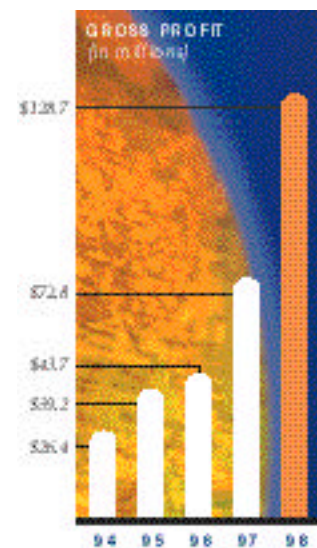
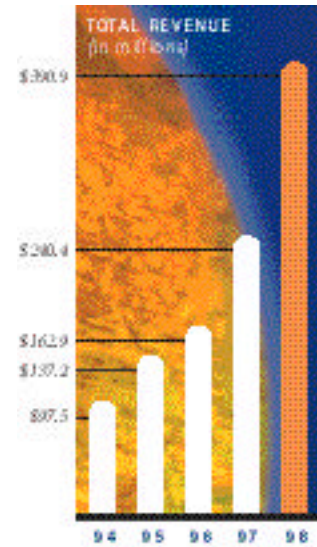
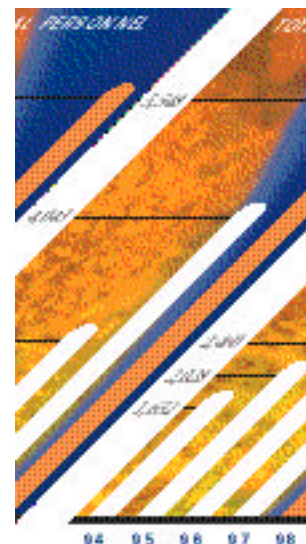


Financial Highlights



(Dollars in thousands)	Year Ended December 31,		
	1996	1997	1998
Revenues	\$162,939	\$240,448	\$390,871
Gross profit	43,671	72,763	128,693
Income from operations*	13,456	26,105	53,782
Income before income taxes	13,125	27,298	53,891
Net income	8,989	16,067	33,432
Pro forma net income	\$ 3,698		

*Includes certain non-recurring charges discussed in Notes to Consolidated Financial Statements



Shareholders

DEAR SHAREHOLDER: 1998 was an outstanding year for Mastech, and a year that marked our "coming of age" as a truly **global, full-service**, information technology (IT) firm, focused on today's latest technologies.

As we enter the new millennium, clients want companies that understand and can help them leverage the newest technologies, providing solutions on a global basis. During 1998, Mastech focused on new technologies and helped clients implement e-business strategies, enterprise packages, Internet-based solutions, and more.

Three years ago, we set the goal of becoming one of the industry's leading global IT services firms. We set this goal because we foresaw that customers would need IT solutions worldwide and want to work with fewer vendors, ones with global capability and a full range of services. There are very few firms who truly meet these criteria.

We took major strides toward this goal in 1998. We added several new practices, including E-Business, Customer Relationship Management, Supply Chain Management, and J.D. Edwards. We added 15 new offices worldwide and now have 36 locations across five continents, including ten of the biggest IT services markets worldwide.

Our workforce expanded to more than 5,500, up from just over 4,000 at the close of 1997. Revenues increased by nearly 63% to \$390.9 million in 1998 from \$240.4 million in 1997. Net income increased to \$33.4 million, or \$.67 per diluted share, which represents a 91% increase over last year.

These benchmarks indicate that we are the fastest growing firm among our global information technology services peers and that our strategy is working. In an industry that is growing by 15% yearly, among peers who are growing at 20–30% organically, Mastech experienced a 60% organic growth rate.

We would have been unable to execute our strategy without the support of our customers, shareholders, and especially our employees. We are deeply indebted to you for helping us achieve our goals in 1998 and look forward to sharing future success with you as the millennium draws to a close, and beyond.

FULL RANGE OF SERVICES Mastech helps clients design, develop and manage large-scale software applications. Our full suite of services includes E-Business, Enterprise Solutions Implementation, Enterprise Network Services, Applications Development, Offshore Outsourcing, Software Modernization and Applications Management. This range of services encompasses virtually all client needs within the applications and network services marketplace.

Our proprietary SmartAPPS methodologies and tools are at the heart of our service delivery process and ensure that our services match client needs. SmartAPPS includes some of the most robust re-engineering tools in the industry, while our metrics-based methodology represents best-of-breed practices and includes repeatable processes, quality measurements, knowledge management, and phased-in reviews and audits. Our SmartAPPS practices have achieved ISO 9001 certification, which is a significant accomplishment for a U.S.-based IT services firm.

Mastech has established four state-of-the-art global development centers, where we are executing large-scale, complex engagements for some of the world's largest companies. In 1998, we added two new centers located in Toronto, Canada, and Chennai, India.

GLOBAL DELIVERY CAPABILITY Mastech is emerging as one of only a handful of truly global IT services firms. Over the last three years, Mastech has expanded geographically from only three U.S. offices to 36 offices today on five continents, adding 15 new offices just in 1998.

The Company uses a global, high-speed wide area network and secure satellite links to connect offices. Our proprietary systems for global project management, knowledge transfer, issues tracking and applications reuse help clients design and implement applications more quickly and cost-effectively.

Letter

Our global expansion has allowed us to achieve leadership positions in key geographies: we are now among the top IT service firms in the U.S., Canada and Australia, and we are emerging as one of the industry leaders in other key markets.

SOLID INFRASTRUCTURE ENHANCING GROWTH

We significantly strengthened our management team and infrastructure in the past year. Our exceptional results are being driven by more than 30 business unit leaders worldwide, who are industry veterans and highly motivated. We have scaled up our financial systems, human resource processes and IT infrastructure. We have done seven acquisitions within the last twelve months, integrating them efficiently and effectively. Our financial position is even stronger now than a year ago — we increased our accounts receivable turnover significantly, generated \$35 million in operating cash and reduced our tax rate.

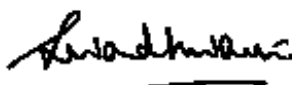
HIGH VALUE TO EMPLOYEES In the past year, Mastech has enhanced its infrastructure for attracting and retaining high-quality technical professionals. The Mastech Valuable Player program rewards employees for technical excellence, work quality and client relationships. We also offer employees unparalleled training opportunities through seven training centers around the world. These centers are complemented by Mastech Virtual University, which provides distance learning to our technical professionals via the Internet, with over 200 learning modules.

Our people remain our most important bridge to tomorrow's technology. That's why we have enhanced communications by establishing employee help lines, electronic bulletin boards, intranets and quarterly "state-of-Mastech" teleconferences. Such communications, retention and training programs are the reasons Mastech is the career choice for many of the world's best technical professionals.

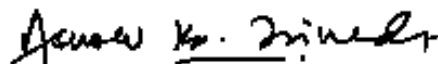
GOALS Our future goal is clear — to become one of the industry's leading global IT services firms. We will continue to broaden our range of services while helping clients deal with today's newest technologies, expand our geographic reach and increase the value we provide to customers. Companies are grappling with major challenges, particularly leveraging the increasingly rapid changes in technology. Our mission is to help them deal effectively with those challenges today.

To you, our shareholders, please be assured that we are deeply appreciative of the confidence you have shown in us by your continued interest in Mastech. We guarantee you our very best efforts in working toward our ambitious goals.

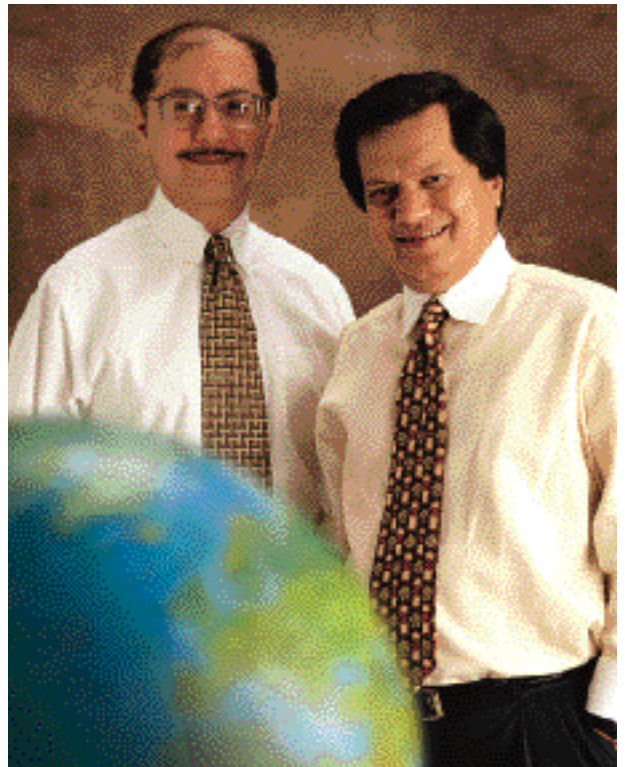
Sincerely,



Sunil Wadhvani
Chief Executive Officer and Co-Founder



Ashok Trivedi
President and Co-Founder





Solutions for the E-Business Age

Mastech is one of the firms
moving fastest today to provide
Internet-based, e-business and
network solutions

Customers need firms who can help them leverage new technologies to their greatest advantage. Mastech is one of the firms moving fastest today to provide Internet-based, e-business and network solutions. Customers also demand that IT solutions firms apply formal systems and tools that can be reused for maximum return on consulting dollars. Our proprietary systems and tools are an integral part of our state-of-the-art solutions.

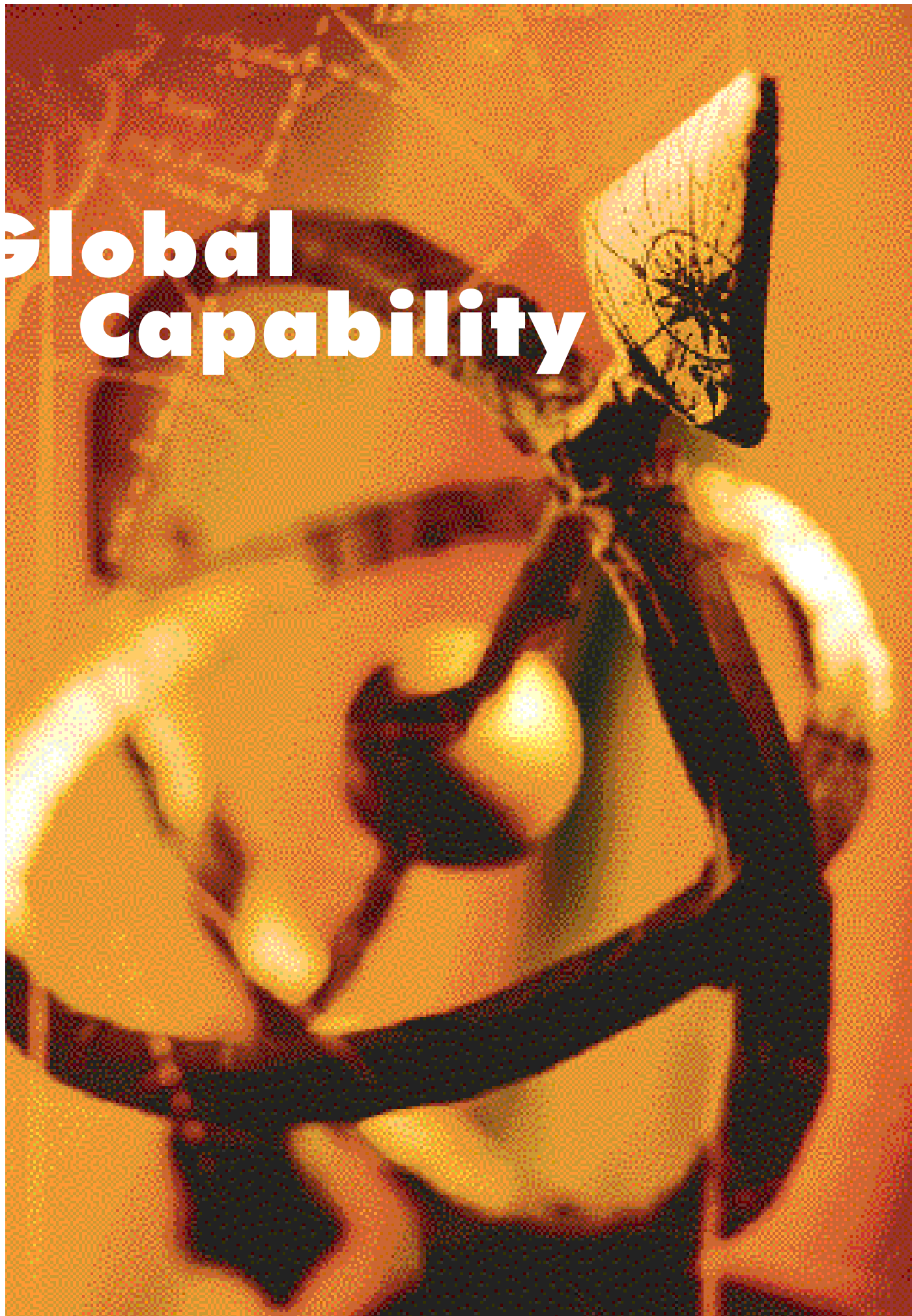
Mastech's SmartAPPS framework ensures robust, reliable, and repeatable solutions delivery. It implements best-of-breed practices in project, quality and knowledge management, provides a high degree of flexibility and incorporates customer approaches. Our SmartAPPS practices have been recognized with the leading ISO 9001 industry certification. Key components include:

