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SYSTEMHOUSE

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

INFRASTRUCTURE OUTSOURCING: A MATURE MARKET, A DEMANDING CUSTOMER

By Kate Hanaghan

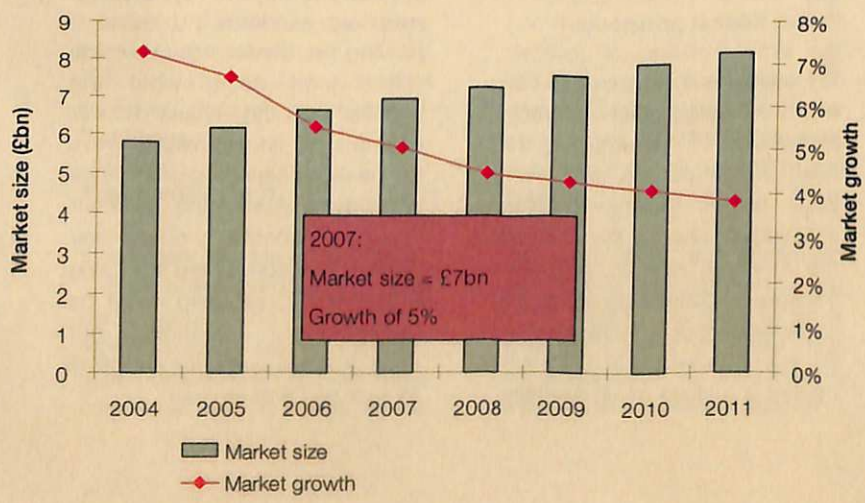
Kate Hanaghan
Senior Analyst

Infrastructure outsourcing accounts for a £7bn chunk of the UK IT services market but it is mature and commoditised in many parts. As a consequence, customers of infrastructure services are in a very strong position, able to pit suppliers against one another to push prices right down. The difficulty for suppliers is responding to this when differentiation is hard to demonstrate. At the same time, customers are becoming increasingly demanding, not just around pricing but in how they engage with suppliers and how services are delivered. They want even more flexibility in how they deal with their suppliers - for example, being able to swap-out underperforming suppliers with greater ease. And, ultimately, what they want is total flexibility around the way they receive services. In other words, they want to be able to turn the 'dial' up or down as their demand for services goes up and down.

A need for leadership

But all is not lost! Suppliers can respond in a number of positive ways. Infrastructure outsourcing (of data centres, servers, desktops and so on) for most customers is about stripping out costs. It is certainly not about ploughing in new investment. Suppliers need to focus on proving that they know how to get the most out of the customer's infrastructure – at the right price, of course. For example, customers want to see suppliers prove that they have a specific understanding of the industry within which they operate (e.g. manufacturing, utilities or transport). Having this insight is attractive to customers, but it must go further. Clients

Infrastructure outsourcing: modest growth in a big market



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want to know what a supplier can do to specifically enable them to hit business objectives. Furthermore, if suppliers can provide a clear plan around how this will be achieved and how it can be measured, then even better.

A benefit of having this proximity with the customer is that it may well position the supplier for additional and higher-value work. Or indeed, it may enable the supplier to create new business from scratch. For example, many of the larger outsourcing suppliers have been using this method in order to stimulate the need for larger outsourcing contracts. And it looks like it could be a strategy that is starting to pay dividends. Recent data from third party advisor, TPI, shows that the number of restructuring deals coming onto the market has declined quite notably in the first half of 2007. We think this is partly down to the proactive stance many suppliers have been taking to ensure they are in a strengthened position at renewal. This is also applicable outside of the UK and across Europe more broadly.

Seeking a full outsource alternative

As we pass the mid-point of 2007, we see a continuation of certain themes that have been shaping the market – and the performance of suppliers – for a time now. Notably, the preference for multi-sourced infrastructure outsourcing contracts is continuing – and the larger suppliers are feeling the negative impact more than most. Take IBM as an example. Its infrastructure outsourcing business shrank by 11% in FY06 as a result of it not being able to win the very large deals that really help it to notch-up growth. Customers want to de-risk their contractual arrangements and at the same time introduce more opportunities for competition by tendering multiple deals rather than one, large deal. Our view into supplier pipelines, combined with our insight into customer plans, indicates that this trend is set to continue.

Another manifestation of the wish to de-risk deals and increase flexibility is the interest in managed infrastructure services. In other words, customers increasingly want to outsource parts of the IT function, not necessarily the whole lot. This is not necessarily bad news for suppliers, because we see customers who might previously have been reluctant to use an external supplier in any capacity now considering this to be a realistic option. Of course, this changes the nature of the game and doesn't give outsourcers the large growth 'hit' they would get from one large, end-to-end outsourcing deal. Instead, these suppliers must gear themselves towards being able to win and manage a greater volume of smaller deals in areas such as managed storage, managed email and remote monitoring. Of course, these are not new services, but the customer propensity to take up these services has increased. And that applies to both those customers who are outsourcing for the very first time and those who have previously gone the full-outsource route.

Future market prospects

TPI estimates that almost €1.6bn worth of outsourcing contracts (globally) is up for award in the next three months. However, 2007 is still looking relatively soft (largely due to the state of the Americas market), not least because customers are continuing to demand more offshore services. In this context, the European market is looking much healthier. For example, the value of new scope deals in 2007 thus far is up on last year, and we can thank Europe for making a huge contribution to this. Furthermore, in the first half of 2007, there were five mega deals (worth €800m+) awarded in Europe – an increase in both volume and value on the comparable period in 2006. Three of these were awarded in Q2, with the victorious suppliers including BT and Capita.

In the UK, the ILO market will be worth an estimated £6.88bn in 2007. A large portion (approaching 30%) of the ILO market is in the public sector, which we see hitting something of a plateau in 2007. 2006 was lifted by strong growth from the Aspire (Capgemini) and DII (EDS) contracts, but this was counteracted by subdued growth elsewhere in the market. In the coming few years, we see a softening in public sector demand. Meanwhile, we are currently seeing a slight up-tick in private sector demand – meaning that public sector-heavy players may need to reconsider exactly where they put their efforts.

Even in a market where it is difficult to differentiate, suppliers must find a way of setting themselves apart from the competition. They may all offer the same core services, but there are elements that can be wrapped around these to make them more attractive to buyers. Furthermore, suppliers need to find ways of proving the services they provide are indeed doing what the supplier said they would do. For example, by finding reliable ways to measure service performance and staying close to the customer in order to constantly check their business objectives are still being addressed. Customers might be getting more demanding, but there are still ways for suppliers to succeed and prosper.

BPO: TIME TO TAKE "PARTNERSHIPS" SERIOUSLY

Samad Masood
Analyst

"Partnership" can be a bit of a throw away term in the IT services industry – particularly when it is applied to client/vendor relationships. Most so-called partnerships are no different to normal outsourcing contracts, i.e. driven more by service-level agreements and key performance indicators than a shared investment in a mutually beneficial outcome for both client and supplier. But in the BPO market things are changing. And as client's expectations of BPO services mature, and the supply-side evolves to match this, we think it's time for both sides to start taking client/vendor partnerships seriously.

Most UK clients still primarily adopt BPO to drive cost downward, not for transformation or business growth. But we are seeing a growing (albeit still small) trend among clients to view BPO as a tool to enable strategic business transformation. For example, clients in finance, public sector, retail and manufacturing are increasingly using BPO services to reduce the risk and investment needed to support international growth (with services to support new branches, for example) or the provision of a new product or service (with services providing the scalable back-office processes to support them). Clients are also more keen to work under joint-venture or partnership conditions, whereby the vendor shares the risk of launching a new product or service through a risk/reward-based contract.

The bundling of IT

In addition, we see clients taking a more holistic view of the value derived from IT, and as such favour more 'business-oriented' metrics than previously. IT is now more commonly seen in terms of the business process it supports rather than on technical performance. This shift in perspective is starting to accelerate the bundling of IT services provision into BPO deals. It also means that BPO deals are increasingly measured on business outcomes rather than purely transactional performance.

