June 2007

Available by Subscription Only

ISSN 0967-2583

ovum

SYSTEMHOUSE

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

ICT: HOW FAR IS TOO FAR?

By Phil Codling

Phil Codling
Principal Analyst

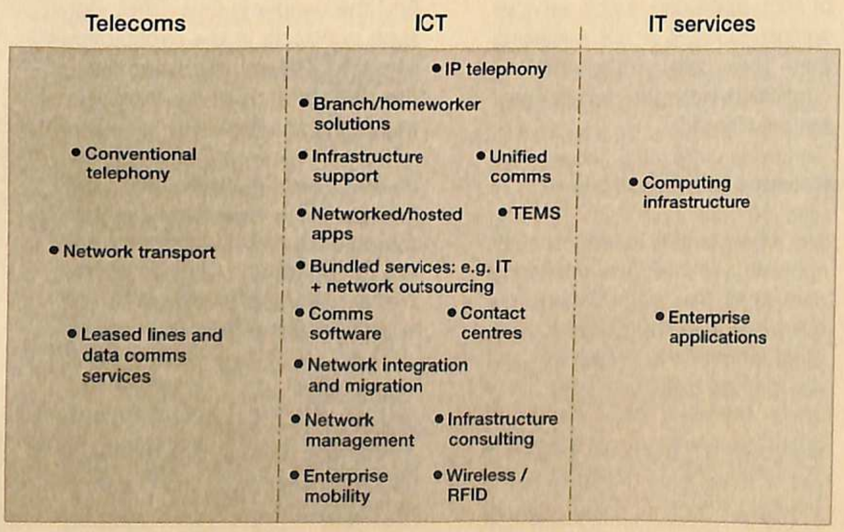
IT services firms are on the lookout for new sources of revenue and growth. Against a backdrop of decidedly "mature" market conditions, they are pushing into both new customer bases (notably the mid-market) and less familiar service lines (business process outsourcing, for example). One slightly less glamorous area that is nevertheless attracting a lot of attention is ICT, by which we mean the growing intersection of telecoms/networks and IT.

IT services firms by no means have the ICT space all to themselves. Telcos, and BT in particular in the UK market, provide plenty of competition. Meanwhile, ICT and network services can be prone to commoditisation, something the IT services industry is keen to avoid. So just how far should vendors go in tackling the ICT opportunity and what challenges might they face?

Growing portfolios

IT services providers are keen to both stimulate and exploit convergence in the enterprise. All the vendors we spoke to on this topic show a strong preference for IP in both their skillsets and their propositions to customers, with network integration and migration services featuring prominently in their portfolios and marketing. On top of this, they are developing and delivering solutions around IP telephony and convergence-centric applications such as enterprise collaboration, contact centres and unified communications, as well as

ICT lies at the growing intersection of IT and telecommunications



Source: Ovum

[continued on page two]

Contents

INDICES
(changes in May 2007)

Ovum S/ITS Index	**1.0%**	**6612**
FTSE IT (SCS)	**-0.7%**	**611**
techMARK 100	**4.6%**	**1735**

[continued from front page]

wireless/mobility and telecoms expense management (TEM).

We find an emphasis on standardised (although tailorable) solutions and packages in these areas. This is in line with broader productisation strategies, and should help to manage costs/prices and complexity in ICT offerings. Take Fujitsu's managed VoIP service. It's a good example of a simply packaged solution (with per user per month pricing) aimed at not just medium-sized but also the very largest customers. Fujitsu aims to sell VoIP design and build (i.e. consulting and integration) services as a precursor to the managed service. The design-build-run approach is again typical, and helps to explain why IT services firms are so keen to bring in consultants with network expertise.

Bundling and upselling

IT services providers are primarily selling ICT solutions as part of larger deals, either as an add-on to existing (typically outsourcing) clients or as bundled elements of contracts. We agree that such tactics open up opportunities for the vendors with large outsourcing customer bases. However, for this to work, vendors also need to continue to bring ICT and network-savvy business development expertise into their operations and to connect this effectively with account teams.

So far, so good. Helping customers get the most out of their enterprise networks and the applications that run on them plays to the IT services industry's core competencies in designing, integrating and running technical solutions. Such solutions are closely tied to the performance of the network – both LAN and WAN – and clearly demand network-centric expertise. However, it is one step further to start to deliver to customers end-to-end network services (as in connectivity and management of the WAN such as IP VPNs, as typically provided by a telecoms operator).

A swing towards network services

IT services vendors' thinking on the desirability of providing network connectivity to customers has ebbed and flowed over time. Right now the flow, at some larger firms, is heading back towards network service provision. For while all large IT services firms will provide network connectivity and management for a customer when required to as part of an outsourcing contract (take EDS's mega-deal at Kraft, for example), a number of firms are increasingly open to bidding for standalone network service provision as well. IBM's IP network win at LloydsTSB is the UK's most prominent example thus far. Meanwhile, CSC too says it is responding to more network-specific bids and Fujitsu continues to run and manage UK customers' networks.

Why the swing back towards network service provision? It isn't just about maximising the account and upsell opportunity, although this is important. Nor is it just a way of leveraging their multi-million-dollar investments in global IP networks. All manner of enterprise applications and services (from ERP to corporate intranets to e-commerce services) now rely on connectivity. Given that IT services providers are often paid according to the performance of such applications and services against SLAs, it is not surprising that they see advantages in controlling network management for the client too.

Reasons to be cautious

So where's the catch? Firstly, network services are the home domain of the telecoms industry. Competition in this space is high. Differentiation is difficult, and margins are thin.

Moreover, IT services providers would have a mountain to climb if they wanted to enjoy network brand recognition from the majority of enterprise customers. Research conducted by Ovum with the EVUA indicates that enterprise CIOs do not see IT services providers as credible in this area: less than 20% of those surveyed rate leading IT Services vendors as "capable" in the provision of network connectivity.

Finally, larger customers seem cautious towards the concept of the "one stop shop" ICT vendor. They are not pushing en masse to buy everything from one provider. Even those that are not multi-sourcers in the IT services market tend to retain a telco as network provider. Take the Post Office or the MoD – both have IT Services mega-deals in place, but continue to contract network elsewhere.

The limits of ICT

For all these reasons, we recommend that IT services providers exercise caution in the network services market and only bid for standalone network contracts when they tie in with other contracts on an existing account (thus enabling customer lock-in and control of network performance to support applications and business processes). This may sound conservative, but IT services providers simply do not need a load of low-margin, standalone network contracts on their books. And the danger is that if they sign such contracts in the expectation of future business with the account, the realities of multi-sourcing may see them disappointed.

Overall, we believe that ICT will prove a relatively low-risk (compared, for example, to some areas of BPO) revenue-earner for IT services providers in the coming years and a useful tool for unlocking pockets of additional value in some accounts. We should not overplay the concept of industry convergence, however. IT services providers are not about to become telcos, and nor, in our view, should they try to.

Ovum's new report on ICT strategies for IT services providers will be published in June as part of the Holway@Ovum service.

EARLY SIGNS OF SOFTNESS IN THE UK SOFTWARE MARKETS?

David Mitchell
Practice Leader, Software

There are early signs of weakness entering the UK software market, sufficient to raise early warning signals. However, the picture is complex below the surface, with some segments booming while others are having a much harder time. It is by no means certain that the current weaker segments will show through into sub-standard year-end results but the possibilities are there.

Where the signs of greatest uncertainty are occurring are in the performance of the UK operations of some of the largest global software providers. Strong results at a global level for these companies have masked business difficulties for some of their regional subsidiaries – including the UK. The largest global software companies do not regularly publish disaggregated financial results for their operating subsidiaries – quite a useful convenience when trying to mask specific country operational problems. Instead their financial health has frequently to be estimated by piecing together data from other sources.

Current difficulties are manifesting themselves in the form of pipeline weakness, deal slippage and an over-reliance on a small number of very large transactions. Some of these difficulties will be unwound in the traditional last-minute dash for revenue at the end of financial reporting periods but the pipeline weakness in some of the companies is such that only a monumental effort will see all of the shortfalls addressed. Expect patchy results among the big software companies but, equally, expect these to be obfuscated by global reporting.

