

SYSTEMHOUSE

The monthly review of the financial performance of the UK software and IT services industry

SUPPLIERS LOOK TO MID-MARKET – AGAIN

By Kate Hanaghan

In our regular conversations with suppliers to the UK's software and IT services market, and in our ongoing analysis of their strategies, we have noticed an increased interest in the mid-market (companies with 500-1,000 employees). Interest in this part of the market seems to come and go in cycles and it is by no means consistent across the industry. For some suppliers, it is just not a key part of their strategy. But others believe that the challenge of tapping into the market is worth the effort and that they will be rewarded with good growth to supplement their revenues from enterprise customers.

The fragmented nature of the mid-market (with its large number of potential customers across many different industries) coupled with its tendency to use local or specialist, smaller S/ITS providers means it's been difficult for larger corporate-focussed suppliers to become dominant players here. Indeed,

given just how crucial larger (or mega) deals are to their growth prospects, it's no: difficult to understand why they have kept their focus at the enterprise level.

Assessing supplier strategies

With the S/ITS market hitting maturity in the past few years (with growth rates stabilising at around 6%), the pressure on suppliers to find additional areas for growth has increased. A new piece of research available now to HolwayOvum subscribers looks at some of the approaches taken by suppliers who want to deepen their presence in the mid-market. Some of the key areas we explore in the analysis include: the importance of global sourcing in addressing the market,



Kate Hanaghan
Analyst

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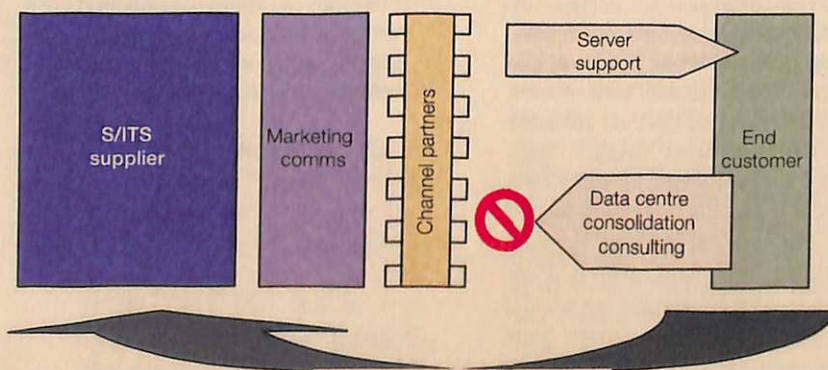
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(changes in March 2007)

Ovum S/ITS Index	5.1%	6233
FTSE IT (SCS)	1.0%	596
techMARK 100	2.8%	1605

Figure 1 The channel: avoiding the barrier to the upsell



Challenge:
Capturing opportunities for higher value services

[continued from front page]

the significance of relationships and (that rather woolly term) culture. We also look at where channel delivery works and where it doesn't. In this article, we present some of the key findings relating to channel strategies in the mid-market.

The role of the channel

Our research saw us speaking to suppliers who work directly with customers (e.g. CSC and Dell) as well as those who use the channel to tap into mid-market customers (e.g. IBM and HP). The latter tend to be hardware/software vendors who use partners to not only sell their products but to attach their services to those products too. Our research showed that this set of suppliers wants to make their service offerings more channel friendly. That's not surprising, but it is interesting given some of the productisation work we're seeing IT suppliers undertake right now. In other words, the creation of repeatable, pre-integrated solutions – such as those being developed by IBM and HP – in theory play well to sales via the channel.

The question is whether selling indirectly is better than selling directly. Of course, an obvious criticism of not dealing directly with customers is how can you truly understand their needs. Channel-oriented suppliers claim they can get a good enough understanding of customers via partners (and perhaps by working directly with customers in certain instances too). In theory this works, but the degree of success is totally dependent upon the quality of the channel relationship. None of the suppliers we spoke to as part of this research believed their channel strategy is perfect. And that's not unreasonable given the complexities relating to it.

Below we highlight three key challenges channel-focused players face when dealing with the mid-market.

- The partner has to make a living too. There are obviously instances where both supplier and partner will be vying to supply services to the same customer. Channel conflict will always be with us.
- Likewise, the use of a channel means the supplier is one-step removed from the customer. This means there is a risk of loss/dilution of message from supplier to customer via partner.
- Do customers want to buy services from one company (i.e. the channel partner) and have them delivered by another company (i.e. the supplier)? Certain customers will have reservations about this (and again, this is where the trust between customer and supplier is critical).

Furthermore, there could be occasions where the channel might in fact act as a barrier for the supplier to upsell services (see *Figure 1*). While the channel is a good medium for getting more transactional services out to a large number of customers, the relationship with the vendor has to allow for a loop back from the customer to the vendor in order to capture opportunities for higher value services – services that the partner might want to deliver itself or worse still, ignore/fail to notice.

We've taken server support as an example of where the relationship with the end user might begin. What if this simple (and commoditised) service (sold via the channel partner) revealed a more complex need – such as the requirement for consulting around data centre consolidation? If the channel partner couldn't address that need, there is a risk the vendor could miss out on that important 'lead' for a much more valuable service. And given that many IT services suppliers will be driving their mid-market strategy with a view to creating larger

opportunities within this customer set, this is potentially a serious problem.

The solution lies in combining excellent channel communications with processes that enable the vendor to intercept/identify opportunities. It's about accepting that leaving the channel completely to its own devices is not always the most effective approach. The vendor must maintain its own contact too, where practical.

Summary of Ovum's view of the channel strategy

- The channel is good for achieving broad geographical coverage of the fragmented mid-market and for fulfilling transactional-type services. But for more complex services, perhaps where channel conflict might also come into play, partnerships will be difficult to build and the rewards much harder to bag.
- Going direct requires more effort and resources, and a better internal ability to understand the customers' buying needs. But we think there is a lot of mileage in building these relationships – especially if the end game is really about moving the customer up to more valuable services.
- For those reliant on a channel strategy, the key task is making solutions as channel friendly as possible...and then combining this with a direct connection with the customer in order to identify additional larger, more valuable opportunities.

To access *The mid-market in IT services: vendor strategies*, visit Ovum's store to buy the research. Alternatively, contact Suzana Murshid (Suzana.murshid@ovum.com or call 020 7551 9071). Ovum's lead analyst on the research, Kate Hanaghan, can be contacted at kate.hanaghan@ovum.com to discuss bespoke advisory engagements.



BLACKBOX: ANOTHER CHANGE IN DATA CENTRE ECONOMICS?

When I heard Sun Microsystems CEO and President Jonathan Schwartz describe Project Blackbox at Oracle OpenWorld in San Francisco in 2006 I was convinced that it was just another embarrassing concept. The idea of a portable data centre, built into a standard 20 foot industrial shipping crate seemed farcical – after all data centres are always housed in facilities with special flooring, power, and cooling requirements. Data centres and portability are anathema to each other. When I heard the story again in January 2007, and got a chance to scratch beneath the surface of the programme, it dawned on me that there might just be something to it.

Blackbox opened up

Sun Microsystems describes Blackbox as the “first virtualised data centre”. In essence Blackbox begins life as a 20 foot shipping container. Sun Microsystems then adds external connectivity for water, power, and networking. The unit is water-tight and insulated when closed, meaning that it can be housed outside in some very inhospitable environments. On one side are racks of servers, storage, and networking equipment, which slide in and out for easy access and maintenance. The Blackbox also has a central aisle or corridor, for operator access, although it is really designed to have minimum operator intervention. In terms of computing equipment inside Blackbox, this can be up to:

- 250 x 64 processors, with 1,000 cores
- 250 SunFire T1000 servers with 2,000 cores and 8,000 threads
- 1.5 petabytes of disk storage or 2 petabytes of tape storage
- 7 terabytes of memory.

This is an enormous amount of computing power. In a standard business environment it would be enough to support 10,000 simultaneous desktop users. In a super-computing environment a

properly specified and built Blackbox would be in the top-200 chart of the fastest machines globally.