As BPO becomes more clearly tied to overall business performance rather than cost, clients are also taking a more pro-active approach to contracting and managing BPO relationships. They are tending to invest more time and money into managing relationships, and are more interested in playing a role in how suppliers deliver their services. This is evidenced by the increasing use of third-party advisors (TPAs) to help them develop their BPO strategy, source suppliers and manage the relationship on an ongoing basis.

Deal structures evolve

Looking ahead, we expect partnerships where the client gets more involved in delivery strategy and where there is a shared risk/reward component for the vendor to become more common going forward. Clients will also look to manage the transformation delivered under BPO deals much more closely – for example, by splitting large contracts into smaller, more defined, 'incremental' deals with BPO providers. Such deals can give the client more control over each phase of a transformation, and reduce risk for both client and supplier.

So what does this mean for vendors? A key strength going forward will be the ability to prove in-depth vertical expertise and an understand of the context within which a client organisation is operating. Understanding the client's "big picture" enables suppliers to empathise with their client's challenges, and to pro-actively bring them BPO solutions that meet their needs today and in the future.

Know your customer and their context

BPO vendors have begun to realise this need for in-depth vertical expertise. Most are now investing more in hiring senior executives from within their clients' industries. These 'rainmakers' are expected to help develop new BPO sales opportunities for vendors. Vendors are also increasingly targeting specific niche markets and developing more structured sales processes that force internal collaboration during the proposal and bid stages of a deal. This can help vendors be more innovative in building client solutions, but it also helps the vendor spot potential risks from large BPO deals.

Ultimately, both clients and vendors are taking BPO more seriously. They are less willing to take the potential benefits of BPO for granted, and are both investing more in signing the right type of deal, rather than looking for a quick fix. True BPO partnerships are still the exception rather than the norm. But as both clients and vendors invest more on working closer, and understanding each other better, we expect to see BPO enter a new era where the flexibility of partnerships is preferred over relationships driven by the letter of a contract.

TECHNOLOGY AND MODERN MANAGEMENT: KILL OR CURE?

David Mitchell
Practice Leader, Software

Technology and management innovation seemingly go hand-in-hand. Business change is habitually driven by one or more of the three-letter acronym family - whether it is ERP, CRM or a host of others. It is hard to find a major business change programme that is not driven by technology.

The trouble is that technology has become a crutch for many bad managers. It has become a way of forcing through change and processes that are unwelcome by the organisation at large. Many of the human subtleties of management have been lost, killed by a reliance on technology that has become stifling and oppressive.

Approaches with deep roots

The management foundations of these technologies lie deep in history. Adam Smith highlighted the importance of the division of labour for economic growth over 200 years ago. In so doing he laid the foundations for the business process analysis and business intelligence practices that are the foundations of modern-day enterprise resource planning (ERP).

Many management approaches and concepts - from Michael Porter's value chain framework to lean manufacturing - are underpinned by technology. There are deep historical roots to the management thinking behind many of the technology-based business change programmes that operate today.

Although often incredibly difficult to manage in practice, the abstract management roots behind the technology tend to be very simple. The focus is on analysis, standardisation of process, specialisation of role, measurement, control and so on. The optimisation of the overall system is the goal, and individuals are aligned to become the most efficient cogs in the machine that they are able to be.

The practical blocks

This provides practical management challenges. The following three are the most often cited as blockages to technology adoption or to delivering the full business potential of technology:

- **De-personalisation** - role-based management can lead to individuals feeling like cogs in the machine rather than as valued individuals. This can in turn lead to individuals losing their sense of grounding in the business and becoming progressively detached.
- **Stifling creativity and innovation** - when all processes with a business are carefully defined it can be difficult to find space for creativity, innovation and invention. The creation of innovation processes simply misses the point and is an anathema to many creative individuals.
- **Suppression of generalist talent** - many talented individuals have an ability and desire to contribute to many different parts of the business, at the same time. Removing a niche for generalist talent can have a long term depressive impact, and a policy of management rotation does not address this. Serial specialisation is not the same as concurrent generalism.

More to come with Web 2.0

There is a new generation of technology looming on the horizon. This broad basket of technology, somewhat vaguely categorised as Web 2.0, includes social networking, wikis, blogs, instant messaging, VoIP and a panoply of other communication and collaboration-related technology. Although most written about from a consumer perspective the impact on business has potentially even greater magnitude, and provides sizeable management challenges.

What is going to be needed by the next generation of managers is a wide variety of management skills, some of which have remained dormant or have almost been pushed to extinction by our current management generation. They will need to be comfortable with a range of intervention styles that span a spectrum from process-driven intervention through to more personal and humanistic styles. Social networking transcends organisational boundaries, with the threat to corporate intellectual property and a reduced ability to exercise corporate control. Managers will simply need to grow accustomed to this and respond accordingly, rather than seek to place increasingly stringent rules on the participation of their workforce. The different forms of collaboration and communication technology will produce a whole range of unforeseen impacts on working patterns, processes and business organisation.

Softer skills needed

Nobody yet has enough foresight to see how these technology changes will impact management. All we can clearly see is that management will face an increasing number of challenges, all of which will require much greater management innovation than many have been accustomed to using. Management cannot micro-plan this impact in advance. In the words of Shakti Gawain: "We need to be willing to let our intuition guide us, and then be willing to follow that guidance directly and fearlessly". A diversity of management approaches will be needed that is every bit as diverse as the people in our organisations.

LOGICACMG AND THE NEED TO BE MORE EUROPEAN

In the past two years, LogicaCMG has made two major acquisitions: Unilog in France and WM-Data in Sweden. It has gone from being essentially an Anglo-Dutch services provider to being more of a European vendor – or at least one with significant businesses in Northern Europe and France. Its strategy has been to gain scale in Europe and to maintain a balanced market-sector profile.

We think both are the right strategies. To succeed in the top tier of the European IT services market, vendors need scale. Large multi national enterprises want to deal with pan-European service providers that can deliver the same services at multiple locations. A balanced market-sector profile – no over-dependence on any one vertical market – means that the vendor can better survive peaks and troughs in the spending cycles of different sectors.

Right strategy, patchy execution

Nevertheless, we don't think that LogicaCMG is firing on all cylinders yet. Investors haven't been too impressed with the company's performance in recent months and in June and July, the share price dipped following CEO Dr. Martin Read's decision to retire early. No doubt shareholders were disappointed by UK revenues that were down 9 percent in the first half of FY2007 after a disappointing FY2006. The UK division lost out on its deal with Transport for London to CSC and this in particular adversely affected UK revenues for the period.

Meanwhile, the continental European divisions have been performing reasonably well, with Germany and France hitting 10 percent revenue growth in the first half of 2007. LogicaCMG seems to have absorbed Unilog and WM-Data without too much disruption and is managing to hold onto existing customers as well as win new ones. But there's a sense in which it isn't yet operating as a unified pan-European business. Each of the European businesses is doing its own thing – selling to the industries they know in their own backyard rather than LogicaCMG presenting itself as a true European player.

We'd like to see LogicaCMG winning more pan-European deals. Perhaps it can get them through its UK, Dutch, French and Nordic divisions, but it's hampered by its lack of scale in the German market. Germany is undergoing an economic revival and is the powerhouse of European manufacturing, yet LogicaCMG's German revenues are less than half those of its Nordic, French or UK subsidiaries. No matter how much it grows organically, it's not going to have the scale to compete with the big global or top-tier European players for multi national deals from German enterprises.

Share and share alike

Then there's LogicaCMG's ability to replicate vertical-market strengths in its different geographies. While it's to be expected that Unilog and WM-Data will have brought their own local strengths related to the markets in those countries, we think LogicaCMG needs to do more to smooth out the imbalances in vertical market sales between countries if it's to be seen as a real European player.

For example, LogicaCMG's successes in the Dutch and French financial services sectors haven't rubbed off on the UK yet. Its UK financial services (FS) revenues measured just 60 percent of its Dutch FS revenues in FY2006. We think this is well below par, given the fact that London is arguably the number one financial market in the world. Other examples of the imbalance between vertical-market successes in different geographies exist in Energy and Utilities and Public Sector.