The emerging weakness in the UK operations of global software companies has a more wide reaching impact – through the multiplier that exists between software sales and IT services revenues. The ratio of software revenue to IT services revenue is generally between 3 and 9 i.e. for every £1 of software product revenue a further £3-9 of services revenue is generated. Global software companies generate a larger IT services backwash, by virtue of their scale, with most of the UK IT services companies having dedicated capabilities for Oracle, Microsoft, SAP, etc... A relative weakness in demand for any one of the global software providers is generally met by a scaling back of the associated implementation practice. However, another organisational response is now available to the larger IT services companies – practice merger and vertical segmentation of the implementation of the supply chain. The impact of SOA on the implementation practices of most of the technologies is increasingly dividing the analysis and definition phases from the assembly phases of large implementations, with assembly being carried out in lower cost labour locations. With this backdrop there is active consideration to merging the analytical and business change elements of consulting practices that are currently dedicated to specific package software. This would be a major change of structure for many of the IT services companies.

The difficulties being experienced by many of the larger companies is in stark contrast to the buoyancy that many of the smaller companies are enjoying. Many of the smaller software companies are experiencing annual growth rates of 15-25%+, with no sign that those rates of growth are due to decline in the next 12 months. Some might expect software-as-a-service providers and Web 2.0 companies to represent the main growth areas, reacting to the market froth around these technologys – this is not the case. Software-as-a-service and Web 2.0 companies are doing well, but they are not the only technologies successes. More traditional categories of software from small companies such as information management, search, desktop productivity, etc are all equally represented in the higher growth mix of small companies.

The IT services market impact of revenue growth in smaller software companies is complex. Many of the software companies are UK-only, making it difficult to build up implementation competency at any scale. Equally, the products from the various software providers are all sufficiently different that the prospect of using multi-skilling to build a practice is equally difficult. One option is for the larger services companies to make use of contingent labour or specialist sub-contracting to give them access to the necessary skills.

However, the larger IT services companies are also likely to face competition from a different angle – federations of smaller, specialist firms who work in concert. The growth of revenue from specialist software is producing a clutch of small, niche implementation consultancies around each of those software vendors. Small, independent implementation houses are not a new phenomenon – what is new is the ability of these firms to work together to undermine the larger IT services companies, combined with some weakness in the large software company implementation market. SOA is producing increased inter-operability between specialist software solutions, allowing smaller implementation companies to work together with lower "technical friction". The result will be increased competition from collectives of smaller firms. Embracing this phenomenon rather than ignoring it may be the best strategy for the large IT services companies.

-6%
242p Computacenter

COMPUTACENTER SERVICES IS GROWING UP

Kate Hanaghan
Analyst

Computacenter, a company that originally made its name as a reseller of IT hardware, has been evolving its services offering over the past few years. The services business, as it evolved, registered some good growth rates, particularly in the area of managed services and project services (for example, within the data centre). And looking at market conditions more broadly, it's clear to see why growth hasn't been too hard to find. Overall, our view is that managed services, which are focused on the right customer set (i.e. the mid-market, or departments of large corporates) hold good potential. There is growth for the suppliers who can get the relationship with the customer right.

But Computacenter's loss of three significant services contracts HBOS, O2 and Barcap hit Q406 hard. While the project business continued to perform strongly in FY06 – and into Q107 – the contracted services business has really stumbled – against the backdrop of what is essentially a healthy market. And it is primarily down to these three contract losses. In each case, Computacenter claims that lack of "strategic alignment" and innovation with the customer was to blame. In other words, Computacenter was either out of touch with the customer's strategic aims, or was not able to articulate how Computacenter Services could enable those strategic aims. This is a significant weakness for any supplier operating in the outsourcing (in the broadest sense of the term) market. On contracts where the supplier is providing horizontal or difficult-to-differentiate services, the focus must be on demonstrating to the customer where the added-value is in using their services.

And this is precisely where Computacenter has put a lot of thought over recent months. We see two key themes forming much of the work the company has done to assess how it can secure and sustain future growth and profits: value and efficiency.

Value

Computacenter is building into every managed services contract a "Value Statement" that will specify precisely what will be delivered in terms of improved performances, savings, strategic benefits and so on throughout the term of contracts. To us, this is something that could have been done some time ago. Indeed, it could well have helped Computacenter fight its corner from a much strengthened position with HBOS, Barcap and O2. For competitors, what does this mean? Computacenter Services is becoming a more refined services organisation. "Value Statements" have the potential to really show CC's worth with the customer, throughout the life of the contract and at renewal.

A 'softer' benefit we see in the introduction of "Value Statements" is the confidence Computacenter is gaining internally. As we have said, the company has done a lot of self-reflection, and we see an organisation that is growing in confidence as its 'armoury' in services grows. A word of warning is that while we applaud the company's evaluation of itself, it must be very careful that it does not become too internally focused and that it can sufficiently communicate its 'armoury' to customers.

Efficiency

Another big piece of work Computacenter has been focused on over the last nine months is its Shared Services Factory (SSF). The concept of the 'factory' is to bring together, in a central repository, processes and tools that can be accessed by technical staff. The SSF clearly relates to a much broader theme in the IT services industry, where reuse has become a watchword for a community of suppliers looking to improve the consistency of the customer experience and squeeze more out of the bottom line.

It is very much early days for the SSF, which is not yet fully rolled out. We believe the SSF is a critical part of Computacenter's continued evolution. Reuse and standardisation are a critical element for any services company that wants to keep turning a profit in today's mature IT services market. In this respect, Computacenter is not 'ahead of the curve'.

A better period ahead?

Given the themes of value and efficiency, what can we predict about Computacenter's forthcoming financial year? With the losses at HBOS, Barcap and O2 behind it, we think Computacenter is stabilising. Any growth will be based on gains it has made since the close of last year. Based on signings, we expect to see a marked improvement as it hits the end of H1. In the longer term, we would be disappointed if Computacenter doesn't start to feel the benefit of the work it has done, around both value and efficiency.

WILL CLIENTS BUY 'INNOVATION' FROM IT SERVICES VENDORS?

Angel Dobardziev
Practice Leader, IT Services

Innovation in vogue

Many, if not most, IT services vendors have spent a great deal of time focusing on innovation over the last year. We examined approaches in this area in the *Innovation in IT services: vendor strategies* study. For vendors, innovation crystallised a drive focused on tapping into clients' growth agendas, as well as an attempt to find new sources of revenues beyond the commodity type of services.

But what is innovation to client organisations? Are they interested in buying 'innovation' from their IT services vendors? How are they approaching the innovation sourcing process with their vendors? These are some of the issues we explored with a number of CIOs from client organisations – below we outline of some of the key findings.

Innovation equals business outcomes

Client organisations take a business view of innovation. It is all about new ideas that increase revenues or reduce costs. Even the CIOs in this study state that technology is simply an enabler of innovation, and no organisation is interested in innovation for its own sake.

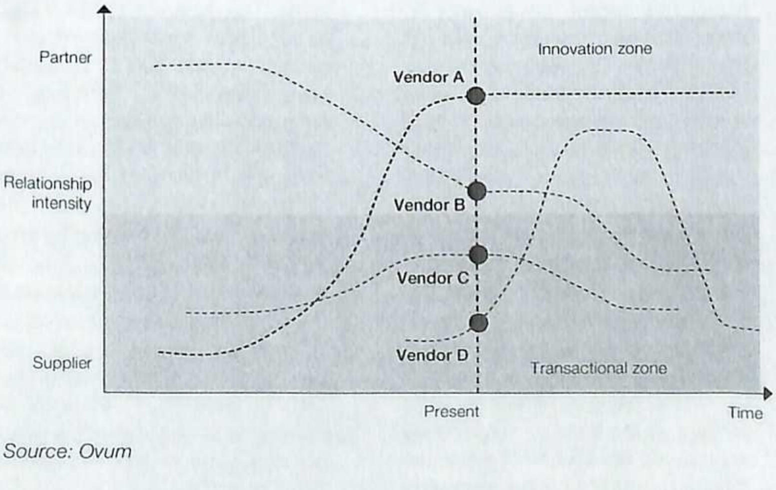
There are clients that confess challenges in routing out the 'not invented here' syndrome from their organisations, which prevents them from fully exploiting external sourcing of innovative ideas. But most accept that there is a competitive market for bright ideas out there with IT vendors playing a key part in it, and they are open to making use of it.

Where is their most critical innovation need? It does vary by individual clients and specific industries, but in general, most clients see process innovation (as opposed to technology and business model innovation) as a key area where external partners can help them in achieving their business objectives. Technology innovation is just an enabler to this process innovation and clients don't see most IT led vendors as qualified to talk about business model (or strategy) innovation. This puts massive emphasis of marrying technology competence with industry and business process expertise on the part of the vendors in order to truly deliver innovation in clients, business processes.

