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SYSTEMHOUSE

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

PROJECTS: FAIR WINDS FOR GROWTH

By Phil Codling

Phil Codling
Principal Analyst

Recent research in the run-up to our *Market Trends 2007* reports has confirmed that demand for SI and consulting projects is at its highest level in the UK since the lows of 2002/3. This follows gradually improving conditions in the preceding three years and reflects both the generally positive macro-economic climate and the renewed desire among businesses to invest in IT in order to drive business value – or the "growth agenda", as we have previously labelled it. We're also detecting some significant drivers of growth...

The drive for intelligence and "good data"

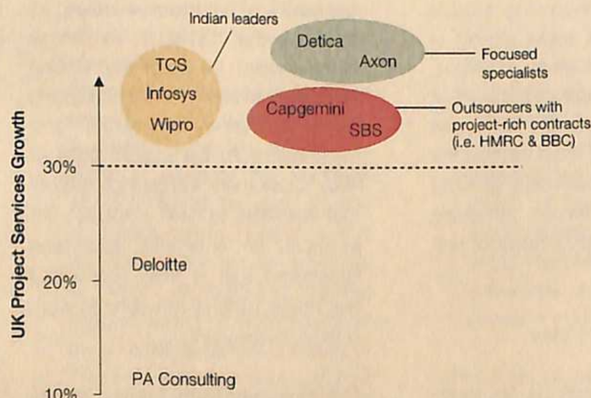
We are seeing strong demand for projects involving business intelligence, data analytics and data warehousing. Our belief is that many of these projects (as well as internal initiatives by end users) are uncovering ever more challenges in the area of data management and data integrity. And all the while, the complexity and sheer volume of data held by organisations continues to mushroom.

Such pressures, heightened further by regulatory requirements in financial services, in particular, will mean that the whole area of business intelligence and data will remain fertile ground for consultants and other IT services providers for some time to come.

Compliance is key

Financial services firms are proving important spenders in the current growth cycle as regulatory pressures build. We'd highlight the way Solvency II is driving projects in insurance right now. Meanwhile, we expect MiFID-related projects to be in plentiful supply up to and beyond the EU mandated November MiFID deadline. That said, we do not expect SEPA to have a huge impact in the UK market, given that it is restricted to Euro-denominated transactions.

Top growers in project services



Qualification = £50m of UK project services in most recently completed financial year.
Most of the largest players (e.g. IBM, Accenture, LogicaCMG and Atos Origin) grew by less than 10% and are therefore not shown.

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INDICES
(changes in June 2007)

Ovum S/ITS Index	**-0.61%**	**6570**
FTSE IT (SCS)	**-3.87%**	**588**
techMARK 100	**-7.91%**	**1598**

[continued from front page]

Enterprise applications: SAP in the ascendancy

SAP continues to take over in the enterprise ERP space, with even previously non SAP-prone verticals like utilities now increasingly appearing open to the software, helped by both SAP's and service providers' attempts to deliver more vertically-tailored packages. While the typical time and effort required for an SAP implementation is falling and big new implementations remain rare, project activity around SAP remains high thanks to the number of upgrades and integrations being demanded.

Technology for service and product effectiveness

We have been detecting good signs of demand in the PLM (product lifecycle management) project market. There appears to be a renewed drive from some sectors (notably pharmaceutical and engineering) to harness software in order to improve product development and competitiveness in the global economy. Meanwhile, we see huge potential for rationalisation and supply chain management (SCM) usage in the retail back-office and believe the pressures on retailers to implement such solutions are intensifying.

Legacy alive and well

We remain in a positive part of the legacy renewal cycle, with customers finding they need to upgrade and replace systems installed in the Y2K era. This factor in the market has been with us for some time, but it appears to be remaining a significant driver of projects throughout 2007. There is also a general shift from bespoke to packaged applications as part of this renewal process, although we see in-house applications clinging on in many areas, especially where they are absolutely critical to the operation's functioning and where the risks of migration are greater than the potential benefits (for example, core banking systems at large financial organisations).

M&A as a driver

Mergers and acquisitions are a well-established feature of the UK and indeed global economies. But the pressures of globalisation and the activities of private equity firms are causing an accelerating increase in M&A. Many such moves drive the need for systems consolidation and rationalisation, which can stimulate consulting and one-off projects, as well as increased contract scope and value for application outsourcers. In the years ahead, the biggest mergers affecting the UK will most likely be witnessed in media/entertainment, retail and financial services, with many subsequent integrations assuming an international (as opposed to UK-only) dimension.

Skills scarcity hits in places

The recent uptick in demand in the industry has created skills shortage challenges for many organisations. This is true in some areas of packaged software but also remains a particular challenge around legacy applications. Such shortages are driving end users to the external market (both staff agencies and project firms) in search of skills and they are prepared to pay good prices where skills are critical and hard to find.

Price pressure varies according to service

As one might expect in a market with pockets of scarce skills, customers appear tolerant of fee rate increases in pockets too, hence the current room to raise fee rates slightly in some areas of SI and consulting. However, we should highlight that price pressure remains in many areas of the market, and most particularly in areas where customers see the service primarily as an efficiency measure, rather than a driver of real business value.

Deflation is here to stay

Customers will continue to push for global sourcing solutions in our view, even though some sectors of the market (notably capital markets) appear to have reached something approaching saturation in terms of SI and applications work. This suggests that the "deflationary" effect of global sourcing on the market, whereby services gradually become cheaper per unit of work, is set to remain with us, despite general rate rises for offshore work. This is one reason why we are keeping our growth forecasts in the UK projects market firmly in mid-single digits territory, despite the current positives.

Public sector gets tougher

To end on a further cautionary note... the UK government appears to be turning a corner in the way it procures services. An incessant run of efficiency reports, targets and initiatives means that government departments are tending to hold their IT purse strings rather tighter these days. This is beginning to have an effect in the consulting and SI arena, where fewer contracts outside the "mega-deals" and larger "framework agreements" level are now available to suppliers. Finding growth in the private sector is set to become even more important for those players that have become too reliant on government.

Innovation and change is a constant process

Despite the emphasis on costs and consequent pressure on pricing, customers are looking for suppliers that can offer innovation and flexibility. In the current business environment, businesses regard change as a constant and are therefore looking for providers that can adapt to change when needed. It's worth emphasising too that innovation doesn't necessarily mean something bespoke and expensive from the buyer's point of view. Customers increasingly expect their suppliers to have a solution (for example, on enterprise application integration) that is tried and tested and needs minimal re-writing to work in their environment.

The Holway@Ovum Market Trends series of reports will be published this month.

FIXING THE COMMERCIAL DIVIDE BETWEEN SOFTWARE AND THE SERVICE PROVIDER MARKET

David Mitchell
Practice Leader, Software

In late May VMware announced the creation of a VMware Service Provider Pricing (VSPP) programme, aimed at providing a pricing scheme to serve the needs of the service provider community. In essence, it allows the service provider to pay VMware based on the amount of software being used in a month, with the payment flexing either up or down in line with the actual deployment. This allows service providers who use this pricing scheme to offer flexible commercial models more easily to their end customers, such as monthly rental agreement, capacity on demand, utility pricing, etc. It is far more significant than the simple pricing model change that is filed away in the 'boring but worthy file'. The announcement is a reflection of wider forces at work in the market, and of important issues for software manufacturers and service providers alike.

An incompatible marriage?

Although software companies and service providers have partnered with each other for decades, their commercial models have been deeply incompatible.

- Software companies have sought to drive short-term revenue growth through maximising early revenue recognition on contracts. This inevitably produces revenue spikes and results in a lack of revenue predictability between quarters. More canny companies have supplemented this with a more predictable support and maintenance scheme. Successful software companies are highly cash generative but their horizons are often short term.
- Service providers typically have revenue spread over the life of a contract, and are required to invest in capacity for hardware and software at the start, so that efficiencies can be generated. It is not unusual for service providers to have unpredictable income streams, based on factors such as the commercial uptake of a service. These investments impact cash flow adversely. Horizons in the service provider world are much longer.

Simply put, if it's good for a traditional software company in the short term then it's probably bad in the short term for the service provider. It's very much like John Gray's book *'Men Are from Mars, Women Are from Venus'* but with the distance between the two being slightly larger!