This is about more than cross-selling between the different geographical divisions. It is about exploiting synergies within the newly expanded organisation. It's about marketing the company as LogicaCMG the European IT services vendor. Perhaps it's something that a change of CEO will bring about. Whoever it is, he or she will ideally be someone with strong European credentials, who can ensure that common processes and go-to-market messages are shared across geographies.

In our opinion, LogicaCMG also needs to be more ruthless and selective in picking projects that it knows are repeatable and saleable across Europe. Its growing expertise in satellite communications, biometrics and e-identity are good examples of where we think it has made the right choices. To really enter the top tier of European players, it now needs to be more agile and adept at marshalling its skills and expertise where they're needed, provided the return on investment can be recouped across its geographical markets.

Ian Brown

25%
23p

smartFOCUS Group plc

SMARTFOCUS PROSPERS IN BUOYANT MARKET

Marketing software firm smartFOCUS held its AGM during July. Chairman John Charles was able to give an upbeat talk to shareholders, telling them that the company has seen "a substantial increase in revenue and EBITDA in the first half of 2007 compared to the same period in 2006". The cash position has improved by £0.2m against the same point in 2006 and "the Board remains confident about continuing to deliver sustained growth in 2007".

Comment: smartFOCUS is pointing to a first half performance that is slightly above its previous expectations. It's being helped by market conditions in online marketing-related software and services, which are buoyant right now. It's a sector that's highly susceptible to the economic cycle, which may now be in the process of turning less favourable, although not, as far as we can tell, dramatically so. Meanwhile, smartFOCUS is among the vendors "making hay while the sun shines".

That's not to underestimate a couple of important qualities the company possesses. We think its focus on marketing solutions and online marketing in particular has helped it build (organically and through acquisition) a fairly broad suite of applications that nonetheless sit within a well-defined area. As we've said so many times, smaller firms can only prosper with a (smart) focus these days. Moreover, smartFOCUS's strategy for international business, which is based on reseller partnerships, also makes a lot of sense and continues to open up affordable growth opportunities for the company.

Phil Codling

2%
240p

MISYS

MISYS PRELIMS SHOW THERE IS MORE WORK TO DO

Misys's FY07 results showed revenue for the year down 3% to £563m. Operating profit from continuing operations was £37m, down 36%. Net profit was £15m, down 93%, due to the exceptional gain of £161m from the disposal of General Insurance. In FY07, Misys took total charges of £40m relating to its turn-around strategy.

The banking division saw sales rise 3% to £274m, while the healthcare division saw a fall of 9% to £289m. Operating margins in the two businesses were 12.4% and 9.0% respectively, before central costs were taken off.

Comment: Misys is aware of the need to up its game and fulfil more of its potential, and the need is most urgent in healthcare. Mike Lawrie, CEO, went into great detail with analysts on the reasons for recent changes here (including the recently-announced disposal of two US-based healthcare businesses) and future opportunities. He said that Misys has a strong position in the US physician market, with approximately 10-12% of the market for practice management systems. This contrasted with hospital systems, where Misys is seventh placed in market share and sees no growth prospects with its current portfolio, hence the sell-off.

There is a challenge in practice management systems because a range of newer applications, such as e-prescribing and electronic medical records management, need to sit on top of the clinical practice system. Misys needs to develop, buy or partner with suppliers of these kinds of applications to make them available to its customers, and this is a key priority for the healthcare business going forward.

Meanwhile the banking division is building its next generation core banking platform, BankFusion, and delivering it in stages to pilot customers. The opportunities in banking look promising, as they have for a while. Banks will have to move away from the aged, legacy-based core banking systems that they have been patching and maintaining for many years, onto up-to-date core banking systems from software vendors. But this kind of move is very risky for them. Consequently, the banks tend to hold back. However, according to Lawrie, some banks are buying Misys's current generation of technology, Midas and Equation, with the intention of following the upgrade path to BankFusion.

Meanwhile, Lawrie also restated his determination to get into open source but said his revenue expectation is zero this year. Misys is looking at building products for carbon derivatives trading and personalised medical records (the latter for the US market). He also talked about pursuing software-as-a-service - Misys already provides some hosting services to customers, and that's a step in the SaaS direction.

In summary, this is a transition year for Misys. We will look for the company to be better positioned by the end of the current financial year. However, we cannot expect miracles, at least not overnight.

David Bradshaw

-2%
409p

SDL INTERNATIONAL e-nabling global business

SDL PROFITS TO BEAT MARKET EXPECTATIONS

Language translation software and services provider SDL plc said last month that its profits for the half-year ending 30 June 2007 are expected to be ahead of market expectations. Specifically, it is expecting to report profits before taxation and amortisation of intangible assets of not less than £8.5 million, up 67% from 2006. Revenues will be in the region of £54 million, up 20% from 2006. SDL will announce full results on 3rd September 2007.

In a statement on the expected results, Chairman and CEO, Mark Lancaster, said: "Our service volumes are up and we have seen great efficiency gains from the use of our technology. The performance of our recent acquisition of Tridion in the last month of the quarter also over-achieved on our expectations."

Comment: This confirms our view that the purchase of software localisation specialist, Tridion, was a good synergistic buy. The software industry is a major consumer of translation services, and is constantly changing its products - from the large-scale launches of new products and major updates to existing products, to the small scale regular updates and patches. Very many of these will require the localisation of text, whether part of the software itself or the instructions for its use, into the language of the customers. We also know that many of the largest software companies in the world use SDL, so there's a relatively easy cross-sell opportunity for Tridion.

In summary this is a good performance from SDL and it looks like the acquisition of Tridion is delivering ahead of expectations.
David Bradshaw

-1%
721p

CAPITA

CAPITA SPLASHES ITS CASH FOR INVESTORS

Capita announced its interim results during July. The FTSE100 firm grew revenue by 17% in the first half of 2007 to £985m and operating profit by 20% to £119m. The operating margin rose to 12.1%, from 11.7% in H1 last year. EPS was up 22% at 12.13p.

Capita raised its interim dividend by 43% and promised a £155m "special dividend" to return cash to shareholders.

Comment: Yet another typically robust set of results from Capita. The topline growth remains buoyant and in advance of the overall BPO market (which we see growing by just under 10% this year). Contract wins have been positive, at twice the level seen in H1 of 2006, with six major contracts signed in the first half (including £100m+ agreements at Swindon, Southampton, Birmingham and Resolution).

The 40-basis-point margin improvement is a result of both growth (i.e. the efficiencies of scale in delivery) and the increasing use of offshore delivery. Capita plans to have 1,500 people in India by the end of the year. Assuming it keeps growing its offshore capability, it has effectively rectified its competitive Achilles Heel around global sourcing, in our view.

The "special dividend" was widely expected, and CEO Paul Pindar's comments indicate that there will be more such moves to come. Along with the raised interim dividend and ongoing share buybacks, Capita is being most munificent towards its shareholders. We are not among those shareholders and do not have the luxury/pressure of running a cash-rich FTSE100 firm, but we have to say that we feel a little sad to see a fast-growing firm in a fast-growing market investing so much of its cash this way. A taxable 25p per share doesn't seem a huge bonus when the share price is over £7 and has risen by £2.50 in the past twelve months. But £155m could surely open up a lot of new opportunities for Capita, both organically and inorganically.

Capita likes to quote Ovum's estimate of the BPO market in the UK potentially being worth just shy of £100m. Of course that total will never be realised - it assumes that all business processes in all sectors are 100% outsourced, which will never happen. Nonetheless, the point of our estimate is to highlight the fact that there's still a huge amount of untapped potential for Capita and other BPO providers to invest in targeting.
Phil Codling

17%
11p

IDOX

IDOX REPORTS FLAT FIRST HALF - LOOKS TO CAPS INTEGRATION

Local government software vendor, IDOX, has released results for the first half ended April 30, 2007. Revenue fell 3.3% to £6.7m, with operating profit up to £143k from a £65k loss last year.

Comment: Flat revenue of £1.7m from information solutions (including consultancy and content services), and sharp declines in recruitment revenues (down 24% to £1.9m) have held IDOX back in this first half - despite core software revenue growing by 15% to £3.1m. Nonetheless the business is being well managed, with cash inflow from operating activities up by 84% to £1.7m, and a return to profit. We also think IDOX is doing the right thing by looking to divest itself of its recruitment arm, which is not a core focus, and an area that has been struggling.