Partners innovate, suppliers sell products & services

In general, clients see IT vendors as just above average in their innovation capabilities. Nevertheless they are clear on a two tier league among their external vendors when it comes to innovation: partners who are in the innovation zone and able to deliver substantial business outcomes through innovative inputs, and suppliers who are used for smaller, more routine and repeatable engagements. There is considerable dynamism and fluidity in these leagues: vendors are in different leagues for different clients; and a client's rating of vendors is dynamic and evolving, as illustrated in *Figure 1*.

Figure 1 **Client relationship dynamics**



Source: Ovum

Implications for IT services vendors

Vendors need clarity over which clients they can play a partnership role with and where their potential remains at a supplier role. Vendors must strike front a team with a good balance of technical and industry/business process expertise. Clients feel that IT vendors can do better in bringing in greater industry and business skills to add to their technical capability.

Clients will buy 'innovation' only from vendors with whom they have built a close relationship of trust, and the client sees sufficient understanding of their industry and business processes on top of their technical expertise. These vendors will be able to unearth new and unique business with clients, often where clients have not articulated that need before. In other words, vendors which get the client relationship and their innovation value chain right stand a chance of creating the 'blue oceans' of uncontested market space which other vendors will not be able to approach.

Vendors have an expectation that these innovative engagements will be higher margin than the more routine and repeatable ones. We are not so sure. Yes, these projects may have a lower cost of sale. But higher margins in this new business will be highly contingent on vendor ability to execute on what will be unique projects with uncharted methodologies – and IT vendors have a mixed track record here.

'Innovation in IT services: client strategies' will be published in June.

-3%
53p
SANDERSON

SANDERSON MARGINS DIP IN H1

Sanderson Group, a provider of enterprise applications to the manufacturing, food and process industries, has released its results for the six months to March 2007. Revenue increased 11% to £8.12m. Operating profit was £1.41m, producing a margin of 17.4% (down from 19.9% in the previous year). Conversion of operating profit to profit was 100%.

The downward movement of Sanderson's operating margin is due to increased operating expenses. We, however, think it is likely that the company will be able to correct this. Certainly moves to rationalise development costs will help. Overall, Sanderson has a strong balance sheet, good levels of recurring revenues and good cash conversion. There are, however, difficulties within its manufacturing division, which accounts for 40% of revenues. Customers in areas such as engineering, electronics and printing have lowered their discretionary IT spend. Despite this, Sanderson has managed to ink deals with existing clients, the benefits of which will start to trickle through into H2.

The remainder of Sanderson's business is focussed on multi-channel sales. In other words, customers who have more than one channel to market (e.g. retailers). Prospects here generally look stronger and more consistent. In February the company acquired Elucid from K3, which will slot into this part of the business. During the period, it made a "small contribution" to both revenue and operating profit. H2 is expected to show a good performance.

Sanderson's stable client base continues to provide good growth. The overall strategy is to combine this with appropriate acquisitions. Sanderson is a small firm, but it has its own IPR and is nicely focused on two specific areas. In the longer term, it may well make for an attractive acquisition target itself.

(Kate Hanaghan)

HP A 'WORK IN PROGRESS'

HP announced the results of its most recent quarter recently. The results had been previously trailed, but confirmed that revenue grew 13% year-on-year to $25.5 billion – or 10% growth on a constant currency basis. Non-GAAP EPS rose 1% to $0.70, with cash flow from operations generating $4.2 billion.

It's become customary practice for HP to declare that it has not finished its corporate transformation, rather that it is a 'work in progress'. Some will find it difficult to describe HP as less than a polished product when it is likely to cross the highly significant $100 billion revenue threshold in its current fiscal year – a massive milestone for HP and for the industry as a whole. Mark Hurd's description of the company performance is more than an exercise in stoical and 'glass half full' positioning – it is a realistic admission that businesses as diverse as HP will always have soft spots that need to be addressed and that successful business units need to stay sharp, to avoid the pursuit of the pack. However, a little more celebration of the successes so far would be entirely appropriate.

In each of the business units there is progress to celebrate. In IPG revenue was up 6% to $7.2 billion, with operating profit up from 15.5% to 16.3%. The 40% growth in shipment of multi-function printers is particularly notable. There are further innovations in products that offer potential for continued growth. In PSG the 45% growth in notebook revenue confirms the broader shift from desktop to notebook categories. In ESS the 8% revenue growth to $4.6 billion still masks the slow progress in the storage business, with only 1% progress here. The recent investments in HP's storage business need to demonstrate progress within the next 1-2 quarters. Within ESS there is also an underlying transition from declining lines such as PA-RISC and Alpha, towards blades – with a 58% growth here. HP Services made solid progress, with 7% revenue growth to $4.1 billion. Below this headline, outsourcing services (+12%) and C&I (+8%) were the notable growth engines, both contributing to margin expansion in HPS from 8.9% to 11.1%. HPS is where a large amount of the focus of the recently announced head of HP Labs must focus – using HP's capital advantage to reduce the impact of lower opex competitors must be a major focus area, for HPS and the wider HP organisation.

The conclusion from the detailed analysis is that HP is keeping tight managerial control of the business, working on having a solid base of operational efficiency. It is not using usurious cost cutting to generate artificially inflated margins, rather it is continuing to make sensible investments in both day-to-day business and in acquisitions – with the future portending more of the same. The generation of $4.2 billion of cash flow shows that HP is in a position to continue its acquisition programme, in a strategy to strengthen its position in its core markets. Building on the core asset strengths in the past few quarters has been sensible and pragmatic, but some are questioning whether a more radical acquisition approach is appropriate. A key question for many is whether HP's acquisition strategy will soon see it grow into adjacent or even green-field grounds for HP – only time will tell. Building a strong cash flow would certainly support any ambitions in those directions.

(David Mitchell)

A BIG FIRST QUARTER FOR PRIVATE EQUITY

Samad Masood
Analyst

The first quarter is usually the biggest period for private equity technology investments, and this year has not disappointed. According to Cobalt Corporate Finance, £254m was invested across 36 deals in the three months to the end of March 2007 – a 19% jump on the same period last year, and the highest level of quarterly investment since the end of 2001.

Semi-conductors remain a disruptive force

By a long shot, the two hottest sectors were semi-conductors and wireless software, which respectively received 83% and 64% of the total value invested in the period. There was £83m invested in just five semi-conductor companies this quarter. Most of this money went to Plastic Logic, a company involved in using flexible plastic substrates for chip design. The Cambridge-based company attracted £51m in fifth round funding from Oak Investments, Amadeus, Intel Capital, and BASF VC among others. Businesses with potentially disruptive technology like this are always exciting opportunities, and this quarter had one more example in ZBD Displays. ZBD develops zero power graphical display solutions for electronic signage, labels and portable electronic devices. It received a £10.5m investment in Q1, bringing the total disclosed fundraisings for the company to £25m.

Mobile convergence drives wireless software

The story within the wireless software sector is quite different, with £64m spread a bit more evenly across nine separate companies. Convergence across digital applications, software and hardware has been a key driver in wireless software investments for the past few years, and this sector has been one of the most consistently buoyant areas for investment. Mobile software in particular has shown particular growth due to the increased demand for the mobile-enablement of enterprise and consumer service applications. The largest wireless sector investment went to Picsel, a mobile content software solution provider which closed a fourth round £24m investment in February. Truephone, a mobile VoiP software developer raised £12.5m in the quarter, the fourth largest deal in the period (after another semi-conductor sector firm, Frontier Silicon, which received £16m).

Less for more

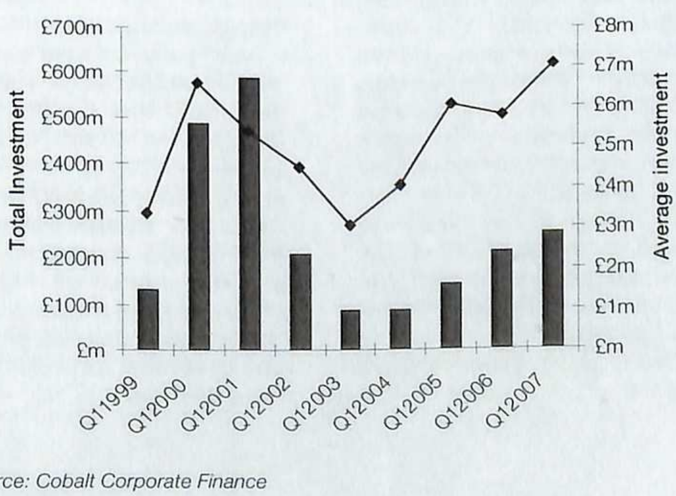
Its worth noting that while private equity money is flowing back into the technology sector, this is not the same as the dot.com boom. While the value of total PE investments has risen rapidly over 2006, the growth in number of investments has not kept pace. Indeed, deal volumes in Q1 2007 have remained flat on Q1 2006, which experienced the highest volume of deals since 2002, when 47 investments were made in Q1. In other words, more money is now being concentrated on fewer companies than before.