A customer ordering a Blackbox tells Sun Microsystems the combination of hardware and when it is delivered the Blackbox is simply connected to the power, cooling, and network utilities and then switched on – in a matter of minutes, compared with the days or weeks or more that data centre build and provisioning of this magnitude would traditionally take.

Blackbox economics

There are several reasons why Blackbox introduces different economics into data centre operations:

1. Thermal matters

Servers are typically designed to cope with heat – lots of it. At the top of a standard computing rack the temperature can be as high as 70C. At this temperature the components in a standard home computer would soon fail. To cope with this components for industrial-class servers to be used in data centres are built with higher thermal tolerance – and cost much more than standard components. When, as Blackbox does, there is a guaranteed cooler thermal regime, lower cost components (up to 1/3 of the price) can be used in the servers.

2. Environment matters

A significant proportion of data centre costs are for factors outside of the servers themselves: property, power and cooling being among the highest. Over the life of a data centre these other costs will exceed 80% of the total cost, when looking at a combination of capital and operating costs. Blackbox reduces the initial outlay in data centre construction by as much as 90%. The power-saving and cooling facilities in Blackbox mean it offers more computing power per square foot and per watt than traditional data centre fabrics.

3. Virtualization

Virtualization is a key design criterion



David Mitchell
Practice Leader, Software

for Blackbox. It allows equipment to be provisioned very flexibly, as business requirements change.

4. Failure

Computer components and the systems that they are built into fail – fact. With Blackbox, failed components are simply de-provisioned rather than the unit being opened up and the components being physical replaced. This can dramatically reduce costs for maintenance and operation. When a threshold volume of units in the entire Blackbox has failed then a new Blackbox is brought to the customer site, and the old Blackbox taken in for refurbishment or recycling.

Implications of an economic change

Geographically isolated locations, such as rural locations or aboard oil production platforms, could not previously have been considered as viable data centre locations – the cost of building and operating them would have been too high. Similarly, a roof-top location in a crowded inner-city district could never have hosted a data centre. With Blackbox there is an ability to locate data centre operations much more flexibly, in the search for a location with optimum power and real estate costs.

When data centre economics change so do the opportunities for outsourcing providers and system integrators. The exact nature of the new opportunities that the new economics brings is not yet clear, though there are some intriguing clues. However, what is clear is that anyone currently running a business that is directly or indirectly related to data centre operations had better begin to look at the impact for them. ■

THE ROLE OF BUSINESS CONSULTANCY IN IT SERVICES

By Georgina O'Toole and Phil Codling

There's a renewed drive among IT services companies to grow consulting capabilities. We're not just talking about Accenture's high profile campaign to double its consulting headcount worldwide. Firms across the industry tell us how they are boosting their consulting force. CSC is adding 20-30 consultants each month in the UK, for example. Fujitsu Services UK says it wants to grow its business consulting headcount from 3% of the workforce today to around 5%.

Consultants in demand

IT services firms want consultants – and in particular business-centric consultants, as opposed to IT specialists – for a number of reasons. Not least, they see in the current, (relatively buoyant) spending environment an opportunity to employ consultants in order to sell and deliver projects that cater to customers' demands for greater value creation and

spoken to a wide range of suppliers and customers.

Co-operation is vital

One clear conclusion is the importance of avoiding a go-it-alone strategy in a business consulting organisation that is part of an IT services player. This is for two reasons. Firstly, business consultancy must be well-aligned with the rest of the organisation in order for clients to see and experience the benefits of working with a business that has an end-to-end offering. Secondly, too much pure consulting work can create an 'us and them' culture. Indeed, we believe that 'pure' consultancy must be a means rather than an end for IT services companies. Consulting should drive profitable growth, either directly or indirectly, for the whole of the company, not just for the consulting operations.

We would not suggest that consulting teams must be merged

"Value-added outsourcing is not possible without business consultancy if any kind of transformation is required." – LogicaCMG

business change in IT services deals. Such deals have, thankfully, returned to parts of the market in the past two years. By extension, upping consultancy capability is also a key strand in strategies to fend off two growing threats: the offshore providers (who currently lack consulting capability, despite their own hiring drives) and the commoditisation of portions of the IT infrastructure and applications services markets.

The stakes are therefore high, and the ability to make consulting work for the good of the overall business will, we believe, be a key determinant of success in the IT services industry in the coming times. We have therefore investigated this area in some detail in recent months, and have

into the rest of the business. Some degree of separation – at least organisationally, if not necessarily through a distinct brand – is important in order for a distinct culture to be fostered in the consulting group. This serves to motivate consultants and reduce attrition rates – an important consideration given the current widespread poaching. The key is that such distinctness must not translate into separation from the rest of the business.

To help ensure cross-company co-operation, there is no reason why consultants shouldn't be rewarded for generating pass-through revenues, as long as the IT services organisation is open and honest with the client and the reward system reflects client satisfaction.

View from a large pharmaceutical client

One senior project leader told us that he "did not feel exploited" when the business consulting arm recommends work for its systems integration arm. From experience, he trusts the business consulting arm to be honest about whether its SI colleagues are capable of a job. This is reinforced by the fact that, on some occasions, the consultancy has recommended outside suppliers.

Such cross-selling raises the thorny question of neutrality. Standalone consultancies have long argued that their lack of IT project and outsourcing arms makes them more trustworthy advisors than "captive" consultants that sit within IT services companies.

Integrity rather than neutrality

The reality is that IT services firms cannot claim to be 100% neutral, but neither do their clients expect them to be. Clients are, we believe, mature enough simply to demand honesty from the provider about its desire to cross-sell other services. And while we believe that suppliers should be open about their consultants' reporting lines and consultant remuneration schemes, more important to the client will be how well the business consultancy organisation is aligned with the rest of the business so that it benefits as much as possible from choosing to go to an IT services firm for its business advice. Otherwise, why not go to a pure play consultancy?

To access our report *Business consultancy in IT services: strategies for success* visit ovum.com. Alternatively, contact Suzana Murshid (Suzana.murshid@ovum.com or call 020 7551 9071). ■

A LITTLE EASTERN WISDOM: "GYAAN BAATNE SE BADTHA HAI"

This Hindu proverb translates simply as "Wisdom increases when it is shared"; it was passed on to me by someone who works in the infrastructure services division of a major Indian outsourcer.

To me, this proverb highlights the importance that collaboration is set to play in the next evolution of the services industry.

In industry, the early part of the 20th century was characterised by the notion of vertical integration. The biggest industrial corporations sought to control the entire supply chain, and in some cases went so far as to own most, if not all, of its components.

Henry Ford generated his own electricity, acquired steel mills and iron ore mines and sought to tie together all of the processes in order to gain the benefits of integration and economy of scale.

In the latter part of the 20th century the reverse started to become true – management thinking from the 1960's onwards drove companies to focus on their core competences in a shift that heralded the birth of the outsourcing industry.

At the close of the century, it was well understood that many of the things that organisations traditionally regarded as "core" could be easily put into the hands of third parties – logistics, for example, fell into the hands of players like Fedex and UPS, payroll into the hands of a plethora of third-party specialists, and the cheque processing market is now dominated by non-banking players like Unisys.

This model is alive and well, but it does have its drawbacks. The principal one is inflexibility. Inflexibility can be a virtue,

especially when applied to utility processes; taking electricity supply as an example, "inflexibility" brings lower cost and more reliable supply. The fact that most electricity consumers cannot ask for a different voltage from their electricity supplier is hardly an inconvenience after all.

But the potential for outsourcing moves way beyond non-differentiating or "utility processes" like payroll or logistics; outsourcers are pushing the "innovation" mantra as a means to allay some of the fears of clients that an outsourcing decision is effectively an acceptance that the activity that is being outsourced is no longer differentiating.

Collaboration is key

It is possible to develop outsourcing contracts that deliver differentiation. But the key isn't simply "innovation" it lies in the way client, outsourcers and the other third parties involved in delivering the service work together.