Looking ahead, IDOX will have more opportunities for growth as its acquisition of CAPS in June begins to kick in. Not only does CAPS turn IDOX into a c£30m revenue software business; it expands its product portfolio further into its local government niche, providing further opportunities to begin growing the company's rather stagnant consultancy and services arm. IDOX management claim they have already completed the actions necessary to achieve £1.5m of annual cost savings from the acquisition. But it will be over this summer that most of the operational and strategic integration between the two businesses takes place. By this time next year IDOX will need to have proved that the combination with CAPS is worth more than the sum of its parts by getting CAPS software to drive growth in services and enable it to grow client wallet share.

Samad Masood

12%
84p

Anite

ANITE SHOWS BENEFITS OF FOCUS IN FY07

Anite plc (as it now wishes to be known, as opposed to Anite Group plc) announced its results for the year to April. Revenue excluding disposed businesses was up 3% at £172m. On the same basis, operating profit was up 15% at £31.0m, which boosted the operating margin from 16.2% to 18.1%. Earnings per share rose from 5.3p to 5.8p. Yesterday Anite separately announced the disposal of its German consulting and SI operation, Anite Deutschland, to Vega Group for a total of £8m in cash.

Comment: Anite continues to show the (mostly positive) effects of its improved focus. Its results are a pretty complex affair, thanks to its various disposals and discontinuations, but the improvement in profitability is plain to see. Meanwhile we'd estimate that the organic revenue performance, in constant currency, was almost exactly flat in the year. That estimate masks, however, some important variations.

One real positive move, and a key factor in Anite's margin improvement, is the strong performance on in-house software sales, coupled with a lowered reliance on pass-through revenue from third party hardware. The latter fell by 38% to £24.3m in the year, while revenue from own product licences rose by 27% to £46.0m. Not surprisingly, this had the knock-on effect of driving additional maintenance and support business, which grew by 23% to £36.5m. Overall, therefore, Anite is going rapidly in the right direction as a player focused on an ability to deliver and support its own specialist software.

Of Anite's three chosen areas of focus, two - wireless and travel - are doing very well. They grew orders by 23% and 51% respectively in the year. The third tranche of the business, public sector, is not such a happy story. Orders fell by 22% to £58.8m. Anite increasingly appears to be running its public sector business for profit rather than growth, and operating profit did rise in the year (to £5.1m), despite the fall in sales. The problem here is that the business could cease to be competitive in what remains a tough but opportunity-rich market in both central and local government. Not least, it's not unusual for strategically de-emphasised operations to struggle in attracting and retaining the best specialist skills in the industry.

Given this outlook, a disposal of Anite's public sector business is surely on the cards. For as the company underlined with its anticipated and sensible sell-off in Germany (to Vega Group, as announced during July), anything non-core to its long-term growth priorities is likely to be seen as extraneous. Given our long-held view that Anite suffered in the past because it tried to fight on too many fronts, we feel this is a sound strategic approach and indeed one that is already paying dividends in the improving performance of much of the business.

Phil Codling

16%
834p
Autonomy

AUTONOMY REPORTS ANOTHER QUARTER OF GROWTH AND EVOLUTION

Autonomy reported $73m in revenues for Q2. That's a 20% year-on-year increase, with an equivalent 18% for the half-year. Q2 operating profit was up 58% at $22.6m.

Comment: The end of the half year provided Autonomy with the opportunity to take stock of what has been a frantic six months for the company. It has OEM agreements with more than 300 companies, 13 of which were added in Q2, with OEM revenues accounting for 18% of the group total.

The company spun off its consumer arm as the video search company Blinkx and announced the intended $375m acquisition of archiving specialist ZANTAZ. This on top of organic growth was, including some new customers e.g. Telecom Italia and The Telegraph. Importantly, given the current software-only business model, 50% of new revenues came from existing customers.

The ZANTAZ acquisition, however, is taking Autonomy into different territory. Not only will the company have a division offering Software-as-a-Service (SaaS) for the hosted archiving, but the combination of Autonomy's IDOL technology, which is agnostic of enterprise applications, and the information lifecycle software from ZANTAZ, clearly provides a capacity to address both operational and compliance issues on an enterprises basis from within one piece of software.

Autonomy's announcements in the last six months show not only that the company is not prepared to sit on its laurels in the enterprise search race and be caught by rivals, but that it also wants to be on a different race track.

Mike Davis

-3%
373p
ncc group
assure secure advise

NCC REPORTS FURTHER PROGRESS

NCC, a provider of escrow and testing services, has announced its results for the year to end May 2007. Group revenue was up by 22% to £25.4m, including the impact of two acquisitions. The core Escrow Solutions business also grew 22% (to £15m). Group operating profits increased by 20% to £8.0m, meaning margins held steady.

The company has entered into a heads of terms agreement regarding the acquisition of an assurance testing company for a maximum consideration of £4m. On 13th July the company will switch to a full listing on the London Stock Exchange to "enhance the Group's corporate identity and... support its ambitious growth plans".

Comment: NCC has closed a very satisfactory year, with revenue up and operating margins (at 32%) holding firm. Not only that, but it has been a year of progress and evolution. In particular, shrewd acquisitions (Source Harbor and Site Confidence) form a solid foundation for future prospects. They add scale to NCC but also additional capabilities and geographical reach. NCC might be small, but it's in a great spot. For example, the demand for escrow solutions continues to strengthen and the threat of organised crime hacking and identity theft (which play to NCC's presence in the web testing and assurance markets) continues to rise.

In the latter half of the year, the company got some pay-back on the campaign it has been running to get software vendors to proactively offer its escrow service. This is significant in that it enables NCC to get into an escrow agreement at the point of purchase rather than attempting to make the sale at some later date. Having the software vendor on-side also adds weight to NCC's 'pitch'. We do see the consultancy business as a weak spot in terms of revenue growth (revenue was down 2%), but it has thus far managed to sustain profitability due to careful cost control. We'll be watching to see whether NCC can get this part of the business back into growth in the current year.

Kate Hanaghan

-2%
47p
microgen

MICROGEN SHOWS IMPROVEMENTS, BUT FOR HOW LONG?

Microgen announced its results for the first half of 2007. Revenue fell by 8% to £18.1m, but operating margins rose from 15.1% in H1 of 2006 to 17.2%. EPS was 2.4p (H1 2006: 1.9p). Microgen is increasing its interim dividend from 0.5p to 0.6p.

Comment: This is a better set of results from Microgen. The encouraging factors include the increase in the operating margin and, despite the topline fall in revenue, a modicum of growth (4% in aggregate) from Microgen's key lines of software business. So the banking division put in an improved performance, with flat revenue. Asset and wealth management was up 7%.

We suspect that the improving focus in Microgen's operations, helped by the withdrawal from SAP support announced earlier this year, is helping the firm do better in its more important target markets (i.e. banking plus asset and wealth management). For a small firm, however, it's still fighting on a lot of fronts, with additional interests spread across other verticals and managed services, as well as billing and database management.

It's slightly worrying then that Microgen appears to be set on its swoop for Trace Group, following its increased offer of 180p and a statement during July from Trace's board that recommended the Microgen bid. Trace would bring a whole load of new distractions and integration challenges, including a property software resale business, managed payroll and re-/insurance broking applications. Such additions would (we fear) harm Microgen's ability to focus its business further (as it needs to) and sustain underlying organic growth, which is after all the long-term route to margin gains.

Phil Codling

-1%
79p
northgate

NORTHGATE REPORTS FULL YEAR, SEEKS FURTHER ACQUISITIONS

For the year to April, Northgate reported a pre-tax profit of £31.9m, compared to a profit of £30.6m in 2006. Revenue grew 5.7% to £351.7m. Organic growth for the year was still sluggish at 3.3%.

