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# SYSTEMHOUSE

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

## CHANGING THE VIRTUALIZATION WORLD

**By David Mitchell**

**David Mitchell**
**SVP IT Research**

November represented the most significant month for the virtualization market since the VMware IPO, with a slew of announcements from different companies, including IBM, Oracle and Sun. These announcements have the potential to change the virtualization climate for both CIOs and for the technology investment community. Let's examine the changes and how they are likely to play out.

### The announcement landscape

At Oracle OpenWorld in mid-November, both Oracle and Sun launched Xen-based virtualization initiatives: Oracle VM and xVM respectively. For Oracle, this is the first foray into the virtualization product market, although its products have been supported on guest operating systems under various virtualization hosts for some time. By contrast, Sun has offered virtualization via Solaris Containers for some time. To different extents the two offerings illustrate that software platform vendors are now seeking to become both 'a good guest' and 'a good host' - breaking the clear demarcation between host and guest providers that was traditional in the market.

At the technology foundation layer, Xen certainly appears to be the platform of choice for many of the new virtualization offerings. Undoubtedly, the open source basis of that technology is encouraging its adoption, as companies seek to bring products more rapidly to market than totally indigenous R&D would permit.

During the same week, IBM launched its Blue Cloud initiative, an integrated cloud computing offering that combines hardware, a Xen-based software stack, and a Tivoli management and provisioning framework.

All three of these virtualization offerings play to the dynamic computing trend that Ovum Summit has documented for the past 3-4 years and that has now become solidly mainstream.

### Impact on the CIO decision-making landscape

Many CIOs have already launched virtualization initiatives, and many, many more are currently in the planning and evaluation stages. Virtualization often begins as part of a consolidation agenda and/or a green IT revisionist strategy, but the technology is increasingly serving as part of a revised disaster recovery and business continuity arrangement.

How, then, should CIOs respond to the most recent announcements and the expanded virtualization environment that they have created? There are three main scenarios to consider. The first is where a virtualization program has already been concluded, with an incumbent virtualization provider already in place. The second is where a virtualization rollout is currently in progress. The third is where the virtualization initiative is still in the planning and design stages.

For scenarios 1 and 2, our basic advice to CIOs is to continue with the status

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quo until they plan a major technology refresh cycle. The delay in benefit realization from re-examining technical options is likely to outweigh the potential benefits of different architectural choices and increased supplier competition.

For scenario 3, we have two simple pieces of advice:

- do not consider virtualization as an isolated element of a corporate architecture. Alternative strategies for achieving greater infrastructure flexibility and improved asset utilization are also possible, using Internet-based facilities such as Blue Cloud or the Sun Grid.

- when selecting a virtualization software platform, the selection criteria should include the architectural flexibility to swap out one virtualization technology for another with relative ease. Anything that ties a CIO to a proprietary virtualization provider should be viewed as a negative constraint. Recent announcements have altered the provider landscape sufficiently that it is worth revisiting selection criteria and extending the strategy and analysis phase to enable the swap out criteria to be fully evaluated for all of the new software products.

**The Ellison hypothesis for virtualization investors**

At an investment analyst meeting in San Francisco, Oracle's CEO Larry Ellison raised an interesting possibility concerning VMware - one of the recent darlings of the technology market. He likened it to Netscape - hypothesizing that the exuberant growth and subsequent decline of Netscape stock could be a pattern that VMware would repeat a few years later.

The root of the argument is that the technology inherent in virtualization has the potential to be commoditized, as newer entrants bring competing products to market - with the engineering barrier to entry being substantially reduced by the availability of Xen, the open source para-virtualization foundation layer. So... will Oracle and Sun Microsystems do to VMware what Microsoft and others did to Netscape? Perhaps...

Of course, there is also the Microsoft factor. Microsoft has a number of different virtualization cards to play. Microsoft Virtual Server 2005 R2 is an existing product, and one that is a strong competitor in the current landscape. At the desktop level there is Microsoft Virtual PC 2007. In addition, the acquisition of Softricity during 2006 provides a strong application virtualization or application streaming technology which is now being included in the Desktop Optimization Pack for Software Assurance. However, the next 12 months will also see Microsoft making further technology progress, most notably when it begins to ship the Windows Server Hyper-V - the product name for the technology previously known by its codename, Viridian. So will Microsoft be the player that begins to take the wind from VMware's sails? Perhaps...

What is certain is that the virtualization market is becoming increasingly competitive, and CIOs will have more credible choices during 2008 than they have ever had in the past. VMware, as the initial market leader, will undoubtedly come under increased pressure from Microsoft, Sun, Citrix/XenSource and Oracle - plus others who have still to enter the battle.

Will VMware become the next Netscape? This is certainly a potential outcome, but it is not the only possibility. VMware has a strong lead and others will need to execute well to catch it - there are no short-term signs of weakness in the progress of VMware, either in terms of stock market performance or in terms of market execution.

**An alternative game changing hypothesis**

The traditional "IT stack" is simple. It has hardware at the bottom and business applications at the top, with operating systems and other infrastructure sandwiched in between. One of the classes of virtualization technology has the potential to change the dynamics of this stack – paravirtualization. It could fundamentally change the role of the operating system in the "IT stack". A graphical illustration of the impact is shown in Figure 1.

This approach came out of research at the University of Cambridge and the Xen programme, and involves: a small hypervisor, virtualization support in the underlying processor, and modifications to the operating systems to make them virtualization aware. Although not precisely correct in technical terms a crude way to understand the hypervisor is to think of it as a mini operating system that can either run another, larger operating system or it can run application code directly.

It is possible that some infrastructure software vendors will begin to develop versions of their software that will run directly on the hypervisor i.e. without the need for an operating system. If paravirtualization becomes the dominant form of virtualization technology then there will be a knock-on effect on the operating system vendors – but it is too early in the evolution of the virtualization market whether this impact will be real or imagined. By this time next year the picture should be far clearer.

# FUJITSU SERVICES – THE GLOBAL BRAND STRIVING TO MAKE IT IN EUROPE

Ian Brown
Senior Analyst

At its recent annual analyst conference in London, CEO David Çourtley reported that Fujitsu Services is making solid progress in Europe. With a reported compound annual growth rate of 17 percent for 2003 to 2006, the vendor claims to be the second fastest growing of the top 12 European IT services players.

Growth has been largely organic and Fujitsu Services has also reported increasing profits for the past five financial years. Fujitsu expects European market growth at roughly GDP levels (plus inflation) at around 4-6% in the next three years, so its key challenge will be to beat it. On top of that, UK government spending is expected to slow and Fujitsu Services has been very dependent on the UK public sector in recent years. Courtley's approach is simple: "hang on to what you've got and take business from competitors."

But you can only take business from your competitors if you're present in their markets. So at its analyst conference, Fujitsu Services was keen to show that it has progressed beyond its UK public sector heartland. Recent outsourcing wins include the UK Financial Services Authority, German insurance and financial services provider Allianz, and the jewel-in-the-crown, a £500 million 10-year deal with Reuters.

Fujitsu reckons the key to its success in these deals is its 'industrialised' approach to IT services and it was difficult to stray far from its "Triole" methodology at the conference. Triole is based on developing pre-tested, reusable templates that form the building blocks for IT solutions. Fujitsu's contention is that 80 percent of the IT infrastructure most organisations need is commodity; only 20 percent is custom or bespoke. There's no point developing the commodity part anew for every project and significant cost savings can be made from assembling pre-tested, pre-configured building blocks. According to the vendor, when the Triole content increases in bids, its win rate improves dramatically from under 20 to nearly 80 percent of bids.

Since Fujitsu started designing and 'manufacturing' these building blocks in 2003, it has concentrated on infrastructure, with over 1,000 templates developed so far. But it's not just developing building blocks for infrastructure – templates for applications (Java and .Net), business processes and management services are also under way.

Triole has already proven a hit in Japan and the success rates quoted by Fujitsu Services suggest it is key to the vendor's competitiveness elsewhere. But Triole alone can't turn Fujitsu Services into a stronger European player. Fujitsu Services has to have a presence and client relationships in order to pitch Triole to multi national firms in France, Germany, and the rest of Europe.

Fujitsu Services has acquired IT services companies in Germany (TDS and dsoftware) and Sweden (Mandator), but its ambitions have been modest. It tried for something larger with GFI Informatique, but didn't succeed, and it's no secret that the vendor is looking for further acquisitions. And while we agree that it needs more scale in Europe, we think there's something else that Fujitsu needs to add to the mix.

