

# System House

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

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## IBM Global Services UK real winner in 1999 as growth slumps

The 2000 Holway Report will be with you in mid-June. We have enclosed another order form in case you haven't returned yours yet.

In last year's Holway Report we forecast that "with recent contract wins, IBM UK looks set to take over the No 1 slot from EDS in 1999". Given that we have to "estimate" the revenues of all UK subsidiaries of US SCS players, we decided that the rankings in

1999 were "too close to call". So we declared a "draw" between EDS and IBM. But, clearly, IBM won in the growth league tables.

On the other hand, Cap Gemini UK had a torrid year and joined EDS UK, ICL UK and Andersen Consulting in reporting lower than market average growth rates.

Interestingly, the Top Ten grew their combined revenues by only 18% in 1999. This was a significant reduction from the 26% growth recorded in 1998 - and not that different from the 16% growth rate for the market as a whole. The Top 10 still accounts for c40% of the market with the Top 40 still representing around 70%.

The absence of acquisition activity amongst the largest UK SCS companies meant that the fastest growth in 1999 was recorded by the companies ranked 11-20.

As we reported last month, UK SCS growth rates have dived from 25% in 1997/98 to just 16% in 1998/99. This had this had an even greater effect on profits growth which reduced from 25% to 15%. Indeed a record 46% of all companies reported a worse financial performance in 1999. Companies quoted on the London Stock Exchange performed even worse - a reduction from 40% profits growth in 1998 to just 5% in 1999. The current raft of profits warnings indicates that profit performance might be even worse in 2000.

But this told just one part of the story as it measures only companies which recorded a profit at all. 20% of all companies in the study reported losses.

Although the Holway (Software and IT Services) Share Index ended May 00 still up 152% since 1st Jan. 99, it has slumped by 40% since its high in early March 2000 and another 13.5% this month alone. Again we pretty accurately forecast this back in Jan. 00. But we still think that prices are historically too high and have further to fall - bearing

in mind the forecasts for profits growth.

For all the "dot.com" fuss, all things remotely connected with the internet and e-services made up only 7% of the revenues in the industry in 1999. However, e-services is forecast to contribute over 30% of the industry's revenues by 2003.

The industry has been hit hard by the Y2K microclimate. This was, however, predictable. Also, those who believed that the pain would

end with the Alka Selters on 1st Jan. 00 have now been shown to have been "living in denial". We report a raft of profit warnings in this issue. **Most major IT services companies we have talked to have had a poor Q1 with forward order books significantly**

Rank	Company	Ownership	Financial Year end	Latest FY UK SCS	Previous FY UK SCS	Growth
1=	EDS (UK)	US	31-Dec-99	£1,450m	£1,270m	14%
1=	IBM (UK SCS)	US	31-Dec-99	£1,450m	£1,100m	32%
3	ICL (UK SCS)	J	31-Mar-99	£825m	£750m	10%
4	CSC (UK)	US	03-Apr-99	£637m	£501m	27%
5	Cap Gemini (UK)	F	31-Dec-99	£635m	£624m	2%
6	Andersen Consulting (UK)	US	31-Dec-99	£609m	£545m	12%
7	Microsoft (UK)	US	30-Jun-99	£540m	£450m	20%
8	Sema Group	UK	31-Dec-99	£521m	£419m	24%
9	Oracle Corp. (UK)	US	31-May-99	£519m	£440m	18%
10	PricewaterhouseCoopers UK MCS	US	30-Jun-99	£460m	£355m	30%

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lower than last year. The market for traditional IT services has changed radically with much shorter/smaller projects the order of the day. This can have a detrimental effect on utilisation and hence our warnings on a further profit slump this year.

All the media and investor interest in the last year has been directed towards the dot.coms. Companies have been investing heavily in their software and services offerings in this area which has, in turn, depressed profits growth

On the other hand, the main players in the sector - EDS, IBM Global Services, ICL etc. - will ultimately be the real winners from the move to e-business. Many blue chip companies, having had a brief affair with a younger model in terms of the management and operation of their e-services operations, are now returning to their long-term IT services partners.

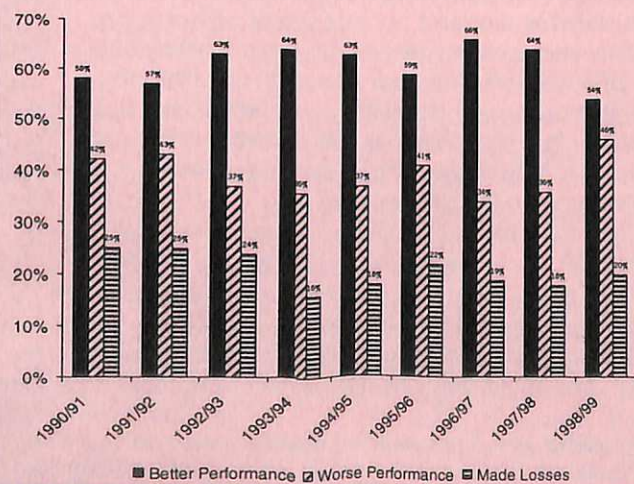
Long term customer relationships, high recurring revenues and

forward order books, strong management and, dare we say it, consistent profits growth, went out of fashion in 1999. We both hope and believe that these will once again become the watchwords for assessing company performance in the future.

**Full 15 page Holway Report Summary on holway.com under Press Releases.**

**Footnote:** Apart from our obvious pecuniary interest in 2000 Holway Report orders, we would like to "warn" you that most of the CEOs from the industry have already booked for the Holway/CSSA Presentation on 13th July. Book soon or risk being disappointed.!