Comment: We attended Northgate's analyst briefing, and CEO Chris Stone was noticeably excited about the company's prospects going forward. Stone said that Arinso (the Belgium-based HR BPO provider that Northgate acquired during H2) now makes Northgate a £500m revenue business, and he expects to make further acquisitions in 2007 to support this deal. Stone anticipates making several small bolt-on acquisitions internationally to plug into the newly acquired BPO capability. This includes an Australian acquisition (currently being finalising).

The full year results themselves show a much better performance from Northgate, which has struggled in the past couple of years to generate healthy organic growth. The 7.7% organic growth generated in the second half of the year is on track with Stone's stated aim of organic growth of 6-8%.

Our concern is that just as Northgate is getting its house in order, attention will be diverted to integrating Arinso. This is the company's biggest strategic acquisition to date and will require management time and effort over the next few months. Stone himself is now based in Brussels to help with the integration process. We also think Northgate needs to be careful that it doesn't overstretch itself in pursuing further acquisitions so soon after Arinso.

Another potential concern is the public services software division, which continues to struggle in a tougher spending environment. Northgate's criminal justice business has particularly suffered. Stone maintains that Northgate remains committed to the market, which he is confident of returning to growth at some point in the future.

The growth drivers clearly continue to be managed services and HR - which both include commercial and public sector clients. In fact there continues to be strong demand for managed services in the education sector. Here, Northgate announced new deals with Leicester Council for a £27m Building Schools for the Future (BSF) contract, and a £15m extension to its Lot 6 Northern Ireland schools programme.

John O'Brien

-5%
241p

VEGA

VEGA REPORTS MARGINAL GROWTH IN FULL YEAR

Vega, the professional services firm targeting the aerospace, defence and government sectors, reported revenue growth of 3% to £64.1m in the year to April, and an operating profit of £4.1m (£4.2m in FY06). Net debt fell to £300k from £1.6m in 2006.

At the same time, Vega announced the acquisition of Anite Deutschland Management GmbH from rival Anite, for £8m in cash.

Comment: While not startling, these are fairly stable results from Vega. They do however belie some strong underlying performances within two business units - aerospace, which grew 7% to £33.6m, and government, which was up 22% on the year to £4.7m thanks to wins at the Foreign & Commonwealth Office, the Department for Communities and Local Government and the London Ambulance Service. Vega's defence business, however, declined 4% to £25.8m.

Vega will be pleased that public sector is performing well. Suppliers that are capable of delivering tactical advice in key priority areas for government such as security and emergency continue to see healthy demand.

The past year has seen considerable internal organisational change for Vega as it shifts its emphasis onto being a "specialist professional services provider", where it can influence and advise the buying decisions of its clients. It has therefore reorganised its business into three units (Consulting, Technology and Managed Solutions) and taken on new senior executives to manage the divisions.

The Anite Deutschland acquisition fits neatly with this strategy of building up strategic consulting capability to maximise its penetration into key accounts. Anite Deutschland adds a key defence sector client to Vega's customer base as well as providing an entry into the financial services market.

Expanding its footprint internationally has been one of Vega's key challenges, and Anite Deutschland should go some way to achieving this aim. With revenue of £11.7m in the year to April 2007, Germany will now account for well over a third of Vega's revenue, compared to 25% currently.

Phil Codling

18%
103p

statpro

STATPRO USES ORGANIC GROWTH AND ACQUISITION TO BOOST PROFITS

Statpro, provider of analytical software and data services to global asset managers, grew revenue and profit in H1. Compared to a year ago, revenue rose by 79% to £11.3m, operating profit by 126% to £2.28m and net profit by 114% to £1.59m. Operating margin climbed to 20.2% from 12.4%. Cash generated by operations was up 48% to £2.89m.

Statpro also announced that it is to buy Canadian competitor Initram Data, for up to C$3m (£1.41m). Initram is a competitor to Statpro Canada (formerly FRI, acquired in September 2006). Statpro says that the acquisition will help it widen its range of data services, as well as bringing 30 customers that it can cross-sell products to.

Comment: Statpro has pursued a smart acquisitions strategy that has produced benefits, not least profitable growth in H1 of 59% from acquisitions on top of 20% organic growth. It has increased its range of offerings, extending into the data services that feed into analytical software. It is combining the existing and acquired capabilities in new ways, for example moving into complex asset pricing as the financial markets dream up ever more ingenious products, like derivatives and securitised debt. The next challenge (and opportunity) the company faces is to really get the sales machine gearing up in North America.

Statpro has not been afraid to dispose of those elements of the acquired companies that did not match its strategy, for example selling off FRI's real time data business. And overall, the company is doing well to combine data services with its software and extending into software-as-a-service to supply smaller financial services companies with few internal IT resources. The bit that the company has to watch is the professional services piece - this seems to be only loosely connected to the other elements of the business and we think that has to change so that the professional services play a strong role in feeding the product business rather than vice-versa.

David Bradshaw

Mergers and Acquisitions – July 2007

Buyer	Patni
Seller	Logan Orviss
Seller Description	Monaco-based provider of consultancy for the telecoms and media industries
Acquiring	100%
Price	n/a
Comment	Privately-held Logan Orviss has interests in the UK, France, Germany, Norway, Israel, Russia, Australia and the US and recorded revenues of 11.8m in 2006. The purchase comes one month after Patni appointed a new head of its European operations (Brian Stones, previously of ACS and prior to that E&Y) to drive through more growth. When we say that rumours of an Indian player buying a large, complex IT services firm like Capgemini are 'far-fetched' and state our view that Indian providers are more likely to make 'more manageable, less disruptive acquisitions', this is exactly the type of move we are referring to. Logan Orviss brings business domain-level expertise to Patni, as well as niche technical capability and senior client contacts in a well-defined vertical market. It thus helps the offshore player increase its onshore presence, get closer to its customers and offer them more business-related advisory services on top of and in conjunction with its offshore-onshore applications services.

Buyer	System C Healthcare
Seller	IQ Systems Services
Seller Description	Provider of patient management and clinical software solutions for private treatment centres and hospitals
Acquiring	100%
Price	A maximum consideration of £2.16m
Comment	The acquisition of IQ is a sensible move by System C, providing the latter with an entrée to the growing private or independent sector healthcare market. As a smaller provider of 'existing systems' to the NHS, System C was quick to recognise that it had to adapt to survive under the National Programme for IT in the NHS (NPfIT). The application provider successfully diversified into services and won business supporting both the LSPs and NHS Connecting for Health, the agency running NPfIT. But the last year has been harder for System C. As the rollout of NPfIT systems slowed so did demand for its implementation services, and revenues dropped by almost a quarter in H1 2007. Moving into the independent sector healthcare market is evidence of further diversification that should stand System C in good stead in the longer term.

Buyer	Maxima
Seller	Centrica Networks
Seller Description	Provider of managed services around infrastructure software
Acquiring	100%
Price	Up to £6.4m
Comment	This is Maxima's fifth acquisition (at a total cost of £37m) in the past year. During that time, the company's share price has doubled, giving it a market capitalisation of £76m. But given the experiences of some serial acquirers (most recently the infamous Torex Retail) and the rising cost of debt thanks to interest rate hikes, should we not be concerned as to Maxima's ability to sustain its M&A-fuelled growth strategy? There are a number of reassuring factors in this case. Firstly, consistency and quality of management, which we rate as a vital factor. Maxima's CEO Kelvin Harrison founded the business, was an NED at Axon for five years and once led Vega Group. He and FD Linda Andrews have now been working together for seven years. Moreover, they have been careful to bring in businesses that are open to being acquired, which tends to lead to a smoother integration process and better performance from the acquired operations. As we all know, many acquisitions that are not officially "hostile" are nonetheless far from "friendly". Finally, Maxima's overall strategy to fill out its mid-market offerings and customer base is solid in our view. The larger IT services players are generally just not set up to cater to businesses below 2,000 employees. But such customers increasingly need more capable and broad providers to make their IT both more efficient and more effective. So while Maxima's expanding portfolio of integration capability and managed services may look ever broader, it looks to us well focused in terms of market need. Full-year results in a couple of weeks should provide further evidence of Maxima's solid execution and underlying performance.