On top of this, PE companies are more likely to share the risk of investment with other partners in "syndicates" or consortiums that invest in funding rounds together. Seventy-two percent of PE technology investments in Q1 were by syndicates rather than by single PE firms. This compares to the average of 63% since 1999. These two trends tell us that PE firms are now more targeted with their investments, but at the same time they are more risk averse – using syndicates to spread the risk of failure or loss.

End of the cycle?

The final point to consider is that first round investments are now threatening to trend downwards after a short surge over 2006 – driven partly by the resurgence in Internet technologies and Web 2.0. Although the data is not yet conclusive, it could suggest that most investors have spent their money allotted for high risk seed funding and will now be looking to support established businesses in their portfolio with further rounds. We can't confirm this trend for another quarter or so – if it bears out, it could be further evidence of cautiousness amongst investors. It could also suggest that the PE investment cycles are getting shorter. *(Samad Masood)*

Total and average first quarter investments since 1999



Source: Cobalt Corporate Finance

GONE IN THE BLINKX OF AN EYE?

Here at Ovum, we are quite experienced in the areas of IPO and subsequent acquisition. It was just over a year ago that we were floated, only to be acquired by Datamonitor in December 2006, and for those who are following the acquisition trail, you will be aware that this week Informa has made an offer to acquire Datamonitor.

So what of smaller, specialist, listed companies, which offer innovative technology? How long will they last in the open seas of the equity markets of the world?

Recently UK-based software infrastructure provider Autonomy announced that its consumer arm Blinkx would be traded on the LSE AIM from 21st May priced between 35 and 34 pence per share, raising approximately £25 million and giving a potential capitalisation of approximately £114 million.

Autonomy, which will be retaining a 10% stake in the new business, saw its shares spike 15 pence on the announcement with a drop back to a still respectable 2% at 770 pence.

Blinkx is going up against the current leader in internet search Google, which has made a significant deal of its (still officially Beta) Video search tool. Most importantly in this changing environment is Microsoft, whose CEO Steve Balmer is firmly on record in stating his company's intention to rule again the market place for search.

Rumours amongst the financial analyst community already point to Microsoft being ready to pounce on the 'upstart' of the video search arena. Although, whether there is an undisclosed 'killer' clause in Autonomy's agreement with Blinkx to have exclusive access to the IDOL technology that underpins all of Autonomy's offerings, or that the Remond behemoth could stomach another vendor's search engine within its product set, remains to be seen.

Whatever happens, the flurry of announcements and rumours, illustrate (as Ovum stated at the beginning of the 2007) that search, whether internet or enterprise, will be potentially the most dynamic and exciting area of the software industry this year.

(Mike Davis)

SUNGARD COLLABORATES WITH SAP

Chris Conde, CEO of financial services software vendor, SunGard, formally announced at SAP's Sapphire user conference in Vienna that SunGard is to collaborate with SAP in the banking sector. The first fruits of the collaboration will be a version of its BancWare ALM (asset liability management) solution that will run on SAP's NetWeaver platform. No timescale has been given yet for the product's release, though the two companies have said that it will become available first in Europe.

According to Conde, 500 banks already use products in the BancWare suite, and this includes six of the European top ten. BancWare ALM requires tight integration with the underlying data. Going onto NetWeaver will give it 'native' access to the financial database via SOA. He added that he believes SAP to be well positioned in the financial services sector, and that this potentially makes it a very far reaching partnership.

Banking is one of the key growth opportunities that many software and IT services providers are trying to unlock. Projects are typically very large and complex, with many of the tier-1 banks having more software developers than some of the household-name software companies. These tier-1 vendors are harder for a package software vendor to access, with easier pickings being found among the tier-2 banks.

The SAP and SunGard offering aims at both of these tiers and gives SAP a very strong partnership in the banking and financial services sector. It greatly improves SAP's chance of succeeding in this sector. Banks are widely seen as offering enormous potential for software companies, but they are also deeply conservative institutions that keep extending the life of their in-house developed core systems. This moves SAP forward in its campaign to be the preferred vendor when banks finally do get around to renewing their core systems.

Though there is already a range of third-party software products that run on NetWeaver, it is a very significant boost for SAP to get SunGard on board, especially because of SunGard's credibility in such a key market and its size. Many other software vendors will monitor this collaboration closely. If it goes well, we expect to see even more large software vendors offering versions of their products on NetWeaver.

(David Bradshaw)

-3%
38p InTechnology

INTECHNOLOGY ENJOYS LIFE AFTER RESALE

InTechnology, the voice and data managed services provider, recently released its preliminary results for the year ended 31st March. The company reported topline revenue of £186m, compared with £285m in FY06. Revenues from continuing operations, following the disposal of its distribution business, were £33m, up 30% on a like-for-like basis. Operating profit from the continuing business was down 12% to £1.5m.

This has been a year of change for InTechnology, not least because it has divested itself of its distribution business, which made up 90% of revenues in FY06. It sold the business in December for £41m in cash. Meanwhile, it's been investing in the areas where it's now focusing the business. So it bought 43% of Mobile Tornado last October at a cost £4m, taking the Group into push-to-talk, a potentially high growth market. This January it also bought Evoxus, which gives the group a potential channel into managing VOIP for its current customer base. Evoxus also has a legacy voice minutes reselling business, which we think is slightly out of character in terms of how the company is now positioning itself, and will most likely be sold off.

Currently the Group has four main managed services offerings, which are data, hosting, networks and voice. Looking ahead greater focus will be on data and voice, with the intention that by 2009 revenues will be an equal split between the two.

CEO Peter Wilkinson told analysts that "InTechnology is now a 100% managed services company - and I don't ever want to talk about distribution again'. He wasn't joking. For a number of years now the distribution industry has been fighting diminishing margins and we think it's been a bold but wise move for the company to divest itself of this profit burden. Improving margins in the managed services business that remains is now the key challenge.
(Ed Lycett-Marquez)

Atos Origin

ATOS ORIGIN MAKES PROGRESS ON THE PATH TO TRANSFORMATION

In their recent conference call with analysts, CEO Bernard Bourigeaud and his team emphasised the speed with which the process had been wrapped up and the fact that the private equity firms looking at the company had not been advocating a break-up of Atos Origin or a fundamental change in its strategy.

One wonders now whether the private equity industry will back away from IT services, following two expensive and ultimately fruitless examinations of large international firms (Atos and CSC). Everything we hear, however, suggests PE firms are continuing to consider opportunities in our sector. And the recent case of ACS shows that deals can be done. Meanwhile, with each of these failed exercises PE firms are gaining greater awareness of the peculiar ins-and-outs of IT services, which may give them more confidence to make a positive decision in the future. In short, the role (and the distraction) of PE in IT services will not be eliminated by the outcome of the Atos saga.

As for Atos Origin, although its topline performance remains less than stellar (with 2.5% organic growth in Q1), progress is clearly being made on its much needed transformation plan, as unveiled in February. On global sourcing, Atos Origin is ahead of schedule, which is just as well because it reports that demand for offshore solutions in Europe is accelerating faster than predicted. That's partly because the firm has taken the sensible step of turning India into a shared service for the business as whole. Previously India was a profit centre in its own right, which tended to suppress use of the facility by the customer-facing business operations. Given its rapid hiring in recent months in India (recruitment is 20% ahead of plan), and plans in Morocco and Eastern Europe, we suspect Atos Origin may now become more ambitious in its global sourcing objectives. In our view it needs to, as the existing plans will keep it well behind most of its competition.

In the UK, the business is in the process of starting up a number of new contracts won last year (DCA, NFUM, NHS Scotland, Government Gateway). So growth has not yet returned (organically the UK shrank by 1.3% in Q1). But consulting provides a positive indicator, with utilisation shifted from a dismal 51% in December to 63% in March. So it appears that the actions of new UK CEO Keith Wilman (including better target and bonus plans across the business) are having an almost immediate effect. Meanwhile in France, Atos Origin needs to make sure it does not miss out on the current buoyant state of the projects market. With a drop of 17% in consulting revenues in Q1, the French business needs urgently to counter attrition and fill in capacity (through hiring, or even contractors) or the current wave of activity could pass it by altogether.
(Phil Codling)

17%
379p

phoenix

phoenix.co.uk

WHAT'S GOING ON AT PHOENIX?