Major increase in companies reporting a worsening financial performance in 1999

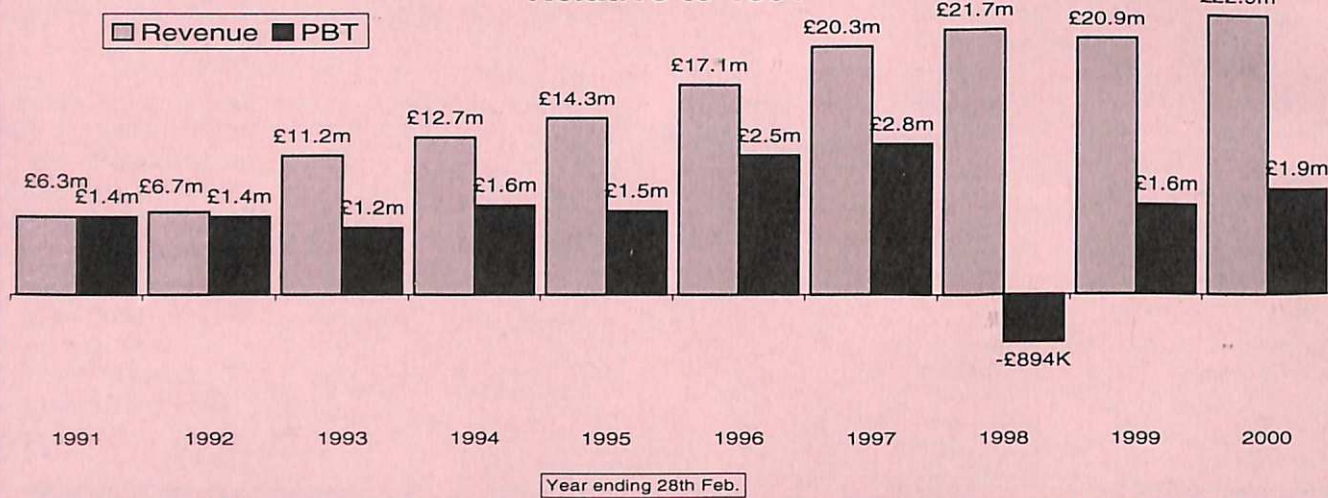


## Recurring Revenues Spell Success for Rolfe & Nolan

Rolfe & Nolan (derivative accounting and admin. software and services) announced revenue up just 11% at £22.9m and PBT up 16% at £1.948m in the year to 29th Feb. 00. Fully diluted EPS was up 18% at 9.3p. Profits on the continuing business increased 36% to £2.8m. Other highlights include recurring revenue (what we really, really like) up from 77% to 81% of the total. US profits doubled to £600K. We like most of R&N since John Lodge was appointed CEO in May 99. Its concentration on repeatable business, FM, "stick to the knitting" etc. are all well-known Hofway themes. But we have publicly doubted the wisdom of their near £500K investment in their internet product - Equity24. More of a "me-too" we have yet to see. We predicted several months ago that they would spend another half million on it...and then abandon it. Lodge doesn't agree...yet. When we spoke with John Lodge he reported "an extremely healthy order book" and it really does look as if the bad days are in the past. The future looks more rosy than in a long while. But, of



### Rolfe & Nolan plc 10 year Revenue and PBT Record Relative to 1991



course, a more attractive R&N will not go unnoticed by other predators. One way that Lodge could boost the share price over night, of course, is to redefine his business as an ASP. Frankly the difference between a bureau running a specific niche service with its own product and an ASP is almost indistinguishable. We also understand that the Equity24 service is funded via a bank guarantee. ie the £400K investment to date has not been taken into the P&L. Lodge told us that take up has "been slower than expected" in the first month. He put the blame the reduction in private investor interest post the March "crash". He seems adamant to keep going. As we said...another £500K investment and then they will abandon it...well, hopefully sell it as non core. Rolfe & Nolan's share price ended the month down 22% at 318p.

## Parity Forced to Make Trading Statement

Following a 20% fall in its share price on 18<sup>th</sup> May Parity issued a trading statement. It said "profits for the current year will be less than last year. Whilst e-business continues to be very buoyant, the Group, in common with its competitors, continues to experience the dull market conditions for traditional services which prevailed in the first quarter".

**PARITY**

Parity is also adding £7m to its investment programme to develop the Group's products and service offerings in e-business. Well, no real surprises here. This is further confirmation of the theme that we are hearing increasingly. "Legacy" businesses are quiet but e-business is motoring. The Computer Weekly/SSP job advertising survey reports "a dramatic downturn in demand for traditional skills". IT jobs advertised fell from 59,000 in Q1 1999 to just 32,000. However the number of jobs advertised for internet specialists doubled to 3,600. But, of course, for all the high % growth, 3,600 is still just 10% of the total. The point we are making, yet again, is that growth in e-services is not/will not compensate for the downturn elsewhere in the SCS market.

IT Staff Agencies have always been the barometer of the industry. They felt the pain of the downturn first in late 1998. So watch this market carefully.

Whether you are a contractor or an ITSA, those that will come out of this difficult period fastest will be those that have made the transition to e-business/web skills most aggressively. The CW/SSP survey castigated companies for not training people in the new skills. They failed to understand that you don't need to do this in a market downturn.

Parity was one of the more aggressive and it has still not helped them, so there may be some more fall out yet. Parity shares ended the month down 49% at 184p.

## Profits Warning from MSW

MSW (manpower planning software and consultancy) issued a profits warning saying that: "delays in completing major contracts will result in the Company not trading profitably (by the year ending 31<sup>st</sup> May 00) however the cost saving programme has been highly successful and break-even is anticipated within the first half of the year to 31<sup>st</sup> May 2001".

MSW also stated that a settlement had been reached with its former MD and "this has no significant impact on the company's financial position". MSW's board underwent a shake-up in Oct. 99 with Ross McBeath, former MD, appointed Chief Exec of US operations. He resigned later that same month. Robert Drummond was appointed MD in his place. MSW's shares ended the month down 40% at 33p, a long way from the float price of 97p per share back in Nov. 98.

## Sage Interims Show Strong Results

Sage has announced results for the six months ended 31<sup>st</sup> Mar. 00. As usual, they were extremely good. Revenues were up 53% to £202.5m, PBT up 52% to £54m and EPS up 43% to 2.937p. Commenting on the outlook Chairman, Michael Jackson said: "Our well defined e-business products and services targeted at our 2.3 million customer base coupled with recent acquisitions will help us build further on our strong existing business and the Board remains confident about prospects for the full year".



The figures were substantially above expectations. USA now accounts for 40% of sales (up from 33%) and will progress further as Best (acquired earlier) was only part of the group for six weeks prior to the period end. Overall the PBT margin was 26-27%. This breaks down to a massive 41% in the UK with an improving 31% in France and 18% in US. Germany broke even after remodelling the business strategy and should grow aggressively as 20% top line growth continues and they build towards critical mass. Sage is selling more to existing customers with 61% of sales (up from 53%) now from the installed base. Strong free cashflow of £45m eliminated debt, and they have existing banking facilities of £140m for infill acquisitions.

Interestingly Sage now carries nearly £500m of goodwill, which is not amortised.

**Peachtree** and **Tetra** (to be rebranded "Sage Enterprise Solutions") are performing strongly. Tetra has a new management team, revamped by Graham Wylie. They are focusing on selling through the VAR channel and should generate higher margins. Tetra has provided Sage with an Asia Pacific (APAC) presence for the first time and this is to be expanded to include the full Sage range. Peachtree has seen further margin improvement, but has some way to go match the Sage "norm". Jackson said that it would be a "serious contributor in the next few years".