Buyer	Capita
Seller	PWC
Seller Description	PriceWaterhouseCoopers CI LLP, the trust administration business of PwC
Acquiring	100%
Price	£12.5m
Comment	This is a classic Capita acquisition. It adds capability in an existing area of service, namely trust admin and offshore finances. The acquisition should thus fit alongside the existing Capita Fiduciary Group business, which already has a foothold in Jersey thanks to the 2005 Channel House acquisition. Such low risk, readily-digestible bolt-ons have been one of the keys to Capita's growth. Secondly, the business being acquired is nicely profitable and thus, we imagine, EPS accretive from day one. Overall, acquisitions like this remain a great way for Capita to spend its cash. Thus far in 2007, it has spent £75m on 8 purchases. Given its cash resources (some of which it is intent on returning direct to shareholders), the only real limit on Capita's acquisition policy is its own selection criteria. Wisely, even as it grows and generates ever more profits, it is sticking to these.

Mergers and Acquisitions – July 2007

Buyer	German e-health company CompuGroup
Seller	iSoft
Seller Description	Healthcare focused proviuder
Acquiring	100%
Price	£160m cash
Comment	Just when you thought the final chapter of the iSoft drama was about to come to an end with an acquisition by IBA, there is another unexpected twist. iSoft's Board has been presented with a better offer from CompuGroup and taken the decision to ditch IBA at the last minute. And it's easy to see why - CompuGroup's offer is in cash, compared to IBA's all-share bid, and it's worth more. The agreement with CSC has some advantages for all concerned but at the same time it's far from perfect. CompuGroup limits its liability to the problematic NPfIT contracts and retains the right to develop Lorenzo. But it loses a significant chunk of iSoft's forward revenue and may find itself competing against a strong CSC product. CSC, the Local Service Provider in charge of implementing iSoft's software under NPfIT, takes on more risk but gains more control over its own destiny and also has the potential to sell its version of Lorenzo in other markets. NHS Connecting for Health (NHS CFH), the agency in charge of NPfIT, can have more confidence that the development of Lorenzo is in the hands of a company it trusts and will know who to blame if things go wrong with the NPfIT rollout. But with CSC becoming a software provider as well as the prime contractor, it will be harder for NHS CFH to switch software if Lorenzo doesn't come up to scratch.

Buyer	**Vista Equity Partners (acquiring the Healthcare Division) and QuadraMed (the CPR business)**
Seller	**Misys**
Seller Description	UK Software firm
Acquiring	
Price	£185m (Healthcare business) and £16m (CPR business)
Comment	Misys has announced that it is selling two businesses in its Healthcare Division. The Diagnostic Information Business will be sold to Vista Equity Partners, a VC based in San Francisco, for $381.5m (£185m at $2.06=£1). Misys is also selling the much smaller CPR business which is a system for collecting and sharing data within hospitals (not what CPR usually stands for!). The CPR business had revenue of £15.2m in fiscal 2006, 5% of the healthcare division's total revenue and it made a loss before tax of £4.2m. QuadraMed Corporation is buying this for $33m (£16m). Few of us expected this disposal even though, in retrospect, the warning signs were there. In the interim results announcement in January, Misys CEO Mike Lawrie said, "_in healthcare, our performance was unacceptable and we have taken action to address this - early indications are positive and we will take further action if necessary." Lawrie explained that the fundamental reason was that the outcome of a strategic review was that Misys could not fund research and stay competitive with larger healthcare players. The company took the decision to focus on the physician space and it used UBS to seek out buyers. Following the disposals, Misys will be a more functionally-orientated organisation with clearer lines of reporting. This should help it grow and launch new products and services. Misys has also signed commercial agreements with the prospective buyers of both business units where they will resell Misys's continuing products in the physician space. This significantly increases the distribution coverage of Misys's continuing product lines in the United States.

Buyer	**Dell**
Seller	**Silverback Technologies**
Seller Description	Service delivery platform provider for remote monitoring and management of information technology infrastructure such as servers, storage, networks, desktops and notebooks.
Acquiring	100%
Price	n/a
Comment	Dell has been building up its infrastructure services capability to become a more rounded systems supplier. But it's coming from a long way behind compared with competitors such as HP and IBM. And rather than build its own support technology and services from the ground up, it has decided to speed up the process through acquisition. The Silverback acquisition is another piece in Dell's infrastructure-services jigsaw, but technology alone won't solve Dell's problems. What it needs are people and processes. Enterprise customers want expertise and skills to help them transform, deploy and manage their ERP, CRM and business intelligence applications. Infrastructure services is about more than just looking after the plumbing, so we'd expect future acquisitions to concentrate on buying in consulting and management skills. But don't expect anything too grand from a company that's always preferred to do things its own way. We expect more small and local, rather than big and global acquisitions.

Buyer	Not disclosed
Seller	**LogicaCMG**
Seller Description	IT services
Acquiring	An element of its payroll business
Price	n/a
Comment	LogicaCMG is a significant payroll provider in the UK and in the Netherlands. In the latter country - before this deal - it handled around 14% of all employees' pay (the share is slightly lower in the UK). However, all payroll is not alike. At the SME end of the market, it is typically a transactional service based on automated processing, with little opportunity for value-add by the vendor. This is where price competition, due to the lack of differentiation between providers, can be most severe. This is the type of service that LogicaCMG appears to be divesting in this deal. Meanwhile, it will retain its managed payroll interests for larger customers. This move does make sense strategically. LogicaCMG is not focused on smaller customers and is not usually a transactional service provider. Its ability to grow its SME customer accounts from its position in payroll services is limited. Better to focus payroll efforts in the Netherlands on larger customers where there is more opportunity to both add value to process deals with IT transformations and to upsell payroll clients to fuller HR BPO services.