The star turn at the London conference was David Lister the CIO at Reuters. Reuters selected Fujitsu to outsource its infrastructure, because of its skills as an aggregator to combine the best components for its solutions and to work well with local and global partners. But there was almost a sense of surprise within Fujitsu Services that it is a global player. Fujitsu Services may be part of the third largest IT vendor in the world, but it's largely autonomous and still striving to achieve scale in continental Europe. Similarly, Fujitsu Consulting in the US and Fujitsu's IT services operation in Japan operate autonomously. That said, we expect the Group to make moves to integrate the different services unit much more closely in 2008.

Fujitsu's IT services organisations will be much stronger when they present one face to the world and to capitalise on global synergies. Surely, operating three separate IT services organisations in three regions of the world isn't an example of the 'lean' operations that Fujitsu likes to boast about? Fujitsu learnt about industrialisation from Toyota. Now it needs to learn about global branding and scale. Until it does, we think Fujitsu Services will continue to punch below its weight in Europe, in spite of its globally-recognised name.

# HR STRATEGY KEY TO TCS'S FUTURE

Samad Masood
Analyst

We recently had a detailed conversation with S. Padmanabhan, executive director and head of Global HR for Tata Consultancy Services. Fears, real and otherwise, of an Indian "skills crunch" holding back near-term growth in offshore services provision are growing. And this has thrown IT services HR executives like Padmanabhan into the limelight as each vendor scrambles to prove that they have an edge over their competition when it comes to attracting, training and retaining the best talent. Overseeing the hiring and training of more than 30,000 staff annually, and a pipeline of 25,000 Indian University students, Padmanabhan is definitely one to listen to when it comes to offshore skills issues.

**Comment:** TCS has a well respected HR and training process, and has always maintained the lowest staff attrition rate of all the big IT services vendors in India. This is partly because the credibility of the TATA group in India makes it a highly respectable place to work. The joke runs that Indian parents now tell their sons to be doctors, lawyers, bankers or work for Tata.

But the company is going global fast, and while India is still its primary source of talent, Padmanabhan is targeting new locations aggressively as well. In the first half of its current fiscal year, TCS hired just under 2000 staff outside of India. 45% of these were hired in Ibero America, with almost 20% hired in China.

This throws up a whole raft of new challenges for TCS. Among these are the need to integrate staff into TCS's culture, to deal with the domestic employment market and culture, and to build links with academia to generate new pipelines of graduate recruits. The benefits are that TCS will ultimately be able to present itself as a truly global organisation, with people at all levels able to engage with clients in different parts of the world effectively by nature of their location and cultural background.

In the meantime, though, Indian nationals still make up 92% of TCS's employee base. And despite its foray into new geographies, it is these employees that will be the foundation of TCS's future for a long time to come. Therefore the two main challenges for Padmanabhan in India are to develop these staff into the future leaders of TCS's business, and to encourage increased mobility amongst staff so that they can be deployed in TCS's new global locations to manage growth and deliver services.

All this requires more focus and investment in HR. For instance, TCS is investing in the top 500 employees in TCS, who will be provided support throughout their career to develop their leadership skills. And while experienced senior Western hires are typically "business ready" and therefore don't require this sort of investment, they do often require additional support to integrate into Indian business culture. Indeed, some of these staff are appointed a junior Indian employee to "hand-hold" senior Western hires to aid their introduction into TCS's culture.

The mobility issue is also a challenge because Indian employees are starting to become a little reticent about working in the US and Europe, where their salaries do not stretch as far as in India. They are also more careful to consider moving to TCS's newer offshore centres in developing countries, such as Morocco where language, culture and moving their families can be a challenge.

With the Indian staffing market so competitive, we imagine it is difficult to put pressure on staff to agree to a transfer – especially as they could simply leave for a competitor. Additionally, Padmanabhan claims that staff in new offshore countries, particularly China, can be even less keen on working overseas. This mobility issue is not yet a serious challenge, but needs to be dealt with for long-term sustainability. The solution (beyond spending more on salaries) is a complex one, and needs to be viewed holistically by the HR division – something that we're glad Padmanabhan agrees with us on.

Looking at the volumes and rate at which TCS is growing, it's clear that the company is breaking new ground in terms of HR processes and strategies. Lessons are being learnt and will continue to be learnt. But having heard the details of TCS's approach from Padmanabhan, we're comfortable that this business is well prepared to deal with this ongoing growth challenge.

# MULTI-SOURCING AND THE SERVICE INTEGRATOR

Phil Codling
Principal Analyst

We have been researching the end user aspects of multi-sourcing. For although multi-sourcing is well established (Ovum first used the term in 2003) and here to stay, it remains an evolving art/science.

Multi-sourcing creates challenges for the CIO and his/her team. Firstly, the more suppliers, the more complex the supplier management task. This is exacerbated by the requirement for competing vendors to co-operate and inter-work. Multi-sourcing thus demands a different type of supplier management and governance structure to single-sourcing.

**Enabling transformation**

Secondly, multi-sourcing is potentially an obstacle to innovation and transformation. Each supplier tends to have little control over the levers of business change. This highlights the requirement for cross-supplier co-ordination. But the truth is that many companies have struggled to provide effective service integration with an in-house team. This has damaged the effectiveness of their contracted services and limited their impact on the business.

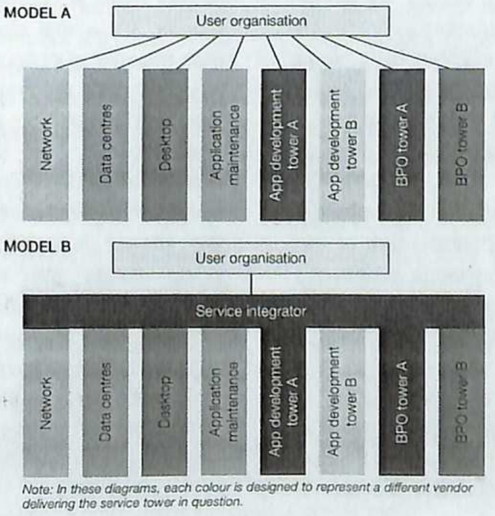
**Sourcing models at work**

The service integrator role, as depicted in Model B, can help. We are not suggesting that the customer should "outsource" full responsibility for service delivery. Most will want to retain a team to provide overall governance, chair steering groups and liaise with the service integrator. However, the use of a service integrator can provide advantages:

- It reduces the burden of managing a complex array of suppliers and contracts across multiple service "towers".
- The in-house supplier management team can be reduced in size (and potentially redeployed), reducing costs and freeing up time for IT directors/managers to do more strategic planning.
- A service integrator with the necessary experience and skills may be able to provide better co-ordination of services than an in-house team.

One consequence of this latter point is that the service integrator may be able to harness the transformational/innovation potential of the supplier ecosystem. This is not a given, but we have seen many instances where an in-house team has taken a largely tactical approach to supplier management and thus struggled to ensure transformation quickly or effectively enough. In some such cases, the appointment of a service integrator could have helped.

Figure 1 **Two common models of multi-sourcing**




*Note: In these diagrams, each colour is designed to represent a different vendor delivering the service tower in question.*

*Source: Ovum*

**Who should be the service integrator?**

In order to opt for the service integrator role, a CIO must have confidence in the appointed firm. So the role is most commonly conferred upon a key existing supplier within the organisation's outsourcing ecosystem. This is the set-up shown in Model B, where the service integrator is also contracted to deliver application development and BPO services. This will remain the preferred option for many organisations, especially since it is not only high on the "comfort factor" but can also appear to involve minimal additional cost.

Another option is to use a third party with specialist capability as a dedicated service integrator. This is a route inevitably seen by organisations as an additional layer of overhead on top of supplier contracts. Moreover, this model remains uncharted territory, so it is hard to find a service provider (consultancies and sourcing specialists come to mind) with direct experience. Furthermore, it is likely that an incoming integrator would struggle to insert itself into an already complex sourcing environment (as many are) that features a number of well-established suppliers.

For the reasons set out above, the reality is that outsourcing organisations tend to be comfortable to contract consultancies and sourcing specialists as advisors and "fixers" but not to entrust them with the fuller integrator role. (Such firms can undoubtedly offer much in this regard, thanks to their experience of such situations and knowledge of available tools (such as balanced scorecards, benchmarking, relationship evaluations and so on)). In the medium term, at least, it is likely, and understandable, that this will remain the case, despite the potential advantages of appointing a dedicated and independent service integrator in complex sourcing environments.

# IBM: IMPROVING CUSTOMER INTERACTION

Kate Hanaghan
Senior Analyst

We recently attended an IBM analyst summit for an update on many aspects of the company's IT services strategy. One notable theme was how IBM is looking to engage with customers more efficiently and effectively. We've seen IBM make improvements to its financial performance over the last few quarters, and how it engages with customers will play a critical role in ensuring this continues.