A service provider backlash?

For many categories of software there has been little real choice, despite the number of software manufacturers who operate in each sub-segment of the global market. As a result software manufacturers have been able to hold a shotgun to the heads of service providers, and force the service providers to work with the commercial terms that the software manufacturers dictate. In essence the power base in the negotiation has often been skewed towards the software manufacturer.

Four factors are seeing a change to that power balance:

- Open source software is becoming a very realistic alternative in many software categories, and this often has a financial model which is more closely aligned to the needs of service providers.
- Software-as-a-service providers, such as Salesforce.com and NetSuite are now offering viable alternatives in many traditional software categories and, again, the commercial models here are more closely aligned to the needs of service providers.
- Many commercial software manufacturers are also introducing pricing models that are tailored to the needs of service providers, seeing commercial advantage in being the first to offer increased licensing flexibility.
- Service providers have become inured to the commercial hardball tactics of many of the software manufacturers and are more willing to call their bluff during negotiations, unlike a few years ago when service providers would have blinked first.

The net result is that service providers are being much more demanding, in terms of commercial flexibility, of the software manufacturers. As a result we are seeing licensing models like VMware's VSPP becoming more common. Software manufacturers who do not respond positively and introduce similar models will find themselves increasingly under pressure to do so, and their business will suffer accordingly.

A better partnership formula?

From the perspective of a service provider a better partnership would involve the software manufacturers being willing to take their revenues in the same way as the service providers do themselves. This would involve the software manufacturer being willing to offer the flexibility to have their revenues related to the actual consumption or usage of their products, and for them to be willing to acknowledge that demand was variable.

Service provider licensing agreements (SPLAs) are one of the most visible ways that software manufacturers have adopted to respond to the demands for a change in the relationship. VMware's VSPP is the most recent example of this type of model. However, it is not the only one. Microsoft has its own SPLA agreements. SAP has a specific pricing model targeted at BPO providers – a sub-category of service provider. There are many others across different sections of the software economy.

Increasingly commercial flexibility at the infrastructure layer, through schemes such as VSPP, is crucial. There is little point in having a flexible application-level commercial model if the technology underpinnings need to be licensed in the old and inflexible ways. The VMware announcement is critical because it provides foundations to allow companies at higher layers in the stack to bring more commercially flexible offerings to market.

perotsystems

PEROT SYSTEMS EUROPE: THE BENEFITS OF FOCUS

Phil Codling
Principal Analyst

We had an opportunity to speak with leading lights at Perot Systems last month when the company held a day-long briefing in London. It was a good chance to get more familiar with a company that has been on our radar for some time as a player in the global and European outsourcing market, but which never quite seems to break into the upper echelons of the industry. Naturally one of our main interests was to hear how mid-sized Perot Systems plans to grow its business without losing sight of its niche areas of focus.

It's not easy being a mid-sized player in IT services and outsourcing these days. The market invariably favours scale and concentration. Those players that have spread themselves too thinly across a wide range of services and customer segments have tended to find the going tough. Even in its native US, Perot Systems, which has global revenues of $2.3 billion, cannot claim to be a tier-one player across the IT services market, unlike IBM, EDS or Accenture for example.

In Europe, with $300 million of revenues from the European market, Perot Systems is even less prominent. Its challenge is also compounded by the ending (from 1 January this year) of its infrastructure outsourcing deal with Swiss-based customer UBS. That single contract was worth $265 million globally to Perot in 2006. The company will still work on apps support for UBS, but the bank's infrastructure insourcing has left Perot UK and Europe managing director John Tilley with a big gap to make up in his revenue line.

Finding space in a crowded market

So how is Perot Systems positioning itself as it pushes for growth in Europe? Firstly, we were reassured to hear that the company is under no illusion as to its place in the overall IT services industry. Tilley describes the company as 'small enough to care' but 'big enough to deliver', and says his focus is on clients with between €0.5 billion and €4 billion in revenues (just below the large multinationals). It's hardly a unique approach, but it reflects a degree of realism that acknowledges that Perot is not well placed to take on the biggest IT services competitors on the biggest accounts.

What is perhaps a little more distinctive about the company's approach, compared to other mid-sized players (one might cite LogicaCMG, Sopra or Getronics as examples) is its emphasis on selected vertical markets. As things stand, the European operation can lay claim to a presence primarily in banking/capital markets (even without the UBS mega-deal), healthcare (where it is a subcontractor to BT in London on the UK NHS's huge National Programme for IT) and TTL (or travel, transport and logistics).

Pushing into new verticals

Right now Perot Systems' strategy is to bring some of its expertise and intellectual property from North America to support and extend its vertical focus in Europe. For example, in healthcare, the company has much experience from its US business of working with private hospital 'chains'. It believes this could be useful as European health systems evolve. We agree, although we remain cautious over the prospects for radical reform and IT-centric 'joining up' of state-run health systems and processes, especially given the slow progress in the UK so far.

Then we have Perot's role on the NHS's vast National Programme for IT (NPfIT). Here it is a subcontractor to BT on its local service provider arrangement in London. Frankly, it looks as though this will remain a source of revenues for some time, given the amount of complex application work still to be done on NPfIT. Meanwhile, it's reassuring to see the company is not attempting a broader attack on the rest of the large but competitive UK public sector IT services market (central government, local authorities, defence, education and so on). Focusing on its interests in health appears the best way forward, especially as UK government is beginning to look like a tougher place to do business for many suppliers.

Perot Systems is also looking to use experience from managing policies in its US life insurance and healthcare businesses to target the UK life & pensions (L&P) BPO market. We expect it will begin by targeting existing multi-country insurance clients with propositions to extend BPO service provision into Europe - this giving it a foot in

[Continued on page five]

the door. However, the company currently has no BPO footprint in Europe, and we think it will find it quite a challenge to break in given the high levels of competition from established players in L&P, not least Capita with the scale advantages it derives from market leadership. Many have tried in this market, but very few have succeeded.

Meanwhile, in the industrial sector, we can expect Perot Systems to import niche expertise and IP in both process (mills and chemicals) and discrete (aerospace and automotive) manufacturing sectors. Of particular interest is its engineering services proposition. As Ovum's recent analysis of the European R&D market has shown, engineering (or R&D) services and outsourcing is a fragmented but growing market. It's also an area where the increasing centrality of IT in the innovation lifecycle is generating opportunities for the IT services providers. Potentially, Perot's (primarily North American) experience in the automotive, healthcare/pharmaceuticals, aerospace and defence sectors could prove useful, given that these segments account for over 50% of total European R&D spending.

Offshore to the fore

A key strand in Perot's R&D services strategy, and indeed across its business more generally, is offshoring. Since the company bought out its India-based joint venture with HCL in 2003 it has continued to build its own global sourcing presence. Indeed, among onshore-based competitors in the European IT services market, it now has one of the highest proportions of staff in nearshore/offshore locations: 1,200 staff onshore stationed in Europe, no fewer than 2,350 offshore/nearshore dedicated to supporting the European operation.

This high degree of offshore/nearshore leverage is potentially a differentiator for Perot, given that all of its target markets are increasingly susceptible to globally sourced delivery. Certainly we can expect the company to bid on a high degree of offshore/nearshore delivery in the market, and to position itself as something of a 'hybrid' option between the 'pure-play' Indian players and the predominantly onshore-based IT services majors in Europe. However, it's worth bearing in mind that this 'hybrid' ground will gradually shrink as the Indian players come onshore and the large US and European players rebalance their workforces towards a greater reliance on offshore. Indeed, in some markets, and particularly among its target size of customer, Perot will already find itself competing against offshore-heavy/onshore-light solutions from the likes of CSC and Accenture, as such vendors push out their 'offshore direct' model.

Enough resources on the ground?

Even in an increasingly offshore-centric world, most business is still won onshore and most relationships are still conducted onshore. Analysing the distribution of Perot's staff across Europe, we'd have to conclude that it is underweight in this regard, at least outside the UK. It has just 220 employees in Europe's second largest IT services market (Germany), plus a further 120 in Ireland (many of whom work on its Bank of Ireland deal) and less than 100 spread across Benelux, Switzerland and Italy.