In the e-business environment the **Ubiquis** acquisition is key providing the website creator which now has 20,000 customers. Peachtree has launched a new web-based accounting product ASP at \$9.99pcm. As for revenues from all this, they are likely to be "immaterial" for the next two years. The ASP model is attractive to new businesses, or those going through software upgrades, but existing customers are inherently conservative and need their hand holding and educating through the process. Much was made by the press, of the reluctance of SME customers to embrace the ASP model, but we feel that this partially misses the point. That Sage customers have the capacity to upgrade to an e-commerce/ASP model is vital to them acquiring new customers now, even though these customers are not willing to go "all the way" immediately. Sage is not just saying, "if we build it, they will come", it is saying, "if we build it, they will come -- and by the way, we still make money even if they don't want to do it just yet". These are very impressive figures.

**Footnote** - Sage went on to acquire **Adaptus Software Services** for £3.5m cash and **Apex Software International**, based in Eire, for £15.7m in cash during the month. Further acquisitions are planned (though **Baan** was explicitly excluded). However, the problems at **freecom.net** (see p8) might yet mean **Pegasus** falling into their hands. More earnings upgrades are expected. Sage's share price ended the month down 9% to 649p.

## Tough Trading for MMT



MMT Computing results for the six months ended 29th Feb. 00 showed a pretty massive 20% reduction in revenues from £21.1 to £16.8m. PBT was down from £5.1m to £2m and EPS was also down from 26.6p to 10.5p. MMT was yet another SCS company reporting that the "Y2K microclimate" had not ended with the Alka Selzers on 1st Jan. 00.

Commenting on the outlook, Chairman, Mike Tilbrook stated: "With tough trading conditions continuing through the early months of 2000, the current year will clearly be somewhat disappointing. However, we should finish the year in very good shape, with much improved staff utilisation rates, sharply increased web and e-commerce solution business, and better trading in software products, all pointing towards a far better performance for the new financial year starting in September".

MMT is clearly one of the worst affected by the Y2K microclimate. Utilisation was down to 80% in Jan/Feb - we remember when Tilbrook used to complain if it fell less than 95%! With this kind of high operational gearing the misjudgement of the severity of the slowdown hit profits hard. At least in its "Business and IT Solutions" division (77.5% of revenue, 83.5% of operating profit) MMT is experiencing "insatiable" demand for web and e-business skills. But, just like Parity (see p2) this was coupled with a marked decline for contractors with "legacy" skills. Although MMT has invested in retraining its staff, it is forecasting an excess of demand over supply for traditional skills in the near future. Recruitment for new e-business skills is being stepped up. In the "Specialist Solutions" division (22.5% of revenue, 16.5% of turnover) the Energy sector (80% of respective sales) should continue to grow strongly buoyed by global deregulation. This should have a geared effect on profitability as the margin improves. The other two divisions, Medical and Derivatives, are mature and troublesome respectively. Tony Grellier (MD) has said that he would consider "acceptable" bids for the two businesses, but when pressed did not seem to be active in pursuing a disposal strategy, which is disappointing. He said MMT would not be averse to demerging the Energy business if the board deemed it to be in shareholders' interests, but again, we would not hold our breath for this.

Like the ITSAs, the likes of MMT, which make a major part of their revenues from people/project based activities have long been a barometer of the industry. And that barometer shows falling demand. But MMT is now not on a demanding rating. Perhaps the market is calling a low even though MMT will not meet forecasts for this year. MMT's share price stood at 553p at the end of the month, down 5%.

## Julian and the Argonauts!

**Argonaut Games** has announced interim results to 31<sup>st</sup> Jan. 00. Highlights: revenues up from £0.8m to £2.5m, LBT decreased from £1.6m to £0.2m, and Loss Per Share decreased from 2.61p to 0.26p. Argonaut listed on the main market in Mar. 00 raising £18m, to be used to develop further titles.

Commenting on the outlook, Chairman Julian Paul said: "As the transition from current to next generation consoles gathers pace, we have entered into discussions with several publishers with a view to signing a number of games for the new consoles and expect to complete these negotiations before the end of the financial year".

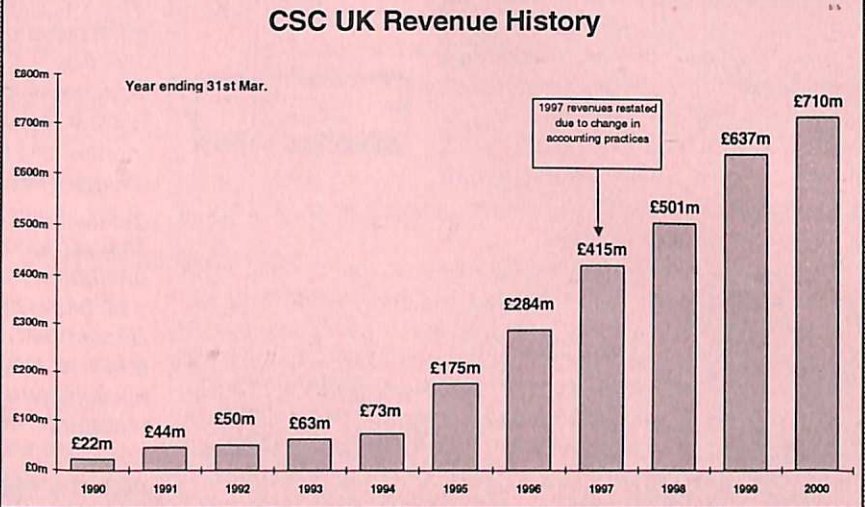
## CSC e-Services revenues grow...but traditional business slows

US Computer Sciences Corporation reported record fourth quarter and results for full year to 31<sup>st</sup> Mar. 00. Revenues were \$9.37 billion, a 15.5% increase over fiscal 1999; Europe totalled \$2.5 billion, up 12.3% (or 19% in constant currency), Net earnings, before special items, were \$432.7 million, a 21.7% increase over the prior year; Earnings per share (diluted), before special items, were \$2.55, a 20.3% increase versus fiscal 1999; and e-business related revenue exceeded \$700 million, more than 3.5 times the fiscal 1999 total.



"The year just completed was certainly full of challenges for our industry," said Van B. Honeycutt, CSC's Chairman, President and Chief Executive Officer. "We closed out fiscal 2000 with \$11.3 billion of major new business awards, more than double the announced major awards for fiscal 1999.... Our e-business related revenue goal of \$600 million was notably exceeded as we delivered more than \$700 million of these services, 3.5 times those of a year ago."

**Comment** - Overall, the 4.6% profit margin is < average- and that was before exceptionals. We understand that Europe grew revenues by 19% (in constant currency terms) but, more importantly, operating profits growth was much better - over 40% we would guess. UK revenues grew by a modest <15% to around



£710m. CSC was yet another of the larger SCS companies being affected by the Y2K microclimate. But it was also hit by the associated ERM slowdown too.

Interestingly, France, Spain etc. (who largely ignored the Y2K effect) suffered little slowdown (and few associated problems!!!) whereas UK, Scandinavia etc. which did most preparation, suffered most from the slowdown afterwards (and didn't seem to be affected any less!)