A couple of year ago the company established a discrete team to bring increased focus to its understanding of, and service to, certain vertical markets - in addition to the vertical specialists within GBS and GTS. Some of the verticals this team addresses are obvious - such as banking. However, some are relatively small industries where IBM sees real opportunities – for example, healthcare. The decision regarding which verticals are supported in this way is made at the worldwide level; a European team then decides how this is applied to the local market.

### The "special attention division"

So what exactly is the work of what IBM informally refers to as its "special attention division"? Primarily, it invests in subject matter experts. These teams are tasked with creating content that will enable account teams (whose job it is to be client experts first, not necessarily industry experts) to "enrich the conversation" with customer. There are local competency centres where these experts are based in order to provide local support to the account teams where it is most needed. For example, in Norway there is an oil and gas centre and in Germany there's an automotive centre.

So how have things progressed since the inception of the division? IBM claims that the unit has got better at selecting where to invest. With the competency centres established, IBM now has a network of locally-based experts, and a better idea of how to fund these centres of excellence for the best return. A secondary gain is that this division gives IBM a central repository for vertical expertise that can be applied to multiple clients.

The obvious flag to raise at this point is: won't those customers outside of these chosen 'special' verticals be concerned they won't get the IBM attention they require? Potentially, yes. And IBM will have to be very careful with how it deals with this. More to the point, it is just not economically viable for IBM to give the same level of attention (investment) across the board.

What's notable is that IBM is looking to extend the use of this division into its mid-market customer segment. We're very interested to see how this pans out in reality. For example, how would the process work with channel partners?

### Progress with products

Another IBM programme we've been following closely for some time is the productisation of IBM's services (within Global Technology Services). Progress to date looks promising. IBM says that the sale of maintenance services as products via telesales and partners "is working brilliantly". This is reflected in the overall performance of the maintenance business, which has moved from a decline into very low single-digit growth.

The same cannot be said for all of the nine product lines in GTS; others are having a much less positive impact. One interesting product is the company's (new) technical consulting offering. This is GTS's own version of consulting – i.e. it's not part of IBM's central consulting offering inside the GBS unit. This is a relatively new offering, and the strongest demand for it is coming from the emerging markets. A key difficulty IBM faces around this is the management of customer expectation. Customers will expect a large degree of consulting to be included as part of the bid process. In other words, they're not used to paying for it!

### Loosening up in outsourcing sales

In terms of infrastructure outsourcing, a key challenge IBM and its peers face is re-crafting their outsourcing strategies in order to play to a market that is being shaped by the combined effects of multi-sourcing buying strategies and increasing demand from mid-sized outsourcing customers. In other words, a greater number of smaller deals are coming on to the market. It's a real challenge; one that requires suppliers to look at many of their internal processes including how bids are put together/ responded to, how accounts are developed and serviced, and so on. In many instances, we think the answer is a combination of doing things the way smaller providers do, but also finding new ways around the problems. One solution IBM has created is giving individuals more power to make a bid decision on smaller outsourcing deals – predominantly to quicken time to response.

# EDS UNDERLINES ITS "BIG AND COMPLEX" CREDENTIALS

**Phil Codling**
**Principal Analyst**

We recently spent some time with EDS EMEA's top brass at the company's annual Analyst Conference in London. Such events normally confirm and add detail to existing strategies and directions, rather than announce anything brand new, and this one was no different. So, among other things, we had a reiteration of the company's continued push into applications business. Helped by a couple of big apps-oriented wins (Vodafone and Arcandor/KarstadtQuelle), applications revenues at EDS EMEA have been growing at double digit rates of late. That's not to say that the firm is turning its back on its traditional infrastructure heartland. Nonetheless, EDS is adamant that it is becoming more selective in its approach to ITO.

Such selectivity makes sense in an infrastructure market that has rapidly matured and, in some areas, commoditised. As for its criteria in selecting which pursuits to go for, EDS emphasises credentials in the "very big and complex" end of the market. Given its background and capability set, it is right to focus energies here. It's true that EDS is not alone in this "very big and complex" space, although the number of potential prime competitors is limited. In the UK, for example, IBM and BT are clearly in this bracket, plus Fujitsu, CSC and Capgemini.

### A potential pitfall

Of course winning in this market requires extremely strong references. The catch is that big and complex engagements can go horribly – and publicly – wrong. Just ask Accenture, following its NHS debacle. EDS needs therefore to be sure that its giant "DII" contract with the MoD, in particular, doesn't attract similarly negative attention.

Last month provided a dose of just such attention, following a joint Computer Weekly and Channel 4 News investigation into progress on DII. There were three main criticisms: slippage on the desktop rollout, an increase in the cost of the programme (from £4bn to >£5bn) and disruption to operations during rollout at the MoD Abbey Wood site.

On all these issues, the MoD and the Atlas Consortium (led by EDS) responded with 'one voice', which thankfully suggests a solid working partnership. And EDS is showing a commitment to getting through the undoubted problems. The programme is now accelerating with 3-4,000 desktops rolling out per month to make up for the delays, for example.

### What of smaller deals and commercial?

DII underlines the persistence of the "big and complex" IT services market space as an opportunity for EDS to address. But we are yet to hear from the outsourcer a parallel strategy for coping with the market's growing preference for smaller deals. We are not talking about the mid-market here, but rather the £10-100m deals that are typically the result of multi-sourcing. This is one reason the firm has not yet made enough headway (in its view, as well as ours) in the European commercial market, despite long-held ambitions in financial services in particular.

At present, EDS is mostly trying to build up its commercial business on the back of very large deals. It may very well win business thanks to these efforts and be able to grow these accounts in the way it has in the government market. However, a business built on very large relationships is not only prone to greater risk than one that is more spread (witness the aftershock of losing HMR&C to Capgemini, for example), it also potentially misses out on a lot of work that could provide entrees into new (and potentially grow-able) accounts.

One positive message that came out in discussion was a desire to provide more separation for EDS's commercial interests. A perennial handicap for the company outside government has been the habit of very large public sector deals to absorb EDS's resources and thus curtail private sector activity. Meanwhile it's good to see EDS viewing its commercial sector interests on a more industry-specific basis (as opposed to its traditional approach of seeing a set of big accounts) and hiring to support its need for deep vertical expertise in areas like financial services.

### Partnering to the fore

Finally, one statistic from EDS stuck in our minds. The company says 71% of its total signed contract value globally this year relies on a partnering model (primarily in the shape of its Agility Alliance). That compares to 30% of TCV on the same basis in 2005, and is a clear indication of one way in which both EDS and the market have evolved in a short space of time.

4%
282p
Xchanging

## XCHANGING KEEPS UP THE GROWTH IN Q3

BPO provider Xchanging has released an update on trading in the first nine months of the year. The firm says revenue hit £338m, in line with its expectations and 17% up on the same period of last year. It also confirmed that, following EU approval, it has completed the retail investment account management deal with Allianz that it first announced back in August.

**Comment:** The nine-month growth figure suggests Xchanging saw growth in the mid-teens in Q3, following its 18% year-on-year revenue rise in H1. Now that the Allianz deal in Germany is signed, we'd expect a slight acceleration in Q4 and into 2008.

Xchanging's "enterprise partnership"-driven business model requires the addition of such large deals on a regular basis to keep it growing. Given current conditions in European financial services (with pressures on costs, more M&A likely and regulatory changes continuing), Xchanging should have plenty of potential new accounts to work on. Indeed, we expect this more specialist side of its business in financial services to provide its best growth opportunities going forward, as opposed to the more horizontal HR, F&A and procurement deals through which it made its name, starting with its mega-deal at BAE Systems in 2001. As the BPO market has evolved, it's increasingly become clear that more focused, vertical-specific services tend to work better for both customers and vendors.

*Samad Masood*

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logicaCMG

## LOGICACMG Q3 RESULTS: FRANCE MAKES UP FOR UK WEAKNESS

LogicaCMG has released its third quarter interim statement. Revenue in the first nine months of FY 2007 was up 3.6% on a pro forma basis. Third quarter revenue was up 4% year-on-year at £710.5m (Q3 2006: £683.4m); revenue for the first nine months of the year to 30 September was £2,236.7m (2006: £2,158.5m). France achieved double-digit growth in the quarter; the Netherlands and the Nordics also performed well. The UK was again LogicaCMG's least successful subsidiary. LogicaCMG also announced that it will change its name to Logica in Q1 2008.