Collaboration requires more than a "logo swap" between partners. Even a commitment to train your consultants on a given partner's technology doesn't create a collaborative partnership. Collaboration requires more – more intimacy, more trust, more commitment and more investment in maintaining the relationship.

Collaboration only works on the basis that everyone gets a share of the fruits of their efforts. It only works if the right framework is in place to manage the ancillary issues that arise when you get multiple partners into a room together – how do you manage disagreements? How do you manage the intellectual property that is jointly created by participants?



Gary Barnett
Research Director

Innovation may be the marketing focus, but collaboration is how it happens. No single vendor can monopolise innovation. Even vendors like IBM, Microsoft, Sun and HP – who together spend over \$10 billion a year on research and development aren't big enough to innovate on their own.

When I last toured the Asia Pacific region, one thing shone out – the confidence of many Asian technology companies that their ability to collaborate would deliver levels of innovation that could eclipse the efforts of many much larger technology companies. As one of my clients pointed out – "Not too long ago, if you went into the design labs at Ford Motor company, you would see only Ford employees. If you then went to the design labs of Toyota, you'd notice that nearly half of the people there are from other companies – like Bosch or Motorola". The financial success of Toyota, compared to that of Ford would seem to be a strong indicator that collaboration is a pretty important skill to acquire. Ford's engineers are among the best in the world and are certainly no less "smart" or hard working than their Japanese counterparts; the key lies in the two differing approaches to collaboration – and it serves to define one of the biggest challenges that the services industry faces today.

The average Toyota engineer isn't necessarily smarter than his opposite number at Ford, but he or she does benefit as a result of working within a company that believes that wisdom grows as a result of being shared. ■

WEB 2.0 SECURITY CHALLENGES

A survey of 60 senior executives in the financial sector, conducted by Conchango, revealed that all of them are planning to implement at least one Web 2.0 function within the next year, and that their major concern is the risk to their brand image. Web 2.0 is more of a concept than a technology and the associated security requirements are not well developed.

What is Web 2.0?

Ovum defines Web 2.0 as a phase in the evolution of the Internet. It is a collection of new social models that has emerged on the Web, along with associated technologies. You cannot buy a 'Web 2.0', although you can buy the technological parts. It positions the Web as a platform, a source of content and services that can be used to create new content and services through a process of 'mix and match'. Web 2.0 will embrace rich Internet/interactive applications (RIAs) in which presentation is largely decoupled from the underlying content.

The intended paradigm is that a Web 2.0 user makes a request to a web server, which responds by returning a page containing scripts. The user then uses the local AJAX engine to interact with the page. In this way, the interaction between the user and the web server is much looser than in the conventional browser/server interaction model.

How will it work out?

Web 2.0 is primarily about collaborative working. It will no doubt strike a resonant chord in some of the more creative spheres of activity, but its application in the world of mainstream business processes is less clear. It could come to be a useful tool in marketing and perhaps in other aspects of business, but only if business

models become more flexible. It will take time to discover how to use it to generate business value in transaction-centric business processes. The RIA aspects of Web 2.0 are likely to be at the forefront of early exploitation of the concept because businesses will readily identify these as a means of reaching a wider market. However, even the RIA aspects will require a more comprehensive and possibly cheaper form of Internet connectivity to reach their full potential.

Security and Web 2.0

It can be seen from this discussion that we need a more specific proposition before we can evaluate the security requirements. AJAX, as a key component technology, is going to be an important focus of Web 2.0 security, but everything needs to be examined in the context of the processes that are being performed on the Web 2.0 platform and whatever security has been built into the inherent fabric of the processes.

The overall focus of security thinking should be risk containment. There is no way that risk can be eliminated without imposing a complete ban on the technology. At this stage we have to assume that the potential business benefits of Web 2.0 justify its deployment.

Securing the components of Web 2.0

Securing the infrastructure involves filtering XML messages to block any malformed messages and securing each of the following platforms:

Clients

There is a need to protect against exploitation of flaws in the JavaScript engine that could be used to mine confidential information held on the platform using malware scripts. Cross-site



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references might also be forged.

The remedies include:

- ensuring that incoming data streams have been validated by the server sending them
- validating the structure of incoming traffic against the anticipated schema
- verifying the integrity of the code running on the browser.

Servers

Server hardening and filtering of outgoing information are strongly recommended to minimise the risks of information leakage. Runtime parameter attacks and XML-based 'denial of service' attacks are the main threats. As well as parameter validation, enterprises should authenticate users, control access to authenticated users, and audit their actions. They should provide secure channels between servers and clients to prevent insertion attacks.

Aggregation servers

The main risk here is the poisoning of the aggregated information base by malicious input. This is the most important risk relating to brand degradation. The problem is much increased in the Web 2.0 environment because the aggregation server operator does not generally have control over the sources of incoming data. The remedy lies in authenticating access to the aggregation server and filtering content coming in to ensure that it is consistent with corporate policies – in so far as this is possible. Particular care should be taken with embedded scripts, which should be closely analysed before allowing them to run on the server. ■

MARKET FORCES AND REGULATION

As the EU ponders several new IT and telecoms initiatives that are likely to shift the balance between regulation and market forces in favour of more regulation, we look at the role of regulation in business continuity and information security. A successful strategy has to blend regulation, market forces and technology. None of these three approaches will work without the other two. We argue for a holistic view of the issues.

Regulation can't deliver information security

Regulations aren't a panacea for ills that are driven by greed, criminality and human weakness. If it was possible to legislate crime into oblivion it would have been done years ago. The notion that regulations can deliver perfect behaviour pre-assumes, falsely, that we already have an ideal model to follow, and that this model is sufficiently static to be converted into regulations. Neither of these suppositions are true.

Technology won't lead to a solution

Technological advance requires an environment in which there is a commercial imperative to drive it forward. Thus regulation and market forces have to power its advance. Technology has a role to play, but it will not be deployed or funded without business imperatives. These imperatives come from economic, legislative and psychological pressures.

Market forces won't deliver the objectives

Market forces have not, and will not deliver either security or business continuity by themselves. Today we see the situation deteriorating, not improving.

Several reasons for the failure of market forces in this area:

Market forces only work once outcomes have been assigned a value. Decision makers are limited by lack of knowledge about the values of the factors that enter into their deliberations.

The cost of an incident is not born by the decision maker. Often the cost of avoiding risk falls on one party, whereas the costs resulting from an incident fall on a different party. For example an organisation decides how much to spend on protecting personal data that it holds, but the costs of identity theft will be born by the data subjects.

The objective of maximising the overall good requires that the consequences of any decision should be born by the person making the decision. This can be achieved either through placing a legal liability on the decision maker to compensate victims, or by regulations. The first option more closely aligns actions with maximising economic outcomes, but the associated legal processes can be costly.

Sometimes it is necessary to go further and place the onus for action on the party that is in a position to act, even if the loss is not the result of their action. For example the law limiting the liability of a credit card holder to a small part of the loss due to the misuse of their credit card by a third party has encouraged the credit card industry to create sophisticated defences against card fraud. It has helped to enhance the health of the overall card payment sector of the economy. The industry has benefited from increased customer confidence.

Many organisations simply take a chance, either because the calculation is too hard to quantify the factors or because they resent



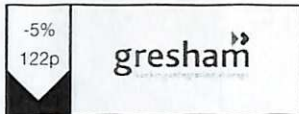
Graham Titterington
Principal Analyst

paying for elaborate protection for something that is unlikely to be used. This makes it difficult to justify adequate business continuity provision.

The main market mechanism for punishing an organisation that suffers a security or business continuity failure is brand degradation. However, there is very little science behind quantification of this factor, and there is anecdotal evidence suggesting that the damage done to a brand is diminishing as stories of information security failures become more commonplace.