We do not expect a company of Perot's size to be winning and delivering the largest multinational deals, so a complete lack of presence in France, Spain and the Nordics, for example, is not necessarily a problem, even though these are significant markets in their own right. However, if Perot is serious about growing in European markets beyond the UK, we feel it will need to scale up. Germany looks a good place to start, given the company's SAP orientation and some useful existing references (for example, Lufthansa Cargo). From our discussions last week, it sounds as though acquisitions are not out of the question for the European business. So that is potentially one way of ramping up, particularly if Perot could find a consultancy or two operating in its chosen verticals.

Niche + full service?

Overall, we think Perot Europe's selected verticals approach to market is wise for a player of its size, and that the strategy of exploiting US-derived skills and experience in Europe to open up new verticals makes sense. Meanwhile, the company is retaining a broad service capability set, which goes right from infrastructure outsourcing (desktop/data centre) through applications to business consulting. It's even talking about BPO. In other words, Perot is seeking to be, if not exactly 'all things to all people', then at least 'all things to some people'.

We'd argue this remit could prove too broad for a company of its size. The IT infrastructure outsourcing space in particular favours scale and is tending to commoditise, with relatively little differentiation between players and indeed vertical markets. Therefore, we have to wonder if Perot Systems would not be better off partnering by default where it needs infrastructure services on a particular deal, thus leaving more resources to concentrate on its niche-focused applications and consulting activities. For a business of its size, that still leaves plenty of market opportunity to shoot for and gives it greater scope to focus on its most important asset for future competitiveness, namely its vertical specialisms and expertise.

GB POSTS LOSSES, BUT CONTINUES TO INVEST

Recently GB Group, the CRM and authentication provider, released its results for year ended 31 March. Revenues were up 16.5% to £15m, but the company was loss-making to the tune of £1.5m. A highlight was the performance of the DataAuthentication division, which more than doubled its revenues to £4.8m and increased its customer base from 101 to 174.

GB's DataAuthentication business has grown well over this last year but in terms of the broader IT services landscape, at just £4.8m, this is still small fry. There are signs that growth will continue in this division, but there are no indications as to whether it will sustain such a stellar rate. Despite this growth, the fact remains that GB is still loss-making.

However, it currently has £5.2m in cash in the bank, which will allow it to invest further in projects for creating additional revenue growth. Indeed, last year the Group invested £1m in new technology and infrastructure. Taking this investment into account, GB actually lowered its operating costs by 9%.

Overall, the company is growing well and we see the need for data authentication services increasing in importance. In this regard, and in the current climate of consolidation, GB may well make a good acquisition target for a larger company looking to add a niche string to its bow. The key challenge for now has to be returning the Group to profitability.
(Ed Lycett-Marquez)

FUJITSU SERVICES POSTS SOLID 2006/07 NUMBERS

Fujitsu Services recently released a solid set of results for its year ended 31 March 2007. Reported revenues were up by 5% year-on-year to £2.46bn, or up 4% on a comparable basis. Operating profits were up by 12% to £163m, amounting to a slightly improved operating margin of 6.6%. Fujitsu's order book was marginally up to a record £6.6bn, from £6.5bn the previous year.

This is a solid, if unspectacular, set of numbers for Fujitsu Services. In pure financial terms, Fujitsu's performance is mid table among its Western IT services peers: not quite in Accenture or Indra's league, (players which reported double digit comparable growth and operating margins), but better than Atos Origin and Getronics which struggle with low single digit growth and operating margins.

There is no lack of ambition about the company. CEO David Courtley has reiterated Fujitsu's ambition to expand beyond its traditional UK Government heartland into the commercial sectors both in the UK and, more importantly, Continental Europe. We also note the underlying drive to move beyond its primarily desktop-led infrastructure services base, and into application services and BPO. The December 2007 acquisition of €100m-a-year, double-digit-operating-margin TDS in Germany was a small but positive step to execute on this vision. If Fujitsu can convince GFI Informatique's shareholders to sell at a price its own masters find palatable, it will further strengthen its base in France and Spain. Furthermore, the deal with Germany's Allianz in May, worth €400m over five years, has given a further boost to its confidence.

While Fujistu is doing a lot of things right, there could be a case for even bolder thinking in terms of M&A, and certainly in its global delivery strategy. Even if it is successful with GFI, Fujitsu will remain a sub-scale player in Continental Europe and it will remain in the trail of market leaders IBM, Accenture, EDS and Capgemini, particularly when it comes to realising its aspirations of winning larger, multinational deals. If more mergers and acquisitions are on the cards, the case for more radical M&A options with the larger players such as Siemens IT Services (it already has a joint product division with Siemens), LogicaCMG and Atos Origin needs to be examined much more closely.

More importantly, following its disposal of its 30% stake in Zensar, Fujitsu doesn't have a presence in India and its overall nearshore count is around 600 staff in Russia, or around 3% of its workforce - well below the 15-16% average among its peer group. Without offshore presence, Fujitsu will struggle in achieving deeper expansion into commercial verticals, particularly with application services and BPO service lines. So, while Fujitsu has done reasonably well to get to where it is now, it has an awful lot to do to get to where it wants to be in a few years' time.
(Angel Dobardziev)

QINETIQ RAISES PROFITS ON US GROWTH

At the end of May defence specialist QinetiQ announced its FY07 results. Revenue was up 9% to £1.15bn, with operating profits up 15% at £103m. The operating margin improved from 8.5% to 9.0%. PBT was up 23% at £89.3m.

North America has proved the real growth engine for QinetiQ once again this year. Helped by acquisitions, the business there grew by 44% to £358m. The topline on the UK and EMEA side of things fared less well, with a 2% drop in revenue to £779m. Performance in some of the more IT-centric areas Qinetiq has been targeting for growth was disappointing in FY07. UK and EMEA security services revenue shrank by 19% to £21m, while managed services grew by 7%. Such figures are unlikely to help QinetiQ climb up our rankings for S/ITS suppliers in the UK market (it's currently sixth).

The outlook for the UK as a whole is better, however. QinetiQ has continued to sign large contracts with the MoD, including the £308m/20 year Combined Aerial Target Service deal and the £50m contract to support the Typhoon programme, not to mention its preferred bidder status (as consortium leader) on the c£1bn Defence Training Review programme. Total UK/ EMEA orders in FY07 were worth £784m - that's up 35% on FY06 and takes the book-to-bill ratio up to 1.3:1. So QinetiQ's push into the UK IT services market may be experiencing limited success, but the key driver of its overall performance - namely its ability to win large, specialised defence work - appears undiminished.

(Phil Codling)

DETICA'S LONG-TERM STRATEGY AND BUSINESS MODEL SERVES IT WELL

Detica is growing fast. It's true that with total revenue growth up 54% and staff numbers up 56% Detica can now compete with the bigger boys for much larger contracts (the company now boasts seven implementation contracts with values ranging from £5m to £30m, while 3-4 years ago it had just two £5m deals). And it's also fair to say that the market perception of Detica has changed; clients are now willing to entrust the company with projects of greater size and greater risk. Nonetheless, the route to these larger deals is the same as it has always been. Detica's business continues to be driven by small, c£200K, front-end consultancy engagements, which are then leveraged to bring in bigger systems integration deals. And all the time, Detica remains committed to its focus on information intelligence and to building up its expertise in a few core markets.

It is the firm commitment to its strategy that's allowing Detica to, firstly, succeed in its focus markets even when market conditions become more difficult, and secondly, to make forays into new markets (such as financial services) and geographies (the U.S.). It has also allowed Detica to take the difficult decision to absorb its internet content security business, StreamShield, into the core Detica products business, and, more importantly, to significantly scale back its investment in the product.

Detica has, of course, put a positive spin on this news. According to Tom Black CEO, the original vision - "to change the paradigm behind anti-virus and anti-spam on large networks" - remains. However, Detica is not winning business as quickly as it might have hoped and StreamShield is therefore highly unlikely to close enough deals to breakeven next year (as was previously forecast). It has also not won any business based on the "per user, per month" consumer pricing model - its clear objective when it launched the business in 2004. As such, Detica could not justify pouring the same level of investment into the business year-on-year. Instead it believes that StreamShield would be better off becoming one of seven products in Detica's portfolio (its products business brought in £16.8m in revenues excluding Streamshield last year - up 21%).