**Comment:** France was LogicaCMG's star performer in Q3 with revenues up 17.1% compared with the third quarter of 2006. This is good news for the UK-headquartered company. Its acquisition of Unilog in 2005 has paid off, giving it a much more balanced financial position in Europe. Most gratifying of all is that the vendor is succeeding in winning new cross-selling orders and growing revenue under contracts signed in 2006.

Again, the major disappointment was the UK business, with revenue down 7.5% year-on-year on a pro forma basis. It's the commercial sector which continues to under-perform in the UK: LogicaCMG says the cancelled transport sector contract, which held back revenues in the first half of the year, continues to have an impact. It also noted lower revenues in financial services compared with the very good Q3 FY 2006 – perhaps a sign of things to come.

It seems clear that the incoming CEO is going to have to concentrate on the UK business, when he comes on board on 1 January 2008. It won't be easy, with signs that the global credit crunch may have repercussions on the commercial sector beyond financial services. This, at a time when we are also expecting UK Public Sector growth to slow compared with 2007. LogicaCMG has sensibly expanded the pillars on which its European business rests with acquisitions in France and the Nordics, but the UK remains its largest geographical market and it needs to pull its weight especially in the commercial sector. No doubt the name change to 'Logica', a reminder of the group's UK heritage, is intended to spur the UK team on to greater things and to match the successes of their European counterparts. With a new (old) name and CEO, let's hope this marks the re-launch of the vendor in the UK.

*Ian Brown*

## SUN IMPROVES MARGIN - TOP-LINE GROWTH MUST BE NEXT

Sun Microsystems posted results of its fiscal Q1 2008 for the period ending 30 September 2007. The results showed a revenue increase from $3.189bn to $3.219bn, a small increase. GAAP net income was $89m, compared with a loss of $56m in the same period of fiscal 2007. Total gross margin increased to 48.5%.

**Comment:** A year ago we would have doubted the long term viability of the company as a whole, and were beginning to chart its journey to oblivion. This is no longer the case; Sun Microsystems is in the throes of a pragmatic turnaround and is entering a crucial period in that process.

Sun Microsystems is in the middle of what we describe as a three step strategy. First is a focus on rationalizing the opex base and ensuring that field execution, in particular, is running efficiently. Second is continued focus on R&D, across software, hardware and services, so that Sun Microsystems has competitive offerings for the market. Following on from these two elements will be the push for revenue growth - with a renewed focus on sales execution. Sun Microsystems is now turning its eye towards step three in this strategy.

Sun Microsystems has definitely taken some difficult decisions around cost - phase 1. However, it is also clear that Sun Microsystems has not been following a scorched-earth plan. It continues to invest in R&D, bringing new products to market - Phase 2. However, let's be clear - when moving to Phase 3 of the plan Sun Microsystems cannot declare Phases 1 and 2 to be over - there are still elements of the product portfolio and operational base that need further focus.

*David Mitchell*

## EDS Q3: SOLID BUT CAUTIOUS

EDS has announced its Q3 results. Revenue was up 6% to $5.63bn, with organic growth of 4%. Operating profit grew by 68% to $362m, which pushed operating margins up from 4.1% (in Q3 of 2006) to 6.4%. EPS was up 75% at 42 cents. Contract signings totalled $5.7bn, which was 61% better than Q3 last year. In EMEA specifically, revenue growth was 8% on an organic basis, but the local operating margin fell slightly (by 14 basis points) to 14.2%.

**Comment:** This was EDS's best quarter since Q4 2006. The improved contract signing number is significant, following a relatively quiet first six months of the year for the Texan giant. It was helped by the signing of eight deals with a value over $100m, in what remains (and will inevitably remain) a very lumpy market for large outsourcing contracts. The pipeline indicators are mostly positive, however, with pipeline value up 20% compared to a year ago. Interestingly, EDS claims that apps and ITO business now accounts for equal shares of its pipeline, providing further evidence that its longstanding push into apps (helped by the Mphasis and RelQ acquisitions) is opening up its addressable market beyond its traditional domain of large-scale infrastructure work.

The growth outlook from EDS remains cautious, nonetheless. The company is reiterating its modest revenue growth target for the full-year (of between 3.3% and 5.6%) and has effectively lowered its contract signing guidance (from c$23bn to $21-23bn). Moreover, for 2008, EDS is projecting just 2% growth. It has some specific reasons for doing this, including the ongoing impact from its termination at Verizon and the timing of other contract run-offs. But the company is also, we feel, taking a conservative view of its addressable market going forward. That view is undoubtedly justified, given current indicators.

Against this backdrop, EDS is planning further rounds of cost-cutting. In a market offering modest growth prospects, it clearly still feels that the best way to raise margins further is not to put faith in a buoyant topline, but rather to make the company more efficient. A number of factors should help EDS to do this without disrupting its business, not least increasing automation and process efficiency, plus a large (25,000 in India alone) and growing offshore workforce.

*Phil Codling*

## CAPGEMINI GROWTH DECELERATES IN Q3

Capgemini has announced its top line results for Q3. Reported revenues were up 11% year-on-year at €2.09bn, or up 6.2% at constant currency and excluding acquisitions. North America revenues were up by 8%, while Europe was up by 6% year-on-year at constant currency. In terms of service lines Consulting was up by 9% while outsourcing was barely up at 1%. Bookings were up 23% year-on-year at €1.97bn. Capgemini also announced that it has agreed a three-year extension of its Aspire contract with HM Revenue & Customs, which will now end in 2017.

**Comment:** It is interesting to note that the Aspire extension came after the contract was already extended last year. As a flagship deal, Aspire is hugely important for Capgemini - in the UK it accounts for over half of its revenues. But the value of the Aspire outsourcing contract has been declining by up to £45m per year, and we suspect this extension may have contributed to further decline. Capgemini has so far more than compensated for this decline with consulting and application development work with this client, but it will have to work even harder on these to make up for any further decline.

The key thing worth highlighting in the Q3 numbers is the deceleration on the quarterly organic growth: in Q1 it was 14% year-on-year, then 11.5% in Q2, and now down to only 6%. The key reason was its performance in Outsourcing: Capgemini outsourcing bookings have been modest over the last year, particularly when it comes to mega deals, even though we note the improvement this quarter over a weak Q3 2006. While Capgemini is indeed trying to lift outsourcing margins by focusing away from infrastructure outsourcing and into applications management and BPO, there is always a question of balance - we are not sure if Capgemini has the right balance right now.

*Angel Dobardziev*

## HP ENDS THE YEAR ON A HIGH

HP has announced the results of its Q4, for the period ending 31 October 2007. At the headline level, revenue for the quarter grew 15% to $28.3bn. For the full year, revenue grew 14% to $104.3bn. GAAP operating profit for the quarter was up 38% to $2.6bn, representing an EPS expansion of $0.60 to $0.81 per share.

**Comment:** HP has been firing on all cylinders recently. The Q4 results confirm this and the forward guidance from HP expects this to continue.

On a geographic basis the largest growth percentages came from EMEA and APAC. The Americas, EMEA and APAC grew at 9%, 12%, and 14% respectively - on a constant currency basis. Growth in the BRIC region was impressive, at 37%, and now accounts for 9% of total revenue. It is clear that HP has grasped the BRIC opportunity better than many companies, investing in the market at the right point in time and now being in a position to harvest the results. The recent acquisition in the MEA region should be seen in the same light - the basis for a long term growth opportunity in a rapidly emerging market.

The performance of the personal systems group (PSG) was strong, showing a growth of 31% in unit shipments and a revenue growth of 30% to $10.1bn. Notebook revenue growth in the quarter grew 49% - indicating that the PC revival is continuing. China represented a high spot in terms of growth, showing over 100% growth and now representing the third largest market for PSG. The storage business has begun to re-ignite, growing by 7% and showing stronger sub-segment growth.

HP software also experienced strong growth; in part driven by the Mercury acquisition, and resulting in a doubling of total revenue. We expect HP software to continue to make traction, looking at further organic growth and the potential for further acquisition.

*David Mitchell*

# BT GLOBAL SERVICES: WORK TO DO

BT Global Services' (BTGS) results for Q2 (to September 2007), announced as part of BT Group results, look sound at first sight. Revenues were up 6% year on year at £2.28bn, while EBITDA was up 5% at £240m (an EBITDA margin of 10.5%). Operating profits before leaver costs were down 10% to £65m.

**Comment:** BT Global Services is now not only the largest and fastest growing unit in the BT Group, but it spearheads BT's vision of becoming an ICT Services organisation. Taking a closer look at its performance this quarter highlights the extent of the work recently appointed BTGS CEO Francois Barrault has on his hands.