Moving forward

We have to align the costs of decisions more closely with the consequences of these decisions if we are to improve the security situation. We also have to place the burden of security on those who are in a position to do something to mitigate a threat, and who profit from the associated economic activity, even if they are not responsible for creating the risk. These aims can be achieved through legal liability to the victims or through regulation to the state, but not through unfettered market mechanisms. Technology is the tool for delivering security but it is not a driver. Security policy and security decisions must take full account of the economic framework in which the players operate, and the psychological outlook of the players. Finally we must remember that this is not an exact science and that much of the data required by our economic models simply does not exist in this domain. ■



GRESHAM NARROWS LOSSES

Storage and financial solutions specialist Gresham Computing has increased its revenue by 4% to £14.5m for the year to December 2006. Its trading operating loss reduced to £530k from £1.4m in 2005, and its net loss reduced to £374k from £1.1m in 2005. Cash inflow from operations was £2.7m compared to a cash outflow of £1.8m the previous year.

This is a fairly modest increase in Gresham's fortunes compared to what we're seeing in the market overall and from other vendors, especially companies that offer

on-line hosted services, which also form part of Gresham's portfolio. What seems to be happening is its storage solutions business is shrinking (it fell by 15% to £2.70m) while the Real Time Financial Solutions grew 9% to £11.8m.

We cannot be too surprised at the fall in storage solutions - there's no lack in major league competition in this sector from the likes of EMC. So Gresham just has to rack up higher growth from its financial sector business to make up the difference. It has spent some of its

energies re-branding its product suite under the new brand name, 'Clareti'.

It has also taken on responsibility for the on-line cash reporting service (now called Clareti Cash Reporting Service, or CCRS) from its hosting partner Cable & Wireless. Gresham is extending the service so that it covers both cash reporting and payables financing in a single online service. Gresham's hosting partner, Cable and Wireless, is also the first customer for the combined service.

(David Bradshaw)



SAPIENT RIDES THE CYCLE WITH HIGH GROWTH IN 2006

Web-oriented integrator Sapient announced its Q4 and full-year 2006 results in mid-March. They revealed 37% revenue growth in Q4 and 29% growth in 2006 as a whole to \$406m. An 82% drop in operating profits meant the 2006 operating margin was just 1.2%, compared to 8.9% in 2005.

These results have a "preliminary and subject to change" tag on them, since US-based Sapient is still reviewing the effect of its stock compensation schemes on past performance. Such lingering uncertainty isn't helpful to the business, but it's probably less of a problem for a projects business like Sapient than, for example, an outsourcer asking customers to commit to longer-term relationships. Moreover, investors continue to take a positive view on the company's future and appear not to be unduly phased by statements such as "all financial statements relating to periods beginning January 1, 1997, should

not be relied upon", as found in its Q4 results release.

If investors are prepared to forgive Sapient not only the doubts over its financial statements but also a sag in profitability in 2006, that's probably because it is delivering growth. Indeed it appears that Sapient is one business riding the growth agenda in IT services to its advantage. As businesses turn back to investments in IT and the web as a source of business differentiation and growth, its web-oriented consulting and implementation services (particularly in such hot spots as CRM, business intelligence and online commerce/marketing) are clearly feeling the benefit.

One area not growing so well is government business, which fell by 35% in the year. Admittedly, this is only 3% of revenue, but it concurs with our view that projects in government - outside the larger mega-deals - are becoming harder

to find. We think, however, that Sapient is right not to give up in the government market, not least because this sector can potentially provide a useful counter-cyclical revenue stream to balance its operations in the private sector, many of which are subject to the vagaries of the economic cycle. Indeed, the company's key emerging growth engine of services combining marketing and web technology - which it markets under the "Sapient Experience Marketing (EM)" sub-brand - is especially prone to any downturn. With the US economy in particular looking like it could take a turn for the worse in 2007, the economic cycle in the near future may not play to Sapient's advantage. That's not just a potential threat in the EM business, but also more generally across the company's core project services. The broader growth agenda in IT, which has benefited so many players in the past 18 months, is also cyclical in nature.

(Phil Codling)



NETSTORE GROWS 24% IN BUOYANT MARKET

Netstore, the managed services and security services player, has grown revenue by 24% to £20m in the six months ended 31 December 2006. Operating profit (before amortisation, share option charges, restructuring costs) was flat at £1.4m. Including all these charges, operating losses reduced by £1.3m to £332k for the period. Cash inflow increased to £3.5m for the period, as compared to £0.6m last year.

Like others in associated markets (Group NBT and IX Europe, for example) Netstore is benefiting from a strong demand for managed hosted services in the mid-market. Continued growth in online commerce means that more and more smaller public and private

sector organisations are reliant on the web to serve their clients - as well as collaborate internally. And as they become more comfortable with how web-based applications fit into their business, they are increasingly keen to outsource the associated management and hosting. After all, web hosting is hardly a core skill set of the average business, and suppliers such as Netstore can provide contracted levels of availability and can enable easier scalability.

While riding this buoyant market, Netstore is also investing in its future. It acquired two companies last year, and still has its eyes on support and business continuity provider ICM Computer, which is still up for offer. Netstore has also

been investing in sales capacity to take advantage of the buoyant market, and also to target more public sector work now that it has established itself as part of the Catalist-accredited Hedra Consortium. The result is that margins have fallen to 7% from 8.7%. But we think that this is a small price to pay considering that this should support growth in the second half and beyond. That said, we would like to see more evidence that Netstore is successfully cross-selling its IT security services into its hosting services client base. Proving that it can crossover services like this will make us feel a lot more comfortable about Netstore's potential future acquisitions.

(Samad Masood)



K3 REPORTS YEAR OF GROWTH THANKS TO RETAIL BUSINESS

Supplier of Microsoft-based software and solutions to the manufacturing and retail markets, K3 Business Technology Group, has reported its 2006 results. Revenue was up 24% to £27.3m, with the vast majority of growth being organic. Operating profit (before amortisation of goodwill) was up 26% at £3.0m, making an operating margin of 10.8% (2005: 10.7%). Loss per share (including £2.2m of goodwill amortisation and an £800k tax charge) was 1.7p (2005: loss per share of 1.8p).

The main growth story is to be found in K3's other vertical focus, retail (which turned in 30% organic revenue growth to £16.4m, with 18 new contract wins). The company appears to be benefiting from its focus on Microsoft solutions in the mid-market, following the software giant's renewed push into

this customer segment under the "Dynamics" banner. Focusing both the solution set and the customer base makes sense for a business of K3's size.

Talking to CEO Andy Makeham, he explained how K3 is increasingly able to focus in on niches of the retail space. This detailed verticalisation strategy appears to be helping the business's sales and marketing efforts, while also enabling it to develop product templates for groups of customers with similar needs. That's a smart way of countering the productisation strategies of larger services players, many of which will struggle to get down to such niche levels of granularity.

K3 may also be benefiting from the "Torex effect". With such a large consolidator in retail IT in

deep trouble, opportunities to acquire both customers and skilled personnel are opening up for K3 and others in the sector. Makeham tells us, nonetheless, that hiring staff to fulfil demand in the retail space is a challenge. No wonder the firm is running a graduate "academy" (with up to 10 software/consulting apprentices at any one time). For a player of its size - 134 staff in total at the last count - that's a significant commitment to onshore training and development. Meanwhile, we wouldn't be too surprised to see K3 boost its capacity with retail sector acquisitions, helped by the cash from the Elucid sale. All in all, while its manufacturing business looks set for a steady but unexciting 2007, the emphasis on growth and verticalisation in retail should continue to drive market share gains for K3.

(Phil Codling)



MORSE LOOKS TO PUSH PROFITS UP FURTHER

We recently attended a briefing with Morse management and learnt more about how the company has been performing and where future challenges lie. As a brief reminder, Morse is now two separate operating businesses: Morse Consulting and Monitise. These businesses are completely separate and the indications are that they will be made even more separate - though management are not yet revealing quite what that might involve.