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

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@UK plc	SP	0.13	4.91	NA	3.38	198.47	0%	-28%	£0.00m
Alphameric	SP	0.32	42.76	11.7	0.65	147.94	-21%	-32%	-£11.61m
Alterian	SP	1.68	73.64	30.2	5.26	837.50	0%	48%	£3.46m
Anite Group	CS	0.84	296.44	16.9	1.72	491.23	12%	3%	£33.53m
Ascribe	SP	0.38	43.44	NA	8.12	2,000.00	-34%	-3%	-£22.29m
Atelis plc	SP	0.05	1.25	NA	NA	232.56	-5%	-26%	-£0.06m
Atlantic Global	SP	0.20	4.47	85.9	2.09	661.02	-11%	44%	-£0.58m
Autonomy Corporation	SP	8.34	1753.44	87.1	13.67	254.58	16%	63%	£332.36m
Aveva Group	SP	9.36	631.25	35.6	9.57	4,680.00	1%	15%	£8.10m
Axon Group	CS	7.99	470.05	32.4	3.42	4,562.86	1%	31%	-£17.82m
Bond International	SP	2.15	65.58	19.6	3.81	3,307.69	14%	25%	£8.10m
Brady	SP	0.56	15.16	23.1	6.23	685.19	-18%	52%	-£2.60m
Business Control Solutions	CS	0.04	11.54	NA	1.44	680.00	-26%	-32%	-£4.07m
Business Systems	CS	0.13	10.00	NA	0.29	109.24	0%	4%	-£0.41m
Cantono	CS	0.05	15.28	NA	2.13	909.09	-9%	-9%	-£1.53m
Capita Group	CS	7.21	4456.91	31.5	2.62	194,765.73	-1%	19%	-£39.34m
Centrom	CS	0.01	1.88	NA	0.30	150.00	-10%	-40%	£0.05m
Charteris	CS	0.18	7.74	17.5	0.87	200.00	-10%	13%	-£0.86m
Chelford Group	CS	1.75	12.50	170.7	0.67	304.35	35%	4%	£3.22m
Civica	CS	2.57	161.97	16.3	1.53	1,468.18	-6%	-7%	-£9.75m
Clarity Commerce	SP	0.46	11.46	6.3	0.86	368.00	-23%	-14%	-£3.49m
Clinical Computing	SP	0.05	1.66	NA	1.00	40.32	-17%	-29%	-£0.41m
CODA Plc.	SP	1.65	126.62	NA	2.37	1,015.43	-12%	2%	-£17.13m
Compel Group	CS	1.49	50.42	22.6	0.80	1,192.00	0%	26%	£0.00m
Computacenter	R	2.08	332.83	16.6	0.15	310.45	-8%	-23%	-£27.76m
Computer Software Group	SP	1.50	85.19	19.3	6.05	1,276.59	0%	23%	£0.00m
Corero	SP	0.12	5.58	NA	0.89	163.33	-13%	-16%	-£0.80m
Corpora	SP	0.05	11.27	NA	4.33	131.58	0%	-11%	£4.17m
Dealogic	SP	1.72	120.47	11.7	3.00	747.82	-3%	9%	-£3.08m
Delcam	SP	4.12	31.79	12.4	1.32	1,584.62	-1%	32%	£6.16m
Detica	CS	3.67	425.14	36.8	2.73	4,587.50	-5%	0%	-£14.87m
Dicom Group	R	1.66	147.18	20.2	0.70	507.36	-11%	-29%	-£15.49m
Dillistone Group	SP	2.13	11.48	NA	NA	1,556.78	11%	45%	£1.08m
Dimension Data	R	0.57	879.69	44.1	0.63	100.71	-1%	32%	£1.79m
DRS Data & Research	SP	0.34	10.95	65.7	0.88	304.55	-1%	-9%	-£0.25m
eg Solutions	SP	0.45	6.43	NA	1.19	306.12	3%	-45%	£0.21m
ELCOM	CS	0.02	6.54	NA	18.88	400.00	0%	-52%	£0.00m
Electronic Data Processing	SP	0.74	18.10	42.0	2.60	2,265.77	-9%	15%	-£1.59m
FDM Group	A	1.48	34.37	17.0	0.77	1,815.95	7%	58%	£2.33m
Ffastfill	SP	0.08	29.16	NA	11.00	65.00	-3%	30%	£5.65m
Financial Objects	CS	0.59	26.00	7.8	1.31	254.35	-4%	7%	-£1.09m
Flomerics Group	SP	0.54	11.68	11.0	0.82	2,076.92	-33%	-28%	-£0.27m
Focus Solutions Group	CS	0.54	15.76	9.5	1.59	274.36	7%	10%	£1.44m
GB Group	CS	0.29	24.45	NA	1.63	187.05	-9%	-37%	-£2.56m
Gladstone	SP	0.24	12.39	9.0	1.62	592.50	-1%	-7%	-£0.12m
Glotel	A	0.68	26.52	20.1	0.29	354.28	0%	8%	£0.14m
Gresham Computing	CS	1.24	62.44	150.3	4.47	1,333.33	-2%	-16%	-£1.26m
Group NBT	CS	2.79	70.03	24.9	8.34	1,392.50	-5%	34%	-£2.58m
Harvey Nash Group	A	0.79	56.80	12.0	0.23	448.57	-14%	8%	-£8.46m
Highams Systems Services	A	0.06	1.87	14.1	0.14	161.11	-3%	25%	-£0.08m
Horizon Technology	CS	0.60	55.88	15.7	0.29	220.66	-15%	-13%	-£30.40m
IBS OPENSystems	CS	1.95	77.80	NA	4.98	1,275.41	-1%	7%	-£0.80m
I S Solutions	CS	0.22	5.35	19.0	0.97	819.84	16%	40%	£0.58m
ICM Computer Group	CS	5.43	115.74	34.6	1.53	3,016.67	0%	88%	£0.00m
IDOX	SP	0.11	35.90	NA	2.54	13.48	17%	65%	£3.84m
Imaginatik	SP	0.08	8.75	NA	6.25	882.35	-5%	-12%	-£0.44m
In Technology	CS	0.31	44.34	NA	0.24	1,248.00	-16%	-27%	-£8.51m
InterQuest Group	A	1.12	32.72	NA	1.19	1,947.83	5%	28%	£1.81m
Innovation Group	SP	0.34	217.30	26.9	3.56	147.38	-8%	8%	-£16.10m
Intelligent Environments	SP	0.10	15.75	27.0	5.05	102.34	-6%	54%	-£0.94m
Intercede Group	SP	0.37	13.17	NA	7.29	608.33	-6%	-39%	-£0.73m
Invu	SP	0.32	33.56	16.2	5.17	3,368.39	19%	7%	£6.51m
iSOFT Group	SP	0.65	151.12	NA	0.58	590.91	33%	15%	£37.78m
iTrain	SP	0.03	2.11	NA	1.15	29.41	-11%	11%	£0.06m
IX Europe	CS	1.40	253.21	NA	6.79	4,580.33	12%	185%	£26.73m
K3 Business Technology	SP	1.49	32.40	14.3	1.19	1,138.46	-1%	28%	-£0.20m
Kewill	SP	0.89	72.43	49.2	1.74	1,762.85	5%	13%	£3.58m
Knowledge Technology Solutions	SP	0.01	3.82	NA	3.06	230.00	15%	-29%	£0.08m
LogicaCMG	CS	1.54	2344.81	19.4	0.88	2,109.01	1%	-17%	£9.64m
Lorien	A	0.81	15.18	34.1	0.10	810.00	-5%	91%	-£0.65m

