- complicated licensing and work permit requirements may hinder our ability to operate in some jurisdictions;
- our intellectual property rights may not be well protected in some jurisdictions;
- our operations may be vulnerable to terrorist actions or harmed by government responses;
- governments may restrict our ability to convert currencies; and
- additional expenses and risks inherent in conducting operations in geographically distant locations, with customers speaking different languages and having different cultural approaches to the conduct of business.

*We have a significant business presence in India, and risks associated with doing business there could decrease our revenue and profits.*

In December 2003, we acquired our joint venture partner s interest in HCL Perot Systems B.V., a joint venture entity formed by us and HCL in 1996, for approximately $98.8 million (including acquisition costs and net of $12.7 million of cash acquired). Subsequently, we changed the name to Perot Systems TSI B.V, which now operates as our Technology Services line of business. In addition to the risks regarding fluctuations in currency exchange rates and regarding international operations discussed in the two immediately preceding risk factors, the following risks associated with doing business in India could decrease our revenue and profits:

- governments could enact legislation that restricts the provision of services from offshore locations;
- difficulty in staffing and managing operations in India;
- difficulties in collecting accounts receivable;
- developments between the nations of India and Pakistan regarding the threat of war;
- potential wage increases in India which could prevent us from maintaining our competitive advantage; and

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cost increases if the Government of India reduces or withholds tax benefits and other incentives provided to us or if we are unable to obtain new tax holiday benefits when our existing tax holiday benefits expire in 2006 through 2009.

*Our government contracts contain early termination and reimbursement provisions that may adversely affect our revenue and profits.*

Our Government Services line of business provides services as a contractor and subcontractor on various projects with U.S. government entities. Despite the fact that a number of government projects for which we serve as a contractor or subcontractor are planned as multi-year projects, the U.S. government normally funds these projects on an annual or more frequent basis. Generally, the government has the right to change the scope of, or terminate, these projects at its convenience. The termination or a major reduction in the scope of a major government project could have a material adverse effect on our results of operations and financial condition. Approximately 99% of the revenue from the Government Services line of business in 2004 is from contracts with the U.S. government for which we serve as a contractor or subcontractor.

U.S. government entities audit our contract costs, including allocated indirect costs, or conduct inquiries and investigations of our business practices with respect to our government contracts. If the government finds that we improperly charged costs to a contract, the costs are not reimbursable or, if already reimbursed, the cost must be refunded to the government. If the government discovers improper or illegal activities in the course of audits or investigations, the contractor may be subject to various civil and criminal penalties and administrative sanctions, which may include termination of contracts, forfeiture of profits, suspension of payments, fines and suspensions, or debarment from doing business with the U.S. government. These government remedies could have a material adverse effect on our results of operations and financial condition.

*If customers reduce spending that is currently above contractual minimums, our revenues and profits could diminish.*

Some of our outsourcing customers request services in excess of the minimum level of services required by the contract. These services are often in the form of project work and are discretionary to our customers. Our customers ability to continue discretionary project spending may depend on a number of factors including, but not limited to, their financial condition, and industry and strategic direction. Spending above contractual minimums by customers could end with limited notice and result in lower revenue and earnings.

*If we fail to compete successfully in the highly competitive markets in which we operate, our business, financial condition, and results of operations will be materially and adversely affected.*

We operate in extremely competitive markets, and the technology required to meet our customers needs changes. In all of our lines of business, we frequently compete with companies that have greater financial resources; more technical, sales, and marketing capacity; and larger customer bases than we do. Because many of the factors on which we compete are outside of our control, we cannot be sure that we will be successful in the markets in which we compete. If we fail to compete successfully, our business, financial condition, and results of operations will be materially and adversely affected.

*Increasingly complex regulatory environments may increase our costs.*

Our customers are subject to complex and constantly changing regulatory environments. These regulatory environments change and in ways that cannot be predicted. For example, our financial services customers are subject to domestic and foreign privacy and electronic record handling rules and regulations, and our customers in the healthcare industry have been made subject to increasingly complex and pervasive privacy laws and regulations. These regulations may increase our potential liabilities if our services contribute to a failure by our customers to comply with the regulatory regime and may increase the cost to comply as regulatory requirements increase or change.