Yes, there are some significant contract wins and BT is making decent progress on its NHS NPfIT work. But the 6% growth rate includes more than half a dozen acquisitions which have all been/are integrated in BTGS - and BT is one of the few ICT organisations that does not report the important comparable/ organic growth rate figure. Given the number and size of the acquisitions, we suspect BTGS' organic revenues were at best flat year on year. And operating profit margin was a mere 2% including leaver costs.

So if BTGS is not growing organically, and barely breaking even at operating level, where does it leave it for the future? Certainly we might want to view its acquisitions diet over the last two years with some caveats. Yes BT is complementing its service capability by buying companies, but it is also 'buying' revenue growth. For how long can it continue to do that before it gets acquisition indigestion? Francois Barrault has an awful lot to do to lift both BTGS top and bottom lines in the coming quarters.

*Angel Dobardziev*

# EXPERIAN FEELS THE CRUNCH IN FIRST HALF

Experian, the credit data, services, and software player, has grown revenue in its first half ended 30 September by 16% to $1.9bn. Organic growth was 6%. Earnings before exceptionals, amortisation, and tax grew by 22% to $396m. In the UK and Ireland, revenue grew by 6% to $499m, with EBIT up by 7% to $126m. Revenue from EMEA/Asia Pacific was up by 13% to $326m, with EBIT up 9% to $34m.

**Comment:** These are pretty good results considering the challenges Experian has been facing in the market. The sub-prime mortgage credit crisis hit Experian in the second quarter, and this served to compound the already reducing spending levels amongst financial services clients (Experian's biggest market) in the US and UK. Experian executives have described the crisis as the biggest market challenge for the company to date.

But the credit crisis is not all bad news for Experian. Indeed, many of the company's higher value analytics tools could gain traction as lenders look to improve their risk management processes and improve collection rates. However, these products and services currently account for the smaller part of Experian's business. The majority of its revenue comes from Credit and Marketing services - the two areas where banks are slowing their spend the fastest.

So, the challenge is for Experian to continue to diversify its business into areas that are less affected by the credit crunch. Data analytics and Interactive services are two areas, but the company is also doing the right thing in building up its collections services to diversify away from its credit data roots. Acquisitions will continue to be key to this, and have already played a large part in boosting first-half revenue to a respectable level.

Experian will continue to face an increasingly tough market, and this is reflected in the 12% fall in its share price. We expect acquisitive growth will be the main driver for revenue over the coming year, and this will undoubtedly have an effect on its bottom line in the short-term. Nonetheless, the long-term prospects for Experian are still very positive - it just needs to ride this downturn as best it can, and hopefully come out the other side a more diversified and stronger business.

*Samad Masood*

-1%
91p
KEWILL

# KEWILL GROWS AND IMPROVES MARGIN

Kewill Systems, a provider of supply chain execution software and services, has announced its financial results for the six months to end September 2007. Total revenues increased 28% to £24.4m, with the operating margin up from 9.7% to 13.3%. European revenues increased 39% (to £14.2m) while US revenues increased 11% (before currency differences) to £9.1m.

**Comment:** Kewill's revenue growth is being driven by organic and inorganic factors. With regards to the former, the company says it's seeing more cross-selling between lines of business and geographies. But what's really notable is the buoyancy of the market within which it is operating. Kewill provides solutions to companies that run global supply chain networks - for example, the shipping industry. As the need for legislative controls and compliance has grown, so too has the need for improved supply chain systems. And, as supply chains have increased in complexity, customers have looked to overhaul their legacy systems. In the second half of the year, Kewill expects to introduce new products to take greater advantage of the generally positive trends in those industries most reliant on supply chain technologies.

What's also notable is Kewill's increasing shift to the SaaS (software as a service) model, which means it now has a larger proportion of recurring revenues (50% of total revenues). These recurring revenues of course give the firm greater visibility of its activities going forward.

In terms of the year as a whole, the company is feeling pretty confident - it says the order book and pipelines are both "robust". In addition, Kewill says it has been unaffected by the credit crunch. Provided it does indeed capture the anticipated new business, the second half of the year is set to show further positive signs.

*Kate Hanaghan*

Atos Origin

# ATOS ORIGIN DELIVERS A BETTER Q3

Atos Origin has released a Q3 revenue update. The company delivered topline growth of 11.1% to €1.41bn. Organic growth at constant exchange rates was 6.6%. This means that in the first three quarters of 2007, Atos Origin has grown revenue by 8.4% (or 4.0% organically) and is therefore maintaining its 4% growth outlook for the year as a whole. Orders were up 9% in the year so far. The company does not provide profitability details but said that the Q3 operating margin was an improvement on Q2's 4.6% and the 3.8% in Q3 2006.

**Comment:** This was an encouraging quarter for Atos Origin. The organic growth rate of 6.6%, which is roughly in line with its addressable market, was its best quarterly showing since Q4 2005. The growth looks better if you strip out the reselling activities that Atos says it is deliberately reducing - the resulting 'IT services' organic growth rate was 9.3% for the quarter and 7.1% for the year so far. The margin improvement is welcome news too, since in Q1 and Q2 Atos Origin had delivered an operating margin below the equivalent period in 2006.

A key factor in Atos' improved performance is the UK business. The UK is now back in profit and delivered 11% growth in the quarter. It's still only flat in revenue terms for the year so far, but it's clear that the revenue from wins including NFUM, Premier Foods and DCA is starting to come through.

But Atos Origin still has plenty of room for improvement. Consulting, although only 5% of the total business in revenue terms, remains a drag (with a 16% drop in revenue in Q3 and 10% in the year so far). To tackle this, Atos has replaced consulting leadership in the UK (which now has a Dutch caretaker manager in consulting) and France. We like the concept, which CEO Philippe Germond explained to analysts, of getting the various consulting units of the company to behave more like the successful Dutch consulting operation. As Germond and his team explained, consulting in the Netherlands has been much more closely integrated with the rest of the business (i.e. SI and managed operations). We've long said that a lack of such integration has been a major Achilles Heal for Atos, so it's good to see this issue being tackled in a pragmatic manner at a corporate level, as well as at the country level.

*Phil Codling*

# Mergers and Acquisitions – November 2007

| | |
|---|---|
| **Buyer** | Dell |
| **Seller** | EqualLogic |
| **Seller Description** | Privately-held data storage network vendor |
| **Acquiring** | 100% |
| **Price** | $1.4m |
| **Comment** | EqualLogic focuses on iSCSI technology for storage networks. We believe this is the future of storage networks as it allows enterprise scale storage systems to work with IP protocols and cuts the complexity and management overhead associated with the more ubiquitous SAN networks. It also removes the distance limitations on wide area storage networks. It is a good acquisition for Dell as it seeks to re-establish itself as a major enterprise infrastructure supplier. It has the potential to strengthen Dell's relationship with EMC. The timing of this announcement is significant. Dell has been losing market share, particularly to HP, and needs a boost to its image. It has also just emerged from an audit of its accounts from previous years with a relatively minor restatement of past results, and so has lifted this cloud from its operations. It can now unfreeze its substantial financial assets and use them for both acquisitions and shareholder refunds. But perhaps the major significance of this deal is that it represents a very different Dell from the one we've known in the past. Dell 2.0 doesn't rely on organic growth. Like HP and IBM, it's not afraid to reach out and expand its portfolio by acquisition. It's also buying into the channel. EqualLogic sells virtually all of its products through partners and Dell says it wants to build on that as part of its own efforts to build up a channel presence. Dell no longer appears to believe its direct marketing model is the only way to serve its target customers. EqualLogic's channel partners may have some misgivings, however: Dell's own sales force is likely to be keen to retain any existing customers of the two companies for itself. Storage is an area that is bound to keep on growing as new media and increased regulation become increasingly hungry for space. It is a good investment for Dell. |