The consulting business is still a work in progress. Its capabilities here span management consulting, applications consulting and infrastructure consulting, with a focus on advising customers on issues such as organisational change impact and sourcing, and then executing on that. It's been a difficult six months for the

applications business in particular, but we understand things are stabilising. The infrastructure consulting business has witnessed a real improvement in margins having offloaded a lot of the lower-value resale business.

Morse is now verticalising the consulting piece around financial services, media comms, commercial and public sector. Financial services has a massive head-start; the challenges will be in building up business in the other sectors. In public sector, for example, Morse already has some business here thanks to its Wisdom product, but will look to build on this with relatively small £3m-£4m deals.

Looking at what Morse has done over the past year, there is no doubting the progress.

The consulting business is now organised around a clearer set of capabilities, ending the reign of multiple brands that existed before. Margins have improved (and are expected to improve further), and work has begun to grow business within clearly-defined vertical businesses.

We do, however, want to see more evidence of performance improvement across all consulting areas. Yes we've seen a good improvement in margins from 4.1% to 6.1% as more lower-margin (resale) business has been taken out of the equation. But what we're interested in is how well Morse can continue to improve profits not by taking away, but by adding. In other words, by selling increased amounts of higher-value services to customers.

(Kate Hanaghan)



EG SOLUTIONS CLOSES A TOUGH YEAR

EG Solutions, a provider of software and services for improving operational management, recently announced its results for the twelve months to end January 2007. Turnover declined from £5.8m to £5.4m in the year. Operating profit was wiped out (£738k last year) to become a £402k loss. Fully diluted EPS moved from 4.3p to a loss per share of 1.3p.

Unfortunately, EG did exactly what we warned against six months ago. As we said at the time, "EG needs to pace itself. It shouldn't grow too quickly, and should also be careful to protect its profits while it's making investments into new areas". Simply put, CEO Elizabeth Gooch says, "We tried to do too much". So where was the specific problem? In a way, EG committed

one of its own cardinal sins; before a large engagement (worth c£1m) EG has always run a pilot project - which has enabled it to be sure the 'real thing' will indeed go ahead. On two occasions the company failed to run a pilot (partly due to customer pressure) and went straight for the deal. Unfortunately, on two deals the business did not come through at expected levels.

We spoke to Gooch, and we think a real lesson has been learned here - the key one being the company must always do a pilot project before heading straight into a large contract. Gooch believes that although mistakes were made, she has the right team on-board.

But we'd also mention a couple of positive things. New sector

penetration is working well, with notable contract signings in general insurance. The company has also reduced costs by £1m and has doubled investment in R&D. EG's recovery will not happen overnight - indeed it's going to be a number of months before it even starts to get back on track.

It's a tough old world out there - and can be even tougher if you're a relative minnow. Mistakes can cost you dearly and can be easy to make when you're eager to crack on with signing bigger and better deals. The warning to SME S/ITS companies is always be completely sure you're not taking on too much. Better to move at a slower, steadier pace than risk taking your eye off the ball.

(Kate Hanaghan)



BOND INTERNATIONAL BOOSTS BOTH PROFITS AND REVENUE

For the full year to December 2006, recruitment and HR software vendor Bond International increased its revenue by 26% to £17.2m. At the same time, it increased its operating profit by 43% to £3.6m and its net profit by 59% to £3.0m. Operating margin for the year was 20.8%, up from 18.4% last year, and up on the interim margin of 20.3%. Cash from operating activities was £5.6m, up 68% on the previous year.

Looking at revenue by destination, revenue from the UK was £8.7m, up 18%, while revenue from the Americas was £7.2m, up 48%.

Revenue from Asia-Pacific rose 21% to £753k and Africa rose by 89% to £109k, but revenue from mainland Europe fell 38% to £753k.

Building on a successful first half, this is an excellent and encouraging performance from a relatively small software company. It shows that you don't have to be a billion dollar company to get your operating margin over 20%! To be fair, the company has been helped by its relationship with customer Manpower, which is an \$18 billion company, but that five-year \$12m deal alone would have not been enough to

produce this performance.

We trust that the Bond's recent acquisitions of Gowi Group (in December) and Strictly Education (in February) will contribute to the continued success of the company. Bond has paid a total of £11.6m for these companies (including £3.5m in shares). Its intention is to sell these companies' products and services into Bond's existing customer base and vice versa. As we said when it announced the acquisition of Strictly Education, Bond will have to stay focused on the cost of delivery as well as revenue growth.

(David Bradshaw)



GETRONICS ENDS 2006 UNDER PRESSURE

Dutch IT services company, Getronics, recently announced its full year results to end December 2006. Revenue from continuing operations (i.e. excluding disposals, such as the Italian operation) was euro2.6 bn, up 4.0%. Organic revenue growth on a comparable basis (i.e. comparing the combined PinkRoccade and Getronics businesses in 2006 versus 2005) was less than 1%. Services revenue increased by 7% to euro2.2bn (organic services revenue growth on a comparable basis was 2.3% in 2006).

EBITA margin before exceptional items was 4.5%, compared with 5.7% in the previous year. The company registered a net loss of euro145m versus a profit of euro4m in the previous year. It will no longer issue revenue targets and wants industry watchers to focus instead on profit performance.

The media is reporting that the

Dutch market watchdog may investigate Getronics following suggestions that CEO Klaas Wagenaar knew about the losses incurred within the (now sold) Italian business some time before the market was informed.

We are not going to comment on the issue around the Italian unit at this point. Needless to say, these negative reports just add to the pressure Wagenaar and team are under. The financial results show that the company faces a clear challenge around profitability. It's aiming for an operating margin of between 4.0% and 4.5% (excluding acquisition costs and other one-off gains) and a net profit in 2007. Work to improve its nearshore and offshore capabilities (where a lot of the investment and groundwork has been completed) should help to contribute towards this, but Getronics faces a more general challenge of trying to increase the

level of higher-margin services work it does.

We would, however, point out a couple of positives going on beneath the surface. For example, Wagenaar says the company has a "good quality pipeline" and that it managed to attract many good quality new hires to the business in 2006. In the UK - which had a worse-than-expected first half but recovered in H2 - there has been notable progress on the large Barclays deal. Getronics says it is the third supplier (previously the contract was held by EDS) to attempt to transform the architecture at the bank. It now claims to have completed this project - an important milestone given how significant (strategically and financially) the contract is to it. For the group as a whole, the company is predicting improved revenue growth in the current year.

(Kate Hanaghan)