ROBUST SOLUTIONS DELIVERY Development occurs in a well-defined, process-oriented software factory environment and utilizes robust, high-performance processes and tools for automating tasks. Systems for issue management, progress tracking, deliverable management, management reporting and defect tracking form the backbone for project delivery. Processes incorporate quality assurance and control, including the extensive use of checklists, standards, guidelines, and templates, which provide reliability and rapid error detection.

KNOWLEDGE MANAGEMENT Formal practices and tools ensure that knowledge is captured and used across the organization. A Knowledge Repository containing over 3,000 artifacts is constantly updated and mined for reuse across projects. Processes ensure systemic reuse of the repository and emphasize knowledge refinement through interaction among workgroups with common business interests. Mastech's practices allow customers to share information across multiple sites and stakeholders and to redeploy tools, utilities, and standards in later projects.

GLOBAL DEVELOPMENT CENTERS Mastech's global development centers in Canada and India foster the creation of global, virtual teams, which can accelerate software development schedules and simultaneously reduce costs. The facilities are fully supported by processes and tools for metrics-driven performance, including systems for WAN management, systems and network tracking, call reporting, resource management and backup information management. These processes and tools ensure uptime on WAN links in excess of 99%, and LAN uptime of over 99.9%, enabling a round-the-clock operation.

Global Capability



GLOBAL SUPPORT Multinational customers who are faced with the daunting task of implementing global e-business strategies, enterprise-wide packages and information systems worldwide require IT solutions firms who have global support capability. Also, companies outside the U.S. are now aggressively adopting new technologies after lagging behind the U.S. for several years. The global need for IT services has never been greater.

With more than 5,500 employees in 36 offices across five continents, Mastech is ideally equipped to provide global solutions. We are present in ten of the largest markets for IT services worldwide. More than 2,000 Mastech employees now serve clients from outside the U.S.

EXPANDING OUR REACH Two of Mastech's 1998 acquisitions were aimed at extending our global reach: in Canada, we acquired one of the country's leading services providers, Quantum Information Resources, while in Australia, we acquired MC Computer Services.

As evidence of our explosive geographic expansion, we are now represented in 19 locations in North America, three countries in Europe, four cities across Australia, as

well as in South Africa, India, Singapore and Japan. Only a handful of IT services firms have this global capability, which is becoming increasingly important to clients.

With more than 5,500
employees in 36 offices
across five continents,
Mastech is ideally
equipped to provide
global solutions

1998 Milestones

FEBRUARY

Starts Southwest regional office based in Dallas, Texas.

MARCH

Announces a two-for-one stock split.

APRIL

Establishes a Georgia office to support the growing hi-tech market needs of the southeast.

MAY

Establishes Mastech Virtual University, a state-of-the-art, Internet-based distance learning platform for employees.

JUNE

Acquires Quantum Information Resources, one of the largest privately held IT services firms in Canada.

JUNE

Proprietary SmartAPPSSM tool for software modernization is released.

JULY

Starts operations in Johannesburg, South Africa.

JULY

Acquires MC Computer Services, an Australian information technology services firm.

AUGUST

Opens office in Neuchatel, Switzerland, its third European location.

OCTOBER

Acquires IMIS Inc., an IT consulting and project management firm specializing

OCTOBER

Ranks #26 on Forbes Magazine's list of "The 200 Best Small Companies in America."

NOVEMBER

Launches J.D. Edwards solutions implementation practice.

DECEMBER

Opens a 60,000 sq. ft. Global Development Center in Chennai, India.

DECEMBER

Launches a Customer Interaction Management practice that includes partnerships with Siebel Systems and

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The data herein are published solely for the information of the Company's shareholders. No statement in this booklet is made for the purposes of inducing the purchase or sale of any security issued by the Company. This report is not to be considered as part of any proxy soliciting materials.

Year Ended December 31,

(dollars in thousands, except per share data)	1998	1997	1996	1995	1994
INCOME STATEMENT DATA¹					
Revenues	\$390,871	\$240,448	\$162,939	\$137,201	\$ 97,531
Gross profit	128,693	72,763	43,671	39,218	26,362
Income from operations ²	53,782	26,105	13,456	18,473	11,281
Interest (income) expense, net	(3,321)	(1,193)	331	169	323
Merger-related expenses ³	3,212	—	—	—	—
Income before income taxes	53,891	27,298	13,125	18,304	10,958
Provision for income taxes ⁴	20,459	11,231	4,136	—	—
Net income	\$ 33,432	\$ 16,067	\$ 8,989	\$ 18,304	\$ 10,958
Basic earnings per common share ⁵	\$ 0.68	\$ 0.36			
Diluted earnings per common share ⁵	\$ 0.67	\$ 0.35			
Pro forma income taxes ⁴			5,291	7,222	4,385
Pro forma net income ⁴			\$ 3,698	\$ 11,082	\$ 6,573
Pro forma basic and diluted earnings per share ^{4,5}			\$ 0.09	\$ 0.29	\$ 0.17
Basic average common shares ⁵	48,997	45,251	39,194	38,130	38,130
Diluted average common shares ⁵	49,830	45,720	39,200	38,130	38,130

December 31,

(dollars in thousands)	1998	1997	1996	1995	1994
BALANCE SHEET DATA					
Cash and cash equivalents	\$ 36,455	\$ 82,924	\$ 46,566	\$ 3,026	\$ 4,267
Investments	47,153	—	—	—	—
Working capital	130,191	110,928	48,625	14,068	13,524
Total assets	215,781	162,060	89,038	36,143	31,648
Total shareholders' equity	158,207	119,426	49,588	14,613	13,896

¹ Amounts presented above have been restated to reflect the Company's acquisition of all of the shares of Quantum Information Resources ("Quantum") in a business combination that was accounted for under the pooling-of-interests method.

² Income from operations for the year ended December 31, 1996 reflects a nonrecurring charge of \$875,000 incurred pursuant to an agreement with an executive to pay, as compensation for past services, an amount equal to the value of 109,200 shares of Common Stock at the initial public offering price of \$7.50 per share. The Company has reflected this payment along with the applicable tax withholdings as a nonrecurring charge. For the years ended December 31, 1997 and 1998, income from operations reflect nonrecurring charges of \$518,000 and \$258,000, respectively, relating to the amortization of deferred compensation for this same executive.

³ The Company incurred merger-related costs related to the acquisition of Quantum and charged these costs to expense during the second quarter of 1998.

⁴ The Company's S-corporation status terminated on December 16, 1996 in connection with the Company's initial public offering of Common Stock, thereby subjecting the Company's income to federal and state taxes at the corporate level. Pro forma net income and pro forma net income per share reflect federal and state taxes (assuming an approximate 40% effective tax rate) as if the Company had been taxed as a C-corporation for all periods presented. See Note 13 of Notes to Consolidated Financial Statements for information concerning the computation of pro forma net income per common share. In connection with the Company's conversion from S-corporation status to C-corporation status, the Company recorded a provision for income taxes of \$3.9 million in the fourth quarter of 1996.

⁵ In the fourth quarter of 1997, the Company adopted Statement of Financial Accounting Standards No. 128, "Earnings per Share." Earnings per share for the pro forma periods were not impacted by the adoption of this Statement. See Note 13 of Notes to Consolidated Financial Statements for information concerning the computation of basic and diluted earnings per common share.

This Annual Report contains certain "forward-looking statements" (statements which are not historical facts) such as statements about future financial performance, capital expenditures, liquidity sources and needs, the Year 2000 problem and certain other operations matters. Words or phrases denoting the anticipated results of future events — such as "anticipate," "believe," "estimate," "expect," "will likely," "are expected to," "will continue," "project," and similar expressions that denote uncertainty — are intended to identify such forward-looking statements. These forward-looking statements are subject to several risks and uncertainties, and the Company's actual future results may differ significantly from those stated in any forward-looking statements. While it is impossible to identify each factor and event that could affect the Company's results, variations in the Company's revenues and operating results occur from time to time as a result of a number of factors, such as the significance of client engagements commenced and completed during a quarter or a year, the number of working days in a quarter or a year, employee hiring, retention, and utilization rates, acceptance and profitability of the Company's services in new territories, integration of companies acquired, competition, general economic conditions and economic conditions specific to the information technology industry. Many of these factors are beyond the Company's ability to predict or control. As a result of these and other factors, quarterly revenues and operating results are difficult to forecast, and the Company may

OVERVIEW

Mastech Corporation was incorporated in Pennsylvania on November 12, 1996. Mastech Systems, a Pennsylvania corporation through which the business of the Company has been conducted since its inception in July 1986, is an indirect, wholly owned subsidiary of the Company.

In December 1996, Mastech completed the initial public offering of its Common Stock, and in December 1997, completed a secondary offering of its Common Stock. Subsequent to the initial public offering, Mascot Systems and Scott Systems, both of which are corporations organized under the laws of India, became wholly owned subsidiaries of Mastech Systems.

Mastech's revenues are derived from fees paid by clients for professional services. Historically, a substantial majority of the Company's projects have been client-managed. On client-managed projects, Mastech provides professional services as a member of the project team on a time-and-materials

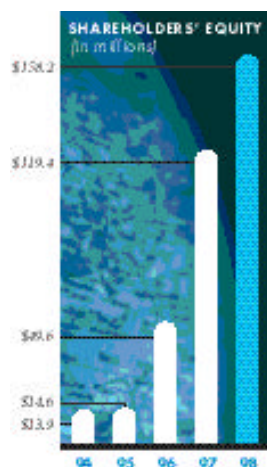
basis. The Company recognizes revenues on time-and-materials projects as the services are performed. On Mastech-managed projects, Mastech assumes

responsibility for project management and bills the client on a time-and-materials or fixed-price basis. Revenues on fixed-price contracts are recognized by the percentage of completion method. Revenues generated through offshore software development centers on U.S. client engagements are included in U.S. revenues.

Mastech's most significant cost is its personnel expense, which consists primarily of salaries and benefits of the Company's billable personnel. The number of information technology ("IT") professionals assigned to projects may vary depending on the size and duration of each engagement. Moreover, project terminations, completions and scheduling delays may result in periods when personnel are not assigned to active projects. Mastech manages its personnel costs by closely monitoring client needs and basing personnel increases on specific project engagements.