| | |
|---|---|
| **Buyer** | HP |
| **Seller** | EYP Mission Critical Facilities Inc |
| **Seller Description** | New York-based consulting firm |
| **Acquiring** | 100% |
| **Price** | N/A |
| **Comment** | This is a case of HP hiring - and then acquiring - a company with skills that fit with its renewed marketing focus on infrastructure services, which HP is touting under its new three-part Data Center Transformation banner. HP contracted with EYP MCF to assist with its ongoing consolidation of 80-plus worldwide data centres to six locations - and HP executives were evidently impressed enough with the experience to acquire the company outright. EYP MCF executives said the company has focused on mission-critical data centres, where any downtime could result in lost revenue or, in extreme cases with public agencies, the loss of human life or breaches of national security. HP intends to add the firm, organisationally, to its Technology Services unit within HP Services (HPS), with links into its Consulting & Integration and other divisions. EYP MCF's expertise and methodologies will become part of HP's Data Center Services offerings (the first of the three parts of the Data Center Transformation portfolio). HP will also leverage EYP MCF's extensive experience in building energy efficient data centres, as power, cooling and energy consumption become even more critical design factors. According to EYP MCF, the firm has experience building many major "green" data centres, including one recently for mortgage lender Fannie Mae, and has implemented some of HP's newer green technology, including its Dynamic Smart Cooling solution. This deal demonstrates that HP, for the moment, appears to be content with smaller, more targeted services acquisitions in order to pick up specific skills, to increase its presence in a specific vertical/geography, or both. This differs from its approach to acquiring software vendors, where HP has shown an appetite for larger deals (think Mercury Interactive). More importantly, HPS picks up additional consulting capabilities to highlight the vendor's infrastructure prowess into global enterprise customers. HP constantly talks about its own data centre consolidation project as a model that enterprise customers can follow. EYP MCF has been so intimately involved with that project that its consultants, as part of HP, can quickly bring lessons learned and best practices to real-life engagements. And EYP MCF and HP also share a passion about tackling green IT issues - which will be an important asset as green IT gains more and more attention from business and IT leaders. |

| | |
|---|---|
| **Buyer** | IBM |
| **Seller** | Cognos |
| **Seller Description** | Business Intelligence |
| **Acquiring** | 100% |
| **Price** | $5bn |
| **Comment** | IBM had been the obvious buyer of Cognos for quite sometime. The rumours started circulating when the two companies entered into a strategic relationship in early 2006 and intensified when SAP's acquisition of Business Objects left IBM as the last of the major infrastructure players without a convincing BI story. Despite previous claims by Ambuj Goyal that IBM had no interest in acquiring a '1st generation' BI company, it became obvious that market pressures coupled with the moves by SAP and Oracle meant that IBM had to act now. So what does IBM gain from the Cognos acquisition? First and foremost, Cognos augments IBM's Information On Demand (IOD) strategy, a grandiose vision that aims to pull together the company's middleware software and services to help organisations drive more business value out of their information. The company has built up an arsenal of components (mostly through acquisitions such as Ascential and FileNet) to complement its DB2 database and help deliver the vision. The company has also worked to build awareness that comprehensive information management, integration and consistency is a necessary foundation for SOA-based deployments. IBM's IOD vision has thus far concentrated on strengths in data management, but has lacked a coherent message about what role core BI capabilities play. Cognos's market leading front end BI tools for query, reporting and analysis provide a natural complement to IBM's back-end information management and integration capabilities. The potential for IBM is to use the Cognos toolset as an analysis engine and container for serving up all forms of information - structured and semi-structured, historical and realtime, operational and analytical - to help deliver on its IOD vision. However, this leaves a question mark over IBM's plans for Cognos's performance management products. Cognos is garnering a reputation in the Office of Finance with its planning, budgeting and forecasting applications. IBM's information management division (like the rest of the software group) on the other hand has traditionally shied away from the applications business and typically sold into IT shops. If IBM wants to continue to play in the performance management space it must ensure that Cognos's emphasis on the CFO is not lost or diluted by the old 'we don't do applications' messaging. |

## UK software and IT services share prices and market capitalisation - November 2007

| | SCS Cat. | Share Price 30-Nov-07 | Capitalisation 30-Nov-07 | Historic P/E | PSR Ratio Cap./Rev. | S/ITS Index 30-Nov-07 | Share price move since 31-Oct-07 | Share price % move in 2007 | Capitalisation move since 31-Oct-07 |
|---|---|---|---|---|---|---|---|---|---|
| @UK plc | SP | 0.08 | 3.02 | NA | 2.08 | 122.14 | -6% | -56% | -£0.19m |
| Alphameric | SP | 0.28 | 36.46 | 10.0 | 0.55 | 128.44 | 30% | -41% | £7.95m |
| Alterian | SP | 1.36 | 59.09 | 24.5 | 4.22 | 680.00 | 2% | 20% | £0.62m |
| Anite Group | CS | 0.43 | 149.90 | 8.6 | 0.87 | 251.46 | -32% | -47% | -£73.12m |
| Ascribe | SP | 0.28 | 32.88 | NA | 6.15 | 1,473.68 | -30% | -28% | -£14.09m |
| Atelis plc | SP | 0.03 | 0.75 | NA | NA | 139.53 | 0% | -56% | £0.00m |
| Atlantic Global | SP | 0.13 | 2.86 | 55.1 | 1.34 | 440.68 | -7% | -4% | -£0.35m |
| Autonomy Corporation | SP | 7.99 | 1690.49 | 84.4 | 13.18 | 243.89 | -19% | 56% | -£376.42m |
| Aveva Group | SP | 9.20 | 620.49 | 35.0 | 9.41 | 4,600.00 | -20% | 13% | -£156.93m |
| Axon Group | CS | 5.82 | 365.63 | 23.6 | 2.66 | 3,325.71 | -34% | -5% | -£154.16m |
| Belgravium Technologies Plc. | SP | 0.11 | 11.09 | 10.2 | 2.12 | 733.33 | -2% | -15% | -£0.24m |
| Bond International | SP | 1.48 | 44.99 | 11.0 | 2.62 | 2,276.92 | -22% | -14% | -£16.99m |
| Brady | SP | 0.50 | 13.53 | 28.2 | 5.56 | 617.28 | 27% | 37% | £2.73m |
| Business Control Solutions | CS | 0.03 | 6.79 | NA | 0.85 | 480.00 | 9% | -52% | -£0.67m |
| Business Systems | CS | 0.12 | 10.31 | NA | 0.30 | 100.84 | 0% | -4% | £1.08m |
| Cantono | CS | 0.06 | 11.58 | NA | 1.61 | 1,145.45 | -11% | 15% | -£8.87m |
| Capita Group | CS | 7.42 | 4458.94 | 32.5 | 2.62 | 200,577.62 | -1% | 22% | -£28.76m |
| Centrom | CS | 0.01 | 2.61 | NA | 0.41 | 166.67 | 0% | -33% | £0.00m |
| Charteris | CS | 0.20 | 8.39 | 29.1 | 0.94 | 222.22 | 21% | 25% | £1.29m |
| Chelford Group | CS | 1.38 | 9.82 | 134.2 | 0.53 | 240.00 | -7% | -18% | -£0.82m |
| Civica | CS | 1.67 | 104.83 | 9.8 | 0.99 | 954.03 | -18% | -39% | -£23.06m |
| Clarity Commerce | SP | 0.32 | 7.85 | NA | 0.59 | 256.00 | 3% | -40% | £0.13m |
| Clinical Computing | SP | 0.03 | 3.15 | NA | 1.90 | 24.19 | 0% | -57% | £2.15m |
| CODA Plc. | SP | 1.61 | 123.93 | NA | 2.32 | 993.83 | -5% | -1% | -£6.35m |
| Compel Group | CS | 1.49 | NA | NA | NA | 1,192.00 | 0% | 26% | NA |
| Computacenter | R | 1.70 | 271.49 | 13.5 | 0.12 | 253.73 | -17% | -37% | -£57.75m |
| Computer Software Group | SP | 1.49 | NA | NA | NA | 1,268.08 | -1% | 23% | NA |
| Corero | SP | 0.07 | 3.02 | 30.3 | 0.48 | 93.33 | -15% | -52% | -£0.74m |
| Corpora | SP | 0.06 | NA | NA | NA | 157.89 | -14% | 7% | NA |
| Dealogic | SP | 1.83 | 123.31 | 12.5 | 3.07 | 795.65 | 0% | 16% | -£0.67m |
| Delcam | SP | 2.63 | 16.21 | 7.1 | 0.68 | 1,011.54 | -24% | -16% | -£10.41m |
| Detica | CS | 2.30 | 266.73 | 23.1 | 1.71 | 2,875.00 | -31% | -37% | -£119.02m |
| Dicom Group | R | 1.90 | 159.63 | 16.2 | 1.00 | 582.46 | -1% | -18% | -£3.98m |
| Dillistone Group | SP | 2.20 | 11.88 | NA | NA | 1,611.72 | -1% | 50% | £0.00m |
| Dimension Data | R | 0.62 | 954.87 | 22.7 | 0.69 | 110.12 | 0% | 44% | -£11.00m |
| DRS Data & Research | SP | 0.23 | 7.36 | 44.1 | 0.59 | 209.09 | -26% | -38% | -£2.78m |
| eg Solutions | SP | 0.30 | 4.29 | NA | 0.79 | 204.08 | -13% | -63% | -£0.64m |
| ELCOM | CS | 0.02 | 8.28 | NA | 23.91 | 400.00 | 0% | -52% | £0.00m |
| Electronic Data Processing | SP | 0.51 | 12.48 | 28.9 | 1.79 | 1,561.54 | -14% | -21% | -£1.99m |
| FDM Group | A | 1.10 | 25.54 | 12.3 | 0.57 | 1,349.69 | -14% | 18% | -£4.18m |
| Ffastfill | SP | 0.08 | 30.08 | NA | 11.35 | 66.67 | -7% | 33% | -£1.87m |
| Financial Objects | CS | 0.47 | 20.67 | 7.5 | 1.04 | 204.35 | -11% | -14% | -£2.89m |
| Flomerics Group | SP | 0.46 | 9.95 | 11.3 | 0.70 | 1,769.23 | -23% | -39% | -£3.03m |
| Focus Solutions Group | CS | 0.45 | 13.26 | 8.0 | 1.34 | 230.77 | 3% | -7% | £0.44m |
| GB Group | CS | 0.23 | 19.26 | NA | 1.28 | 148.35 | -4% | -50% | -£0.98m |
| Gladstone | SP | 0.20 | 10.56 | 7.6 | 1.38 | 500.00 | -10% | -22% | -£0.35m |
| Glotel | A | 0.70 | NA | NA | NA | 363.64 | 1% | 11% | NA |
| Gresham Computing | CS | 0.75 | 39.64 | 90.9 | 2.84 | 806.45 | -35% | -49% | -£21.80m |
| Group NBT | CS | 2.30 | 57.83 | 18.8 | 6.88 | 1,150.00 | 2% | 11% | £0.88m |
| Harvey Nash Group | A | 0.56 | 40.39 | 0.6 | 0.16 | 320.00 | -16% | -23% | -£7.78m |
| Highams Systems Services | A | 0.06 | 1.95 | 0.1 | 0.14 | 166.67 | -13% | 30% | -£0.24m |
| Horizon Technology | CS | 0.80 | 65.86 | 0.8 | 0.35 | 294.21 | -18% | 16% | -£14.81m |
| I S Solutions | CS | 0.22 | 5.33 | 18.6 | 0.97 | 819.84 | -3% | 40% | -£0.19m |
| IBS OPENSystems | CS | 1.70 | 68.00 | 1.7 | 4.35 | 1,114.75 | -10% | -7% | -£7.60m |
| ICM Computer Group | CS | 5.38 | NA | NA | NA | 2,988.89 | -1% | 86% | NA |
| IDOX | SP | 0.12 | 40.18 | NA | 2.84 | 15.40 | 2% | 88% | £0.00m |
| Imaginatik | SP | 0.04 | NA | NA | NA | 500.00 | 13% | -50% | NA |
| In Technology | CS | 0.31 | 43.63 | NA | 0.23 | 1,230.00 | -10% | -28% | -£4.97m |
| Innovation Group | SP | 0.30 | 194.76 | 24.1 | 3.19 | 131.00 | -12% | -4% | -£25.75m |
| Intelligent Environments | SP | 0.08 | 12.42 | 0.1 | 3.98 | 83.51 | -15% | 26% | -£2.72m |
| Intercede Group | SP | 0.36 | 12.81 | NA | 7.09 | 600.00 | 7% | -39% | £0.72m |
| InterQuest Group | A | 0.89 | 26.57 | NA | 0.96 | 1,539.13 | -11% | 1% | -£3.15m |
| Invu | SP | 0.29 | 24.69 | 14.7 | 3.80 | 3,052.60 | -1% | -3% | £0.29m |
| iTrain | SP | 0.03 | NA | NA | NA | 29.76 | 27% | 12% | NA |
| K3 Business Technology | SP | 1.57 | 36.64 | 15.0 | 1.34 | 1,199.58 | -13% | 35% | -£5.51m |
| Kewill | SP | 0.91 | 73.95 | 50.2 | 1.78 | 1,798.42 | -1% | 15% | -£0.52m |
| Knowledge Technology Solutions | SP | 0.01 | 3.42 | NA | 2.73 | 200.00 | 23% | -38% | -£0.54m |
| LogicaCMG | CS | 1.24 | 1806.23 | 15.6 | 0.68 | 1,698.16 | -24% | -33% | -£569.40m |
| Lorien | A | 0.98 | NA | NA | NA | 980.40 | -1% | 131% | NA |
| Macro 4 | SP | 1.58 | 34.88 | 5.4 | 1.05 | 637.10 | -7% | -25% | -£2.87m |