Although Black states that the company is "not giving up" on StreamShield, we expect to hear very little of the product going forward. Having struggled to make an impact despite the level of investment over the last few years; the chances of significant success going forwards seem even slimmer.

However, it would be foolish to place too much emphasis on this 'disappointment'. In the grand scheme of Detica's business, StreamShield is small. What's important is that, with a consistent strategy, Detica's strong management team were able to make this decision quickly and with minimal disruption. The focus can now be on ensuring the continued success of the core business; a business which appears to be going from strength to strength.

(Georgina O'Toole)

REDSTONE STEPS OVER £100M THRESHOLD WITH COMUNICA

Redstone, the IT and communications solutions provider, recently released its results for the year ending 31 March. Revenues grew 56% to £113m with EBITDA of £7.9m (compared with last year's breakeven) giving the Group a healthy 7% margin. During the year the Group acquired Comunica, Symphony Telecom, IDN and the Tolerant Group. Redstone's share price rose 0.5% on the day of the results announcement, after a significant 16% rise over the previous week, following the announcement of a contract win.

In FY05 Redstone reorganised its business divisions, and has since used acquisitions to build upon this. It now has five divisions: managed solutions, converged solutions, telecom, technology, and most recently, mobile.

Redstone's strategy of acquiring aggressively over the last two years (it has acquired 5 companies since 2005) has been to build enough scale and capability to land bigger contracts, and bid on multiple projects at once. The Group seems to be reaping the rewards of its hard work having recently won the Lancashire Building Schools for the Future (BSF) contract (worth a total of £16m), the University College Dublin project (worth up to €4.5m) and the Bristol and Leicester shopping centre infrastructure projects (combined total of £3.4m). The Group has also been recently awarded preferred bidder status for the London White City development, one of the largest shopping developments in Europe.

Redstone has grown quickly and to a decent size so it's better placed to ink the larger contracts (e.g. BSF). This is not to say that further acquisitions shouldn't be considered, but we think the Group's management should now focus on growing the business from within and working hard to identify opportunities to cross-sell between its divisions. That would be the most effective way in our view to benefit from the ongoing customer trend towards the convergence of IT and communications.

(Ed Lycett-Marquez)

CIVICA CONTINUES TO GROW AS PE FUND SHOWS INTEREST

Civica has announced interim results for the six months to 31 March 2007. In the last six months Civica's turnover has increased by 11% (8% organically) to £62.8m. Profitability has also improved with operating profit before amortisation and exceptional charges up 15% to £9m in the period. PBT was £905k compared to a loss of £2.3m in the same period last year. EPS came in at 0.2p (H106: -5.0p).

The public-sector focused software and services group also revealed that it had received an unsolicited preliminary approach from a private equity fund. The company said discussions are at an early stage and there can be no certainty that an offer will be made.

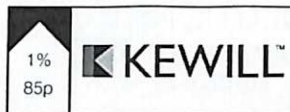
It is no surprise to see that Civica, a growing public-sector focused business, has attracted the attention of private equity investors. PE interest in the sector has increased recently and Civica seems a suitable candidate for investment, but it is clearly too early to say whether anything will come of these discussions.

In the meantime, Civica continues to grow organically while building on its many acquisitions - most recently that of social housing software player VTSS Group. It's good to see margins improving as the company continues to move away from reselling third-party software to focus on its own software and related services. Revenues from IPR increased by 17% to £11m while turnover in the third party licensing business declined by 19%. The increased focus on process improvement and efficiency-led assignments across government helped Civica's consulting and project services revenues to £15m, up 18%. But managed services were the real star - revenue from this part of the business climbed 62% to £18m in the period and boosted profits.

Across the public sector, it was the local government business that recorded the best performance. Civica has continued to win new business in the sector as local authorities look to combine front office contact management, workflow and EDRM systems over core administration systems in order to improve performance - this plays very nicely to local authority efficiency demands. In other areas of the public sector business has been harder to come by, notably in enforcement where Civica's revenues were down 18% in a "challenging" market. Tight budgets and uncertainty in the police market mean that the market focus has been on extending the deployment of existing systems.

Civica is all too aware that the tightening financial climate puts technology investment under increasing scrutiny across the public sector but it remains positive about the outlook. The key to growth in the coming months will be demonstrating to its customers that process-led solutions, such as flexible and mobile working, can help deliver improved service with fewer resources.

(Tola Sargeant)



KEWILL GROWS 31%

For the year to 31 March 2007, global logistics vendor Kewill has grown revenue by 31% to £41.6m. Operating profit was £1.0m, up 9%. Without amortisation of intangibles, operating profit would have been £4.7m, an increase of 56% over the same number for last year. Thanks to lower interest income and higher interest charges, reported net profit was down 45% to £1.5. Cash generated by operations was £5.3m up 147%.

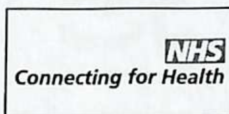
Its Order Management and Visibility Division increased sales by 5% to £10.2m, Enterprise Shipping Management increased by 5% (13% in constant currency) to £11.3m, and International Trade and Logistics by 80% to £20.1m.

Kewill has an interesting business model that mixes software and business services for the global logistics industry. It aims to become the leader in what it calls dynamic supply networks, helping companies to manage complex global supply chains, and the even more complex regulatory, logistical and financial baggage that goes with operating across multiple borders.

Kewill has increasingly been using the software-as-a-service delivery model to answer the needs for flexibility and predictability from its customers. This model lends itself to the mix of information-based business services and smart software. Kewill said that around 19% of its revenues came from these kinds of mixed software and transaction services, and they expect it to grow to 26% in the full year.

The company has been on the acquisition trail this year, spending £12m in cash to buy CSF in Germany, IPACS in Australia, and Innovate IT in the Netherlands. Kewill didn't say how much of its revenue growth was organic and how much was from acquisition, but we'd guess there was probably a bit more of the latter.

The year was not all plain sailing as its order management and visibility business was hit by the closure of customers Allders and Littlewoods in the UK. The company did well to make up the lost ground and more with business from the insurance sector.
(David Bradshaw)



RICHARD GRANGER TO LEAVE THE NATIONAL PROGRAMME FOR IT

Richard Granger, the chief executive of NHS Connecting for Health, the agency responsible for delivering the £9bn National Programme for IT in the NHS, is to leave later this year.

In a statement, Granger said, "My decision should be seen in the context of the changing role of the centre of the NHS and the fact that when I took on this challenge I said I would give this job five years.

"I passionately believe that the programme will deliver ever greater levels of benefit to patients over the coming years. There remain a number of challenges ahead, but I firmly believe that the leadership of the programme by Lord Hunt, David Nicholson and my colleagues within CFH will ensure these hurdles are overcome."

CfH will now focus on recruiting a successor to Granger over the coming months.

From 2008, Granger will move to work in the private sector once again. Granger previously worked for consultancy firm Deloitte, where one of his major achievements was negotiating the contract for the London Congestion Charging scheme. This is largely seen as a success, and Granger brought in some of the contractual innovations delivered here into the NPfIT, such as the payment to suppliers only on successful delivery.

Granger's legacy to the National Programme will be his strong leadership and commitment to making a difference to the way that the NHS performs its day-to-day duties. He often cites the way in which a new IT-enabled NHS will eradicate the piles of paper records in hospitals and clinics, making the NHS more efficient and effective, and ultimately helping to save people's lives.

Granger will however leave behind him an NPfIT that is in the midst of major change. The Programme is moving towards a more localised approach, where control and accountability is increasingly moving into the hands of the NHS Trusts themselves. This means that clinicians and healthcare professionals will have more of a say over their choice of IT systems and services.