While the number of IT professionals may be adjusted to reflect active projects, the Company must maintain a sufficient number of professionals to respond to demand for the Company's services on both existing projects and new engagements.

The Company has incurred significant incremental expenses to help ensure that the Company has both an adequate number of skilled IT professionals and the infrastructure necessary to sustain the Company's growth. These expenditures were incurred in connection with: (i) the development of additional service offerings, including Year 2000 conversion services and ERP package implementation services; (ii) the establishment of a recruiting division to recruit IT professionals in the U.S. and worldwide; (iii) the



opening of foreign sales offices to provide better access to the global market; (iv) the development of three offshore software development centers in India; (v) the hiring of additional managers to support a larger organization; (vi) the relocation of the Company's headquarters to larger, more efficient office space; and (vii) the establishment of a training center to improve the skill levels of new and current employees. While these expenses have increased the Company's selling, general and administrative expenses, the Company believes that the revenues expected to be derived as a result of these expenditures have not yet been fully realized.

Mastech sells its services to large and medium-sized organizations. The Company's sales force is organized to meet the needs of the marketplace through three primary groups: (i) the U.S. Client Services group; (ii) the High Value Services group; and (iii) the International Client Services group.

The U.S. Client Services group is divided into geographic regions, each of which is directed by a Manager or Regional Director. Each region includes multiple new business development managers. These individuals use a proprietary database of several thousand prospects to telemarket Mastech's services nationally. The Company subsequently sends interested prospective clients a written proposal providing information about the Company, its approach and methodology, schedules, team members, pricing and terms.

The U.S. Client Services group also focuses on developing national and global relationships with major systems integrators such as EDS, IBM, KPMG, Ernst & Young and Oracle. Mastech assists these integrators in meeting their customers' needs by providing specialized technical expertise and complementary capabilities such as offshore development.

The High Value Services group provides IT professionals trained in ERP implementations, E-business consulting, network services, and Year 2000 services; in addition to managing engagements in the aforementioned services. Additionally, this group provides services through offshore software development centers which are connected via secure, high-speed satellite links to the Company's headquarters and client sites. This group works directly with the end-user clients and also partners with a wide array of software companies, ranging from ERP to supply-chain and custom-interaction vendors, and systems integrators on teamed implementation efforts.

The International Client Services group operates through offices in nine different countries. Each office is supervised by a Country Manager and supported by dedicated sales personnel who sell directly to new clients using an approach similar to the Company's U.S. sales approach. Additionally, these offices focus on leveraging Mastech's existing relationships with its U.S.-based multinational clients.

Financial results for the years ended December 31, 1997 and 1996 have been restated to reflect the acquisition of Quantum in a business combination that was accounted for as a pooling of interests.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, selected statements of operations data as a percentage of revenues:

	Year Ended December 31,		
	1998	1997	1996
Revenues	100.0%	100.0%	100.0%
Cost of revenues	67.1	69.7	73.2
Gross profit	32.9	30.3	26.8
Selling, general and administrative	19.1	19.2	18.0
Nonrecurring charges	0.1	0.2	0.5
Income from operations	13.8	10.9	8.3
Interest (income) expense, net	(0.8)	(0.5)	0.2
Merger-related expenses	0.8	—	—
Income before income taxes	13.8	11.4	8.1
Provision for income taxes	5.2	4.7	2.5
Net income	8.6%	6.7%	5.5%

Note: Percentages may not add due to rounding.

1998 COMPARED TO 1997

Revenues. The Company's revenues increased 62.6%, or \$150.4 million, to \$390.9 million in 1998 from \$240.4 million in 1997. Of this growth in revenues, the U.S. Client Services group, High Value Services group, and the International Client Services group contributed \$37.3 million, \$81.1 million and \$32.0 million, respectively, to this increase. The increases in U.S. Client Services and High Value Services can be attributed to additional services provided to existing clients and continued market penetration. The Company's client base grew to over 900 during 1998 from approximately 600 in 1997. The increase in the International Client Services group is primarily the result of increased market penetration in Australia and Europe.

Gross Profit. Gross profit consists of revenues less cost of revenues. Cost of revenues consists primarily of salaries and employee benefits for billable IT professionals and the associated travel and relocation costs of these professionals, as well as the cost of the independent contractors used by the Company. Gross profit increased 76.9% to \$128.7 million in 1998 from \$72.8 million in 1997. Gross profit as a percentage of revenues increased to 32.9% in 1998 from 30.3% in 1997. The primary reason for the increase in gross profits as a percentage of revenues was higher margins in the High Value Services and U.S. Client Services groups. The number of IT professionals (including independent contractors) used by the Company increased to over 4,800 as of December 31, 1998 from approximately 3,500 as of December 31, 1997.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist of costs associated with the Company's sales and marketing efforts, executive management, finance and human resource functions, facilities and telecommunication costs and other general overhead expenses. Selling, general and administrative expenses increased 61.8%, or \$28.6 million, to \$74.7 million in 1998 from \$46.1 million in 1997. The increase in selling, general and administrative expenses reflects the Company's continued investment in infrastructure and in the initiatives required to implement the Company's marketing strategies. These costs include the development of additional service offerings, the expansion of its global recruiting capabilities, the opening of additional international offices, the establishment of training centers and the

continued expansion of its offshore software development centers. As a percentage of revenues, selling, general and administrative expenses remained relatively unchanged at 19.1% and 19.2% for 1998 and 1997, respectively.

Interest and Other (Income) Expense, Net. Other income was \$3.3 million in 1998 compared to other income of \$1.2 million in 1997. The increase of \$2.1 million in other income was the result of increased interest income from higher levels of interest bearing funds.

Merger-related Expenses. The Company incurred \$3.2 million of merger-related costs and expenses in connection with the Quantum acquisition during the year ended December 31, 1998.

Income Taxes. Provision for income taxes was \$20.5 million, or an effective tax rate of 38% for the year ended December 31, 1998, compared to \$11.2 million, or an effective tax rate of 41% for the year ended December 31, 1997. The primary factors contributing to the reduction in the effective tax rate included a reduction in state income taxes and foreign income taxes, tax-exempt interest income generated by the Company's municipal bond portfolio and the tax holiday for the Company's Indian operations; offset by the effect of non-deductible one-time acquisition charges.

Outlook. The Company believes that the IT services industry remains strong and growth oriented. Furthermore, the Company believes that the breadth of the services and solutions that it offers positions it to continue to increase its revenues and operating profits in 1999. The Company anticipates that it will experience a shift in the demand for certain of its services in 1999 as a result of Year 2000 (Y2K) related factors. Although Y2K-related projects represented only 10% of Company revenues in 1998, the Company believes that, as customers focus on completing their Y2K readiness efforts in 1999, the demand for other IT services may be affected. The Company believes that the percentage of revenues derived from Y2K has peaked and will continue to decline, as a percentage of total revenues, in 1999. Reductions or shifts in the timing or demand for Company services could result in fluctuations in the Company's quarterly revenues or operating results, and could result in differences between actual and expected results.

1997 COMPARED TO 1996

Revenues. The Company's revenues increased 47.6%, or \$77.5 million, to \$240.4 million in 1997, from \$162.9 million in 1996. The U.S. Client Services group, High Value Services group and the International Client Services group contributed \$16.9 million, \$48.0 million and \$12.6 million, respectively, to this increase. The growth in U.S. Client Services and High Value Services primarily was attributable to successful market penetration and additional services provided to existing clients. International growth primarily was the result of successful market penetration in Europe. Furthermore, in the first eight months of 1996, the Company experienced a higher than normal rate of employee attrition because the Company was experiencing delays in securing the first stage approval for permanent residency status for some of its professionals. This attrition resulted in increased costs for IT professionals and reduced revenue growth during 1996.

Gross Profit Gross profit consists of revenues less cost of revenues. Cost of revenues consists primarily of salaries and employee benefits for billable IT professionals and the associated travel and relocation costs of these professionals, as well as the cost of the independent contractors used by the Company. Gross profit increased 66.6% to \$72.8 million in 1997 from \$43.7 million in 1996. Gross profit as a percentage of revenues increased to 30.3% in 1997 from 26.8% in 1996. The primary reasons for the increase in gross profits as a percentage of revenues were higher margins in the High Value Services and U.S. Client Services groups.

Selling, General and Administrative Expenses. Selling, general and administrative expenses consist of costs associated with the Company's sales and marketing efforts, executive management, finance and human resource functions, facilities and telecommunication costs and other general overhead expenses. Selling, general and administrative expenses increased 57.3%, or \$16.8 million, to \$46.1 million in 1997 from \$29.3 million in 1996. As a percentage of revenues, selling, general and administrative expenses increased to 19.2% in 1997 from 18.0% in 1996. The increase in selling, general and administrative expenses reflects the Company's continued investment in infrastructure and in the initiatives required to implement the Company's marketing strategies. These costs include the development of additional service offerings, the expansion

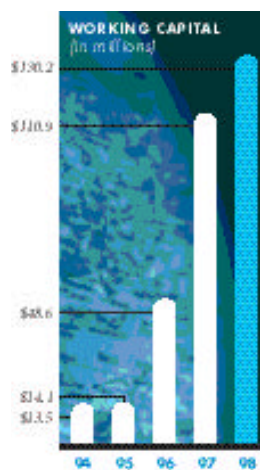
of its global recruiting capabilities, the opening of additional international offices, the establishment of training centers and the continued expansion of its offshore software development centers.

Interest and Other (Income) Expense, Net. Other income was \$1.2 million in 1997 compared to other expense of \$331,000 in 1996. This increase in other income was the result of increased interest income from the investment of the net proceeds from the Company's public offerings of Common Stock. This increase in interest income was, however, partially offset by an increase in interest expense charged on borrowings outstanding under the Company's revolving credit facilities, principally to support the Company's Indian operations. These borrowings increased the Company's interest expense to \$858,000 in 1997 from \$511,000 in 1996.

Income Taxes. Provision for income taxes was \$11.2 million, or an effective tax rate of 41% for the year ended December 31, 1997, compared to \$4.1 million in 1996. Due to the S- to C-corporation conversion, a comparison of 1997 with 1996 is not meaningful. The tax provision for 1996 is composed primarily of the tax associated with the termination of the Company's Subchapter S-corporation status at the time of the initial public offering in December 1996.

LIQUIDITY AND CAPITAL RESOURCES

Effective December 3, 1998, the Company entered into a new \$75.0 million revolving credit facility with PNC Bank, National Association (the "Credit Facility"). This Credit Facility bears interest at a rate per annum equal to a base rate (which is adjusted by a change in the prime rate or the Federal Funds Effective Rate at the Company's option) that is equal to the sum of the Euro-rate



plus an applicable Euro-rate margin. The Credit Facility contains certain restrictive covenants and financial ratio requirements which would limit distributions to shareholders and additional borrowings. There were no borrowings outstanding under this arrangement as of December 31, 1998. This Credit Facility replaced a previously existing \$25.0 million revolving credit facility also with PNC Bank, National Association. Average outstanding borrowings under this arrangement were approximately \$161,000 for the year ended December 31, 1998.

In December 1997, the Company completed the registration of 3,000,000 (pre-split) shares of the Company's Common Stock for sale to the public. Of this total, 1,800,000 (pre-split) shares were newly issued by the Company, and 1,200,000 (pre-split) shares were sold by selling shareholders. The Company did not receive any part of the proceeds from the sale of shares by the selling shareholders. The net proceeds to the Company of the offering were approximately \$51.3 million after deducting underwriting discounts, commissions and offering expenses paid by the Company. In addition, the net proceeds to the Company, generated from Mastech's initial public offering in December 1996, were approximately \$45.6 million after deducting underwriting discounts, commissions and offering expenses paid by the Company.