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|---|---|---|---|---|---|---|---|---|---|
| Manpower Software | SP | 0.54 | 24.13 | 24.5 | 5.57 | 556.70 | -17% | 108% | -£4.71m |
| Maxima Holdings | CS | 2.38 | 59.18 | 12.4 | 1.86 | 1,730.91 | -22% | 3% | -£17.19m |
| Mediasurface | SP | 0.07 | 6.71 | 7.1 | 0.69 | 514.71 | -10% | -59% | -£1.02m |
| Micro Focus | SP | 2.88 | 578.33 | 25.7 | 7.65 | 0.00 | -2% | 38% | -£9.51m |
| Microgen | CS | 0.36 | 36.96 | 9.4 | 0.98 | 153.85 | -24% | -34% | -£11.86m |
| Minorplanet Systems | SP | 0.29 | 8.36 | 7.0 | 0.35 | 592.20 | -12% | -48% | -£2.28m |
| Misys | SP | 2.01 | 1013.28 | 24.1 | 1.80 | 2,500.68 | -17% | -7% | -£206.01m |
| Monitise | CS | 0.15 | 37.55 | NA | 0.08 | 98.33 | -5% | -31% | -£1.91m |
| Morse | R | 0.70 | 90.28 | 5.0 | 0.25 | 280.00 | -34% | -35% | -£77.46m |
| NCC Group | CS | 3.58 | 116.76 | 22.6 | 4.60 | 2,143.71 | -9% | 29% | -£6.68m |
| Ncipher | SP | 2.44 | 40.93 | NA | 2.36 | 976.00 | -7% | -4% | -£3.19m |
| Netcall | SP | 0.25 | 16.51 | 22.3 | 4.98 | 505.05 | -18% | 47% | -£3.64m |
| Netstore | CS | 0.26 | 32.60 | 12.2 | 1.63 | 173.33 | -5% | -13% | -£7.08m |
| Networkers International | A | 0.31 | 28.56 | 13.1 | 1.50 | 968.75 | -11% | -11% | -£3.68m |
| Northgate Information Solutions | CS | 0.67 | 387.29 | 11.0 | 1.10 | 257.69 | -15% | -22% | -£71.34m |
| NSB Retail Systems | SP | 0.23 | 93.73 | 10.0 | 1.94 | 2,000.00 | 2% | -33% | £0.30m |
| OneclickHR | SP | 0.04 | 5.76 | NA | 0.97 | 100.00 | -3% | 0% | -£0.38m |
| OPD Group | A | 2.21 | 58.70 | 7.0 | 1.34 | 1,004.54 | -20% | -55% | -£14.67m |
| Parity | A | 0.65 | 24.71 | NA | 0.16 | 601.85 | -3% | -17% | -£0.77m |
| Patsystems | SP | 0.28 | 49.20 | 36.2 | 3.22 | 261.68 | 8% | 62% | £3.11m |
| Phoenix IT | CS | 2.99 | 222.60 | 13.5 | 1.76 | 1,107.41 | -24% | -2% | -£70.08m |
| Pilat Media Global | SP | 0.43 | 25.46 | 10.6 | 1.96 | 2,150.00 | -5% | -47% | -£1.47m |
| Pixology | SP | 0.40 | NA | NA | NA | 283.01 | -3% | 39% | NA |
| Portrait Software | CS | 0.15 | 14.30 | 37.0 | 0.99 | 98.49 | -3% | 0% | -£0.73m |
| Proactis Holdings | SP | 0.64 | 19.32 | NA | 10.17 | 1,319.59 | -7% | 1% | -£1.51m |
| Prologic | CS | 0.89 | 8.90 | 10.4 | 1.28 | 1,072.29 | -1% | 5% | -£0.10m |
| QinetiQ Group | CS | 1.82 | 1203.72 | 18.3 | 1.05 | 829.16 | -3% | -5% | -£20.97m |
| Qonnectis | CS | 0.02 | 3.66 | NA | 33.45 | 533.33 | 0% | 167% | -£0.60m |
| Quantica | A | 0.46 | NA | NA | NA | 370.97 | -2% | 51% | NA |
| Revenue Assurance Services Plc | SP | 2.02 | NA | NA | NA | 1,346.67 | 0% | 64% | NA |
| RM | SP | 2.07 | 191.80 | 20.3 | 0.71 | 5,914.29 | 1% | 7% | £2.82m |
| Royalblue Group | SP | 9.57 | NA | NA | NA | 5,629.41 | -17% | -8% | NA |
| Sage Group | SP | 2.16 | 2809.36 | 18.3 | 24.22 | 83,076.92 | -11% | -20% | -£346.58m |
| Sanderson Group | SP | 0.50 | 20.93 | 10.1 | 1.30 | 1,000.00 | 0% | 2% | -£0.21m |
| SciSys | CS | 0.41 | 11.61 | 8.4 | 0.46 | 317.83 | -12% | -53% | -£1.63m |
| SDL | CS | 2.80 | 209.75 | 29.4 | 2.21 | 1,866.67 | -7% | 19% | -£15.18m |
| ServicePower | SP | 0.15 | 13.37 | NA | 1.68 | 150.00 | -12% | -9% | -£1.81m |
| Sirius Financial | SP | 1.74 | 5.74 | 8.7 | 0.26 | 1,160.00 | -23% | 18% | -£33.90m |
| SiRViS IT plc | CS | 1.68 | 5.91 | 22.0 | 0.74 | 1,460.87 | -6% | 4235% | £0.00m |
| smartFOCUS plc | SP | 0.16 | 23.66 | NA | 2.57 | 1,729.73 | 3% | 5% | £9.28m |
| Sopheon | SP | 0.16 | 24.02 | 15.0 | 4.00 | 233.81 | -15% | -28% | -£4.00m |
| Spring Group | A | 0.47 | 76.34 | NA | 0.19 | 516.67 | -32% | -33% | -£36.10m |
| SSP Holdings | SP | 1.48 | 121.83 | 14.8 | 6.81 | 1,391.51 | -4% | 22% | -£5.78m |
| StatPro Group | SP | 0.85 | 44.85 | 9.8 | 3.53 | 1,062.50 | -11% | -18% | -£6.06m |
| SThree Group plc | A | 1.96 | 727.00 | NA | 3.00 | 950.00 | -21% | -49% | £383.58m |
| Stilo International | SP | 0.01 | 1.31 | NA | 0.57 | 25.00 | -9% | -47% | -£0.13m |
| Strategic Thought | CS | 0.50 | 13.42 | NA | 1.17 | 369.00 | -5% | -50% | -£0.36m |
| SurfControl | SP | 6.99 | NA | NA | NA | 3,495.00 | 0% | 34% | NA |
| Tadpole Technology | SP | 0.04 | 13.92 | NA | 2.88 | 96.56 | -9% | 300% | -£4.75m |
| Tikit Group | CS | 2.47 | 31.56 | 15.1 | 1.34 | 2,147.83 | -11% | -4% | -£4.10m |
| Total Systems | SP | 0.29 | 3.05 | NA | 0.87 | 547.17 | 2% | -19% | £0.05m |
| Touchstone Group | SP | 1.58 | 19.40 | 57.6 | 0.64 | 1,504.76 | -7% | -12% | -£1.02m |
| Trace Group | SP | 1.53 | NA | NA | NA | 1,224.00 | -1% | 54% | NA |
| Triad Group | CS | 0.24 | 3.64 | NA | 0.09 | 177.78 | -13% | -4% | -£0.53m |
| Ubiquity Software | SP | 0.37 | NA | NA | NA | 923.37 | -1% | 84% | NA |
| Ultima Networks | R | 0.01 | 1.79 | 22.4 | 0.94 | 24.39 | 14% | 14% | £0.00m |
| Ultrasis Group | SP | 0.01 | 12.93 | NA | 10.40 | 20.41 | 0% | -30% | -£0.37m |
| Universe Group | SP | 0.07 | 7.60 | NA | 0.17 | 311.11 | -10% | -50% | -£1.29m |
| Vega Group | CS | 2.72 | 55.27 | 15.3 | 0.86 | 2,229.51 | 31% | 29% | £12.48m |
| VI group | SP | 0.16 | NA | NA | NA | 320.00 | 0% | 12% | NA |
| Xansa | CS | 1.30 | NA | NA | NA | 3,325.64 | 0% | 50% | NA |
| Xchanging | CS | 2.82 | 597.00 | 39.7 | NA | 923.08 | 4% | -8% | £23.80m |
| Xpertise Group | CS | 1.09 | 5.75 | 18.7 | 0.36 | 4,360.00 | -17% | 169% | -£1.29m |
| XploiTe | CS | 0.47 | 18.38 | 1.8 | 0.62 | 1,446.15 | 7% | 42% | £0.99m |