So where next for Granger? For someone with such a high profile track record Granger is unlikely to be stuck for options, and we don't expect him to fade out of the spotlight. Indeed, he is apparently considering "several significant approaches" at the moment. Rumour has it that a role at the Olympics might be a worthy next challenge, but we will just have to wait and see.
(John O'Brien)

STRONG RESULTS LAUNCH FOCUS SOLUTIONS ON THE ACQUISITION TRAIL

Point-of-sale solutions vendor to the financial sector Focus Solutions is set to go on the acquisition trail following a strong set of results reported in June. For the year to 31 March, the company's revenue grew 20% to £9.9m from £6.6m a year ago. Operating profit was £990k compared to £94k a year ago, however both numbers were impacted strongly by reorganisation costs of £196k and £257k respectively. Net profit was £1.6m compared to £112k. Cash generated by the operations was £2.8m compared to an outflow of £833k last year.

As these numbers show, Focus Solutions has worked its way into a really strong commercial position through cost reduction and revenue growth. It is now on the verge of taking the next step in its development.

The company has a portfolio of solutions in front office banking solutions in wealth management, insurance, mortgages and pensions. Over the last year or so it has been turning these solutions into a flexible set of products that encapsulate its intellectual property. In the long term this should enable it to increase the software portion (licence, maintenance and/or subscription fees) from its current level of around a quarter into more like half. This helps not only the company but also its customers - making it possible for them to configure their front office for new financial products themselves.

The really big step that the company is taking is openly seeking acquisition targets. In the first phase it is searching for companies that offer complementary front-office solutions. Ideally these should both increase the amount of business Focus can do with existing customers like HSBC, St James's Place and Irish Life, as well as bring new customers that Focus can sell its existing products to. In the second phase of acquisitions it will be looking for back-office capabilities so that it can deliver an integrated offering. Focus has already started on the first phase (front office) in fiscal 2008, the current year.

With its war chest of over £3m and strong improving performance over the last year, Focus is in a good position to acquire despite its relatively small size. CEO Richard Stevenson assured us that he doesn't yet have a queue of prospective acquirees outside his door, but we're sure that will happen soon.

(David Bradshaw)

L!BERATA

LIBERATA BACK ON TRACK

Liberata, the privately-held UK BPO player, recently released its interim results. Revenue fell by 10.6% to £104 million for the six months to the end of February 2007. Operating profits were up to £3.2 million from a £300,000 loss last year. Net cash inflow from operating activities was £2.3 million, up from a £1.8 million outflow last half year. However, after capital expenditure and repayment of finance, cash decreased by £1.5 million in the period.

CEO Robert Gogel's restructuring and re-focusing of Liberata has helped it start to turn around after a struggle with growth and profitability over the past couple of years. And of course we are pleased to see that the strategic changes that have enabled the improvement in the bottom line match many of those that we now advise BPO vendors to consider in this increasingly competitive and 'lumpy' market.

This includes focusing on existing strengths and on profitability, not just chasing revenue growth through big deal wins (as has been the case with many vendors in the past). So for example, Liberata has outsourced some of its non-core back-office and IT services to partners such as Xchanging and Kanbay. It has also started to build a more 'balanced portfolio' of BPO business by targeting smaller, more profitable BPO deals that complement the large deals it already has in local government and life & pensions, where profits are weighted to the end of the contract. For Liberata this has meant taking the existing F&A, HR, and contact centre skills it has from larger deals and using them to win business in new markets such as retail. Its recent £2 million, five-year deal with TGI Fridays is a great example of this working. Such a deal should reach profitability rapidly, balancing out the back-ended profitability of Liberata's large governmental and financial services contracts.

Investment in sales has also increased, and Liberata now claims it also has a stronger bid process that can help it identify risks much earlier. This is important because a company such as Liberata needs to be more proactive in developing new areas of the market, but also must be in touch with the risks that can be associated with large BPO deals. Gogel claims that this change has pushed Liberata's pipeline (for bids at long list stage) over £1 billion. We will wait to see whether all of these changes will result in a return to revenue growth in addition to the improvement in profitability.

All in all there are good signs for a company that only a couple of years ago was struggling. It is too early to say that a full recovery has occurred, but the company is now in better shape.

(Samad Masood)

PAC REPORTS ON ASPIRE: INSIGHT INTO A MODERN PUBLIC SECTOR IT CONTRACT

The Public Accounts Committee (PAC) recently published its report on HMRC's Aspire outsourcing contract with Capgemini. The headline finding picked up by the media is that the contract could now cost an estimated £8.5 billion over 10 years, almost three times the original contract value.

The PAC report has already been picked up by some of the media as another example of problems in public sector IT. It is based, however, on last year's National Audit Office (NAO) report into Aspire, which, as we commented at the time, was largely positive in tone.

It reasserts some of the NAO's criticisms (for example, regarding the handling of transition costs of the contract). Inevitably, given the escalation in the size of the contract, it also urges departments to consider more carefully alternative growth scenarios for IT services requirements and the likely impact on costs and margins.

Capgemini's increased profit expectations are also highlighted, which could be up to £1.1bn compared to the original estimate of £300m. However, the report also notes that current margins of around 10-13% have not triggered the profit sharing agreement and are in line with accepted levels for PFI agreements.

However, it is important to recognise that this is far from being a case of public sector IT failure. Capgemini's performance has matched requirements and the Department is progressing on its major projects and adapting to future demands. The PAC report recognises that the increased value of the contract largely reflects the later inclusion of Fujitsu's £900m HM Customs & Excise contract along with "work needed to deliver the Department's Transformation Programme including, for example, the further development of online services". The contract is therefore proving to be adaptable to the evolving needs of the Department - which is what it was intended to do.
(Eric Woods)

CSC ENDS FY07 WITH A BETTER QUARTER

CSC has reported revenue growth of 4% for Q4, with constant currency growth of 1%. Total revenue was $4.0bn, with EBIT (before special items) up 25% to $393m. CSC's Q4 operating margin thus rose from 8.1% to 9.7% year-on-year. Contract wins totalled $4.3bn, taking the year's haul to $16.9bn (40% up on the previous year).

CSC took a charge of $22m against its FY07 accounts and $91m for FY06, following the discovery of errors related to tax accounting, as previously flagged.

After a challenging start to FY07 (with no topline growth in the first three quarters, unsettling private equity advances and a lot of restructuring), CSC has got itself into better shape. It is finally able to report some revenue growth, albeit of just 1% in current currency. Meanwhile constant currency growth for the year was just shy of flat at -0.5%. But the outlook overall is improving. The company is expecting 6-7% organic growth (i.e. excluding the Covansys acquisition) in the current year. That's thanks to the improved signings total in FY07.

Overall, we feel that CSC's rapidly-executed restructuring of its business (which has seen job reductions in Europe and the US, plus continued rapid growth offshore) has been a necessary, albeit often painful, step to put the company on a more competitive footing. In short, it's now in a better position to win a fair share of deals against not just the Indian majors but also key rivals like Accenture, IBM and EDS, particularly outside its federal government heartland. The Covansys acquisition will continue this beneficial process. The effect on margins is also noticeable - full-year EBIT margin was 7.1%, up 50 basis points, and compares favourably with that of key (and increasingly profitable) rival EDS, whose comparable full-year 2006 margin was just under 4%.

We can expect CSC to continue its ramp-up in consulting, where it has been an active onshore hirer of late. For a business with CSC's exposure to commoditising ITO markets, ensuring it has the "business outcome capability" to deliver higher value projects to its customers is vital.

One final concern is the lack of a replacement head in the UK/Northern region (since Keith Wilman joined Atos Origin in December). Given immediate needs such as finding a way through the NHS/iSoft debacle and leading CSC through contract recompetes, strong leadership and management bandwidth are undoubtedly essential commodities at CSC Europe right now.
(Phil Codling)

Mergers and Acquisitions – June 2007

Buyer	Experian
Seller	Sarasa
Seller Description	Brazil-based credit bureau and operator of the fourth largest credit bureau in the world
Acquiring	65%
Price	$1.2bn
Comment	Don Robert, Chief Executive of Experian, commented: "The acquisition of Serasa represents a unique and transformational opportunity for Experian. It propels us to a market leading position in one of the most attractive growth markets for credit products globally, and we see significant potential as we deploy our world-class value-added products. It fits our strategic objectives of owning market-leading credit bureaux in key markets around the world and of expansion into exciting emerging economies. We are also delighted to have the continuing support of Brazil's largest banks, as both shareholders and clients of Serasa."