Results from Phoenix, the support services company, for the year to end March 2007, showed that organic revenue growth was just 1.3%. The top line was hit by a significant contract loss and a contract renegotiation. Excluding this, the core UK IT services business would have grown a more solid 9.5%. Margin was also down (from 20.2% to 18.6%), partly due to the acquisition of Servo, which has a high proportion product mix.

Phoenix is currently trying to buy ICM Computer, a fellow support services player. So, given this and the previous acquisition activity, what kind of services company is Phoenix shaping up to be? Well it's certainly strengthening itself in new, better growth areas outside of the core business. Notably in the business continuity and SME markets. The acquisition of Servo and the offer for ICM accelerate both of these strategies.

We've always applauded the financial performance of Phoenix: margins, revenue growth and cash generation have been consistently strong. What hit Phoenix during FY07 was the renegotiation of the DWP contract and the loss of the Met Police contract. In both situations, Phoenix was (as is the case with its partner-centric core business) reliant on its partner to win the bid. If the partner loses, obviously Phoenix loses. This partner model has, however, served it well (as the financials demonstrate), and we are not suggesting it changes that. But, the situation serves to illustrate how important it is for Phoenix to develop other capabilities, as it is indeed doing. Completing the ICM acquisition would be an important step forward, not only in enabling Phoenix to take out a significant competitor but in progressing its footing in both the SME and BC markets. And if it can do that alongside the maintenance of solid organic growth in the core business, it will be able to defend itself more effectively against contract losses that are ultimately out of its control.
(Kate Hanaghan)

experian

EXPERIAN GROWS 14% IN A YEAR OF TRANSITION

Experian saw revenues from continuing activities rise by 14% at constant currencies to $3.4bn, while EBIT rose 16% to $825m. Organic revenue growth rate was 8%, also at constant currencies. Excluding inter-segment revenue, Experian saw $1.99bn (up 10% in nominal terms) of revenue in the Americas, $907m (up 24%) from the UK and Ireland, and $591m (up 13%) from other regions.

The credit services division, which offers consumer credit and business information, commercial lending software and automotive services, had $1.52bn (up 4%, with 3% organic growth). The group's contribution to operating profit before corporate overheads and charges grew $482m (up 8% - no organic figure available). This is a strong albeit mature area in its own right, and it provides much of the basis for other business lines. Decision Analytics is one of those groups, and it offers credit analytics, decision support software and fraud prevention solutions. This group had revenue of $392m (up 16%, with 15% organic growth) and a contribution of $136m (up 27%). In particular, with online fraud breeching new levels every year, this is clearly an area of enormous opportunity - and not just for the bad guys.

The marketing group had revenues of $728m (up 13%, with o% organic growth) and contribution of $73m (up 24%) before $8m of restructuring charges. This group is in effect a microcosm of what's happening to the group as a whole - with a fall off in data services but growth in more value-adding services, increasingly delivered using software-as-a-service. This group is also in the process of integrating ClarityBlue and Eiger Systems in the UK and building a single UK business unit, Experian Integrated Marketing, offering the full gamut of marketing services - this looks set to give competitors a hard time.

At Interactive group offers online services to consumers, and also includes LowerMyBills and PriceGrabber service. It had revenue for $784m (up 40%, with 23% organic growth) and contribution of $173m (up 50%). Revenue growth was obviously good in the Americas where the main portion of its business originates, but in the UK and Ireland it grew strongly, but from a low base.

Following its emergence from GUS, Experian is coming out into the open about being as much a supplier of software (and in particular, software-as-a-service) as it is a supplier of credit and other information. Increasingly the decision analytics and marketing groups are combining the credit and other data with smart software and services to solve customer problems, in a hybrid delivery model that crosses boundaries between software-as-a-service, business services and information services.
(David Bradshaw)

-13%
162p
ALTERIAN

ALTERIAN CATCHES UP IN THE UK

Following a flat first half, marketing software and services vendor Alterian saw growth return in the UK and continued strong growth in the US, despite unfavourable currency movement. For the full year to 31st March 2007, total revenue was £14.0m, up 32% as reported or 38% in constant currencies. The revenue growth and good control over costs turned a first half loss into full year profit. Operating profit increased by 275% to £1.69m, taking operating margin to 12.1%, compared to 4.2% for the previous year. Net profit was £2.42m, up 76% on the previous year. Net cash inflow from operations was £971k compared to an outflow of £416k the previous year.

Alterian has benefited from two acquisitions in the period, UK-based Nvigorate which brought around £400k of revenue from existing clients, and US-based Dynamics Direct, which brought around £1.3m in the period. These were of some help in achieving the growth, but by no means the whole story - the company clearly managed a good chunk of organic growth too.

Alterian is in a market that is currently very open. Unlike most parts of the enterprise software market, there are plenty of players (including folks like Experian) doing good business. The switch to online marketing has created opportunities for players to differentiate themselves, especially in the way they enable clients to mix and match internet and other forms of marketing and manage their campaigns in a coordinated way. Indeed, how well they do this is going to be a key differentiator. Though some aspects of marketing, like direct mail, have long moved from being a 'craft' to a science, marketing analytics tools from vendors like Alterian are making the overall marketing process measurable and controllable. Alterian is doing a good job of competing in this market against some formidable competition.

(David Bradshaw)

-5%
251p
sage

SAGE ANNOUNCES H1 07

Recently Sage posted its H1 2007 results. The Group's revenues grew 34% (at constant exchange rates) to £574.7m, with an operating profit (EBITA) of £138.6m, up 22% (on the same basis). Compared with H1 2006, the Group improved organic growth 2 percentage points to 7%.

Much of the results briefing with analysts was spent discussing Sage's US business. Since the Group made its largest ever acquisition last August, of Emdeon, the software and services provider to doctors' practices, there has been focused attention on Sage's US divisions. Part of Sage's strategy in the US has been to reorganise its operations into the following divisions: Business Management (accounting, ERP and CRM software and services), Industry and Specialised Solutions (including HR management), Healthcare (Emdeon), and Payment Solutions (Verus). This is a good move for Sage. In an environment of consolidation this reorganisation clarifies the Group's offering.

With 4% organic growth and 19% operating margin in H1 07 in the US (compared with the Group's 7% and 24%, respectively), we wanted to know what could be expected from the US division. In terms of the future for Sage in the US, CEO Paul Walker confidently stated that the board saw no reason why the US business shouldn't grow margins like the rest of the Group.

When we spoke with Sage in December they talked about changing the ratio of the Group's revenue mix. In 2006 we didn't see much of a change in terms of the proportion of revenue from accounting software (1 percentage point down on 2005, to 60% of revenues). However, this has changed. In H1 2007 Sage has a revenue mix of 51%, 28%, 11%, 6% and 4% for accounting, industry-specific solutions, payroll and HR, CRM and payment processing, respectively. Considering Sage's accounting business contributed 64% in H1 2006, the Group's diversification programme is progressing well, primarily due to acquisitions, notably Emdeon and Verus, which boosted industry-specific and payment processing revenues, respectively.

Sage's healthy growth rate has always been underpinned by well managed M+A activities. In FY06 Sage made a variety of acquisitions at a total cost of £637m, three more in H1 07 and won't stop a previously successful strategy now. However, with the considerable rise of VC spending, industry players are losing their traditionally strong buying power. In April last year Sage conceded Visma to a Norwegian subsidiary of HgCapital and we expect VCs to increase the level of M+A competition and possibly slow down the rate at which Sage has previously been able to acquire. Such a slow down could endanger not just Sage's overall growth but also its ability to keep diversifying its business.