The Company has and will use these proceeds to develop new services, to expand existing operations including offshore software development operations, for possible acquisitions of related businesses, and for general corporate purposes including working capital. Management currently anticipates that the proceeds from these offerings, together with the existing sources of liquidity and cash generated from operations, will be sufficient to satisfy its existing cash needs at least through the next twelve months. During 1997, the Company used the initial public offering proceeds to pay approximately \$900,000 of corporate income taxes related to the termination of its status as an S-corporation. In April 1997, the Company also paid a dividend of approximately \$6.3 million of undistributed S-corporation earnings due the controlling shareholders for the periods prior to Mastech becoming a public company.

Historically, the Company has financed its working capital requirements through internally generated funds and with the proceeds from the aforementioned offerings. The Company's financial statements reflect cash flows provided by operations of approximately \$35.1 million for 1998,

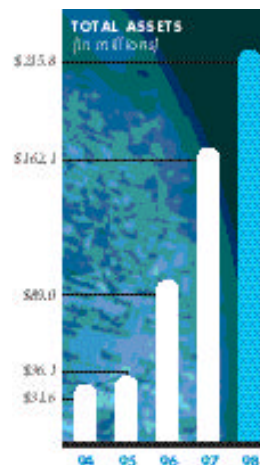
cash flows used by operations of \$3.5 million for 1997, and cash flows provided by operations of approximately \$11.7 million for 1996. The Company's cash pro-

vided by operations prior to the initial public offering does not reflect any income tax expense due to the Company's prior status as an S-corporation. Prior to the initial public offering, the Company made S-corporation distributions to its shareholders and, in 1997, made the final S-corporation distributions.

Cash used from investing activities of \$77.7 million for the year ended December 31, 1998 primarily was due to the net purchase of investments of \$47.3 million. These investments are classified as available-for-sale and recorded at fair value. Additionally, the Company made several key acquisitions during 1998 totaling \$19.2 million.

Capital expenditures for 1998, 1997 and 1996 were approximately \$11.1 million, \$5.9 million and \$3.1 million, respectively. During 1998 and 1997, the Company spent approximately \$5.8 million and \$2.8 million, respectively, on computer and related equipment to support its technical, consulting and administrative functions. The Company also spent approximately \$3.4 million and \$1.3 million in 1998 and 1997, respectively, in connection with the buildout and other development of the infrastructure for its offshore software development and training facilities in India. During the next twelve months, the Company expects to incur approximately \$500,000 in remaining costs to license and implement its new management information system. Of this amount, a portion of the cost will be expensed.

As of December 31, 1997, Mascot Systems had aggregate borrowings of approximately \$1.7 million outstanding under revolving credit agreements with ICICI



Banking Corporation Limited and IndusInd Bank Limited, both of India. Interest rates charged on these borrowings ranged from 18.75% to 19.25% per year. These borrowings were repaid in full by the Company in May 1998.

The Company does not believe that inflation had a significant impact on the Company's results of operations for the periods presented. On an ongoing basis, the Company attempts to minimize any effects of inflation on its operating results by controlling operating costs and, whenever possible, seeking to ensure that billing rates reflect increases in costs due to inflation.

The Company invoices its clients in the local currency of the country in which the client is located. Gains and losses as a result of fluctuations in foreign currency exchange rates have not had a significant impact on results of operations.

RECENTLY ISSUED ACCOUNTING STANDARDS

Statement of Financial Accounting Standards No. 132, "Employers' Disclosures about Pensions and Other Post-retirement Benefits—an amendment of FASB Statements No. 87, 88 and 106," revises employers' disclosures about pension and other postretirement benefit plans. It does not change the measurement or recognition of those plans. The Company currently has no pension benefit plans for its employees and, as such, will not be subject to the disclosure requirements of this Statement.

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"), which establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS No. 133 is effective for periods after June 15, 1999. Management does not anticipate that the adoption of this statement will have a significant effect on the Company's financial position.

OTHER MATTERS

Year 2000. The Year 2000 ("Y2K") problem refers to problems which may occur because some computer systems currently record years in a two-digit format. These computer systems may have difficulty recognizing or processing date information after December 31, 1999. The Y2K problem also may occur with embedded chips. The Company has been working to evaluate the potential effect of the Y2K problem on the Company's operations.

Internal Systems. The Company developed a plan to evaluate its key internal computer systems. The plan consisted of the following four phases: Inventory; Evaluation/Assessment of Y2K Risk; Remediation; and Testing. The Company has completed all phases of evaluation for the internal financial and operational systems located at the corporate headquarters of the Company. Based upon written documentation and information available on vendor websites, certain testing procedures for business critical hardware and software were developed and implemented by the Company. An independent third party reviewed both vendor information and testing results, and conducted other tests to validate work performed. As a result of this, the Company does not believe that the internal computer systems at its corporate headquarters will experience significant Y2K problems.

The Company also has completed the evaluation of the internal financial and operational systems of its other U.S. locations and international operations, excluding certain systems involving operations of companies recently acquired by the Company. The Company currently is evaluating the internal financial and operational systems of the companies recently acquired and expects to complete this evaluation by June 30, 1999.

Cost of Year 2000 Compliance Efforts. The Company does not expect to incur substantial costs with respect to its Y2K compliance efforts and the Company has not deferred other information technology projects as a result of the Y2K problem. To date, the Company has incurred expenses totaling \$123,000 and anticipates that its total expenses will not exceed \$250,000. These figures primarily are reflective of the costs associated with the use of third parties to review and validate work performed, and the costs assessing Y2K problems relating to or arising with respect to third parties. The cost estimates do not include the cost of internal efforts by Company personnel. The Company has not separately accounted for these internal costs.

Third Party Relationships. The Company has contacted its key vendors regarding their Y2K compliance efforts. Although the Company has received some information from its vendors regarding their Y2K compliance efforts, there can be no assurance that the Company will not experience disruptions in its ability to conduct its business because of Y2K problems experienced by the Company's vendors.

In addition, the Company has contacted its key customers regarding their Y2K compliance efforts. Although the Company has received some information from its customers regarding their Y2K compliance efforts, there can be no assurance that such customers will not experience disruptions in their business which would result in material adverse affects to the Company. One example of a worst case scenario would be a failure in the accounting systems of a significant number of the Company's key clients due to the Y2K problem that resulted in a delay in the payment of invoices issued by the Company for services and expenses.

Potential Liability to Third Parties. The Company has participated in Y2K remediation projects for some of its customers. Although the Company has no reason to believe that any such work will result in litigation against the Company, it is possible that the Company could be materially adversely affected by litigation in connection with the Y2K remediation services provided by the Company.

The Company's policy has been to attempt to include provisions in client contracts that, among other things, disclaim implied warranties, limit the duration of express warranties, limit the Company's liability to predetermined amounts, and disclaim any liability arising from third-party software that is implemented or installed by the Company. The Company also maintains insurance to protect against potential liability in connection with Y2K remediation services provided by the Company. There can be no assurance that the Company will be able to obtain the desired contractual protections in agreements or that any such contractual provisions will prevent clients from asserting claims against the Company with respect to the Y2K issue. There also can be no assurance that the contractual protections, if any, obtained by the Company or the insurance coverage will operate to protect the Company from, or adequately limit the amount of, any liability arising from claims asserted against the Company.

Contingency Plan. The Company is developing a contingency plan to address various situations which may result if the Company experiences Y2K problems. The plan will include identification of major systems, dependencies on third parties and resources and strategies necessary to restore operations or work around failures. It is expected that the contingency plan will be completed by April 30, 1999 and approved by the Board of Directors on June 1, 1999. There can be no assurance that the contingency plan developed by the Company will adequately protect the Company from internal Y2K problems, or prevent service interruption or failures experienced by customers and suppliers, from having a material adverse effect on the Company.

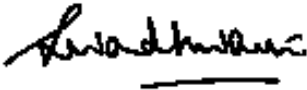
Demand for Year 2000 Services. Many of the Company's clients have needed to repair or replace their legacy systems because of Y2K issues. The Company believes this has favorably impacted the demand for its services and products. Mastech expects that the demand for its services related to the Y2K problem will diminish significantly over time and eventually will disappear. The Company also believes that, as companies focus on Y2K issues, other less critical projects have not been and may not be initiated or may be suspended. Although the Company provides a broad range of information technology services, Mastech believes that the reduction in demand for its services that may result from these Y2K-related factors could have an adverse impact on its future financial performance.

The accompanying consolidated financial statements of Mastech Corporation have been prepared by management, who is responsible for their integrity and objectivity. The statements have been prepared in conformity with generally accepted accounting principles and necessarily include amounts based on management's best estimates and judgments.

Management has established and maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that the Company's financial records reflect authorized transactions of the Company. The system of internal controls includes widely communicated statements of policies and business practices that are designed to require all employees to maintain high ethical standards in the conduct of Company affairs. The internal controls are augmented by organizational arrangements that provide for appropriate delegation of authority and division of responsibility.

The Company's consolidated financial statements have been audited by Arthur Andersen LLP, independent public accountants, whose report thereon appears on page 19 of this Annual Report. As part of its audit of the Company's 1998 financial statements, Arthur Andersen LLP considered the Company's system of internal controls to the extent it deemed necessary to determine the nature, timing and extent of its audit tests. Management has made available to Arthur Andersen LLP the Company's financial records and related data.

The Board of Directors pursues its responsibility for the Company's financial reporting and accounting practices through its Audit Committee, a majority of the members of which are independent directors. The Audit Committee's duties include recommending to the Board of Directors the independent public accountants to audit the Company's financial statements, reviewing the scope and results of the independent public accountants' activities and reporting the results of the committee's activities to the Board of Directors. The independent public accountants have met with the Audit Committee, with and without the presence of management representatives, to discuss the results of their audit work and their comments on the adequacy of internal accounting controls, and the quality of financial reporting. The independent public accountants have direct access to the Audit Committee.



Sunil Wadhvani
Co-Chairman, Chief Executive Officer and Director



JEFFREY A. MCCANN
Vice President, Finance and Chief Financial Officer

March 10, 1999

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF MASTECH CORPORATION:

We have audited the accompanying consolidated balance sheets of Mastech Corporation (a Pennsylvania corporation) and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Mastech Corporation and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.



ARTHUR ANDERSEN LLP
Pittsburgh, Pennsylvania,
February 9, 1999

	December 31,	
	1998	1997
<i>(dollars in thousands)</i>		
ASSETS		
Current assets:		
Cash and cash equivalents (cost approximates market value)	\$ 36,455	\$ 82,924
Investments	47,153	—
Accounts receivable, net of allowance for uncollectible accounts	71,108	60,366
Unbilled receivables	12,261	1,829
Employee advances and related party advances	3,568	2,578
Prepaid and other assets	2,672	1,511
Prepaid income taxes	2,218	—
Deferred income taxes	2,312	2,154
Total current assets	177,747	151,362
Equipment and leasehold improvements, at cost:		
Equipment	18,859	9,686
Leasehold improvements	3,630	1,577
	22,489	11,263
Accumulated depreciation	(5,661)	(2,488)
Net equipment and leasehold improvements	16,828	8,775
Intangible assets, net	21,206	1,923
Total assets	\$215,781	\$162,060
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Revolving credit facilities	\$ —	\$ 6,905
Accounts payable	8,326	5,319
Accrued payroll and related costs	28,483	17,949
Other accrued liabilities	10,024	8,083
Deferred revenue	723	127
Deferred income taxes	—	46
Accrued income taxes	—	2,005
Total current liabilities	47,556	40,434
Other long-term liabilities	4,563	490
Deferred income taxes	5,455	1,710
Shareholders' equity:		
Preferred Stock, without par value: 20,000,000 shares authorized, 1 share and 0 shares of Series A Preferred Stock issued and outstanding, respectively	—	—
Common Stock, par value \$0.01 per share: 100,000,000 shares authorized, 49,141,079 and 48,789,800 shares issued and outstanding, respectively	491	252
Additional paid-in capital	111,119	105,375
Retained earnings	47,168	14,722
Deferred compensation	—	(258)
Accumulated other comprehensive income	(571)	(665)
Total shareholders' equity	158,207	119,426
Total liabilities and shareholders' equity	\$215,781	\$162,060

The accompanying notes are an integral part of these consolidated financial statements.