Buyer	Ffastfill
Seller	Exchange Systems Technology (EST)
Seller Description	London-based provider of back-office technology
Acquiring	100%
Price	£4.8m (£4.2m in cash, the rest in shares)
Comment	EST's products include its back-office clearing and settlements system Eclipse and margin calculator service, MarginClick. The firm also supplies a securities processing system that it acquired when it bought out Sam Group in 2005. In the year ended 31 March 2007 EST generated revenues of £3.2m and made a loss before tax of £0.2m. EST's back-office products appear complementary to Ffastfill's current offerings and could potentially provide it with a product set earlier and more cost effectively than if the company were to develop the functionality in-house. News of the offer came as Ffastfill reported a 28% increase in turnover to £6.1m for the year ended 31 March 2007.

Buyer	IBM
Seller	Telelogic
Seller Description	Swedish headquartered Application Lifecycle vendor
Acquiring	100%
Price	$743m
Comment	On the surface this is a worthy deal for both IBM and Telelogic with clear advantages for both parties and their customers. But how successful the union turns out to be depends largely on the IBM Rational team, the group that will subsume the Telelogic product portfolio. Having quietly reorganised itself over the last few years, IBM Rational now appears to be on something of a buying spree, having acquired software security and compliance testing vendor Watchfire on June 6th (see below). All of which suggests that it has some understanding of what it is lacking in its armoury when it comes to addressing the lifecycle needs of solutions targeting a broader range of markets and infrastructures. In terms of culture and ethos, IBM and Telelogic have probably more in common than most of the others in the purchasing frame. But we also thought that of IBM and Rational when the former acquired the latter 5 years ago, and it is only recently that these two companies have finally settled into a coherent and workable product roadmap. IBM has come a lot further since then and certainly recognises its mistakes in the handling of Rational - though doesn't acknowledge them publicly - so there is hope that they will handle the integration of Telelogic more sensibly and productively. Telelogic is far more than a mere 'David' to IBM's Goliath. A strong player in its own right, IBM must convince the market that it is capable this time of getting the most out of its new purchase.

Buyer	IBM
Seller	Watchfire
Seller Description	Supplier of products for testing the security of applications
Acquiring	100%
Price	Undisclosed
Comment	The plan is for Watchfire to become part of the Rational business unit, which is the correct place for it as its main use is in the pre-deployment application testing phase. It is part of the Quality Management suite. However, it should also be noted that it further contributes to IBM's growing security capabilities and it will be useful for Tivoli compliance management offerings and for use by IBM's Global Technology Services. This is a specialist area in which all the players are relatively small and the acquisition is indicative of IBM's desire to be as comprehensive as possible in its offerings. The main area for speculation is what will happen to Watchfire's existing partnerships. At the moment its partnership with Mercury Interactive accounts for a large part of its business, reflecting Mercury's position in the automated testing market. Mercury Interactive became HP Mercury last year, following its acquisition by HP, and so it is hard to see this relationship not being disrupted. A partnership with Fortify Software, a similar sized privately held company that already has a relationship with IBM, should prove less contentious. The latter is technically valuable as Fortify provides 'white box' testing while Watchfire provides 'black box' testing. Fortify is therefore more relevant for testing during code development, and Watchfire for compliance testing. It would be logical for IBM to bring Fortify fully into the fold as well.

Mergers and Acquisitions – June 2007

Buyer	**SDL**
Seller	**PASS Process Automation Software Systems Engineering GmbH ("Passolo")**
Seller Description	Provider of software localisation products
Acquiring	100%
Price	€2m (€1m in cash and the balance in SDL shares)
Comment	This represents a perfectly logical move for SDL, taking its translation services and technology into the software localisation market. Software localisation is the process of taking a software product and readying it for use in multiple languages and cultures. Because most software products are continually updated, its job is never done. And it's not just the software itself that needs translation but the help files and instructions. This is a very specialist area but one that SDL can clearly help in, given its expertise. By buying existing player Passolo and combining its existing technology with Passolo's products, it puts itself in a potentially very strong position in this growing market. My greatest hope is that SDL can help the software companies to write their licence conditions in terms we can all understand. Unfortunately, that may be a forlorn hope...
Buyer	**Sopheon**
Seller	**Alignent Software**
Seller Description	California-based provider of product and technology roadmapping software
Acquiring	100%
Price	$5.5m ($4.8m initially, a further $750,000 in potential earn-out payments)
Comment	This acquisition is a brave move for Sopheon. On the plus side there are two reasons why this makes sense. Firstly, Alignent's principal product, Vision Strategist is software that helps the user visualise and predict how market and technology trends will impact product plans. At least on paper this fits well with Sopheon's Accolade product, which automates innovation process governance. Whilst the two products will be marketed separately they go some way to providing a more comprehensive product planning suite. Second, Alignent brings with it a raft of clients, and approximately 100 of them will deepen Sopheon's penetration of the chemical and consumer packaged goods markets. It also opens up new, potentially high-growth, opportunities for Sopheon, in particular in the aerospace, defence and high-tech industries. Alignent's customer base includes big names such as Boeing, BAE Systems, Corning, Honeywell, Lockheed Martin, Motorola and NAVAIR, giving Sopheon greater visibility. However, there is a down side. Alignent has recently been through an 'extensive' restructuring, probably in a bid to make it a more attractive acquisition target. Buying a company shortly after a restructuring, however extensive, is rather like purchasing a house before it's built, based solely on the plans - you just don't know if it's going to work.
Buyer	**Spring**
Seller	**Glotel**
Seller Description	Telecoms-focused staffing agency
Acquiring	100%
Price	£27.2m
Comment	Consolidation in the world of staffing agencies continues, as expected. This is a market that favours scale, not least because providers need to have a broad portfolio of interests in order to ride out the ups and downs of staffing demand. For Spring, this acquisition looks to play nicely to some of its key strategic priorities. Under CEO Peter Searle the business has been aiming both to grow its interests higher up the staffing value chain (i.e. in more niche and professional services areas) and to diversify its customer segments and geographic coverage. Glotel is in our view a good move on the diversification point in particular. Firstly it will help boost Spring's telco interests (currently the former Triage Consulting business, now rebranded Spring Telecoms, which Spring acquired in 2002) as a counterbalance to its reliance on IT. Secondly, on the geographic point, Glotel earns half of its revenue outside the UK. The entrée to the US market (where Glotel earned £46.3m in revenue in FY07) is the real prize for Spring, but it also gains licensed operations in Germany, Netherlands, Belgium and Australia.