(Ed Lycett-Marquez)

Mergers and Acquisitions – May 2007

Buyer	Computer Software Group
Seller	FAST Limited
Seller Description	Software training, education and membership organisation
Acquiring	100%
Price	£10.5m in cash
Comment	IT compliance is a component of business risk management and FAST's methodology should complement Computer Software's existing compliance technology. Also, expanding their solution portfolio has the potential of providing compliance benefits to a wider range of customers and sectors, in particular the Legal and Not for Profit sectors.
Buyer	IDOX
Seller	CAPS
Seller Description	UK-based owned by US geographic information systems firm ESRI
Acquiring	100%
Price	£21m
Comment	With its complementary solution set and vertical focus, CAPS fits the bill. But this is no simple bolt-on acquisition. Indeed CAPS is a larger business than IDOX itself, with 2006 revenues of £16.4m (versus £13.0m at IDOX). Shareholders will need to weigh up the benefits of enlarging the group with the inevitable risk that such a large acquisition undoubtedly presents for a small company, especially given IDOX's intention to raise £11.6m of the required cash sum via a loan from the Bank of Scotland (the rest will come from a share placing). On the plus side, we can see that CAPS fits well with IDOX's stated strategic focus and that gaining scale in the target market of local government is key for the business's future. Meanwhile, the acquisition may also precipitate the necessary divestment of non-core interests, notably IDOX's small recruitment business. It's also worth emphasising that IDOX has worked with ESRI previously - and as we all know, prior knowledge of the acquired business and its strengths, weaknesses and culture is a significant asset when selecting and integrating an acquisition. All in all, this looks an ambitious but nonetheless well thought-out and indeed necessary move for one of the UK's niche software firms.
Buyer	JCE Group
Seller	Caran
Seller Description	LogicaCMG's R+D services unit
Acquiring	100%
Price	€43m
Comment	The move does not come as a surprise for several reasons. First, LogicaCMG is in digestion mode and focusing on its core IT services business, selling non core businesses such as its telecom software business. Second, Caran mostly operates in a difficult automotive segment of R&D services where margins are down overall across Europe. We reckon that it would have taken time and effort to bring back Caran to more acceptable operating profits. It is also unclear whether Caran can live as a standalone business and would need to develop much further into Germany - where the big automotive clients are located. According to LogicaCMG, the deal has followed 'a competitive process'. JCE will probably not ring many bells for readers. However, the conglomerate is not a newcomer to R&D services. In 2006, it made a public offer to acquire a large R&D services player Semcon, based in Sweden. The management of Semcon opposed the deal but JCE still managed to secure a 30% share in Semcon. Interestingly, Semcon with its recent purchase of IMV automotive has become one of Europe's top providers of R&D services to the automotive industry.
Buyer	Maxima
Seller	3net
Seller Description	Networking and security managed services firm
Acquiring	100%
Price	£18m (£14m in cash and the rest in shares)
Comment	Once this purchase goes unconditional it will represent Maxima's ninth acquisition since flotation in November 2004. 3net is only a £6m company (with a pre-tax margin of 28%) but that's not an insignificant size to Maxima, which had first half revenues of £13m. We think the purchase makes sense in that it adds further bulk to Maxima's managed services business. Indeed, increased scale is critical if it wants to get in on larger managed services contracts. This approach reminds us of 2e2, which also has a strategy of growing scale in managed services in order to gain access to bigger contracts. It too has thus far made a success of this approach. Maxima's track record shows that it is very skilled at making acquisitions and, more importantly, making them work (operating margin has hit 17.3% - as at end of November 2006 - from 13.9%). The only question we have is pace. Maxima has made many acquisitions but it's still a relatively small player. Perhaps it needs to start looking at acquiring something relatively large.

Mergers and Acquisitions – May 2007

Buyer	**Northgate Information Solutions**
Seller	**Arinso**
Seller Description	Brussels-based HR services company
Acquiring	60%
Price	€378m
Comment	On paper this a good match, as the two companies are quite complementary. The idea is that Northgate's UK mid-market focused products and services will slot underneath Arinso's multi-national SAP-focused services across the 27 countries in which Arinso already has a presence. So, for Northgate, Arinso is a ready-made channel into these markets. Meanwhile, by selling Northgate's services into the mid-market globally, Arinso gains the ability to increase utilisation and profitability in many of the regions where it is subscale but where it has had to build a small presence to support its multi-national clients. There is a concern that the acquisition might complicate Arinso's relationship with SAP. However, as Northgate's products are targeted at those clients which typically are too small to invest in a large SAP implementation, this should not be too much of a problem in the near term. But in the 'big picture' this acquisition is about building a 'technology agnostic' HR services business, and in the longer term we would not be surprised if Northgate/Arinso consider targeting large clients that are not SAP-centric.

Buyer	**Oracle**
Seller	**Agile Software**
Seller Description	Producer of application software in the PLM category.
Acquiring	100%
Price	$495m
Comment	The acquisition of Agile brings a further depth of product capability, a strong reference customer list, and a sector-skilled sales capacity. Agile, along with other pure-play companies like Dassault Systems and UGS, are strong in the PLM market - with Agile behind both of these, in terms of market share. The acquisition of SGS by Siemens earlier this month is a further demonstration of the attractive nature of this market. The acquisition of Agile will allow Oracle to begin to take the game to SAP in its heartland. In this respect the gloves are coming off. However, nobody should expect an immediate short-term market shift. Manufacturing and other asset intensive industries do not change software platforms easily; they sweat software assets in the same way that they sweat physical assets. A 10-15 year software sweat lifecycle is not unusual. The adage that 'a dog is for life, not just for Christmas' could have been created for this market.

Buyer	**SAP**
Seller	**OutlookSoft**
Seller Description	Performance management provider
Acquiring	100%
Price	Undisclosed
Comment	SAP already has a good degree of visibility in the Office of Finance established through years of strategic ERP implementations. However, despite having its own planning, budgeting and consolidation solution (SAP SEM) the company is under increasing pressure to strengthen its competitive PM positioning after the Oracle/Hyperion acquisition. OutlookSoft gives SAP another chance to establish its planning credentials and provides a good indication of just how seriously it takes the Oracle threat. However, the acquisition does raise some important questions about product integration. OutlookSoft is predominantly based around Microsoft technology (it utilises both Excel and SQL Server) so we expect there will be a certain degree of re-engineering to ensure integration with SAP Netweaver platform. Likewise there are inevitable overlaps with existing SEM components that will have to be ironed out. At this stage it is difficult to determine how the two offerings will either fit together or possibly replace each other. Given that this is not a huge acquisition both in terms of new technology and additional headcount, we don't suppose these challenges are insurmountable for a company like SAP.

Buyer	**Sage**
Seller	**Snowdrop Systems**
Seller Description	HR software and services provider
Acquiring	100%
Price	£17m (in cash)
Comment	This is only the second UK acquisition Sage has made in the UK since the start of the decade. Sage already provides payroll software in the UK and an advice line on HR issues, but this purchase takes Sage further into the HR domain. It may signify a shift towards more acquisitions and diversification in its home market, in order to build a stronger position in HR.

Buyer	**Serco**
Seller	**Cornwell Management Consultants**
Seller Description	Provider of public sector business consultancy
Acquiring	100%
Price	£7m
Comment	Due to the nature of Cornwell's consulting, business revenue and profits tend to be cyclical. Cornwell has the added pressure of being focused primarily on the Government market - in the current efficiency-led climate public sector organisations are spending less on standalone consultancy, in favour of consultancy wrapped up in larger transformation programmes. Pure services suppliers like Serco are under increasing pressure as a result. They need to build up their capability to deliver the kinds of advice and business transformation that underpin IT service delivery. Cornwell's 80 consultants will provide Serco with a considerable degree of increased visibility with Government customers, and add to its own niche existing government consulting business. Cornwell should enable Serco to get closer to the strategic side of its clients' decision-making and thereby help it win more transformational-led business.