And the great myth that e-services would completely replace that spend is borne out in CSC's numbers. Although e-services is up 3.5-times, at \$700m it is STILL only around 7% of the total. But that's not to say that we don't believe that e-services will be what underpin CSC and the other main players in the future. We see e-services representing more than 30% of total SCS sector revenues by 2003.

## Recognition Systems Breaking Records!

**Recognition Systems** more than trebled revenues to £3m (1999: £955K) in the six months to 31st Mar. 00. This "exceeded internal budgets and expectations" and exceeded the entire revenue for the previous year. The loss before tax was £2.3m after heavy investment. They are also one of the increasing number of companies to be hit by the very silly new NI provisions on its share option incentive scheme. Cash at the end of the half year was £15.8m having raised £17m (net) in Nov. 00. Bryan Black, Chief Exec, commented: "The first six months of our 2000 financial year has seen the company break many records and the outlook for the rest of the year remains very positive. With the new clients implementing Protagona during the second half of the year our services business will continue to grow. The pipeline for new business also remains very strong with some well developed opportunities for the second half of the year".

Recognition Systems' share price lost 16% in the month, ending on 185p.

## Change in Direction for Voss Net

**Voss Net**, (internet software), has made a number of announcements: the acquisition of **Sigma Freight Systems** for £708K, to be financed by a placing of 1.07m shares at 50p per share; a further placing of 332K shares to raise £166K to fund business development; the appointment of Barry O'Connell as non-exec Chairman; and results for the year ended 31<sup>st</sup> Dec. 99. Highlights revenue down from £585K to £446K, LBT deepened from £244K to £944K as did Loss Per Share from 4.14p to 15.12p.

Commenting on the outlook, Jeremy Gilbert, Chief Exec. said: "Recent results have reflected the change in direction for Voss Net. The group is now firmly positioned as a supplier of internet software for business - an arena which offers substantial opportunities for profitable growth."



## TCG Hit by Y2K

Terence Chapman Group results for the six months ended 29th Feb. 00 were pretty depressing. Turnover was down 22% at £12.2m. Operating profit was down over 90% at £23K, with EPS down a similar amount at 0.5p. After the profits warning in February these poor figures were not unexpected. "The overall results were affected by the one-off impact of Year 2000 issues on TCA Consulting's market. TCA Consulting's performance since February is much improved. TCA Synergo continues to perform well. TAROT2000 was launched in November, with significant business already won. A Managed Application Service was also launched with the first client implementation already in progress". Sir Colin Southgate (Chmn) said: "Notwithstanding the difficult market conditions experienced by TCA Consulting in the first half, the Board believes that the Group is now well placed to capitalise on its leading position as a software and IT service supplier to the dynamic and growing retail stockbroking market, and the significant opportunities that exist for providers of IT-related services to the finance sector". TCG also announced that it's subsidiary, TCA Consulting, had signed a £9m contract with ABN AMRO, "to prepare systems for new pan-European on-line retail brokerage services". TCG's share's stood at 210p at the end of the month, an 8% decrease.

## Financial Objects also Suffering

Following their AGM on 11th May, **Financial Objects** shares fell sharply. "Since the beginning of the current year levels of enquiries for our software products from banks reviewing their IT systems has increased as anticipated, although the number of banks reaching firm decisions and placing orders to date has not been at the level expected. Licence revenues for the Group are being affected by the delay in decisions and while it is difficult to gauge how long this position will persist, it is likely that there will be a significant adverse effect on financial performance in the first half of the year".

Financial Objects ended the month down 42% at 190p.



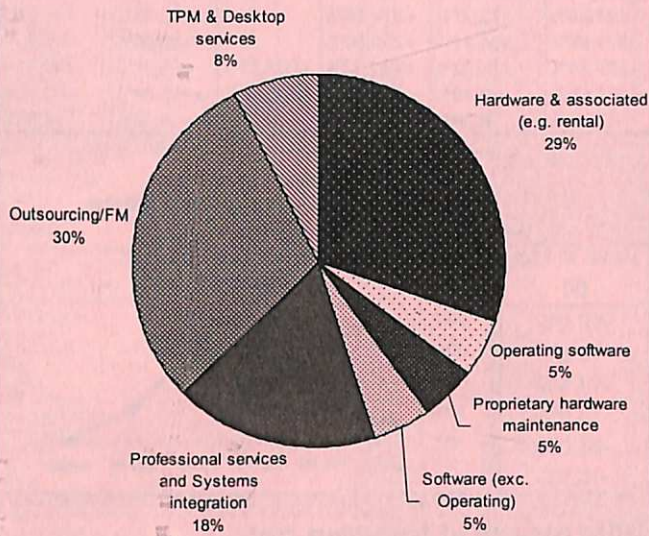




ICL is the 3rd largest supplier of SCS activities to the UK market (after EDS & IBM). They matter. Their results matter. The headlines read as follows:

- revenues unchanged at £2.77 billion
- an operating loss of £70m compared with an operating profit of £36m last time. ICL claims that £35m was restructuring costs but it is interesting to note that staff numbers have reduced by less than 4%/1,000 to 21,312. Another £64m related to preparing ICL for Y2K, the cost of e-business development etc.

### ICL UK Revenues Year to 31st March 2000 = £1.8 billion



- a PBT of £96.1m (loss £128.9m). However the profit was entirely (well actually £187m) due to the profits from disposals, in particular the private placing of 16.8% of ICL's Finnish operations.

- Balance sheet almost tripled from £100m to £283m...but, again, all due to profits on disposal. The bankers seem much happier this year than last.

- ICL reports a major change in its revenue structure with a 15% growth in SCS to 66% of revenues but a 18% reduction in hardware sales.

- UK revenues increased by 11% to £1.8b and UK SCS (excl. op. software and h/w maintenance) was up 24% at £1.25b. UK outsourcing revenues increased by 70% to £535m as over £200m was added to the outsourcing line from the £1 billion/10 year Post Office automation project Horizon (nee Pathway) which billed for the first time. Without this even ICL's UK's SCS revenues would have been flat.

- e-business (what we call e-services) almost doubled to £179m. But, despite ICL claiming to be totally e-business services oriented, these revenues still generate only 6% of ICL's total revenues. The full SCS breakdown is in 2000 Holway Report.

In answer to the eternal question... "When will you float", Keith Todd was INSISTENT "We are still on course for a float in 2000". Warburgs is the likely adviser but that is not, as yet, firm.