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

	SCS Cat.	Share Price 29-Jun-07	Capitalisation 29-Jun-07	Historic P/E	PSR Ratio Cap./Rev.	S/ITS Index 29-Jun-07	Share price move since 31-May-07	Share price % move in 2007	Capitalisation move since 31-May-07
@UK plc	SP	0.13	4.91	NA	3.38	198.47	-7%	-28%	-£0.29m
Alphameric	SP	0.41	54.37	14.8	0.82	188.07	-33%	-14%	-£25.85m
Alterian	SP	1.67	70.18	30.1	5.01	835.00	3%	47%	£2.11m
Anite Group	CS	0.75	262.91	73.8	1.39	438.60	-4%	-8%	-£10.47m
Ascribe	SP	0.58	65.74	NA	12.29	3,026.32	-7%	47%	-£5.15m
Atelis plc	SP	0.05	1.31	NA	NA	244.19	0%	-22%	£0.00m
Atlantic Global	SP	0.22	5.04	96.9	2.36	745.76	13%	63%	£0.58m
Autonomy Corporation	SP	7.20	1421.08	74.3	11.08	219.78	-6%	41%	-£145.23m
Aveva Group	SP	9.25	623.15	35.2	9.45	4,625.00	-2%	13%	-£14.14m
Axon Group	CS	7.91	487.86	32.1	3.55	4,520.00	1%	30%	£2.47m
Bond International	SP	1.89	57.48	17.2	3.34	2,907.69	-10%	10%	-£6.40m
Brady	SP	0.68	17.76	28.1	7.30	839.51	13%	86%	£2.17m
Business Control Solutions	CS	0.06	15.61	NA	1.95	920.00	-12%	-8%	-£2.04m
Business Systems	CS	0.13	10.40	13.9	0.30	109.24	18%	4%	£1.04m
Cantono	CS	0.06	16.81	NA	2.34	1,000.00	0%	0%	£0.00m
Capita Group	CS	7.26	4496.24	31.7	2.64	196,252.49	0%	20%	-£6.62m
Centrom	CS	0.01	1.83	NA	0.29	166.67	0%	-33%	£0.26m
Charteris	CS	0.20	8.60	19.5	0.97	222.22	-9%	25%	-£0.86m
Chelford Group	CS	1.30	9.28	126.8	0.50	226.09	-10%	-22%	-£1.00m
Civica	CS	2.73	171.71	17.3	1.62	1,559.59	11%	-1%	£17.29m
Clarity Commerce	SP	0.60	14.95	8.2	1.12	480.00	-10%	12%	£0.93m
Clinical Computing	SP	0.06	2.07	NA	1.25	48.39	0%	-14%	£0.17m
CODA Plc.	SP	1.86	143.75	NA	2.69	1,148.15	-1%	15%	-£0.96m
Compel Group	CS	1.49	50.42	22.6	0.80	1,192.00	0%	26%	£0.00m
Computacenter	R	2.26	360.59	18.0	0.16	337.31	-7%	-16%	-£25.91m
Computer Software Group	SP	1.50	85.19	19.3	6.05	1,276.59	0%	23%	£0.00m
Renamed Corero	SP	0.14	6.38	NA	1.01	186.67	-11%	-3%	-£0.80m
Corpora	SP	0.05	7.10	NA	2.73	131.58	-17%	-11%	-£1.57m
Dealogic	SP	1.78	123.55	11.9	3.07	773.91	-4%	13%	-£5.44m
Delcam	SP	4.15	25.63	12.5	1.07	1,596.15	-4%	33%	-£1.05m
Detica	CS	3.85	440.01	38.5	2.82	4,812.50	3%	5%	£12.29m
Dicom Group	R	1.85	162.67	22.6	0.78	567.14	-6%	-21%	-£10.76m
Dillistone Group	SP	1.92	10.40	NA	NA	1,406.59	4%	31%	£0.40m
Dimension Data	R	0.57	877.90	43.7	0.63	101.24	8%	33%	£65.45m
DRS Data & Research	SP	0.34	11.20	67.2	0.90	309.09	0%	-8%	£0.25m
eg Solutions	SP	0.44	6.22	NA	1.15	295.92	0%	-47%	£0.00m
ELCOM	CS	0.02	6.54	NA	18.88	400.00	0%	-52%	£0.00m
Electronic Data Processing	SP	0.81	19.69	45.6	2.82	2,480.10	0%	26%	£0.00m
FDM Group	A	1.38	32.04	15.8	0.72	1,693.25	8%	48%	£2.32m
Ffastfill	SP	0.08	23.51	NA	8.87	66.67	14%	33%	£3.26m
Financial Objects	CS	0.61	27.09	8.2	1.36	265.22	2%	12%	£0.44m
Flomerics Group	SP	0.81	11.95	16.3	0.84	3,115.38	13%	8%	-£3.37m
Focus Solutions Group	CS	0.50	14.32	37.5	1.45	256.41	-19%	3%	-£3.30m
GB Group	CS	0.32	27.01	NA	1.80	206.40	-3%	-30%	£0.24m
Gladstone	SP	0.24	12.51	9.1	1.64	600.00	-8%	-6%	-£1.05m
Glotel	A	0.68	26.38	10.7	0.29	353.25	19%	8%	£4.46m
Gresham Computing	CS	1.27	63.69	153.3	4.56	1,365.59	1%	-14%	£0.25m
Group NBT	CS	2.94	72.61	26.2	8.64	1,470.00	-15%	42%	-£12.99m
Harvey Nash Group	A	0.91	65.26	13.9	0.26	520.00	15%	25%	£12.98m
Highams Systems Services	A	0.06	1.95	17.2	0.14	166.67	0%	30%	-£0.04m
Horizon Technology	CS	0.71	86.28	14.8	0.45	386.15	-6%	2%	-£3.29m
IBS OPENSystems	CS	1.97	78.60	15.8	5.03	1,291.80	1%	8%	£0.60m
I S Solutions	CS	0.19	4.77	16.6	0.87	708.04	-5%	21%	-£0.13m
ICM Computer Group	CS	5.43	115.74	34.6	1.53	3,016.67	3%	88%	£3.04m
IDOX	SP	0.09	32.06	NA	2.26	11.55	6%	41%	£15.46m
Imaginatik	SP	0.08	9.18	NA	6.56	927.06	-9%	-7%	-£0.88m
In Technology	CS	0.37	52.85	NA	0.28	1,480.00	-3%	-14%	-£1.41m
InterQuest Group	A	1.07	30.91	NA	1.12	1,860.87	-7%	22%	-£2.16m
Innovation Group	SP	0.37	233.39	NA	3.83	159.39	4%	17%	£5.38m
Intelligent Environments	SP	0.10	16.69	NA	5.35	108.51	13%	63%	£1.63m
Intercede Group	SP	0.39	13.90	NA	7.70	650.00	-19%	-34%	-£3.25m
Invu	SP	0.27	27.05	13.6	4.17	2,842.08	-10%	-10%	-£3.01m
iSOFT Group	SP	0.49	113.34	NA	0.43	445.45	11%	-13%	£12.21m
iTrain	SP	0.03	2.05	NA	1.12	32.94	40%	24%	£0.12m
IX Europe	CS	1.25	226.48	NA	6.07	4,098.36	-3%	155%	-£7.25m
K3 Business Technology	SP	1.50	32.60	14.4	1.19	1,146.10	-3%	29%	-£0.56m
Kewill	SP	0.85	68.85	47.0	1.66	1,679.84	1%	8%	£2.57m
Knowledge Technology Solutions	SP	0.01	3.74	NA	2.99	200.00	0%	-38%	-£0.75m
LogicaCMG	CS	1.52	2335.17	19.0	0.87	2,081.62	-10%	-18%	-£245.82m
Lorien	A	0.85	15.83	35.6	0.11	850.00	1%	100%	£0.19m