Mergers and Acquisitions – March 2007

Buyer	Datatec
Seller	NOXS
Seller Description	European security products distributor
Acquiring	100%
Price	£35.96m
Comment	NOXS has offices in France, Belgium, The Netherlands, Germany, the United Kingdom, Ireland and Italy. NOXS' primary vendors include Juniper Networks, Checkpoint Systems, Trend Micro, Nokia and McAfee and generated over \$220 million of revenue in the year ended 31 December 2006, considerably more than Westcon's comparable revenues from security-related products in Europe. Its EBITDA and EBIT for the year to 31 December 2006 were approximately \$9.3 million and \$8.4 million respectively. The net tangible assets being acquired are approximately \$45 million as at 31 December 2006. The business is being acquired on a debt/cash free basis.
Buyer	HgCapital
Seller	CSG
Seller Description	Consolidator of niche software firms (13 acquisitions since 2003)
Acquiring	100%
Price	£99.6m
Comment	The general trend we've seen in recent months is the increased interest by private equity firms in the software and IT services sector. Of course, the other very interesting element is the fact that this is a management buy-out. We have thus far seen CSG (as a public company) pursue a successful strategy focused on acquiring firms within its chosen focus areas. It's also done a very good job of integrating acquisitions, demonstrated by good organic growth (and margins) achieved through strong cross-selling. So why, if things have gone so well, would management want to get HgCapital involved at this point? The answer is ambition. The team behind CSG are looking to create a much larger organisation. This will require it to perhaps make some very large acquisitions involving a large degree of financial investment and management time. And, often it makes better sense to make this kind of transformation out of the public eye. To this end, we think it makes perfect sense to take the company private.
Buyer	K3
Seller	McGuffie Brunton
Seller Description	Supplies and supports SYSPRO range of Microsoft ERP software
Acquiring	100%
Price	£12.5m (£10m in cash, £2.5m in shares)
Comment	On the face of it, 2x revenues (or 1.8x if we factor in the £1.3m of cash in the acquired business) looks a high price for a distribution and maintenance firm, especially when you consider that McGuffie Brunton is only showing underlying revenue growth of about 5%. Nonetheless, we can see good justification for the move. Most importantly, McGuffie Brunton appears to be a great fit with IEG, the SYSPRO-led firm that K3 acquired in 2005. Indeed, IEG and McGuffie Brunton were essentially the two key independent players in UK SYSPRO distribution. The acquisition thus cements K3's position in this market. However, it's helpful for K3 that the two firms are complementary and in fact tend not to compete head-to-head. That's because IEG has tended to focus on larger, consulting-led deals, while McGuffie Brunton employs a telesales and marketing-heavy approach, which means it focuses on smaller deals.
Buyer	Kewill Systems
Seller	Innovate IT Holding
Seller Description	Dutch software company focused on after-sales services management
Acquiring	100%
Price	£5.65m in cash, and £1.37m in shares
Comment	Innovate IT has operations in Europe, North America and Asia-Pacific. Customers include OEM's like HP, Palm, US Robotics and logistics service providers such as DHL. In most cases Innovate IT host the SLS software on behalf of its customers using a Software as a Service (SaaS) business model. In the financial year ended 31 December 2006, Innovate IT generated revenues of £4.6m, making an audited profit before tax of £206K.

Mergers and Acquisitions – March 2007

Buyer	MBO from Sesame
Seller	Misys
Seller Description	Software and solutions provider
Acquiring	-
Price	Undisclosed
Comment	In a complex 'strategy' statement issued in March, Misys announced that it had sold a majority stake in Sesame, its IFA business, to Sesame's staff. The former regime at Misys had spent years failing to deal with problems with the company, while dismissing any suggestions that radical changes were needed. Its conspicuous failure to sell itself in a market awash with VC funds spoke volumes for the state that the company had got into, but at least forced a regime change. Turning Misys back into a vibrant, expanding company will take time. Misys CEO Mike Lawrie acknowledged the scale of the task when he declared, "There is no quick fix and the turnaround process will take 3-5 years."
Buyer	Oracle
Seller	Hyperion
Seller Description	Provider of enterprise performance management and BI software
Acquiring	100%
Price	\$3.3bn
Comment	<p>Adding Hyperion significantly strengthens the Oracle Business Intelligence (BI) product family and the addition of Hyperion's sales team will add domain-specific BI sales capabilities that will also be of value.</p> <p>Among the large scale BI providers that Oracle could have considered purchasing were Business Objects, Cognos, Hyperion and SAS. From this list Hyperion is the best fit for Oracle, on a number of fronts - product, customer, and organisational culture among them. Hyperion is also widely used among the SAP user community, giving Oracle a potential opportunity to try to unseat SAP. In reality, though, a change of ERP backbone is a major undertaking that customers will need very substantial persuasion to even consider taking on. Where the Hyperion deal may have more impact is on the future uptake of the NetWeaver platform.</p> <p>On a broader note, in five years the BI market will simply not look the same as the market of today - there will be fewer big BI companies, and small innovative BI companies will be looking for trade-sale exit rather than conquering the markets themselves.</p>
Buyer	Proactis Holding
Seller	Alito UK
Seller Description	e-procurement software solutions company
Acquiring	100%
Price	£1.5m in cash
Comment	<p>Wales-based Alito provides services to a number of public sector customers, totalling 40+ local authorities, including 22 Yorkshire and Humberside authorities. For the year ended to 28 March 2007, the unaudited accounts of Alito had a turnover of £1.0m on which it made an operating profit of £0.15million.</p> <p>All Alito's existing employees and members of the management team are transferring to PROACTIS. This includes Alito's founders, Gareth Kempson and Nicholas Lloyd James.</p>
Buyer	Revenue Assurance Services
Seller	Utility Management Services
Seller Description	IT services supplier
Acquiring	100%
Price	Undisclosed
Comment	UMS is a growing supplier of Meter Point Services to the UK Utility industry, including the UK energy and water utilities. The business was established in 2003, based in Warrington and has been purchased from the founders who will continue to manage the business.