When you get your own private briefing with the CEO and directors of one of the top three UK SCS companies, you really would like to be kind. (Ed: we got that from the others like IBM, Cap Gemini etc. So you really don't need to give special treatment to ICL)

OK...So we can be really frank. This is about the biggest disappointment you can imagine. Promise. promise, promise. Loss, loss, loss. When on earth will we get delivery? ICL failed to make it during the years when you had to be seriously mentally deficient not to make a profit (eg in 1998). Now it's pretty tough for everyone. Why on earth should ICL survive in

*the cold when it shivered in the warm?*

Be consistent Holway...read every report we have written. ICL Always takes too long to take any remedial action. It is too soft. Too nice. Five years ago we reported Richard Livesey-Haworth saying that ICL had "too many dogs...we intend to round them into a corral and shoot them". Great... but most of the dogs are still there. And, by the way, there ain't nothing wrong with being a "dog" as Workplace Technologies, Guardian IT et al have proved.

Boring to say, yet again, but ICL has some gems. It's e-services business (all £179m of it) is great. As is its retail arm etc. They are worth far more in their own right than as a part of ICL. Even the PC fulfilment operation (OK, we can't get away from calling it Technology plc) is the 3rd largest PC reseller in the UK. It just doesn't fit in ICL. So why not sell it to Computacenter or whoever. But no...Keith Todd was insistent - well in public anyway - that there would be no more major disposals. But we guess he has to say that. It was interesting that ICL's multivendor business was NOT included in ICL Data (Finland) IPO...thus keeping all this business in tact across Europe. So the option of a sale (or IPO) for this as a standalone business remains. That we firmly believe is the best option.

As I write this the ghost of (Sir) Peter Bonfield hangs over me. A great success in his early years at ICL. Then a decline in the latter years. Now at BT and the subject of ever-increasing criticism. Too weak, too slow to take action they say. Takes years to let the old guard go. Defensive rather than "go for it".

Any likeness to ICL today is entirely intended. These results are extremely disappointing. The hopes of a 4.5% margin this year leading to a projected 6% margin in FY01 have not happened. Indeed we have an operating loss.

So what to do? We think Todd should mount a major disposal programme - quite happy for some bits to be IPOed as well and abandon any thought of an ICL IPO. If he won't do it we can give him the names of quite a few who would. Sorry, I know ICL go out of their way to ensure we are "on message" but...sometimes you have to be cruel to be kind

### Another Profits Warning from Compel

Compel have come out with a second profits warning in six months. "During Q2 revenue levels within Compel source will be substantially below expectations, primarily as a result of a lower than anticipated upturn following Year 2000 lockdowns. Consequently, Compel's trading results are likely to fall materially short of current Stock Market expectations. The Group will also incur some restructuring costs". Mark Howling MD of Compel source is carrying the can. Neville Davis will become MD of Compel source, whilst remaining Group CE.

In the full year (to 30th Jun. 99) Neville Davies said "Beyond the millennium, we believe our prospects are excellent. We anticipate a swift increase in expenditure levels as organisations seek to fulfill pent up demand". After the Interims (which were published on 15th Feb. 00) he said "We are already seeing evidence of an upturn following the year 2000 date change and we are confident that expenditure levels in our customer base will increase materially during the first half of 2000. The Group has recently seen a strong flow of substantial new contract wins". We have long been on record saying that we did not expect post Y2K demand to ramp up as fast as some had hoped, and warnings like this only serve to reinforce that view.

On the 19th May Peter Rigby and Specialist Computer Holdings (the second largest reseller - after Computacenter - in the UK) bought 3.5m shares in Compel and now controls 11.3% of Compel. Although we are not saying that Rigby won't bid for Compel, he has bought shares on countless other occasions in companies that he thinks have fallen too far. When they go up he sells and pockets the profits. Mind you this is the first reseller he has done this with.

STOP PRESS - On 1st June, Computacenter announced that a bid at 275p a share (a 35% premium) for Compel. Makes sense.

## Another torrid month

Our SCS Index fell *another* 13.5% in May. The resellers (down 20%) were hard hit but the real pain was inflicted on the Internet/dot.com companies. The Holway Internet Index fell by another 23% in May and is now nearly 60% off its March 00 high. Indeed, at "just" £11.7b, some £16b has been written off the "value" of the c60 companies in the index.

**Freeserve** was the only major gainer - up 47% on news that **Dixons** will sell its 80% stake. Bidders have been given 10 days to lodge bids and, currently, **T-Online** is the favourite.

The list of losers seems endless. But **Parity**, after its profits warning (p2), got the wooden spoon with a 49% fall. **MSW** on profits warning (p2), **Telme.com**, **Financial Objects** (p4), **Compel** (p7), **Netbenefit** and **Superscape** all slumped by more than 40%.

*The future?* Well, we still think we have not touched bottom yet.

End May 00	Move since 1st Jan 98	Move since 1st Jan 99	Move since 1st Jan 00	Move in May 00
System Houses	237.5%	118.5%	-14.9%	-12.6%
IT Staff Agencies	-25.8%	-11.2%	-22.7%	-11.3%
Resellers	44.7%	53.9%	-25.9%	-19.9%
Software Products	342.0%	277.8%	-9.1%	-13.9%
Holway Internet Index		618.0%	-12.6%	-23.0%
Holway SCS Index	225.9%	151.0%	-13.8%	-13.9%

## Bye Bye Boo.com

The collapse of internet fashion retailer Boo.com with the loss of 300 jobs (200 in the UK) was hardly unexpected. Investors thought it was worth £250m just a few months ago. Dan Wagner's Bright Station (nee Dialog, nee MAID) bought the software assets for £250K. Given our views about Dialog, the words frying pan and fire spring to mind.

As there seem to have been more column inches written about Boo.com than any other IT company, we won't add too many here. But this is the first high profile dot.com collapse in Europe/UK. It is bound to have effects on the share prices of others in the B2C space (and, by the way the ones that should be most affected are the legion of quoted "investment" operations most of which invested your funds in even more "dodgy" operations than Boo.com). US research indicates that of the 30,000 major B2C internet sites, five out of six are expected to run out of cash before the end of 2000.

Now your initial reaction might be a tiny amount of sorrow for those losing their jobs and/or money but a shrugging of the shoulders and a "What's it got to do with me?". But the knock on effects are even more serious. *Where were these dot.coms burning their millions a week?*

1) on advertising

2) on IT enabling software, hardware and services

They probably spent quite a lot on "City" fees (legal, accounting, PR etc.) but no one ever has any sympathy for those kinds of people anyway.

The point is that the ripple effects on our own SCS sector are significant. If dot.coms can't raise the funds, they can't spend it with you...the IT services companies and our research subscribers.

So, at the end of the day, the hit just must be across the board. We hope that the quality end will be least affected. Maybe those established IT services companies which made great play of being "entirely e-business now" might want investors to know that they really were only kidding!