**Note:** We calculate PSR as market capitalisation divided by sales in the most recently announced financial year.
Main **SYSTEMHOUSE** S/ITS Index set at 1000 on 15th April 1989. Any new entrants to the Stock Exchange are allocated an index of 1000 based on the issue price. The Ovum 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 Staffing Agency

# S/ITS STOCKS START THEIR DIVE

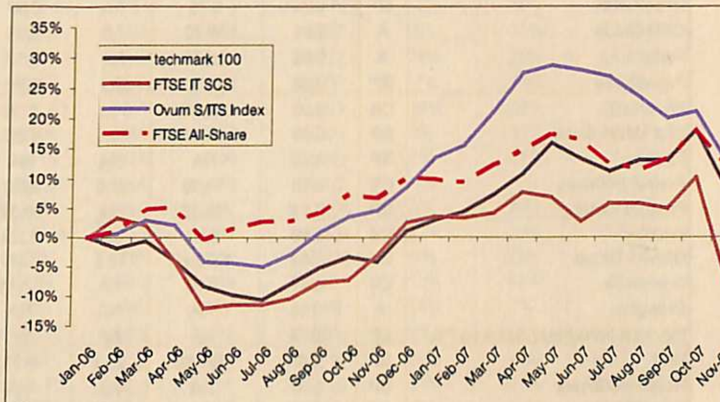
**Samad Masood**
**Analyst**

The tide suddenly turned for software and IT services shares in November. The view that IT may well be a "safe haven" in the sub-prime storm has been turned on its head after UK sector indices started a nose dive.

While the FTSE All-Share fell by 5%, reflecting the general mood in the broader market, the FTSE IT SCS dropped a massive 15.9%. The techMARK 100 fell by 8.2% while Ovum's S/ITS index fell by 6.9%. The gains made over what has been a pretty good 2007 for IT shares have either been wiped out or significantly reduced. Only the techMARK 100 is still higher than January 2007, and then only by 5%.

As a group, IT staffing agencies saw their share values fell by 12%, while resellers and computer services players each fell by 8%. Software vendors were the least affected as a group, falling by 5%. Almost 60% of the S/ITS companies that we track have share prices below that at the start of the year.

**UK Indices comparison, January 2006 to end of November 2007**




*Source: Ovum*

No one specific thing has caused this sudden loss of favour in IT stocks. It is a delayed reaction to a number of "sub-prime" related issues that have now started to filter down into the IT sector. One of these is the effect that higher credit prices have had on the ability of private equity firms to borrow the cash they need to fund acquisitions.

As regular readers will recall, a good deal of the best performing shares listed in these pages were as a result of acquisitive approaches – either real or imagined – by competitors and PE firms. Now that the cost of credit is rising, it seems that the bottom could be falling out of the M&A market – resulting in falling share values. Supporting this view is the fact that the two best performing shares in November were of companies that are being approached or acquired: Vega Group (up 31%) and Alphameric (up 30%).

Another big reason for this sudden lack of confidence in the S/ITS sector is that those suppliers most directly hit by the sub-prime crisis are in the financial services sector themselves. The financial services sector accounts for 21% of the UK S/ITS market, and banks are consistently the biggest drivers of growth, given that they are typically the first to invest in new technological initiatives such as software-as-a-service (SaaS) and service oriented architectures (SoA).

With the financial services sector tightening its belt, the fear is that many software and services players will be hit over 2008. The fears started when Detica announced that it expected its financial services sector business to stall over its second half. We don't expect Detica to be the last to admit this, and clearly investors in the market don't either.

We won't speculate on how far S/ITS shares as a group will fall, and for how long – there are simply too many factors to consider. But we do believe that there are many players that are being punished unfairly due to the general fears in the market. We maintain that there are still some great picks in the UK S/ITS industry, and that this round of falls will sort more of that wheat from whatever chaff still remains.