UK software and IT services share prices and market capitalisation - March 2007									
	SCS	Share Price	Capitalisation	Historic	PSR	S/ITS	Share price	Share price	Capitalisation
	Cat.	30-Mar-07	30-Mar-07	P/E	Ratio	Index	move since	% move	move since
					Cap./Rev.	30-Mar-07	28-Feb-07	in 2007	28-Feb-07
@UK plc	SP	0.15	5.45	NA	3.75	221.37	45%	-19%	£1.69m
Alphameric	SP	0.50	65.97	17.8	1.00	228.21	-1%	4%	-£0.66m
Alterian	SP	1.56	65.75	47.9	6.19	780.00	17%	37%	£9.48m
Anite Group	CS	0.82	289.39	81.0	1.53	480.99	1%	1%	£3.57m
Ascribe	SP	0.58	65.74	NA	12.29	3,026.32	26%	47%	£13.73m
Atelis plc	SP	0.06	1.44	NA	NA	267.44	0%	-15%	£0.00m
Atlantic Global	SP	0.16	3.55	68.3	1.66	525.42	-6%	15%	-£0.23m
Autonomy Corporation	SP	6.85	1296.79	64.3	10.11	209.10	11%	34%	£243.02m
Aveva Group	SP	8.21	553.05	68.0	8.39	4,105.00	-6%	1%	-£36.29m
Axon Group	CS	6.48	381.16	26.3	2.77	3,702.86	-3%	6%	-£12.94m
Bond International	SP	2.08	62.82	27.5	3.65	3,200.00	15%	21%	£7.87m
Brady	SP	0.63	16.23	NA	6.67	777.78	11%	73%	£1.52m
Business Systems	CS	0.11	8.46	NA	0.24	92.44	2%	-12%	£0.19m
Capita Group	CS	6.83	4213.69	29.8	2.48	184,628.72	6%	13%	£219.21m
Centrom	CS	0.01	1.34	NA	0.21	166.67	-20%	-33%	-£0.57m
Charteris	CS	0.22	9.25	19.0	0.46	244.44	10%	38%	£0.65m
Chelford Group	CS	1.44	10.20	8.0	0.86	250.44	-3%	-14%	-£0.44m
Civica	CS	2.50	155.73	14.2	1.47	1,428.19	-8%	-9%	-£14.20m
Clarity Commerce	SP	0.54	10.87	NA	0.82	428.00	7%	0%	£0.71m
Clinical Computing	SP	0.07	2.05	NA	1.24	56.45	12%	0%	£0.08m
CODA Plc.	SP	1.95	150.10	NA	2.81	1,203.70	-6%	20%	-£9.81m
Compel Group	CS	1.49	50.42	22.6	0.80	1,192.00	30%	26%	£11.55m
Computacenter	R	2.79	444.83	22.2	0.20	416.42	2%	4%	£6.79m
Computer Software Group	SP	1.47	83.20	18.8	5.91	1,251.05	38%	21%	£18.39m
Cornwell Management Consultants	CS	0.17	2.99	2.3	0.17	122.08	3%	48%	£0.08m
Corpora	SP	0.05	6.83	NA	2.63	131.58	-14%	-11%	-£2.48m
Dealogic	SP	1.90	133.71	12.4	3.33	826.08	1%	21%	-£1.08m
Delcam	SP	4.30	26.55	13.4	1.11	1,653.85	4%	38%	£1.08m
Delica	CS	4.13	461.58	47.6	4.55	5,162.50	3%	13%	£6.14m
Dicom Group	R	2.28	198.63	27.8	0.95	698.96	-5%	-2%	-£12.80m
Dillistone Group	SP	1.30	7.02	NA	NA	952.38	-7%	-11%	-£0.54m
Dimension Data	R	0.50	773.94	37.9	0.56	88.81	4%	16%	£29.79m
DRS Data & Research	SP	0.37	12.01	NA	0.96	336.36	12%	0%	£0.58m
eg Solutions	SP	0.54	7.65	12.5	1.42	367.35	10%	-34%	£0.65m
ELCOM	CS	0.02	6.54	NA	18.88	400.00	0%	-52%	-£5.88m
Electronic Data Processing	SP	0.67	16.37	38.0	2.35	2,051.44	-1%	4%	-£0.24m
FDM Group	A	1.29	29.95	23.8	0.67	1,582.82	19%	38%	£4.76m
Ffastfill	SP	0.07	19.53	NA	7.37	56.25	-29%	13%	-£7.96m
Financial Objects	CS	0.70	31.09	24.4	1.56	304.35	5%	28%	£1.55m
Flomerics Group	SP	0.92	13.59	18.6	0.96	3,538.46	-3%	23%	-£0.38m
Focus Solutions Group	CS	0.55	15.97	40.9	2.94	279.49	20%	12%	£2.80m
GB Group	CS	0.41	33.77	NA	2.63	264.45	9%	-11%	£2.16m
Gladstone	SP	0.24	12.38	9.0	1.62	600.00	4%	-6%	£0.39m
Glotel	A	0.59	22.99	9.3	0.25	306.49	1%	-6%	£0.26m
Gresham Computing	CS	1.22	61.33	28.4	4.39	1,311.83	-5%	-18%	-£2.93m
Group NBT	CS	3.18	77.39	NA	9.21	1,587.50	29%	53%	£17.18m
Hamsard Group (Renamed Cantono	CS	0.06	16.81	-0.6	2.34	1,000.00	0%	0%	-£0.00m
Harvey Nash Group	A	0.75	47.05	14.9	0.23	428.57	-5%	3%	-£4.57m
Highams Systems Services	A	0.05	1.63	14.4	0.12	138.89	14%	8%	£0.24m
Horizon Technology	CS	0.77	54.11	18.0	0.28	284.10	13%	12%	-£1.63m
IBS OPENSsystems	CS	1.92	76.60	15.4	4.90	1,259.02	2%	5%	£1.60m
IS Solutions	CS	0.23	5.60	NA	1.02	857.10	48%	46%	£1.76m
ICM Computer Group	CS	4.47	95.38	28.5	1.26	2,481.94	35%	55%	£24.98m
IDOX	SP	0.08	16.11	NA	1.14	10.27	3%	25%	£0.98m
Imaginatik	SP	0.09	10.79	NA	7.70	1,088.24	-3%	9%	-£0.29m
In Technology	CS	0.39	54.97	NA	0.19	1,550.00	-1%	-10%	-£0.21m
InterQuest Group	A	1.43	41.26	NA	1.49	2,486.96	9%	63%	£3.59m
Innovation Group	SP	0.33	208.58	26.1	3.42	144.10	-4%	6%	-£11.15m
Intelligent Environments	SP	0.08	14.42	NA	4.62	85.11	7%	28%	£2.21m
Intercede Group	SP	0.55	18.68	NA	10.34	916.67	-3%	-8%	-£0.51m
Invu	SP	0.20	26.84	17.0	8.52	2,105.24	-5%	-33%	£0.60m
iSOFT Group	SP	0.47	109.27	NA	0.42	427.27	6%	-17%	£5.81m
iTrain	SP	0.02	1.82	9.6	0.99	23.53	-6%	-11%	£0.15m
IX Europe	CS	0.88	158.54	NA	4.25	2,885.25	19%	80%	£24.46m
K3 Business Technology	SP	1.26	22.27	12.2	0.82	962.72	6%	9%	-£0.92m
Kewill	SP	0.79	62.38	NA	2.34	1,561.26	5%	0%	£2.96m
Knowledge Technology Solutions	SP	0.01	3.82	NA	3.06	230.00	-34%	-29%	-£2.00m
LogicaCMG	CS	1.78	2734.02	26.7	1.02	2,437.68	5%	-4%	£130.56m
Lorien	A	0.67	12.39	27.9	0.08	665.00	30%	56%	£2.89m
Macro 4	SP	2.18	48.25	8.3	1.46	879.03	-8%	3%	-£4.21m

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Manpower Software	SP	0.56	25.04	NA	5.78	579.90	20%	116%	£4.14m
Maxima Holdings	CS	2.83	52.37	18.4	4.22	2,058.18	9%	23%	£4.63m
Mediasurface	SP	0.24	18.54	24.8	1.92	1,764.71	9%	41%	£1.55m
Micro Focus	SP	2.28	455.75	54.8	6.03	0.00	-5%	9%	-£26.39m
Microgen	CS	0.51	51.72	12.2	1.38	217.95	-4%	-6%	-£2.69m
Minorplanet Systems	SP	0.56	16.00	13.4	0.67	1,143.56	-1%	0%	-£0.29m
Misys	SP	2.39	1197.48	26.3	2.56	2,973.44	2%	11%	£27.79m
Mondas (Renamed Corero)	SP	0.20	7.47	NA	1.19	260.00	20%	34%	£1.67m
Morse	R	0.97	151.07	NA	0.41	386.00	-2%	-11%	-£2.96m
NCC Group	CS	3.16	102.90	23.1	4.96	1,892.22	2%	13%	£2.29m
Ncipher	SP	2.38	68.11	NA	3.92	952.00	-3%	-6%	-£0.24m
Netcall	SP	0.22	14.70	41.1	4.44	444.45	-9%	29%	-£1.32m
Netstore	CS	0.32	40.44	14.2	2.02	213.33	-10%	7%	-£4.21m
Networkers International	A	0.40	36.85	71.4	1.93	1,250.00	-1%	14%	-£0.46m
Northgate Information Solutions	CS	0.83	445.40	21.7	1.34	319.23	2%	-3%	£6.71m
NSB Retail Systems	SP	0.29	120.03	12.3	2.48	2,521.74	-6%	-15%	-£1.78m
OneclickHR	SP	0.06	8.18	127.9	1.38	150.00	0%	50%	-£0.75m
OPD Group	A	4.27	112.12	13.4	2.56	1,940.91	-1%	-13%	-£2.03m
Parity	A	0.73	27.50	NA	0.18	675.92	-1%	-7%	-£0.38m
Patsystems	SP	0.27	44.32	35.2	2.90	252.34	10%	57%	£4.10m
Phoenix IT	CS	3.47	209.20	16.7	1.92	1,285.19	3%	14%	£6.65m
Pilat Media Global	SP	0.77	45.31	17.0	3.48	3,850.00	1%	-6%	£0.39m
Pixology	SP	0.24	4.83	NA	1.07	171.95	1%	-16%	£0.01m
Portrait Software	CS	0.18	15.32	NA	1.32	118.18	9%	20%	-£0.51m
Proactis Holdings	SP	0.63	18.83	NA	9.91	1,288.66	0%	-2%	£0.00m
Prologic	CS	0.73	7.25	NA	1.05	873.49	0%	-15%	£0.00m
QinetiQ Group	CS	1.87	1235.84	22.0	1.17	851.94	-3%	-2%	-£114.82m
Qconnectis	CS	0.01	1.38	NA	12.61	234.67	17%	17%	-£0.26m
Quantica	A	0.43	25.51	11.3	0.66	344.76	10%	40%	£2.24m
Red Squared	CS	0.09	2.48	NA	1.01	480.77	13%	35%	£0.28m
Revenue Assurance Services Plc	SP	1.24	52.92	72.0	1.18	826.67	8%	1%	£3.62m
RM	SP	1.90	175.82	16.5	0.67	5,428.57	-4%	-2%	£0.54m
Royalblue Group	SP	11.10	372.80	35.8	3.94	6,529.41	-2%	7%	-£6.71m
Sage Group	SP	2.61	3390.78	NA	3.62	100,192.31	1%	-4%	£51.12m
Sanderson Group	SP	0.50	20.91	11.1	1.29	1,000.00	-4%	2%	-£0.83m
SciSys	CS	0.93	23.63	NA	0.93	720.93	-5%	6%	-£1.51m
SDL	CS	3.40	212.16	35.6	2.24	2,266.67	-2%	44%	-£4.06m
ServicePower	SP	0.12	9.29	NA	1.17	120.00	-8%	-27%	-£1.16m
Sirius Financial	SP	1.70	29.64	19.4	1.36	1,133.33	-1%	16%	-£0.72m
SIRViS IT plc	CS	0.03	3.57	NA	0.45	27.13	-14%	-19%	£3.15m
smartFOCUS plc	SP	0.17	15.54	25.5	1.69	1,810.81	14%	10%	£4.19m
Sopheon	SP	0.25	32.99	NA	5.50	359.71	8%	11%	£1.93m
Spring Group	A	0.63	100.79	20.3	0.25	700.00	-4%	-9%	-£4.84m
SSP Holdings	SP	1.23	87.79	NA	4.91	1,155.66	1%	2%	£1.08m
StatPro Group	SP	0.86	45.24	15.0	3.56	1,075.00	-15%	-17%	-£7.77m
SThree Group plc	A	4.35	600.30	21.2	2.48	2,111.65	0%	13%	£0.13m
Stilo International	SP	0.02	1.81	NA	0.79	40.00	-6%	-16%	-£0.32m
Strategic Thought	CS	0.89	23.14	NA	2.02	653.14	-8%	-12%	-£2.08m
SurfControl	SP	4.75	136.53	46.7	2.39	2,375.00	0%	-9%	-£13.79m
Tadpole Technology	SP	0.05	19.60	NA	4.06	120.71	186%	400%	£12.64m
Tikit Group	CS	3.33	41.78	26.6	1.78	2,895.65	17%	30%	£5.56m
Total Systems	SP	0.40	4.21	18.9	1.21	754.72	1%	11%	£0.05m
Touchstone Group	SP	1.87	22.42	12.0	1.30	1,780.95	4%	4%	£0.90m
Trace Group	SP	0.86	12.18	9.6	0.85	688.00	-10%	-14%	-£2.33m
Triad Group	CS	0.25	3.71	NA	0.09	185.19	4%	0%	£0.07m
Ubiquity Software	SP	0.37	75.39	NA	10.10	929.65	-1%	85%	£6.19m
Ultima Networks	R	0.01	2.14	NA	1.12	24.39	14%	14%	£0.35m
Ultrasis Group	SP	0.01	21.88	NA	17.60	30.20	11%	4%	£2.30m
Universe Group	SP	0.09	6.65	NA	0.15	400.00	-12%	-36%	-£0.71m
Vega Group	CS	2.58	52.42	17.4	0.84	2,114.75	9%	22%	£4.07m
VI group	SP	0.15	5.59	9.8	0.58	300.00	-5%	5%	-£0.28m
Xansa	CS	0.87	302.89	25.1	0.85	2,230.77	0%	0%	£1.74m
Xpertise Group	CS	0.86	4.56	14.4	0.29	3,440.00	39%	112%	£1.27m