UK software and IT services share prices and market capitalisation - May 2007

	SCS Cat.	Share Price 31-May-07	Capitalisation 31-May-07	Historic P/E	PSR Ratio Cap./Rev.	S/ITS Index 31-May-07	Share price move since 30-Apr-07	Share price % move in 2007	Capitalisation move since 30-Apr-07
@UK plc	SP	0.14	5.20	NA	3.58	213.74	0%	-22%	-£0.09m
Alphameric	SP	0.61	80.22	21.9	1.22	279.82	2%	28%	-£0.66m
Alterian	SP	1.62	68.07	29.2	4.86	810.00	-13%	43%	-£7.95m
Anite Group	CS	0.78	273.38	76.8	1.44	456.14	1%	-4%	£0.00m
Ascribe	SP	0.62	70.88	NA	13.26	3,263.16	6%	59%	£4.00m
Atelis plc	SP	0.05	1.31	NA	NA	244.19	0%	-22%	£0.00m
Atlantic Global	SP	0.20	4.47	NA	2.09	661.02	22%	44%	£0.92m
Autonomy Corporation	SP	7.68	1566.31	NA	12.21	234.43	3%	50%	£133.81m
Aveva Group	SP	9.46	637.29	36.0	9.67	4,730.00	11%	16%	£63.32m
Axon Group	CS	7.87	485.39	31.9	3.53	4,497.14	6%	29%	£16.03m
Bond International	SP	2.10	63.88	19.1	3.71	3,230.77	-7%	22%	-£3.48m
Brady	SP	0.60	15.59	24.8	6.41	740.74	0%	64%	-£0.53m
Business Control Solutions	CS	0.07	17.64	NA	2.21	1,040.00	-9%	4%	-£1.70m
Business Systems	CS	0.11	9.36	12.5	0.27	92.44	0%	-12%	£0.21m
Capita Group	CS	7.28	4502.86	31.8	2.65	196,793.13	4%	20%	£101.37m
Centrom	CS	0.01	1.57	NA	0.25	166.67	0%	-33%	£0.23m
Charteris	CS	0.22	9.46	21.4	1.06	244.44	5%	38%	£0.43m
Chelford Group	CS	1.44	10.28	1.4	0.55	250.44	-7%	-14%	-£0.79m
Civica	CS	2.46	154.42	14.0	1.46	1,405.34	-5%	-11%	-£8.65m
Clarity Commerce	SP	0.67	14.02	9.1	1.05	536.00	-3%	25%	£2.82m
Clinical Computing	SP	0.06	1.90	NA	1.15	48.39	-14%	-14%	-£0.17m
CODA Plc.	SP	1.88	144.71	NA	2.70	1,160.49	-2%	16%	-£3.27m
Compel Group	CS	1.49	50.42	22.6	0.80	1,192.00	0%	26%	£0.00m
Computacenter	R	2.42	386.50	19.3	0.17	361.19	-6%	-10%	-£36.51m
Computer Software Group	SP	1.50	85.19	19.3	6.05	1,276.59	-1%	23%	-£0.28m
Cornwell Management Consultants	CS	NA	NA	NA	NA	NA	NA	NA	NA
Corpora	SP	0.06	8.67	NA	3.33	157.89	20%	7%	£0.13m
Dealogic	SP	1.85	128.99	12.2	3.21	804.34	0%	17%	-£0.00m
Delcam	SP	4.32	26.68	13.0	1.11	1,661.54	1%	38%	£0.53m
Detica	CS	3.74	427.72	43.1	4.21	4,675.00	-11%	2%	-£14.86m
Dicom Group	R	1.97	173.43	24.1	0.83	603.92	-15%	-15%	-£30.56m
Dillistone Group	SP	1.85	9.99	NA	NA	1,355.31	14%	26%	£1.22m
Dimension Data	R	0.53	812.45	39.8	0.59	94.14	8%	23%	£80.87m
DRS Data & Research	SP	0.34	10.95	65.7	0.88	309.09	-8%	-8%	-£0.43m
eg Solutions	SP	0.44	6.22	NA	1.15	295.92	-3%	-47%	-£0.21m
ELCOM	CS	0.02	6.54	NA	18.88	400.00	0%	-52%	-£0.54m
Electronic Data Processing	SP	0.81	19.69	45.6	2.82	2,480.10	21%	26%	£2.44m
FDM Group	A	1.28	29.72	14.7	0.67	1,570.55	9%	37%	£2.55m
Ffastfill	SP	0.07	20.25	NA	7.64	58.33	0%	17%	£1.44m
Financial Objects	CS	0.60	26.65	8.0	1.34	260.87	-13%	10%	-£4.66m
Flomerics Group	SP	0.72	15.32	14.3	1.08	2,750.00	-21%	-5%	£1.96m
Focus Solutions Group	CS	0.62	17.62	46.1	3.24	317.95	-2%	28%	-£2.43m
GB Group	CS	0.33	26.77	NA	1.78	212.85	-6%	-28%	-£2.27m
Gladstone	SP	0.26	13.56	9.9	1.77	650.00	4%	2%	£0.26m
Glotel	A	0.57	21.92	8.9	0.24	296.10	-3%	-10%	-£1.07m
Gresham Computing	CS	1.26	63.44	NA	4.54	1,354.84	1%	-15%	-£0.25m
Group NBT	CS	3.46	85.60	30.9	10.19	1,730.00	5%	67%	£6.68m
Hamsard Group (Renamed Cantono	CS	0.06	16.81	NA	2.34	1,000.00	0%	0%	£0.00m
Harvey Nash Group	A	0.79	52.28	12.0	0.21	451.43	0%	8%	£0.98m
Highams Systems Services	A	0.06	1.99	17.6	0.15	166.67	0%	30%	£0.12m
Horizon Technology	CS	0.75	89.57	15.4	0.47	275.82	1%	9%	£0.82m
IBS OPENSystems	CS	1.95	78.00	15.7	4.99	1,278.69	-1%	7%	-£0.60m
I S Solutions	CS	0.20	4.90	17.1	0.89	745.31	1%	27%	£0.09m
ICM Computer Group	CS	5.28	112.70	33.7	1.49	2,933.33	7%	83%	£7.79m
IDOX	SP	0.09	16.60	NA	1.17	10.91	6%	33%	£1.22m
Imaginatik	SP	0.09	10.06	NA	7.18	1,014.12	-6%	1%	-£0.58m
In Technology	CS	0.38	54.26	NA	0.29	1,520.00	-3%	-12%	-£18.08m
InterQuest Group	A	1.15	33.07	NA	1.20	2,000.00	5%	31%	£1.58m
Innovation Group	SP	0.35	228.01	NA	3.74	152.84	9%	12%	£25.61m
Intelligent Environments	SP	0.09	15.06	26.0	4.83	95.74	-25%	44%	-£4.03m
Intercede Group	SP	0.48	17.15	NA	9.50	800.00	-6%	-19%	£0.85m
Invu	SP	0.30	30.06	15.2	4.63	3,157.87	3%	0%	-£2.00m
iSOFT Group	SP	0.44	101.13	NA	0.39	400.00	13%	-22%	£4.07m
iTrain	SP	0.02	1.93	NA	1.05	23.53	0%	-11%	£0.11m
IX Europe	CS	1.29	233.73	NA	6.27	4,229.51	45%	163%	£72.93m
K3 Business Technology	SP	1.54	33.16	14.7	1.21	1,176.66	8%	33%	£1.21m
Kewill	SP	0.84	66.28	24.4	2.48	1,660.08	0%	6%	-£0.79m
Knowledge Technology Solutions	SP	0.01	4.49	NA	3.59	200.00	0%	-38%	£0.83m
LogicaCMG	CS	1.68	2580.99	21.0	0.97	2,300.73	-8%	-10%	-£250.02m
Lorien	A	0.84	15.64	35.2	0.10	840.00	2%	98%	£0.37m