31-May-00

SCSI Index

9934.80

FTSE IT (SCS) Index

3028.41

techMARK 100

3256.25

FTSE 100

6359.30

FTSE AIM

1645.20

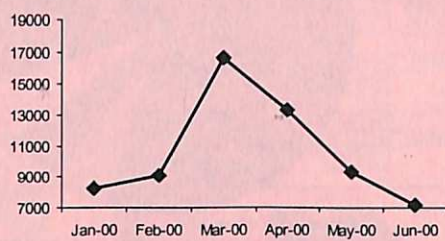
FTSE SmallCap

3185.49

SCSI Index = 1000 on 15th April 1989

Changes in Indices	SCSI Index	FTSE 100	techMARK 100	FTSE IT SCS Index	FTSE AIM Index	FTSE Small Cap
Month (30/4/00 to 31/5/00)	-13.53%	+0.50%	-11.32%	-12.80%	-6.73%	+0.42%
From 15th Apr 89	+893.48%	+209.67%				
From 1st Jan 90	+979.75%	+169.23%				
From 1st Jan 91	+1303.48%	+194.36%				
From 1st Jan 92	+850.83%	+155.08%				
From 1st Jan 93	+523.42%	+123.41%				+129.61%
From 1st Jan 94	+495.05%	+86.03%				+70.47%
From 1st Jan 95	+562.68%	+107.45%				+82.40%
From 1st Jan 96	+339.88%	+72.37%	+312.58%		+72.56%	+64.07%
From 1st Jan 97	+271.05%	+54.41%	+256.00%		+68.55%	+45.92%
From 1st Jan 98	+227.34%	+23.83%	+241.32%	+202.84%	+65.85%	+37.71%
From 1st Jan 99	+152.06%	+8.10%	+123.64%	+109.43%	+105.24%	+53.82%
From 1st Jan 00	-13.39%	-8.24%	-13.84%	-18.55%	-14.88%	+2.83%

Holway Internet Index  
dives nearly 60% from March 200 high



## Wild month at freecom.net

What a month at freecom. If you remember Bob Morton's freecom came to AIM in Dec. 99 at 130p, bought **Pegasus** in Mar. 00 for c£30m and then **Oneview.net** for £136m in Apr. Then, this month they bought 80% of **Systems Union Group (SU)** for a maximum consideration at £31.92m (based on the value of a freecom.net share of 222.5p). SU develops and distributes the Sun Systems range of business and accounting software products, targeting the SME market. SU's revenues in the year to 31st Aug. 99 were £73.35m, and borrowings were £9.18m. We were a fan of SU, but it seems that they were running out of cash having had a £10m injection from 3i in Oct. 99. Only 40% of turnover was in the UK and they have offices in 26 countries. SU should have come to the market a few years ago, and it looks as if this was a "distressed" sale - the price is very low a PSR of 0.45. They spent £11.6m on R&D in year ended 31st Aug. 99, which equates to 16% of turnover, which is high but acceptable if the company is a high margin cash generating machine, but looks pretty strange when they sell the company for less than three times this sum a year later.

freecom.net also announced that it will not actively seek any further acquisitions until all of these acquisitions have been 'bedded down' to the board's satisfaction.

But in late May it was announced that several board members of its recent acquisition, **Oneview.net** - Stuart Lawley (Chairman), Steven Salmon (MD), and Stephen Winyard (Sales and Marketing Director) - had resigned over differences of opinion in the "current status and future direction" of Oneview.net. Nine million shares in freecom.net are to be handed back. It turned out that Oneview.net's customer base was lower (c4000) than the figure stated at the time of the acquisition.

The Times reported that Freecom.net had appointed DLJ to "sound out potential bidders". So it's really not impossible that **Sage** might get their hands on Pegasus after all!

Freecom ended May down 40% at 123p...strangely close to the Dec 99 IPO price.





**Northgate Information Solutions** (the MDIS of old) has acquired **HARVEST**, "provider of business process outsourcing for personnel, recruitment and payroll services", for a max. consideration of £1m.

**Yeoman** has acquired **Laser-Scan** for £14.1m.

**Anite** has acquired an option to purchase **IOL** (developing managed services that assist organisations in the use of electronic document handling) for £1 plus a maximum earn-out of £1.5m + £300K preference shares.

**Comino** (workflow for housing, occupational pensions and local government) has established a JV with **Montal Computer Group** to provide ASP to its user base. Comino has invested £1m for its half share in the new company. The JV will be called **Comino Montal**.

Javaid Aziz (ex IBM UK MD) has raised £38m for his **Aspective** (yes, its an ASP...). It now employs 110 people after just 5 months. UK **CallCentric** has acquired US **Datapoint** (those as old as Holway remember it for its mini computers) for £38m.

**Staffware** has bought US **Marketforce** (CRM specialists) for \$20m. For the financial year ended 31st January 2000, MarketForce had gross revenues of \$2.2m, PBT of \$300K.

Spanish company **Meta4**, a "web based people and knowledge management software company", has acquired **Cyborg Systems** (an HR and payroll services company) for a minimum consideration of £15m, (maximum £22m dependent on performance to end 2002) in cash and Meta4 shares. Cyborg's results to 31st Dec. 99 showed a strong return to profits with a PBT of £1.3m on revenues up just 4% to £11.9m. Having completed an MBO from parent company **Cyborg Systems Inc.** under the management of MD David Stallion, with an exclusive agreement to continue supplying Cyborg's products in the UK, we were looking forward to seeing a continuation of the growth and profits in 2000.

**Future Integrated Telephony** (B2B supplier of telecomms solutions) has acquired **Alan Stephens Associates** for £250K in cash and 350K shares valuing ASA at approximately £2.0m. ASA "develops and implements web sites, corporate intranets, extranets, e-commerce and marketing support".

**Infobank** has acquired **Proactive Solutions International** (an e-business consultancy with 9 staff) for an initial consideration of £1.5m made up of £1.2m in shares and £300K cash. Further consideration of max. £1.5m in shares is based upon PSI's performance to 31st Dec. 00.

**Macro 4**, an operating systems software company, has bought the IPR's to Xtrace (a fault management programme) from **BankNet Technologies Inc.** of Canada. The max. consideration is £9.15m cash, made up of staged payments totalling £1.04m and a 15% share of sales revenues for the next four years.

**Reuters** has acquired **The Yankee Group Research Inc.** from **Primark Corp** for £72.5m. The Yankee Group is "an international technology research and advisory firm", based in Boston.

**Nettec** has acquired **Syslogic** (developer of e-commerce applications) for total consideration of £4.5m, with an initial payment of £3.5 million (in cash and shares) and a further £1 million will be paid in early 2001 (again split between cash and shares).

**Griff-Tech.com** has announced a £13.2m reverse takeover by **Future Internet Technologies**. The company also said it is planning to raise £3m through a placing of 150m shares at 2p per share to provide working capital. Following the reverse takeover the company is to change its name to Future Internet Technologies.

**Medi@Invest** acquired a 33% stake in **Creations Group** (holding company of **Software Creations**) for a total consideration of 25.4m new shares and £3.45m cash, a small proportion of which is deferred. The total consideration is valued at £6.6m, based on the closing mid market price of Medi@Invest's shares of 12.5p on 12th May 00.