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*Our quarterly financial results may vary.*

We expect our financial results to vary from quarter to quarter. Such variations are likely to be caused by many factors that are, to some extent, outside our control, including:

- mix, timing, and completion of customer projects;
- hiring, integrating, and utilizing associates;
- timing of new contracts;
- the resolution of outstanding tax issues from prior years;
- issuance of common shares and options, together with acquisition and integration costs, in connection with acquisitions;
- currency exchange rate fluctuations; and
- costs to exit certain activities or terminate projects.

Accordingly, we believe that quarter-to-quarter comparisons of financial results for preceding quarters are not necessarily meaningful. You should not rely on the results of one quarter as an indication of our future performance.

*Changes in technology could adversely affect our competitiveness, revenue, and profit.*

The markets for our information technology services change rapidly because of technological innovation, new product introductions, changes in customer requirements, declining prices, and evolving industry standards, among other factors. New products and new technology often render existing information services or technology infrastructure obsolete, excessively costly, or otherwise unmarketable. As a result, our success depends on our ability to timely innovate and integrate new technologies into our service offerings. We cannot guarantee that we will be successful at adopting and integrating new technologies into our service offerings in a timely manner.

*Ross Perot has substantial control over any major corporate action.*

Ross Perot, our Chairman Emeritus, is the managing general partner of HWGA, Ltd., a partnership that owned 31,705,000 shares of our Class A common stock as of December 31, 2004. Mr. Perot also beneficially owns 58,100 additional shares of our Class A common stock. Accordingly, Mr. Perot, primarily through HWGA, Ltd., controls approximately 28% of our outstanding voting common stock as of December 31, 2004. As a result, Mr. Perot, through HWGA, Ltd., effectively has the power to block corporate actions such as an amendment to our Certificate of Incorporation, a change of control, or the sale of all or substantially all of our assets. In addition, Mr. Perot may significantly influence the election of directors and any other action requiring stockholder approval. The other general partner of HWGA, Ltd. is Ross Perot, Jr., our Chairman, who has the authority to manage the partnership and direct the voting or sale of the shares of our Class A common stock held by HWGA, Ltd. if Mr. Perot is no longer the managing general partner.

*We could lose rights to our company name, which may adversely affect our ability to market our services.*

We do not own the right to our company name. In 1988, we entered into a license agreement with Ross Perot, who is currently our Chairman Emeritus, and the Perot Systems Family Corporation that allows us to use the name Perot and Perot Systems in our business on a royalty-free basis. Mr. Perot and the Perot Systems Family Corporation may terminate this agreement at any time and for any reason. Beginning one year following such a termination, we would not be allowed to use the names Perot or Perot Systems in our business. Mr. Perot s or the Perot Systems Family Corporation s termination of our license agreement could materially and adversely affect our ability to attract and retain customers, which could have a material adverse effect on our business, financial condition, and results of operations.

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*Failure to recruit, train, and retain technically skilled personnel could increase costs or limit growth.*

We must continue to hire and train technically skilled people in order to perform services under our existing contracts and new contracts into which we will enter. The people capable of filling these positions have historically been in great demand, and recruiting and training such personnel requires substantial resources. We may be required to pay an increasing amount to hire and retain a technically skilled workforce. In addition, during periods in which demand for technically skilled resources is great, our business may experience significant turnover. These factors could create variations and uncertainties in our compensation expense and efficiencies that could directly affect our profits. If we fail to recruit, train, and retain sufficient numbers of these technically skilled people, our business, financial condition, and results of operations may be materially and adversely affected.

*Alleged or actual infringement of intellectual property rights could result in substantial additional costs.*

Our suppliers, customers, competitors, and others may have or obtain patents and other proprietary rights that cover technology we employ. We are not, and cannot be, aware of all patents or other intellectual property rights of which our services may pose a risk of infringement. Others asserting rights against us could force us to defend ourselves or our customers against alleged infringement of intellectual property rights. We could incur substantial costs to prosecute or defend any intellectual property litigation, and we could be forced to do one or more of the following:

- cease selling or using products or services that incorporate the disputed technology;
- obtain from the holder of the infringed intellectual property right a license to sell or use the relevant technology; or
- redesign those services or products that incorporate such technology.

*Provisions of our certificate of incorporation, bylaws, stockholders rights plan, and Delaware law could deter takeover attempts.*