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Macro 4	SP	2.03	46.86	7.8	1.42	818.55	6%	-4%	£2.65m
Manpower Software	SP	0.65	28.95	29.5	6.68	670.10	3%	150%	£0.89m
Maxima Holdings	CS	3.05	76.12	19.8	6.13	2,218.18	2%	33%	£3.07m
Mediasurface	SP	0.24	23.18	NA	2.40	1,764.71	-7%	41%	£3.29m
Micro Focus	SP	3.00	600.53	26.1	7.94	0.00	15%	44%	£76.85m
Microgen	CS	0.47	48.50	12.4	1.29	201.92	-2%	-13%	-£0.77m
Minorplanet Systems	SP	0.35	11.12	8.3	0.47	704.51	-32%	-38%	-£3.59m
Misys	SP	2.40	1207.36	28.8	2.14	2,985.88	2%	11%	£28.17m
Morse	R	0.98	153.01	11.5	0.42	390.00	3%	-10%	£4.28m
NCC Group	CS	3.73	121.65	23.5	4.79	2,233.53	-3%	34%	-£4.08m
Ncipher	SP	2.29	38.49	NA	2.21	916.00	-7%	-10%	-£32.21m
Netcall	SP	0.30	19.82	55.4	5.98	606.06	15%	76%	£2.65m
Netstore	CS	0.34	49.06	14.9	2.45	226.67	6%	13%	£9.56m
Networkers International	A	0.39	35.46	NA	1.86	1,203.13	-7%	10%	-£2.76m
Northgate Information Solutions	CS	0.79	459.99	13.0	1.31	303.85	-1%	-8%	£30.58m
NSB Retail Systems	SP	0.29	109.46	12.6	2.26	2,495.65	2%	-16%	-£7.81m
OneclickHR	SP	0.06	8.36	NA	1.41	140.50	-6%	41%	-£0.57m
OPD Group	A	4.05	107.57	NA	2.46	1,840.91	-15%	-18%	-£19.65m
Parity	A	0.83	31.29	NA	0.20	763.89	-2%	5%	-£0.38m
Patsystems	SP	0.27	44.90	35.2	2.93	252.34	-4%	57%	-£0.24m
Phoenix IT	CS	4.44	330.13	20.0	2.61	1,644.44	6%	46%	£16.23m
Pilat Media Global	SP	0.54	32.07	13.4	2.47	2,700.00	-14%	-34%	-£5.23m
Pixology	SP	0.41	8.26	NA	1.83	293.75	2%	44%	£0.20m
Portrait Software	CS	0.19	18.18	NA	1.26	123.11	-15%	25%	-£0.60m
Proactis Holdings	SP	0.73	21.88	NA	11.52	1,494.85	-11%	14%	-£2.72m
Prologic	CS	1.02	10.25	12.0	1.48	1,228.92	4%	20%	£0.50m
QinetiQ Group	CS	1.76	1162.26	17.7	1.01	801.82	-5%	-8%	-£64.20m
Qonnectis	CS	0.01	1.48	NA	13.49	181.33	10%	-9%	£0.11m
Quantica	A	0.45	26.55	9.7	0.68	358.87	6%	46%	-£2.34m
Red Squared	CS	0.09	2.62	NA	1.07	508.24	-3%	42%	-£0.07m
Revenue Assurance Services Plc	SP	1.94	83.01	26.8	1.85	1,293.33	28%	58%	£18.14m
RM	SP	2.09	192.72	18.1	0.73	5,957.14	0%	7%	£0.69m
Royalblue Group	SP	10.37	358.47	33.5	3.79	6,100.00	13%	0%	£42.22m
Sage Group	SP	2.31	3012.64	19.7	3.22	88,846.15	-2%	-15%	-£40.73m
Sanderson Group	SP	0.47	19.44	NA	1.20	930.00	-8%	-5%	-£1.67m
SciSys	CS	0.74	18.76	NA	0.74	571.71	-2%	-16%	-£0.38m
SDL	CS	4.09	304.19	43.0	3.21	2,726.67	-2%	73%	-£7.44m
ServicePower	SP	0.15	13.37	NA	1.68	150.00	-12%	-9%	-£0.21m
Sirius Financial	SP	2.25	39.64	21.8	1.82	1,500.00	0%	53%	-£0.18m
SiRViS IT plc	CS	0.03	4.46	6.8	0.56	29.39	13%	-13%	£1.04m
smartFOCUS plc	SP	0.23	20.88	33.7	2.27	2,432.43	25%	48%	£4.18m
Sopheon	SP	0.18	26.57	NA	4.43	262.59	-4%	-19%	£1.19m
Spring Group	A	0.81	129.84	26.2	0.32	894.44	12%	17%	£13.71m
SSP Holdings	SP	1.49	122.16	NA	6.83	1,405.66	7%	24%	£22.19m
StatPro Group	SP	1.03	54.69	18.0	4.31	1,287.50	18%	-1%	£8.79m
SThree Group plc	A	4.23	585.41	20.7	2.42	2,051.94	-10%	9%	-£67.50m
Stilo International	SP	0.02	1.62	NA	0.70	32.00	-20%	-33%	-£0.26m
Strategic Thought	CS	0.67	17.39	NA	1.52	490.77	-1%	-34%	-£0.26m
SurfControl	SP	6.80	196.47	69.5	3.43	3,400.00	1%	31%	£3.89m
Tadpole Technology	SP	0.05	18.28	NA	3.78	108.64	-10%	350%	-£0.12m
Tikit Group	CS	3.36	43.23	21.0	1.84	2,921.74	12%	31%	£4.75m
Total Systems	SP	0.33	3.41	NA	0.98	613.21	-23%	-10%	-£0.96m
Touchstone Group	SP	1.60	19.32	59.5	0.64	1,523.81	-11%	-11%	-£2.67m
Trace Group	SP	1.78	25.29	20.0	1.77	1,420.00	0%	78%	£0.00m
Triad Group	CS	0.32	4.92	NA	0.12	237.04	19%	28%	£0.90m
Ubiquity Software	SP	0.37	75.39	NA	10.10	929.65	0%	85%	£0.00m
Ultima Networks	R	0.01	2.30	28.9	1.21	29.27	20%	37%	£0.00m
Ultrasis Group	SP	0.01	16.41	NA	13.20	22.45	10%	-23%	£3.85m
Universe Group	SP	0.08	8.75	NA	0.20	338.67	9%	-46%	£0.43m
Vega Group	CS	2.41	48.96	13.6	0.76	1,971.31	-5%	14%	-£2.44m
VI group	SP	0.17	6.15	8.3	0.63	330.00	-3%	16%	-£0.28m
Xansa	CS	1.27	442.10	30.4	1.16	3,256.41	48%	46%	£143.60m
Xchanging	A	2.70	572.14	NA	NA	883.80	4%	-12%	-£55.96m
Xpertise Group	CS	0.95	5.01	15.8	0.31	3,780.00	-14%	133%	-£0.82m
XploITe	CS	0.41	15.16	NA	0.51	1,261.54	1%	24%	£0.18m

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

COUPLE OF ACQUISITIONS LIFT A RAINY JULY

Samad Masood
Analyst

IT stocks held up well in what was a pretty wet and miserable July for most. The FTSE IT SCS improved by 3%, a very strong performance considering that the FTSE 100 fell by 3.8% in the same period. The techMARK 100 and Ovum's S/ITS indices didn't fair so well, declining by 1.8% and 0.8% respectively. But again, this was not so bad considering the 1.7% decline of the FTSE AIM index, and the 1.5% FTSE Small Cap index decline.

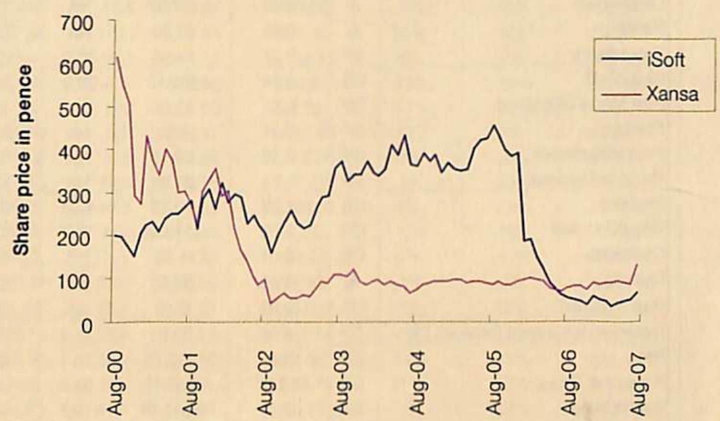
Growth was subdued across the different categories of UK IT shares. And in most cases it was only one or two companies with rapidly growing shares that held up the average. For example, amongst computer services firms, it was Xansa's 48% share price rise to £1.27 (driven by the Steria acquisition approach) that helped the average growth of computer services firms' shares reach 0.6%. Without this, the average would have been -0.4%. The much larger software providers segment wasn't affected as much by its strongest share performers. The biggest mover was iSoft, up 33% to 0.65p on the back of its acquisition by CompuGroup. Now that both Xansa and iSoft are about to be taken off the market, it's worth considering their future prospects.

iSoft

iSoft surprised everyone in July with the announcement that it had accepted an unsolicited £160m cash offer from German e-health company CompuGroup, overturning a bid from Australia's IBA. The deal is a complicated one though - involving the sale of all iSoft's National Programme for IT in the NHS (NPfIT) contracts and an NHS version of its new product Lorenzo and existing products i.PM and i.IE to CSC - and its structure will present some interesting challenges to all involved going forward. iSoft will also have to pay IBA an inducement fee of c£1.4m.

The agreement over Lorenzo with CSC has some advantages for all concerned but at the same time it's far from perfect. CompuGroup limits its liability to the problematic NPfIT contracts and retains the right to develop Lorenzo. But it loses a significant chunk of iSoft's forward revenue and may find itself competing against a strong CSC product.

Xansa and iSoft's share prices between 1 August 2000 and 1 August 2007



Source: London Stock Exchange

Xansa

The acquisition of Xansa will strengthen Sterias presence in the UK. Despite €290m in 2006 UK revenues, Steria has largely been an infrastructure management player working for local government. Xansa is well-known in the UK for its work in application services and F&A BPO with the largest firms in the private sector, largely with banks, retail and utilities. Thanks to Xansa, Steria will therefore greatly improve its services range, and will jump from a ranking of 38 to a ranking of 15 among the largest S/ITS providers in the UK, with £580m in sales, after Siemens and right before Tata Consultancy Services.

We think the timing of the operation is right. Xansa has a well-established offshore presence, and it now has a successful delivery model that blends onshore and offshore capability for its customers. The company has faced several years of flat growth and mid-digit operating margin. In FY07, the company proved its strategy had worked: its application services business had stable revenues, suggesting the company was now able to balance declining prices by contract extensions. Total revenues were up by 6.3%, driven by BPO growth (up by 30%) around F&A and, increasingly, payroll for the NHS (up by 56%).

Despite its tremendous reinvention, Xansa still has to increase its exposure to solutions and consulting in order to move away from direct competition with the Indian vendors. Steria's traditional and growing focus on solutions may help here.