(dollars in thousands, except per share data)	Year Ended December 31,		
	1998	1997	1996
Revenues	\$390,871	\$240,448	\$162,939
Cost of revenues	262,178	167,685	119,268
Gross profit	128,693	72,763	43,671
Selling, general and administrative	74,653	46,140	29,340
Nonrecurring charges	258	518	875
Income from operations	53,782	26,105	13,456
Interest (income) expense, net	(3,321)	(1,193)	331
Merger-related expenses	3,212	—	—
Income before income taxes	53,891	27,298	13,125
Provision (benefit) for income taxes			
Current	17,911	12,140	253
Deferred	2,548	(909)	(17)
Termination of S-corporation status	—	—	3,900
Provision for income taxes	20,459	11,231	4,136
Net income	\$ 33,432	\$ 16,067	\$ 8,989
Basic earnings per common share	\$ 0.68	\$ 0.36	
Diluted earnings per common share	\$ 0.67	\$ 0.35	

PRO FORMA INFORMATION (UNAUDITED)

Net income	\$ 8,989
Pro forma income taxes	5,291
Pro forma net income	\$ 3,698
Pro forma basic and diluted earnings per common share	\$ 0.09

The accompanying notes are an integral part of these consolidated financial statements.

(dollars in thousands)	Common Stock		Series A Preferred		Additional Paid-in Capital	Retained Earnings	Deferred Compensation	Accumulated Other Comprehensive Income	Total Shareholders' Equity	Comprehensive Income
	Shares	Par Value	Shares	Par Value						
BALANCE, DECEMBER 31, 1995	38,023,000	\$198	—	\$ —	\$ 91	\$ 14,342	\$ —	\$ (18)	\$ 14,613	
Amortization of deferred compensation	—	—	—	—	—	—	43	—	43	
Acquisition of minority interest in Scott Systems	—	—	—	—	28	—	—	—	28	
Issuance of Common Stock	6,800,000	34	—	—	50,216	(4,644)	—	—	45,606	
Restricted stock award	109,200	1	—	—	818	—	(819)	—	—	
Disproportionate dividend	—	—	—	—	—	(190)	—	—	(190)	
Dividends—paid by Quantum	—	—	—	—	—	(363)	—	—	(363)	
Dividends	—	—	—	—	—	(19,045)	—	—	(19,045)	
Comprehensive income:										
Currency translation adjustment	—	—	—	—	—	—	—	(93)	(93)	(93)
Net income	—	—	—	—	—	8,989	—	—	8,989	8,989
										8,896
BALANCE, DECEMBER 31, 1996	44,932,200	233	—	—	51,153	(911)	(776)	(111)	49,588	
Amortization of deferred compensation	—	—	—	—	—	—	518	—	518	
Exercise of stock options, includes effect of tax benefit recognized	257,600	1	—	—	2,814	—	—	—	2,815	
Reduction of previously authorized Scorporation dividend	—	—	—	—	162	—	—	—	162	
Issuance of Common Stock	3,600,000	18	—	—	51,246	—	—	—	51,264	
Dividends—paid by Quantum	—	—	—	—	—	(434)	—	—	(434)	
Comprehensive income:										
Currency translation adjustment	—	—	—	—	—	—	—	(554)	(554)	(554)
Net income	—	—	—	—	—	16,067	—	—	16,067	16,067
										15,513
BALANCE, DECEMBER 31, 1997	48,789,800	252	—	—	105,375	14,722	(258)	(665)	119,426	
Amortization of deferred compensation	—	—	—	—	—	—	258	—	258	
Exercise of stock options, includes effect of tax benefit recognized	351,279	2	—	—	5,482	—	—	—	5,484	
Two-for-one stock split effected in the form of a stock dividend paid on April 10, 1998	—	237	—	—	—	(237)	—	—	—	
Issuance of preferred stock	—	—	1	—	—	—	—	—	—	
Non-cash merger costs	—	—	—	—	262	—	—	—	262	
Dividends—paid by Quantum	—	—	—	—	—	(749)	—	—	(749)	
Comprehensive income:										
Net unrealized gain on investments	—	—	—	—	—	—	—	368	368	368
Currency translation adjustment	—	—	—	—	—	—	—	(274)	(274)	(274)
Net income	—	—	—	—	—	33,432	—	—	33,432	33,432
										\$33,526
BALANCE, DECEMBER 31, 1998	49,141,079	\$491	1	\$ —	\$111,119	\$ 47,168	\$ —	\$(571)	\$158,207	

The accompanying notes are an integral part of these consolidated financial statements.

(dollars in thousands)	Year Ended December 31,		
	1998	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES			
Operations:			
Net income	\$33,432	\$16,067	\$ 8,989
Adjustments to reconcile net income to cash provided by operations:			
Depreciation and amortization	3,734	1,487	395
Allowance for uncollectible accounts	513	540	175
Minority interest	—	—	(54)
Deferred income taxes, net	3,160	(2,061)	3,654
Non-cash merger costs, net	262	—	—
Amortization of deferred compensation	258	518	43
Amortization of bond premium	534	—	—
Working capital items:			
Accounts receivable and unbilled receivables	(15,559)	(30,858)	(4,536)
Employee and related party advances	(990)	694	(2,338)
Prepaid and other assets	(1,027)	(541)	280
Accounts payable	2,420	356	2,940
Accrued and other current liabilities	8,379	10,333	2,171
Net cash flows from operating activities	35,116	(3,465)	11,719
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to equipment and leasehold improvements	(11,147)	(5,897)	(3,102)
Purchases of investments	(74,965)	—	—
Sales of investments	27,646	—	—
Acquisitions, net of cash acquired	(19,218)	(2,154)	28
Net cash flows from investing activities	(77,684)	(8,051)	(3,074)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net borrowings (payments) under revolving credit facilities	(8,362)	1,121	2,480
Net proceeds from issuance of Common Stock	—	51,264	45,606
Proceeds from exercise of stock options	5,484	2,815	—
Dividends paid	(749)	(6,772)	(13,098)
Net cash flows from financing activities	(3,627)	48,428	34,988
Effect of currency translation on cash	(274)	(554)	(93)
Net change in cash and cash equivalents	(46,469)	36,358	43,540
Cash and cash equivalents, beginning of period	82,924	46,566	3,026
Cash and cash equivalents, end of period	\$36,455	\$82,924	\$46,566
NON-CASH INVESTING AND FINANCING ACTIVITIES			
Unrealized gain on investments	\$ 368	\$ —	\$ —
SUPPLEMENTAL DISCLOSURE			
Cash payments for interest	\$ 300	\$ 757	\$ 511
Cash payments for income taxes	\$16,148	\$ 9,170	\$ 376

The accompanying notes are an integral part of these consolidated financial statements.

NOTE 1: OPERATIONS

In conjunction with the closing of its initial public offering on December 16, 1996, Mastech Systems Corporation, the entity through which the business of the Company had been conducted since its inception in July 1986, became an indirect, wholly owned subsidiary of Mastech Corporation ("Mastech" or the "Company"), which was incorporated in Pennsylvania on November 12, 1996.

Mastech is a worldwide provider of information technology ("IT") services to large and medium-sized organizations. Mastech provides its clients with a single source for a broad range of applications solutions and services including client/server design and development, software modernization services, enterprise resources planning ("ERP") package implementation services, E-Business solutions, customer interaction management, applications maintenance outsourcing and Year 2000 services. These services are provided in a variety of computing environments and use leading technologies including client/server architectures, object-oriented programming languages and tools, distributed database management systems and the latest networking and communications technologies. To enhance its services, Mastech has formed business alliances with leading software companies such as Oracle, PeopleSoft, SAP, Siebel and Genesys. In addition, the Company has developed its own proprietary methodologies and tools, under the name SmartAPPS, that enhance the productivity of the Company's Year 2000 and other services.

Mascot Systems Pvt. Ltd. ("Mascot"), a wholly owned foreign subsidiary, was acquired upon the closing of the Company's initial public offering. During 1997, Mascot operated one offshore software development center in Bangalore, India, and, during 1998, opened two additional centers in the cities of Pune and Madras, India. Mascot's current operations serve as Mastech's single source for offshore software development. Scott provides IT professional recruiting and training services. As of December 31, 1997, all of Mascot, SWAT and Scott's revenues were derived from services provided to Mastech Systems.

Financial results for the years ended December 31, 1997 and 1996 have been restated to reflect the acquisition of Quantum in a business combination that was accounted for as a pooling of interests.

NOTE 2: STOCK SPLIT

On March 17, 1998, the Company's Board of Directors declared a two-for-one stock split that was effected in the form of a stock dividend paid on April 10, 1998 to shareholders of record on March 27, 1998. All share and per share amounts included in the Company's consolidated financial statements have been restated to reflect the stock split for all periods presented, except where otherwise noted.

NOTE 3: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying Consolidated Financial Statements reflect the application of the following significant accounting policies:

Principles of Consolidation. The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation.

Cash and Cash Equivalents. Cash and Cash Equivalents are defined as cash and short-term investments with maturities of three months or less at the time of acquisition.

Investments. The Company's short-term investments are classified as available-for-sale as defined by Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). These investments consist of investment grade municipal bonds and are stated at estimated fair value based upon market quotes.

Accounts Receivable. The Company extends credit to clients based upon management's assessment of their creditworthiness. Substantially all of the Company's revenues (and the resulting accounts receivable) are from large companies, major systems integrators and governmental agencies. The allowance for uncollectible accounts was approximately \$1,728,000, \$1,215,000 and \$675,000 as of December 31, 1998, 1997 and 1996, respectively.

Unbilled receivables represent amounts recognized as revenues for the periods presented based on services performed under the terms of client contracts that will be invoiced in subsequent periods.

Revenue Recognition. The Company recognizes revenue on time-and-materials contracts as the services are performed for clients. Revenues on fixed-price contracts are recognized using the percentage of completion method. Percentage of completion is determined by relating the actual cost of work performed to date to the estimated total cost for each contract. If the estimate indicates a loss on a particular contract, a provision is made for the entire estimated loss without reference to the percentage of completion. Changes in job performance, conditions and estimated profitability may result in revisions to costs and revenues, and are recognized in the period in which the changes are identified.

Hedging. The Company selectively uses foreign exchange contracts to hedge foreign exchange exposure on certain intercompany debt. Gains and losses on the foreign exchange contracts are recognized under hedge accounting in Shareholders' Equity as Currency Translation Adjustment. Such gains and losses are essentially offset in Currency Translation Adjustment by gains or losses on translation of the related debt.

Depreciation and Amortization. The Company provides for depreciation using the straight-line method in amounts which allocate the costs of equipment over their estimated useful lives of three to seven years, and leasehold improvements over the shorter of the life of the improvement or of the underlying lease term.

Intangible assets, which include the excess of purchase price and related costs over the value of the net assets acquired, are amortized using the straight-line method over periods ranging from five to thirty years. The Company assesses the recoverability of goodwill by determining whether the amortization of the goodwill balance over its remaining life can be recovered through undiscounted future operating cash flows. The Company believes that the carrying amount of these intangible assets will be realizable over their respective amortization periods. Accumulated amortization was approximately \$258,000 and \$11,000 for 1998 and 1997, respectively. Annual amortization expense for 1998 and 1997 was approximately \$247,000 and \$11,000, respectively.