**Marconi** has launched a new company, **Marconi Software**

**Solutions** to focus on providing IT services and solutions for telecommunications and Internet-enabled businesses. The company has four UK offices and around 400 staff. Commenting on the launch MD Fiona Pearson said: "Marconi Software Solutions has a long pedigree, but this is very much a new company with a surprisingly radical outlook, which we believe is vital to meet the demands of today's 'Internet speed' economy.....As a consultancy in e-business and software, I see us operating in the same 'space' as Logica and Cap Gemini." During the month Marconi acquired **Systems Management Specialists (SMS)** a US IT outsourcer, for £76m. SMS has 600 staff and rev to 31st Dec. 99 of \$112m.

**QXL** has taken over (though it is being called a "merger" for accounting reasons) **ricardo.de** in a share-for-share exchange. The enlarged group is expected to be called **QXL ricardo**. Based on QXL's closing share price of 180p yesterday, the offer values each ricardo share at Euro127 and the fully diluted share capital of ricardo at approximately Euro1,104m (£668m). This represents a premium of approximately 27% over the closing market price for ricardo.

So, another aggressive acquisition to make **eBay** twitch. **QXL** has now spent over £1bn of its equity in the last six weeks buying ricardo and **Bidlet**. The valuations look, as ever, farcical, but investors can probably say "who cares?". **QXL** shareholders have acquired a substantial German presence and ricardo shareholders have swapped their overpriced equity for another chunk of overpriced equity (and they have got a 27% premium into the bargain), both parties have a stronger offering and expanded geographical range. **QXL** was always tipped to be scooped up by a European player or eBay. It looks as if **QXL** has done the scooping in Europe and eBay would struggle to buy it now. **QXL** is on a higher rating and deserves a management premium. Buying this out as well as the extra £1bn of equity is starting to look like a rather large mouthful.

**VI Group** (CAD/CAM software designers and distributors) has acquired Milan based **Tecnocam S.p.A.** for c£219K.

**Terra Networks**, the Spanish internet group, has acquired **Lycos**, the web portal listed on NASDAQ, for \$12.5bn in shares. This is a massive 80% premium over the pre-offer price. The new company will be called **Terra Lycos**, and will have revenues of c\$500m this year.

**Integra**, German Internet site operator and provider of e-commerce solutions, has announced the acquisition of **NetSite Productions** for total consideration Euro5.34m, to be paid in Integra shares.

**CMG** has acquired a 50.9% stake in **SDC Software Development & Consulting GmbH** for DM30m/£9.2m. SDC is a project oriented system house with rev of £3.7m and op profits of £500K in year to 31st Dec. 99.

**QSP** has acquired **Inform** (e-business solutions) for £800K in shares plus a further £5.7m depending on performance to 31st Mar 03 and **Information**, (business intelligence solutions), for £1m in shares and a further consideration of £2.6m based upon performance over the next two years.

**Affinity Internet** has acquired the **LoudMouth** software ("to facilitate person-to-person communication on the internet") for \$204K in shares.

### Some of this Month's Investments

**Brainspark** announced that two of its partner companies have completed follow on funding: **Metapack** has received £2.6m in total and **Petspark.com** has received \$7m. Brainspark has also announced two new investments: \$1m in **IPROX** (consumer services to mobile phone users) and £500K in **Kerb**, "a new media creative agency".

**Interregnum** made £500K investment in **ComputerWire** (which publishes Computergram), along with £3.5m from **AMP Private Capital**.

## Planning to Float...

**Venturedome** (a provider of information and services about VC over the internet) plans to float on AIM, raising c£3m.

**Capital.WebOrator** (whose software "links buyers to products and services supplied by member companies" on the internet) plans to list on OFEX, raising £0.5m in a placing of 1.7m shares at 30p per share.

**BSOFTB** (internet applications software) plans to float on AIM, raising £15m. It expects to be capitalised at £45-55m.

**Software For Sport** ("sports venues and events management software") plans to float on AIM, raising over £3m (to be used to fund development, "particularly as an ASP"), and expects to be capitalised c£13m. Michael Jackson is non-exec Chairman and Alistair Hardie (ex-MD SSA Softwright) is CE.

## And Those that Have IPOed this month

Joining the main market this month were **Actinic** (developer of e-commerce software for the SME 's), at 81p per share, market cap. £99.6m; **StatPro** (performance management software for the asset management industry) at 80p per share, market cap. £21.6m; and **The Innovation Group** (developer of claims management software for insurers) at 229p per share, market cap. £241m. **Internet Business Group** (provider of internet services), joined AIM, at 40p per share, market cap. £20.2m.

## Pru sticks with Egg float

**Prudential** has announced a 130-175p price range for **Egg** valuing it at between £1.1 and £1.4b. 18% of the equity will be offered in a retail and institutional offering. Probably even this is "brace" in today's climate. There will be many learned analysts trying to put a value on Egg's loss making business. But it's all fiction as the past few months have shown. Just look at the different valuations of Freeserve over the last year. The similarities are great. Remember the very people (like us) that moved to Egg are very people who have the technical knowledge and desire to maximise their interest rates. As we said in the 2000 Holway Report, we would move from Egg to Yolk as quick as you could say omelette! Investors should remember that. Also, Egg is great for something very simple. You try to do something like a foreign currency transfer and you are back to using Lloyds TSB. We reckon the vast major of Egg users have other accounts. So when they, Barclays etc. really get their act together, Egg could face an exodus of accounts as quickly as they found them in the first place.

## GUS announces e-commerce strategy

**GUS** has announced its e-commerce strategy through a major restructuring of its outsourcing businesses – including BPO 'unusual suspect' **Experian** – into a new division called Third Party Services. They have also acquired £5m p.a. rev. web design consultancy **Reality Group Ltd** for £35m "to complete the division" – indeed, Third Party Services will henceforth trade as **Reality** and at birth has "proforma sales approaching £400m". **Experian** President of Marketing & Strategy **Martin Trees** (ex-EDS, ex-Sema, ex-IBM) will be CEO of the new division. **GUS** is also launching incubator **gusco.com** "to fund and oversee the development of GUS' e-commerce investments". **gusco.com** will have its own board led by Group e-commerce director **Michael de Kare-Silver**.

This is a significant move, both for **GUS** and especially for **Experian**, which seemed to be languishing due to lack of direction and business clarity (well, we couldn't understand it, anyway!) **Experian's** worldwide rev. in FY98/99 was c£900m so there's been a lot chopped out to make the new **Reality** business. Even so, **Reality** is still a bit of a mixed bag – web design, customer management, call centre facilities, logistics management and delivery services (a bit like **Hays** 'business process support' and logistics services) – so we think they'll have their work cut out trying to turn it into a seamless one-stop shop for "end-to-end solutions for businesses seeking access to consumers directly, both on- and off-line". But it's worth a try!