UK software and IT services share prices and market capitalisation - May 2007

	SCS Cat.	Share Price 31-May-07	Capitalisation 31-May-07	Historic P/E	PSR Ratio Cap./Rev.	S/ITS Index 31-May-07	Share price move since 30-Apr-07	Share price % move in 2007	Capitalisation move since 30-Apr-07
Macro 4	SP	2.09	46.45	8.0	1.40	842.74	-2%	-1%	-£0.91m
Manpower Software	SP	0.70	30.88	NA	7.13	721.65	-11%	169%	-£4.11m
Maxima Holdings	CS	2.89	70.48	18.7	5.68	2,101.82	7%	26%	£20.43m
Mediasurface	SP	0.23	17.38	NA	1.80	1,654.41	-4%	32%	-£0.77m
Micro Focus	SP	2.72	543.19	65.7	7.18	0.00	8%	30%	£29.01m
Microgen	CS	0.52	52.87	13.5	1.41	222.22	-4%	-5%	-£2.05m
Minorplanet Systems	SP	0.54	15.43	12.9	0.65	1,102.72	-4%	-4%	-£0.72m
Misys	SP	2.51	1258.74	27.7	2.69	3,122.74	1%	16%	-£0.40m
Mondas (Renamed Corero)	SP	0.16	7.18	NA	1.14	210.00	-2%	9%	-£0.11m
Morse	R	1.00	156.55	11.8	0.43	400.00	8%	-7%	£12.91m
NCC Group	CS	3.56	116.11	26.1	5.60	2,131.74	6%	28%	£6.36m
Ncipher	SP	2.61	74.86	NA	4.31	1,044.00	9%	3%	£6.17m
Netcall	SP	0.24	16.02	44.7	4.83	484.85	0%	41%	-£0.33m
Netstore	CS	0.30	37.93	13.3	1.90	200.00	-3%	0%	-£1.25m
Networkers International	A	0.43	39.15	NA	2.05	1,328.13	10%	21%	£3.69m
Northgate Information Solutions	CS	0.78	420.02	20.4	1.26	300.00	-12%	-9%	-£50.87m
NSB Retail Systems	SP	0.29	121.43	12.5	2.51	2,521.74	4%	-15%	£9.46m
OneclickHR	SP	0.06	9.48	NA	1.60	150.00	0%	50%	£0.18m
OPD Group	A	4.79	127.22	NA	2.91	2,177.27	8%	-2%	£8.90m
Parity	A	0.81	30.72	NA	0.20	750.00	13%	3%	£2.84m
Patsystems	SP	0.28	45.96	36.5	3.00	261.68	-3%	62%	-£0.82m
Phoenix IT	CS	3.79	228.43	17.1	1.80	1,403.70	17%	24%	£28.93m
Pilat Media Global	SP	0.74	43.54	18.3	3.35	3,700.00	-5%	-9%	-£2.06m
Pixology	SP	0.39	16.15	NA	3.58	279.42	0%	37%	£8.24m
Portrait Software	CS	0.20	17.27	NA	1.49	131.32	0%	33%	£0.00m
Proactis Holdings	SP	0.80	23.96	NA	12.61	1,639.18	7%	25%	£1.52m
Prologic	CS	0.93	9.25	NA	1.34	1,114.46	27%	9%	£2.00m
QinetiQ Group	CS	1.97	1300.59	23.1	1.13	897.49	4%	3%	£41.26m
Qonnectis	CS	0.01	1.91	NA	17.48	234.67	0%	17%	£0.00m
Quantica	A	0.43	29.58	9.3	0.76	346.77	7%	41%	£1.03m
Red Squared	CS	0.07	1.99	NA	0.81	384.62	-16%	8%	-£0.39m
Revenue Assurance Services Plc	SP	1.32	56.76	72.3	1.27	880.00	7%	7%	£3.62m
RM	SP	2.06	190.17	17.8	0.72	5,885.71	9%	6%	£15.48m
Royalblue Group	SP	10.42	359.84	33.6	3.80	6,129.41	-5%	0%	-£10.91m
Sage Group	SP	2.51	3270.96	NA	3.50	96,634.62	-5%	-7%	-£171.89m
Sanderson Group	SP	0.53	21.93	NA	1.36	1,050.00	-3%	7%	-£0.65m
SciSys	CS	0.83	21.18	NA	0.83	645.35	-11%	-5%	-£2.73m
SDL	CS	3.90	289.78	41.0	3.06	2,600.00	5%	65%	£54.54m
ServicePower	SP	0.17	13.38	NA	1.69	165.00	27%	0%	£2.84m
Sirius Financial	SP	2.26	39.82	21.9	1.83	1,506.67	36%	54%	£10.01m
SiRViS IT plc	CS	0.03	3.57	NA	0.45	26.09	0%	-23%	£0.00m
smartFOCUS plc	SP	0.17	16.01	26.2	1.74	1,837.84	0%	11%	£0.24m
Sopheon	SP	0.21	28.39	NA	4.73	302.16	5%	-7%	£1.34m
Spring Group	A	0.69	110.88	22.4	0.27	766.67	8%	0%	£2.42m
SSP Holdings	SP	1.40	99.97	NA	5.59	1,316.04	-2%	16%	-£2.15m
StatPro Group	SP	0.89	46.96	15.5	3.70	1,112.50	6%	-14%	£3.17m
SThree Group plc	A	5.05	699.30	24.7	2.88	2,451.46	7%	31%	£34.62m
Stilo International	SP	0.02	2.01	NA	0.87	40.00	0%	-16%	£0.54m
Strategic Thought	CS	0.90	23.40	NA	2.04	660.52	12%	-11%	£2.48m
SurfControl	SP	6.27	180.22	62.0	3.15	3,135.00	-5%	21%	-£8.63m
Tadpole Technology	SP	0.04	17.40	NA	3.60	96.56	-20%	300%	-£3.71m
Tikit Group	CS	3.20	41.05	19.9	1.75	2,782.61	-2%	25%	£0.84m
Total Systems	SP	0.42	4.37	19.6	1.25	792.45	5%	17%	£0.16m
Touchstone Group	SP	2.14	25.72	13.8	1.49	2,038.10	2%	20%	£0.12m
Trace Group	SP	1.52	21.59	17.0	1.51	1,216.00	16%	53%	£2.99m
Triad Group	CS	0.26	3.94	NA	0.09	192.59	4%	4%	£0.23m
Ubiquity Software	SP	0.37	75.39	NA	10.10	929.65	0%	85%	£0.00m
Ultima Networks	R	0.01	4.71	35.3	2.47	24.39	0%	14%	£0.86m
Ultrasis Group	SP	0.01	16.26	NA	13.08	22.04	-20%	-24%	-£3.62m
Universe Group	SP	0.07	7.89	NA	0.18	311.11	-13%	-50%	£2.23m
Vega Group	CS	2.66	54.15	18.0	0.87	2,180.33	-3%	26%	-£1.83m
VI group	SP	0.21	7.83	10.5	0.81	420.00	17%	47%	£0.84m
Xansa	CS	0.87	302.85	25.0	0.85	2,230.77	-5%	0%	-£15.67m
Xpertise Group	CS	0.99	5.35	17.5	0.33	3,960.00	-7%	144%	-£0.22m
XploITe	CS	0.39	14.24	3.2	0.48	1,184.62	1%	17%	£0.19m

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

STAFFING AGENCIES BOUND AHEAD

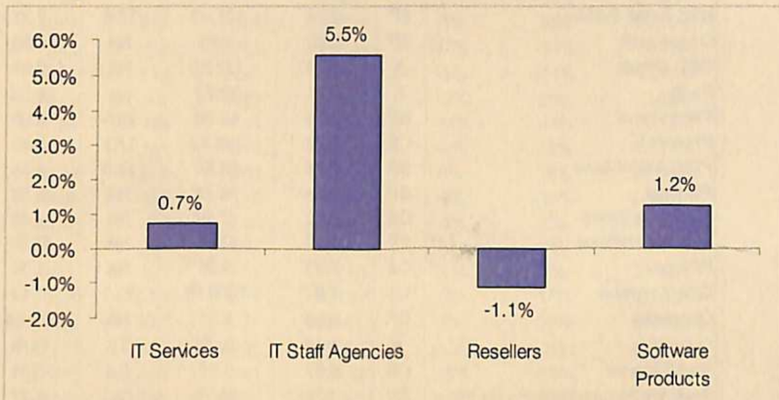
Samad Masood
Analyst

Overall growth in the Ovum S/ITS index was subdued over May at 1.03%. This was generally in line with FTSE IT SCS index which fell by 0.65% - and both indices underperformed the overall UK market. The FTSE 100, AIM and Small Cap indices all rose by more than 2% for instance. However, the impressive 4.58% achieved by the techMARK 100 suggests that larger S/ITS companies are performing better than the average.

Within our index, it was once again IT staffing agencies that outperformed the rest of the pack. One of the smaller staffing agencies that released results in May was Networkers International. On an annualised basis (not including the revenues acquired with MSB) the Group grew organic revenue 28% to £43m. On the same basis pre-tax profits increased 25% to £3.7m. The acquisition of MSB, on an annualised basis, will help to triple the Group's revenue in FY07. While it is often easier to grow a smaller company, 28% compares well with the already strong average revenue growth of the top 10 ITSAs at 13%. Shares in the business were up 10% to 43 pence over May, and are up 21% since the start of the year.

We have been commenting on the favourable trading environment for ITSAs over the past year. We think this reflects the positive shape that the UK ITSA sector is in, driven in part by what we're calling the 'Growth Agenda'. In particular, this environment should signal the potential for growth for MSB, which is principally an IT contract placement business focused on the UK market. However, this current wave of demand in the UK won't last forever, and ITSAs will be increasingly challenged by the offshoring wave, as well as by a tightening market for project services as the "Growth Agenda" begins to lose some of its impetus (potentially as soon as late 2007).

Average share price performance by business type - May 2007



Source: Ovum

For now things are still looking good though. As a group staffing agencies share prices rose by 5.5% on average in May. But outside of the ITSA boom there were as many fallers as risers in each sub segment, leading to a pretty paltry performance overall. IT services firms share prices grew by 0.7% on average, with 1.2% growth for software vendors, and a 1.1% decline for resellers.

Although not one of the bigger IT services fallers, it's worth highlighting the announcement from LogicaCMG regarding the early retirement of CEO Martin Read. Read has been CEO of the firm since 1993. The announcement followed a disappointing Q1 results update and subsequent share price falls and is reported to have been precipitated by activist shareholders, including Morley, which owns 2% of the company.

The resignation was not just a reaction to last week's Q1 update, but rather reflects longstanding shareholder dissatisfaction with the company's performance. Consider the fact that over the past five years, a period when tech stocks and equities more broadly have enjoyed a sustained recovery, LogicaCMG's share price has actually fallen - by 18%. Patience had clearly run out, and the last results update was the final straw. Now there are rumours of PE interest in LogicaCMG, raising the prospect that the largest listed UK-based IT services firm could fall into private hands...interesting times indeed.