Currency Translation Adjustment. The financial statements of foreign subsidiaries are translated using the exchange rate in effect at year end for balance sheet accounts and the average exchange rate in effect during

the year for revenue and expense accounts. Translation gains and losses are excluded from the consolidated income statements and are instead reported as the currency translation adjustment component of shareholders' equity.

The functional currency of international offices and foreign subsidiaries is the currency of the country in which the office or subsidiary is located. Revenues of the Company are billed in the currency of the country in which the customer is located. Translation gains and losses arising from differences between the functional and billing currencies are recognized in the consolidated income statements.

Mastech Systems has loans outstanding from Mascot Systems, which have been eliminated in the accompanying consolidated balance sheets as of December 31, 1998 and 1997. The terms of the loans provide for the scheduled repayment of principal and accrued interest in fiscal years 2001 through 2005. However, the Company considers these loans permanently reinvested and, therefore, has recorded the related foreign transaction gains and losses in the currency translation adjustment as of December 31, 1998.

Income Taxes. The Company provides for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). Deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities.

Prior to its initial public offering, the Company elected to be taxed under Subchapter S of the Internal Revenue Code of 1986, as amended ("S-corporation") for income tax purposes. Accordingly, the income of the Company was reported on the individual income tax returns of its shareholders. Therefore, the financial statements do not include a provision for income taxes related to income prior to the closing of the initial public offering.

The Company's S-corporation status terminated in connection with the Company's initial public offering, thereby subjecting the Company's income to federal and state income taxes at the corporate level. Due to temporary differences in recognition of revenues and expenses at the time of the initial public offering, income for financial reporting purposes exceeded income for income tax purposes. Accordingly, the application of the provisions of SFAS No. 109 resulted in the recognition of deferred

tax liabilities (and a corresponding one-time charge to expense) of \$3.9 million as of the date the S-corporation was terminated. The majority of this tax provision will be paid through the year 2000.

In the recent past, the government of India has provided incentives, in the form of tax holidays, to encourage foreign investment. The Company's operation in India was eligible for a tax holiday for a five-year period beginning in 1997.

Use of Estimates in the Preparation of Financial Statements. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Financial Instruments. The fair values and carrying amounts of the Company's financial instruments, primarily accounts receivable and payable, are approximately equivalent. The financial instruments are classified as current and will be liquidated within the next operating cycle.

Pro Forma Information (Unaudited). The pro forma adjustments for income taxes included in the accompanying consolidated income statements are based upon the statutory rates in effect for C-corporations during the periods presented.

Reclassifications. Certain reclassifications have been made to the Company's 1997 and 1996 financial statements to conform to current year presentation.

NOTE 4: INVESTMENTS

Short-term investments, classified as available-for-sale, consist of investment grade municipal bonds at December 31, 1998 with an amortized cost of \$46,785,000, unrealized gain of \$368,000 and market value of \$47,153,000. The value of securities with a contractual maturity within one year at December 31, 1998 was \$28,271,000. The value of securities with a contractual maturity at December 31, 1998 over one year and less than three years was \$18,882,000. Gross realized gains on sales of securities in 1998 was immaterial.

NOTE 5: HEDGING ACTIVITIES

The Company selectively uses foreign exchange contracts to hedge foreign exchange exposure on certain intercompany debt. At December 31, 1998, the Company held one foreign exchange contract, which was the far end of a Canadian dollar swap, maturing on March 31, 1999. The outstanding contract is for the sale by the Company of 7 million Canadian dollars at 1.54875 (US \$4,519,774).

NOTE 6: INCOME TAXES

The components of the provision (benefit) for income taxes for the years ended December 31, 1998, 1997 and 1996 are as follows:

(dollars in thousands)	December 31,		
	1998	1997	1996
Current provision:			
Federal	\$13,806	\$ 9,312	\$ 216
State	1,869	1,577	—
Foreign	2,236	1,251	37
Total current provision	17,911	12,140	253
Deferred provision (benefit):			
Federal	2,057	(700)	(17)
State	491	(155)	—
Foreign	—	(54)	—
Termination of S-corporation status	—	—	3,900
Total deferred provision (benefit)	2,548	(909)	3,883
Total provision for income taxes	\$20,459	\$11,231	\$4,136

The reconciliation of income taxes computed using the statutory U.S. income tax rate and the provision for income taxes for the years ended December 31, 1998 and 1997 follows:

(dollars in thousands)	December 31, 1998	
Income taxes computed at the federal statutory rate	\$18,862	35.0%
State income taxes, net of federal benefit	1,534	2.8
Other, net	63	0.2
Provision for income taxes	\$20,459	38.0%

(dollars in thousands)

December 31, 1997

Income taxes computed at the federal statutory rate	\$ 9,554	35.0%
State income taxes, net of federal benefit	924	3.4
Other, net	753	2.7
Provision for income taxes	\$ 11,231	41.1%

The Company's S-corporation status terminated in connection with the Company's initial public offering, thereby subjecting the Company's income to federal and state income taxes at the corporate level.

Prior to the initial public offering, the Company elected Subchapter S-corporation status for income tax purposes. Accordingly, the income of the Company was reported on the individual income tax returns of its shareholders. The financial statements, therefore, do not include a provision for income taxes prior to the closing of the initial public offering.

The reconciliation of income taxes computed using the statutory U.S. income tax rate and the provision for income taxes for the 15-day C-corporation period ended December 31, 1996 follows. Due to the S- to C-corporation conversion, a reconciliation of the effective tax rate expressed in percentages is not meaningful for 1996.

(dollars in thousands)

December 31, 1996

C-corporation income before taxes for the 15-day period ended December 31, 1996	\$ 413
Net taxable temporary differences	4
Current portion of S-corporation deferred revenue	123
Book taxable income as a C-corporation	540
Income taxes computed at the federal statutory rate	216
Provision for change in tax status to C-corporation	3,900
Other, net	20
Provision for income taxes	\$4,136

The components of the deferred tax assets and liabilities are as follows:

	December 31,	
(dollars in thousands)	1998	1997
Deferred tax assets:		
Allowance for doubtful accounts and employee advances	\$ (356)	\$ (304)
Accrued vacation	(1,088)	(418)
Foreign tax credit carryforward	(31)	(225)
Reserve for contract costs	(653)	(692)
Reserve for Canadian employment taxes	(915)	(979)
Accrued pension cost	(187)	(196)
Other	(660)	(615)
	\$ (3,890)	\$ (3,429)
Deferred tax liabilities:		
S-corporation deferred revenue	\$ 1,200	\$ 2,345
Compensation for IMIS employees	3,372	—
Section 481(a) adjustments	381	—
Other	2,080	686
Total deferred tax liability	\$ 7,033	\$ 3,031
Net current (asset) liability	\$(2,312)	\$(2,108)
Net long-term liability	5,455	1,710
	\$ 3,143	\$ (398)

The foreign tax credit carryforwards of \$31,000 recognized as of December 31, 1998 expire during fiscal year 2002.

NOTE 7: REVOLVING CREDIT FACILITY

The Company had a revolving credit facility with PNC Bank, National Association. Borrowings under this arrangement were unsecured, were limited to \$15.0 million, bore interest at LIBOR plus 1.0% or the prime rate, and were payable upon demand. There were no borrowings outstanding under this arrangement as of December 31, 1996. Average outstanding borrowings under this arrangement were \$535,000 and \$1.4 million for the years ended December 31, 1997 and 1996, respectively.

Effective May 30, 1997, the Company replaced the above-mentioned revolving credit facility with a \$25.0 million revolving credit facility with PNC Bank, National Association (the "Facility"). The Facility bears interest at a

rate equal to LIBOR plus 1.0% or prime, at the Company's option, and borrowings are unsecured. The Facility contains certain restrictive covenants and financial ratio requirements which would limit distributions to shareholders and additional borrowings. There were no borrowings outstanding under this arrangement as of December 31, 1997. For the year ended December 31, 1997, average outstanding borrowings were approximately \$489,000 and the maximum outstanding borrowings were \$4.0 million. The weighted-average interest rate for the year ended December 31, 1997 was 8.5%.

Effective December 3, 1998, the Company replaced the aforementioned Facility with a \$75.0 million revolving credit facility with PNC Bank, National Association ("the Credit Facility"). This Credit Facility bears interest at a rate per annum equal to a base rate (which is adjusted by a change in the prime rate or the Federal Funds Effective Rate at the Company's option) that is equal to the sum of the Euro-rate plus an applicable Euro-rate margin. The Credit Facility contains certain restrictive covenants and financial ratio requirements which would limit distributions to shareholders and additional borrowings. There were no borrowings outstanding under this arrangement as of December 31, 1998. For the year ended December 31, 1998, average outstanding borrowings were approximately \$161,000 and the maximum outstanding borrowings were \$4.0 million. The weighted-average interest rate for the year ended December 31, 1998 was 8.5%.

During the first quarter of 1998, Mascot Systems had aggregate borrowings of approximately \$1.7 million outstanding under revolving credit agreements with ICICI Banking Corporation Limited and IndusInd Bank Limited, both of India. Interest rates charged on these borrowings ranged from 18.75% to 19.25% per year. These borrowings were repaid in full by the Company in May 1998.

The Company assumed \$6.9 million of borrowings outstanding under a revolving credit agreement with the Bank of Montreal related to the Quantum acquisition. This amount was repaid in full as of June 30, 1998.

NOTE 8: RELATED PARTY TRANSACTIONS

As an S-corporation, the net income of the Company was attributed, for federal (and some state) income tax purposes, directly to the Company's shareholders rather than to the Company. During 1997 and 1996, the Company had from time to time paid the corresponding income taxes due on these amounts on behalf of the controlling shareholders in the form of interest-free advances which were later repaid. The highest aggregate amounts of advances outstanding to one of the controlling shareholders and his Qualified Subchapter S Trust during 1998, 1997 and 1996 were approximately \$87,000, \$96,000 and \$1,682,000, respectively. The highest aggregate amounts of advances outstanding to the other controlling shareholder and his Qualified Subchapter S Trust during 1998, 1997 and 1996 were approximately \$118,000, \$158,000 and \$1,682,000, respectively.

Mascot Systems leases from the controlling shareholders the office space for the offshore software development facilities in Bangalore, India. The acquisition of the real estate and the construction of this office building (but not the buildout of the office space) was financed entirely by the controlling shareholders out of personal funds. Specifically, Mascot Systems leases approximately 4,500 square feet of office space on one floor of an office building located in Bangalore, which is owned by the controlling shareholders. The lease has a ten-year term expiring in February 2008, with a rent revision clause every March. The rent is approximately \$29,000 per year. Mascot Systems also leases a 32,500-square-foot office building located in Bangalore from the controlling shareholders. This lease has a ten-year term expiring in October 2006, and the annual rent is approximately \$95,000. The Offshore Development Center at Chennai was partly functional during 1998 and fully functional beginning January 1, 1999. The lease agreement effective for a ten-year period effective March 1998 and expiring February 2008 has an annual rent of \$449,000. The rental agreement may be revised each March. Since the facility was partly occupied during 1998, rent paid to the controlling shareholders was \$118,000. Mascot Systems also has rented approximately 9,000 square feet of space for its facilities located in Bangalore and Chennai, for which rent in the amount of \$9,000 was paid during 1998.

Scott Systems leases, for its training facilities, approximately 2,100 square feet of office space on one floor of an office building located in Mumbai (Bombay, India). The leased space is divided into five separately owned suites owned individually by the controlling shareholders. The lease expires in March 2003, and the aggregate rent is approximately \$20,000 per year. Scott Systems also leases further office space of approximately 900 square feet on another floor in the same office building, which is owned by the controlling shareholders. This lease has a term that expires in August 2007, and the rent is \$6,000 per year. Scott Systems also leases a portion of the Pune facility from the controlling shareholders. This lease covers 7,500 square feet of office space and expires in August 2007. The rent is approximately \$18,000 per year.