## Cadcentre Moving On Up

**Cadcentre**, (design systems for process and power plants), increased revenues by 34% to £23.9m in the year ended 31st Mar.

**00. PBT** increased 45% to £4.3m and **EPS** increased 55% to 17.4p. Chairman, **Richard King** "looks forward with confidence to achieving further improvements in financial results this year." We thought people would have stopped using that word by now!

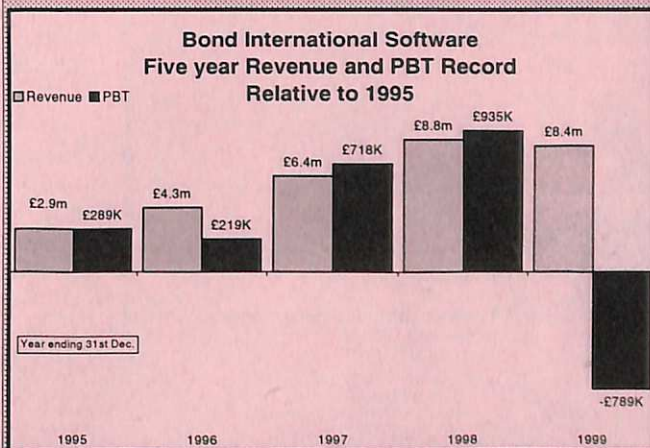
**Richard Longdon** (CE) said: "We have been working towards creating a services business in which we provide systems integration and facilities management for the design and engineering environment within our major customers. This is our first major contract and we are confident of expanding this part of our business - complementing our traditional software and services activities".

As others will testify, **Cadcentre's** shift towards higher value added services (from hardware sales), is not an easy one to make, and the management deserve credit for this success. We have long been advocates of these moves up the food chain and this is further proof (if it were needed) of the sound commercial logic behind such initiatives.

**Cadcentre's** share price ended May up almost 10% at 357p.

## Bond Suffers Losses For First Time

**Bond International Software** (software for recruitment, HR and tourism markets), reported a loss of £789K compared to **PBT** in 98 of £935K in the year ended 31 Dec. 99. Revenue was also down 4% to £8.4m. Chairman **Martin Baldwin** said: "We have already received a number of orders for **ADAPT** including a major order from one of the world's largest recruitment companies for



the deployment of the product throughout its UK offices". Failure to meet the group's targets was due to "a significant slowing of activity in the last months of the year". **Bond's** share price was down 20.6% to 57.5p on the day of the results, and down 12% to 51p at the end of the month. Also announced was a deal with **tempz.com**, an online temp agency, worth £250K to provide the back office solution.

## Azlan Positioned to Grow

**Azlan's** results for the year ended 31st Mar. 00 showed turnover up 20% to £411m, **PBT** up 141% to £9.3m, and **EPS** up 136% to 5.9p. Commenting on the

outlook, **Barrie Morgans**, Chairman said: "Looking ahead, **Azlan** is in a strong position to take advantage of the fast growing network communications sector. Its pan-European structure and partnerships with some of the world's leading technology companies positions us to grow the business both organically and through selective acquisition opportunities that support our value added strategy."

At the end of the month **Azlan's** shares stood at 139p, a rise of almost 9% on the month.

# 2000 Holway Report

We finished the 2000 Holway Report on schedule and it should be with subscribers by mid-June. It really is bigger (about 20% bigger) and better (the UK market breakdowns and forecasts are our most comprehensive ever, the company profiles the most detailed we have done, the M&A section contains a record number of acquisitions). If you haven't ordered yet...please do so. We attach another order form in case you missed last month's which was enclosed with the brochure.

Also, on Thursday 13th July 2000, Richard Holway, the author of the Holway Report, is presenting the main findings of the report to an evening seminar on behalf of the Computing Services & Software Association at the Grosvenor House, Park Lane, London. Last year over 350 top CEOs attended what is now considered to be "the CSSA networking event of the year".

The advance orders this year are fantastic with almost every CEO of note booked months in advance.

The evening starts at 5.30pm (for 6.00pm) and includes drinks and a really special dinner.

A **free place** will be awarded to all 2000 Holway Report customers who purchase before that date. An advance order form is enclosed.



Normal price for the evening from the CSSA (Tel: 020 7395 6717 or you can e-mail: zoe.hemming@cssa.co.uk) is £180 + VAT for CSSA members and £230 + VAT for non-members.

## Goodbye Karl...but surely not for long?

Karl Chapman is to step down as CEO at Spring. Spring also acquired **Magenta.com**, for 2.4m shares worth approx. £4.2m. Magenta "is an internet software and tools business ...that manages the end-to-end recruitment process".

More significantly, Magenta is wholly owned by Jon Chait who was CFO and MD of the international operations of **Manpower**. Chait now becomes Chairman and CEO of Spring.

Spring has already reported that its ITSA operation has been adversely affected by the "Y2K micro climate" but shows "some early signs of recovery". We both liked and rated Chapman. But he tells us that he was fully responsible for doing the deal with Magenta and bringing Chait on board.

**Knowledge Universe** bought its 50% stake in 1996 for 160p per share. Since then it's been a rollercoaster ride and they can hardly be happy with the returns over a 4 year period which has seen massive increases in the share prices of most other technology stocks. Spring was up at >400p at one point. Only in Jan. 00 Spring launched **Spring.com** with the novel idea of giving its IT contractors share options. Spring's share price soared to over 300p. Which was a bit of a shame really as the shares slumped by another 34% this month at 115p so the options given to IT contractors at around 178p are not worth anything at all. Even so 12,000 have registered for Spring.com of which 4,000 are IT professional new to Spring "To put that into context, Spring currently has <3,000 contractors on customer sites". But, as we said at the time, there was no reason not to register. So, in some respects, we are surprised there are so few! At the time we were far from happy with the scheme but praised it as a marketing ploy.

Anyway, this all demonstrates the wind of change going through the ITSAs. More consolidation will occur and maybe Chait has the "big company" experience to make it happen. Or, of course, Spring could just become supper not the chef. Either way our world will be a bit less colourful without Chapman...until he reappears somewhere else as he surely will!

## Goodbye Rob Pickering too...

**Origin's** CEO - Rob Pickering - has departed. Indeed, we understand that several others in the top management team left too. Whether this was in response to the quite appalling Q1 results (when revenue slipped 3% to Euro400m but operating profits of Euro25m in Q199 were all but wiped out with Non captive (ie non Philips) revenues declined 10% to Euro248m) or the "difference of opinion" with owners Philips over future direction (a "merger" with another SCS group or a listing were the management's preferred routes) is not known. Origin seems amazingly adept at losing CEOs. Origin is one of the Top Ten largest SCS operations in Europe so would make a good addition for other major SCS players wanting to boost size and spread. Origin UK has revenue of c£150m.

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