Note: We calculate PSR as market capitalisation divided by sales in the most recently announced financial year.

Main SYSTEMHOUSE S/ITS Index set at 1000 on 15th April 1989. Any new entrants to the Stock Exchange are allocated an index of 1000 based on the issue price. The SCS Index is not weighted; a change in the share price of the largest company has the same effect as a similar change for the smallest company. Category Codes: CS = Computer Services SP = Software Product R = Reseller A = IT Agency O = Other

PE AND M&A DRIVE GROWTH

The Ovum UK S/ITS index bounced back better than most by the end of March, after what had been more than a month of falls across world markets. On average S/ITS stocks were up 5.0% in March, and 12.0% on the start of the year. This compares with the 2.2% rise in the FTSE 100 and 2.8% rise in the techMark 100 in March.

Usually surges in average share prices at this time of year are generated by the string of full-year results that come out between February and May, covering the December and March year end periods. But this time, improved revenue growth and profitability amongst S/ITS players is not driving the growth in S/ITS stocks. Instead - and as has been a theme for the past 12 months - it is merger and acquisition activity that is driving most of the share growth.

Of those that reported strong organic results in March, many saw little or no positive effect on share prices by the end of the month. For example, SAP specialist Axon reported revenue growth of 56% to £138m and adjusted operating profit up 81% to £22m - its shares are down by 3%. Dealogic, a supplier of investment banking software and services, saw its turnover for 2006 rise by 23% to \$79m and operating profit up by 28% to \$30m - its shares are up only 1%. Outside of software we can cite Parity, which grew revenue 16% to £156.8m and moved from an operating loss of £1.9m to a profit of £1.4m - its shares are down by 1%. And there are several more examples.

But take a look at the top performing stocks in March and the heavy influence of M&A is clear. Despite delivering no organic growth in its results in February, Xpertise Group's share price is up 39% to 86p in March.

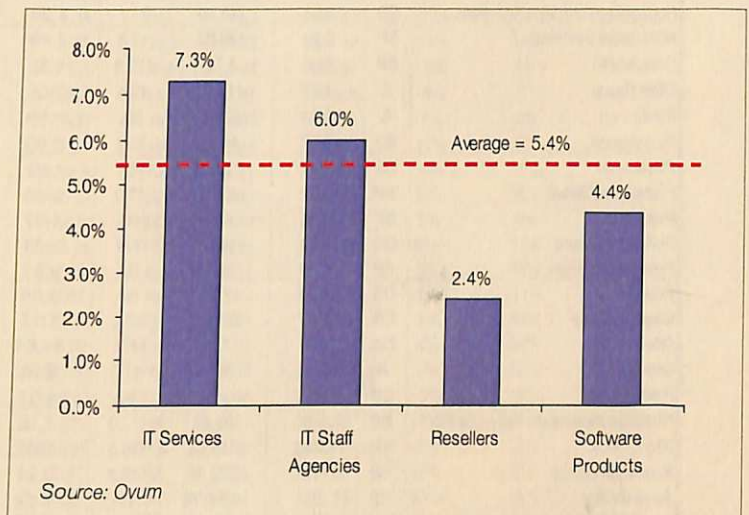
Computer Software Group saw its share price shoot up by 38% to £1.47, after it announced a private-equity backed MBO. ICM Computer Group had a 35% rise to £4.47 on the back of an MBO, and additional interest from Phoenix IT. Next in line is Compel, which saw its shares rise 30% to £1.49 on the back of an offer from 2e2. And then there is Lorien, whose shares rose 30% to 67p - clearly still feeling the effects of the now lapsed offer from Southwind at the end of February. The list goes on...

Part of this M&A effect is driven by the fact that investors are not content watching their companies simply grow organically in line with the market. They want to see strategic acquisitions that can help a company move into new markets and bolster up organic growth for the future. But of course there is a second more recent driver in the return of private equity (PE) investment into the sector. There remains a lot of PE money in the market and one only has to look at the interest in large IT services companies such as Atos Origin and ACS to realise that S/ITS companies (of whatever size) are back in favour. M&A was a big theme last year, and thanks to PE investment, it will continue to have a substantial effect on valuations and investor sentiment in UK S/ITS over 2007.



Samad Masood
Analyst

Figure 1 Average share price rise by type of S/ITS company



SYSTEMHOUSE

With a track record stretching back many years, Ovum is widely acknowledged as the leading commentator on UK Software & IT Services (S/ITS). Through the Holway@Ovum service, which builds on the success of the original Holway Report, our team of experts provides unrivalled analysis of both the market and the players. To find out how you can gain access to the service, including SYSTEMHOUSE and Hotnews, please contact Suzana Murshid on +44 20 7551 9071 or sum@ovum.com.