**NOTE 9: COMMITMENTS
AND CONTINGENCIES**

The Company rents certain office facilities and equipment under noncancelable operating leases that provide for the following future minimum rental payments as of December 31, 1998:

<i>Period ending December 31, (dollars in thousands)</i>	<i>Amount</i>
1999	\$4,010
2000	3,582
2001	2,471
2002	1,466
Thereafter	4,077

Rental expense was approximately \$3,210,000, \$1,984,000 and \$1,448,000 for the years ended December 31, 1998, 1997 and 1996, respectively.

The Company has employment agreements with its controlling shareholders and certain of its executive officers which provide generally for specified minimum salaries and bonuses based upon the Company's performance.

The majority of the Company's projects with customers, including those related to Year 2000 conversion, generally provide that the Company will supply consultants to perform under the customer's supervision. At this time, the Company is unable to quantify the potential risk to the Company related to Year 2000 conversions from future claims. Nonetheless, management does not believe that claims that may arise as a result of the above will have a significant impact on either the financial position or the results of operations of the Company.

The Company is a party to several "preferred vendor" contracts and is seeking additional similar contracts in order to obtain new or additional business from large or medium-sized clients. While these contracts are expected to generate higher volumes, they generally result in lower margins. Although the Company attempts to lower costs to maintain margins, there can be no assurance that the Company will be able to sustain margins on such contracts. In addition, the failure to be designated a preferred vendor, or the loss of such status, may preclude the Company from providing services to existing or potential clients, except as a subcontractor. Nonetheless, management does not believe that claims that may arise as a result of the above will have a significant impact on either the financial position or the results of operations of the Company.

NOTE 10: EMPLOYEE BENEFIT PLANS

The Company sponsors a 401(k) benefit plan. Eligible employees, as defined in the plan, may contribute up to 15% of eligible compensation, as defined. The Company currently does not contribute to this plan.

NOTE 11: NONRECURRING CHARGES

In October 1996, the Company entered into an agreement with an executive pursuant to which the Company agreed to pay this individual, as compensation for past services, an amount equal to the value of 218,400 shares of Common Stock at the initial public offering price of \$7.50 per share. Both of these numbers have been adjusted to reflect the two-for-one stock split. One-half of this payment was made in cash, at the election of the executive, on December 16, 1996. The remaining half of this obligation was satisfied on December 16, 1996 via the issuance of 109,200 shares of restricted Common Stock, as described in Note 12. The Company has reflected the cash payment along with the applicable tax withholdings as a nonrecurring charge in the accompanying consolidated statements of income for the year ended December 31, 1996.

For the years ended December 31, 1997 and 1998, the Company has reflected the amortization of deferred compensation for this same executive as a nonrecurring charge in the accompanying consolidated statements of income.

In connection with the acquisition of Quantum, \$3.2 million of merger-related costs and expenses (primarily severance, legal and accounting costs) were incurred and were charged to expense in the second quarter of 1998. As of December 31, 1998, \$245,000 remains and will be paid during 1999.

NOTE 12: STOCK-BASED COMPENSATION AND RESTRICTED STOCK AWARD

Effective December 16, 1996, the Company adopted the 1996 Stock Incentive Plan (the "Plan") for directors, executive management and key personnel. Effective February 1, 1999, the Company adopted the Second Amended and Restated 1996 Stock Incentive Plan (the "Amended Plan") for directors, executive management and key personnel. The Amended Plan provides that up to 15% of the number of outstanding shares of the Company on each December 31, beginning on December 31, 1998, shall be available for issuance under the Amended Plan. As of December 31, 1998, there were 3,605,286 shares of Common Stock available for issuance under the Amended Plan. The Company accounts for the Plan under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Had compensation costs for the Plan been determined consistent with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), net income and basic and diluted earnings per share for the year ended December 31, 1998 would have been reduced by \$3.5 million, or \$0.07 per share. For the year ended December 31, 1997, net income and basic and diluted earnings per share would have been reduced by \$1.3 million, or \$0.03 per share. For the year ended December 31, 1996, net income would have been reduced by \$24,000 and there would have been no impact on pro forma basic and diluted earnings per common share for the same period.

During 1998, 1997 and 1996, options covering a total of 1,703,873 shares, 820,100 shares and 1,691,100 shares, respectively, of Common Stock were granted under the Plan. Options expire ten years from the date of grant or earlier if an option holder ceases to be employed by the Company for any reason. A summary of stock option activity follows:

	Options	Weighted Average Exercise Price
1998		
Options outstanding, beginning of period	2,134,600	\$ 8.37
Granted	1,703,873	19.47
Exercised	351,279	8.76
Lapsed and forfeited	330,198	11.06
Options outstanding, end of period	3,156,996	\$14.25
Options exercisable, end of period	412,828	\$ 9.11
Available for future grants	3,605,286	
1997		
Options outstanding, beginning of period	1,691,100	\$ 7.50
Granted	820,100	9.76
Exercised	257,600	7.50
Lapsed and forfeited	119,000	7.50
Options outstanding, end of period	2,134,600	\$ 8.37
Options exercisable, end of period	212,064	\$ 7.50
Available for future grants	4,978,961	
1996		
Options outstanding, beginning of period	—	—
Granted	1,691,100	\$ 7.50
Exercised	—	—
Lapsed and forfeited	—	—
Options outstanding, end of period	1,691,100	7.50
Options exercisable, end of period	—	—
Available for future grants	5,680,061	

STOCK OPTIONS OUTSTANDING AT DECEMBER 31, 1998

Options Outstanding			Options Exercisable		
Weighted Average Exercise Price	Options	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Options	Weighted Average Remaining Contractual Life (Years)
\$ 7.50	1,020,257	7.96	\$ 7.50	292,258	7.96
9.56	370,000	7.33	9.98	64,834	7.33
15.80	619,166	8.96	15.26	42,736	8.86
19.26	598,573	9.17	19.72	13,000	9.46
22.37	490,000	9.80	—	—	—
25.84	59,000	9.54	—	—	—
\$14.25	3,156,996	8.63	\$ 9.08	412,828	8.04

STOCK OPTIONS OUTSTANDING AT DECEMBER 31, 1997

Options Outstanding			Options Exercisable		
Weighted Average Exercise Price	Options	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Options	Weighted Average Remaining Contractual Life (Years)
\$ 7.50	1,407,600	9.24	\$ 7.50	212,064	9.24
8.82	560,000	9.62	—	—	—
14.21	167,000	9.91	—	—	—
\$ 8.37	2,134,600	9.39	\$ 7.50	212,064	9.24

STOCK OPTIONS OUTSTANDING AT DECEMBER 31, 1996

Options Outstanding			Options Exercisable		
Weighted Average Exercise Price	Options	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Options	Weighted Average Remaining Contractual Life (Years)
\$ 7.50	1,691,100	9.96	—	—	—

Summary of Stock Options	Stock Option Price
Weighted average fair value of options granted during 1998*	\$9.68
Weighted average fair value of options granted during 1997*	\$2.60
Weighted average fair value of options granted during 1996*	\$2.93

*The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	1998	1997	1996
Risk-free interest rate	5.6%	6.5%	6.2%
Expected dividend yield	0.0%	0.0%	0.0%
Expected life of options	5 years	5 years	6 years
Expected volatility rate	50.0%	33.0%	24.5%

Effective December 16, 1996, the Company entered into an employment agreement with an executive that included the granting of 109,200 shares of restricted Common Stock. During the restricted period (from December 16, 1996 to June 30, 1998), the restricted stock vested ratably and daily. The agreement provides for partial awards and forfeitures under various circumstances. At December 31, 1998 and 1997, the Company's consolidated balance sheet reflects deferred compensation of \$0 and \$258,000, respectively, related to this award, as an offset to shareholders' equity. Compensation expense of \$258,000, \$518,000 and \$43,000 related to the vesting of restricted shares during 1998, 1997 and 1996, respectively, has been recorded in the Company's consolidated income statement.

**NOTE 13: EARNINGS PER
COMMON SHARE**

In February 1997, the FASB issued Statement of Financial Accounting Standards No. 128, "Earnings per Share" ("SFAS No. 128"), which establishes new standards for computing and presenting earnings per share. SFAS No. 128 is effective for financial statements issued for periods ending after December 15, 1997, including interim periods. The Company adopted SFAS No. 128 during 1997. Earnings per share for the pro forma periods were not impacted by the adoption of SFAS No. 128.

Basic pro forma net income per common share and earnings per common share are calculated by dividing pro forma net income and net income, respectively, by the weighted average number of common shares outstanding during the year. Diluted pro forma net income per common share and earnings per common share are calculated by dividing pro forma net income and net income, respectively, by the weighted average number of shares of Common Stock outstanding adjusted for the assumed conversion of all dilutive securities.

The 1996 diluted shares outstanding, as calculated below, also includes 393,462 (pre-split) common shares, which represents the number of shares, when multiplied by the initial public offering price, that would have been sufficient to replace the capital in excess of earnings withdrawn as dividends during the period.

The following table sets forth the computation of earnings per share for the periods indicated.

NOTE 14: BUSINESS ACQUISITIONS

On October 26, 1998, the Company acquired International MIS Inc. ("IMIS"), a business and information technology consulting firm based in San Francisco, California. IMIS provides the financial industry with high-level project management and business analysis consulting services. The acquisition was accounted for as a purchase. Operating results have been included in the Company's consolidated financial statements since the date of acquisition, but pro forma information has not been presented because it is immaterial.

On July 1, 1998, the Company acquired privately held MC Computer Services Pty Limited ("MCCS"), a Canberra, Australia-based information technology services provider. MCCS provides a wide range of high-level information technology services such as applications development, consultant services, systems analysis and design, and project management. The acquisition has been accounted for as a purchase. Operating results have been included in the Company's consolidated financial statements since the date of acquisition, but pro forma information has not been presented because it is immaterial.

Related to these acquisitions, an initial payment of \$15.0 million was paid and \$4.0 million was recorded as a long-term liability, which represents the unpaid purchase price. Future payments will be made based upon a calculation of earnings before interest, taxes, depreciation and amortization of goodwill for the years ending 1999, 2000 and 2001. Future payments will not exceed \$8.0 million

	<i>Year Ended December 31,</i>		
	1998	1997	1996
			(Pro forma)
Basic earnings per share			
Net income	\$ 33,432	\$ 16,067	\$ 3,698
Divided by:			
Weighted average common shares	48,996,895	45,250,620	39,194,023
Basic earnings per share	\$ 0.68	\$ 0.36	\$ 0.09
Diluted earnings per share			
Net income	\$ 33,432	\$ 16,067	\$ 3,698
Divided by the sum of:			
Weighted average common shares	48,996,895	45,250,620	39,194,023
Dilutive effect of Common Stock equivalents	833,539	469,506	6,400
Diluted average common shares	49,830,434	45,720,126	39,200,423
Diluted earnings per share	\$ 0.67	\$ 0.35	\$ 0.09

(dollars in thousands, except per share data)

under the terms of one agreement. The maximum amount of future payments for the other agreement will be established based upon the calculation described above.

During 1998, the Company recorded approximately \$19.5 million of goodwill related to the above acquisitions. The final amount of goodwill will be determined upon the finalization of fair value studies of the assets acquired. Additionally, this amount will be adjusted based upon future payments. These two acquisitions, accounted for under the purchase method of accounting, added \$12.5 million in revenues and \$9.5 million in assets for 1998.

On June 1, 1998, the Company acquired all of the issued and outstanding capital stock of Quantum Information Resources Limited ("Quantum"), a Canadian corporation, pursuant to a business combination the terms of which were contained in that certain Combination and Exchange Agreement dated June 1, 1998 (the "Exchange Agreement"). Pursuant to the Exchange Agreement, the shareholders of Quantum received 1,623,000 exchangeable non-voting shares of Quantum, which are convertible into the same number of shares of the Company's Common Stock (the "Exchangeable Shares"); and PNC Bank, National Association, received 1 share of Series A Preferred Stock, as trustee for the shareholders of Quantum, pursuant to which such shareholders were granted the right to vote the Company Common Stock underlying the Exchangeable Shares.

Quantum provides IT services primarily in Canada and parts of the United States. The business combination was accounted for as a pooling of interests and, accordingly, the Company's consolidated financial statements have been restated to include results for Quantum for all periods presented. Separate revenues and net income, prior to the business combination, are presented in the following table:

	Five Months Ended May 31,	Year Ended December 31,	
	1998	1997	1996
<i>(dollars in thousands)</i>			
REVENUES			
Mastech	\$121,298	\$195,967	\$123,400
Quantum	20,181	44,481	39,539
Total	\$141,479	\$240,448	\$162,939
NET INCOME			
Mastech	\$ 11,093	\$ 15,606	\$ 8,692
Quantum	928	461	297
Total	\$ 12,021	\$ 16,067	\$ 8,989

On December 2, 1997, the Company acquired Asia Pacific Computer Consultants Pty Limited ("Asia Pacific"), a Sydney, Australia-based information technology and telecommunications ("IT & T") services provider. Asia Pacific was merged with Mastech's existing Australia operations and became a Mastech subsidiary, Mastech Asia-Pacific. In addition to an initial payment, a contingent future payment, if required, will be made in accordance with a calculation involving the earnings before interest of Asia Pacific, as defined, for each of the years ended December 31, 1998 and 1999.

NOTE 15: S-CORPORATION DIVIDEND

In December 1996, the Company's Board of Directors declared an S-corporation dividend to former S-corporation shareholders in an aggregate amount representing the estimated amount of all undistributed earnings of the Company taxed or taxable to its shareholders through December 16, 1996 (the "S-corporation Dividend"). The S-corporation Dividend was recorded in the consolidated balance sheets at December 31, 1996 in the amount of \$6.5 million. The S-corporation Dividend was paid in the amount of \$6.3 million in 1997, with the difference recognized as an increase in additional paid-in capital as shown in the accompanying consolidated statements of shareholders' equity.

NOTE 16: SEGMENT REPORTING

In June 1997, the FASB issued Statement of Financial Accounting Standards No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131"), which requires the use of the "management approach" model for segment reporting. The management approach model is based on the way a company's management organizes segments within the company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure, or any other manner in which management segregates a company.

Mastech Corporation's reportable segments are strategic business units that offer similar services to different target markets. They are managed separately because each business unit requires different marketing strategies. The Company has three reportable segments: the U.S. Client Services group, the High Value Services group and the International Client Services group.

The U.S. Client Services group is divided into geographic regions, each of which is directed by a Manager or Regional Director. Each region includes multiple new business development managers. These individuals use a proprietary database of several thousand prospects to telemarket Mastech's services nationally. The Company subsequently sends interested prospective clients a written proposal providing information about the Company, its approach and methodology, schedules, team members, pricing and terms.

The U.S. Client Services group also develops national and global relationships with systems integrators such as EDS, IBM, KPMG, Ernst & Young and Oracle. Mastech assists these integrators in meeting their customers' needs by providing specialized technical expertise and complementary capabilities such as offshore development.

The High Value Services group provides IT professionals trained in ERP implementations, E-Business consulting, network services, and Year 2000 services, in addition to managing engagements in the aforementioned services. Additionally, this group provides services through offshore software development centers which are connected via secure, high-speed satellite links to the Company's headquarters and client sites. The group works directly with the end-user clients and also partners with a wide array of software companies, ranging from ERP to supply-chain and custom-interaction vendors, and systems integrators on teamed implementation efforts.

The International Client Services group operates through offices in nine different countries. Each office is supervised by a Country Manager and supported by dedicated sales personnel that sell directly to new clients using an approach similar to the Company's U.S. sales approach. Additionally, these offices focus on leveraging Mastech's existing relationships with its U.S.-based multinational clients.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates segment performance based on profit or loss from operations. The Company does not allocate income taxes, other income or expense, and nonrecurring charges to segments. In addition, the Company accounts for inter-segment sales and transfers at current market prices.

	<i>Year ended December 31,</i>		
	1998	1997	1996
<i>(dollars in thousands)</i>			
REVENUES			
United States	\$283,569	\$175,364	\$116,514
Canada	49,489	47,830	39,935
Europe	26,126	8,898	329
Pacific Rim	31,687	8,356	6,161
Total Revenues	\$390,871	\$240,448	\$162,939

	<i>December 31,</i>	
	1998	1997
TOTAL ASSETS		
United States	\$168,276	\$145,994
Canada	16,158	3,628
Europe	13,836	5,643
Pacific Rim	17,511	6,795
Total Assets	\$215,781	\$162,060

(dollars in thousands)	U.S. Client Services	High Value Services	International Client Services ¹	Corporate Activities ²	Total
1998					
Revenues ³	\$159,679	\$140,092	\$91,100	\$ —	\$390,871
Income from operations	40,344	33,804	6,407	(26,773)	53,782
Interest (income) expense	—	—	—	(3,321)	(3,321)
Merger-related expenses	—	—	—	3,212	3,212
Provision for income taxes	—	—	—	20,459	20,459
Net income					\$ 33,432
1997					
Revenues ³	\$122,387	\$ 58,961	\$59,100	\$ —	\$240,448
Income from operations	28,876	10,626	4,044	(17,441)	26,105
Interest (income) expense	—	—	—	(1,193)	(1,193)
Provision for income taxes	—	—	—	11,231	11,231
Net income					\$ 16,067
1996					
Revenues ³	\$105,488	\$ 10,931	\$46,520	\$ —	\$162,939
Income from operations	25,129	(183)	2,295	(13,785)	13,456
Interest (income) expense	—	—	—	331	331
Provision for income taxes	—	—	—	4,136	4,136
Net income					8,989
Pro forma tax provision					5,291
Pro forma net income					\$ 3,698

¹Income from operations for the International Client Services group includes certain international administrative and other operating expenses which are not allocated to the U.S. Client Services and High Value Services groups.

²Corporate activities include general corporate expenses, eliminations of intersegment transactions, interest income and expense, and other unallocated charges. The Company evaluates segments based on income from operations. Since certain administrative and other operating expenses have not been allocated to the business segments, this basis is not necessarily a measure computed in accordance with generally accepted accounting principles and it may not be comparable to other companies. Additionally, the Company does not allocate assets, depreciation expense and capital additions to the business segments.

³A single customer, included in U.S. Client Services, accounted for approximately 11%, 11%, and 7% of the Company's revenues for the years ended December 31, 1998, 1997 and 1996, respectively.

NOTE 17: QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following table sets forth certain unaudited financial information for each of the quarters indicated below and, in the opinion of management, contains all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation thereof. All information has been restated for pooling of interests business combinations through December 31, 1998.

(dollars in thousands, except per share data)	Three Months Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
1998				
Revenues	\$81,586	\$92,584	\$103,405	\$113,296
Gross profit	26,303	30,745	34,649	36,996
Income from operations	10,939	12,861	14,964	15,018
Income before income taxes	11,611	10,380	15,699	16,201
Provision for income taxes	4,667	4,627	5,495	5,670
Net income	\$ 6,944	\$ 5,753	\$ 10,204	\$ 10,531
Basic and diluted earnings per common share	\$ 0.14	\$ 0.12	\$ 0.20	\$ 0.21
1997				
Revenues	\$48,339	\$55,905	\$ 64,209	\$ 71,995
Gross profit	13,581	16,277	19,737	23,168
Income from operations	3,461	5,988	7,589	9,067
Income before income taxes	3,867	6,349	7,703	9,379
Provision for income taxes	1,698	2,508	3,148	3,877
Net income	\$ 2,169	\$ 3,841	\$ 4,555	\$ 5,502
Basic and diluted earnings per common share	\$ 0.05	\$ 0.08	\$ 0.10	\$ 0.12

Note: The sum of the four quarters may not equal yearly totals due to rounding of quarterly results.

NOTE 18: COMPREHENSIVE INCOME

During 1998, the Company adopted FASB Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS No. 130"). SFAS No. 130 establishes new rules for the reporting and display of comprehensive income and its components. SFAS No. 130 requires companies to report all changes in equity during a period, except those resulting from investment by owners and distribution to owners. The adoption of SFAS No. 130 had no impact on the Company's net income or shareholders' equity.

NOTE 19: SUBSEQUENT EVENTS

In January 1999, the Company made the following acquisitions: (1) the Amber Group ("Amber") an SAP services company that provides integrated consulting, development, implementation and training; (2) Direct Resources Scotland Limited ("Direct Resources") of Edinburgh, Scotland, an IT services firm focusing on the financial services industry; and (3) Global Resource Management ("GRM") of Jacksonville, Florida. GRM provides information technology consulting and support services to large companies for mission-critical projects.

The above acquisitions had combined revenues of approximately \$26.2 million for the year ended December 31, 1998. Additionally, the assets of the above companies as of December 31, 1998 were approximately \$6.1 million.

The Amber acquisition will be accounted for under the pooling-of-interests method of accounting. Direct Resources and GRM will be accounted for under the purchase method of accounting.

QUARTERLY STOCK PRICES

	<i>High</i>	<i>Low</i>
1998		
First Quarter ¹⁵ / _{41.6}	\$29 ¹ / ₄₂	\$15
Second Quarter ¹³ / _{41.6}	\$29 ²⁹ / _{43.2}	\$17
Third Quarter	\$29 ¹ / ₄₈	\$20 ¹ / ₄₄
Fourth Quarter	\$28 ³ / ₄₄	\$16 ³ / ₄₈
1997		
First Quarter	\$10 ¹⁵ / _{41.6}	\$ 7 ¹ / ₄₂
Second Quarter	\$11 ⁷ / ₄₈	\$ 5 ³ / ₄₄
Third Quarter ³ / _{41.6}	\$17 ¹ / ₄₂	\$11
Fourth Quarter ⁵ / _{41.6}	\$17 ⁷ / _{41.6}	\$13

COMMON STOCK & DIVIDEND POLICY

Mastech's Common Stock is traded on the Nasdaq National Market System under the symbol MAST. As of February 26, 1999, there were 133 registered holders of record of Mastech's Common Stock. The Company intends to retain earnings to fund growth and the operation of its business, and, therefore, has not declared dividends during 1998 and 1997. Additionally, the Company does not anticipate paying any cash dividends in the foreseeable future.

ANNUAL MEETING

The Annual Meeting for Shareholders will take place on Tuesday, June 1, 1999, at Mastech Corporation,

EXECUTIVE OFFICERS

Sunil Wadhvani
Co-Chairman and Chief Executive Officer

Ashok Trivedi
Co-Chairman and President

Steven Shangold
Sr. Vice President, U.S. Client Services

Lisa Kustra
Sr. Vice President, Enterprise Package Solutions

M. Balasubanyam
Co-Managing Director, Scott Systems

John Brendel
Vice President, General Counsel

Jeffrey McCandless
Vice President, Finance and Chief Financial Officer

Ajmal Noorani
Vice President, E-Business Solutions

S. Rajagopalan
Vice President, Human Resources

M. Santhanam
Managing Director, Scott Systems

S. Shekar
Vice President, Offshore Operations

Michael Zugay
Vice President, Corporate Development

DIRECTORS

Michel Berty ^{1, 2}
*Former Chairman and CEO, Cap Gemini America
President, MBY Consultant Inc.*

J. Gordon Garrett ^{1, 2}
President & CEO, RICOH – Canada, Inc.

Ashok Trivedi ^{2, 3}
Co-Chairman and President

Sunil Wadhvani ^{1, 3}
Co-Chairman and Chief Executive Officer

Ed Yourdon
Software Engineering Consultant

Committee Assignments

¹ Audit Committee
² Compensation Committee
³ Executive Committee

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