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

	SCS Cat.	Share Price 29-Jun-07	Capitalisation 29-Jun-07	Historic P/E	PSR Ratio Cap./Rev.	S/ITS Index 29-Jun-07	Share price move since 31-May-07	Share price % move in 2007	Capitalisation move since 31-May-07
Macro 4	SP	1.92	44.21	NA	1.34	774.19	-8%	-9%	-£2.24m
Manpower Software	SP	0.63	28.06	NA	6.48	649.48	-10%	142%	-£2.82m
Maxima Holdings	CS	2.99	73.05	NA	5.89	2,174.55	3%	30%	£2.57m
Mediasurface	SP	0.26	19.89	NA	2.06	1,893.38	14%	51%	£2.51m
Micro Focus	SP	2.62	523.68	64.3	6.92	0.00	-4%	26%	-£19.51m
Microgen	CS	0.48	49.27	12.5	1.31	205.13	-8%	-12%	-£3.60m
Minorplanet Systems	SP	0.51	14.71	12.3	0.62	1,041.45	-6%	-9%	-£0.72m
Misys	SP	2.35	1179.19	25.9	2.52	2,923.68	-6%	9%	-£79.55m
Morse	R	0.95	148.72	NA	0.41	380.00	-5%	-12%	-£7.83m
NCC Group	CS	3.86	125.73	28.3	6.06	2,311.38	8%	39%	£9.62m
Ncipher	SP	2.47	70.70	NA	4.07	988.00	-5%	-3%	-£4.16m
Netcall	SP	0.26	17.17	48.0	5.18	525.25	8%	53%	£1.15m
Netstore	CS	0.32	39.50	13.8	1.98	213.33	7%	7%	£1.57m
Networkers International	A	0.42	38.23	NA	2.01	1,296.88	-2%	19%	-£0.92m
Northgate Information Solutions	CS	0.80	429.41	20.9	1.29	307.69	3%	-7%	£9.39m
NSB Retail Systems	SP	0.28	117.27	12.3	2.42	2,434.78	-3%	-18%	-£4.16m
OneclickHR	SP	0.06	8.93	NA	1.51	150.00	0%	50%	-£0.55m
OPD Group	A	4.79	127.22	NA	2.91	2,177.27	0%	-2%	£0.00m
Parity	A	0.84	31.67	NA	0.20	777.77	4%	7%	£0.95m
Patsystems	SP	0.28	45.14	35.9	2.95	261.68	0%	62%	-£0.82m
Phoenix IT	CS	4.20	313.90	18.9	2.48	1,555.56	11%	38%	£85.47m
Pilat Media Global	SP	0.63	37.30	15.5	2.87	3,150.00	-15%	-23%	-£6.24m
Pixology	SP	0.40	8.06	NA	1.79	286.59	3%	40%	-£8.09m
Portrait Software	CS	0.22	18.78	NA	1.30	144.45	10%	47%	£1.51m
Proactis Holdings	SP	0.82	24.60	NA	12.95	1,680.41	3%	28%	£0.64m
Prologic	CS	0.98	9.75	11.4	1.41	1,180.72	6%	15%	£0.50m
QinetiQ Group	CS	1.86	1226.46	18.7	1.07	847.38	-6%	-3%	-£74.13m
Qonnectis	CS	0.01	1.37	NA	12.48	165.33	-30%	-17%	-£0.55m
Quantica	A	0.42	28.89	9.1	0.74	338.71	-2%	38%	-£0.69m
Red Squared	CS	0.10	2.69	NA	1.10	521.98	36%	46%	£0.71m
Revenue Assurance Services	SP	1.52	64.87	20.9	1.45	1,013.33	15%	24%	£8.11m
RM	SP	2.08	192.03	NA	0.73	5,934.29	1%	7%	£1.86m
Royalblue Group	SP	9.15	316.25	29.5	3.34	5,382.35	-12%	-12%	-£43.59m
Sage Group	SP	2.35	3053.37	20.0	3.26	90,384.62	-6%	-13%	-£217.59m
Sanderson Group	SP	0.51	21.12	NA	1.31	1,010.00	-4%	3%	-£0.81m
SciSys	CS	0.75	19.14	NA	0.75	583.33	-10%	-14%	-£2.04m
SDL	CS	4.19	311.63	44.1	3.29	2,793.33	7%	78%	£21.85m
ServicePower	SP	0.17	13.58	NA	1.71	170.00	3%	3%	£0.20m
Sirius Financial	SP	2.26	39.82	21.9	1.83	1,506.67	0%	54%	£0.00m
SiRViS IT plc	CS	0.03	3.42	NA	0.43	26.09	0%	-23%	-£0.15m
smartFOCUS plc	SP	0.18	16.70	27.4	1.82	1,945.95	6%	18%	£0.69m
Sopheon	SP	0.19	25.38	NA	4.23	273.38	-10%	-16%	-£3.01m
Spring Group	A	0.72	116.13	23.4	0.29	800.00	4%	4%	£5.25m
SSP Holdings	SP	1.40	99.97	NA	5.59	1,316.04	0%	16%	£0.00m
StatPro Group	SP	0.87	45.90	15.1	3.61	1,087.50	-2%	-16%	-£1.06m
SThree Group plc	A	4.72	652.91	23.0	2.69	2,291.26	-7%	22%	-£46.39m
Stilo International	SP	0.02	1.88	NA	0.82	40.00	0%	-16%	-£0.13m
Strategic Thought	CS	0.68	17.66	NA	1.54	498.15	-25%	-33%	-£5.74m
SurfControl	SP	6.70	192.58	67.3	3.36	3,350.00	7%	29%	£12.36m
Tadpole Technology	SP	0.05	18.40	NA	3.81	120.71	25%	400%	£1.00m
Tikit Group	CS	3.00	38.48	18.7	1.64	2,608.70	-6%	17%	-£2.57m
Total Systems	SP	0.42	4.37	19.6	1.25	792.45	0%	17%	£0.00m
Touchstone Group	SP	1.79	21.99	66.4	0.73	1,704.76	-16%	0%	-£3.73m
Trace Group	SP	1.78	25.29	20.0	1.77	1,424.00	17%	79%	£3.70m
Triad Group	CS	0.27	4.02	NA	0.09	200.00	4%	8%	£0.08m
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	24.39	0%	14%	-£2.41m
Ultrasis Group	SP	0.01	12.56	NA	10.10	20.41	-7%	-30%	-£3.70m
Universe Group	SP	0.07	8.32	NA	0.19	311.11	0%	-50%	£0.43m
Vega Group	CS	2.53	51.40	17.1	0.83	2,073.77	-5%	20%	-£2.75m
VI group	SP	0.17	6.43	8.6	0.66	340.00	-19%	19%	-£1.40m
Xansa	CS	0.86	298.50	20.5	0.79	2,205.13	-1%	-1%	-£4.35m
Xchanging	A	2.60	628.10	3.6	NA	851.06	-15%	-15%	£571.34m
Xpertise Group	CS	1.10	5.83	18.4	0.36	4,400.00	11%	172%	£0.48m
XploITe	CS	0.41	14.98	3.2	0.51	1,246.15	5%	23%	£0.74m

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

A FLAT MONTH FOR S/ITS SHARES

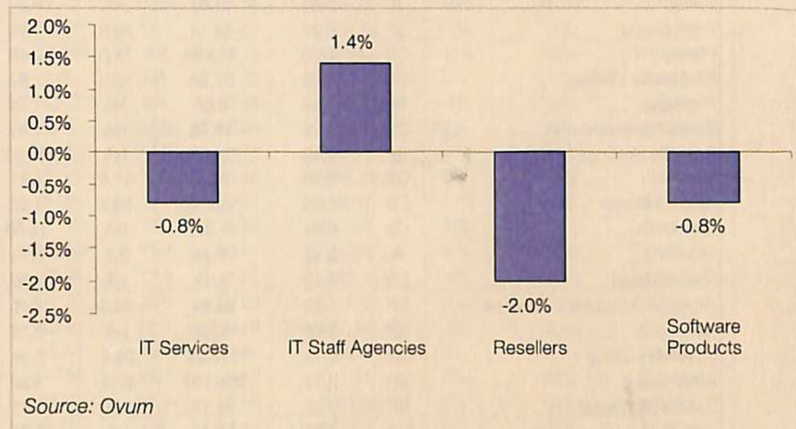
Samad Masood
Analyst

June was a bad month for rain in the UK, and not a particularly good month for S/ITS shares. The Ovum index was slightly down at -0.6%, while the FTSE IT index lost almost 4%. Worst of all was the techMARK, which was down a notable 8%.

So what's been going on? Predominantly it's a mixture of under-performance and the market's response to takeover bids. Across the sectors within the S/ITS industry, we saw a continuation of May's trend with the IT staffing companies leading the pack. Having said that, growth for this sector as a whole was a hardly stellar 1.4%. Telecoms-focused staffing agency Glotel got a nice 19% boost during June to (68p) after staffing giant Spring made an offer for the firm. Glotel is in our view a good move for Spring in terms of the latter addressing its diversification strategy. The market appeared to approve of the move, pushing Spring up 4% to 72p.

Another beneficiary of the acquisition 'boost' was Harvey Nash, which announced during the month that it had bought SilkRoad, a software development firm based in Vietnam. Harvey Nash has steadily grown its offshore business and we consider this acquisition to be both sensible and well-timed. More generally, its offshore strategy makes it a more flexible player in the S/ITS market. The large bulk of its business is still in staffing, but the offshore arm is helping the bottom line and is providing opportunities for cross-sale. The SilkRoad acquisition is of a nice, easy-to-digest size and Harvey Nash is more than capable of integrating and leveraging the new addition - especially given its growing experience in offshoring. The market appears to agree with us, and by the end of June Harvey Nash (at 91p) had gained 15% on its May-end point.

Average share price performance by business type - June 2007



Source: Ovum

It is left to the resellers to bring up the rear. The sector as a whole lost 2% on May's valuation and all the large firms were hit by the cross-sector slump. The biggest loser was resale giant Computacenter (down 7% to 226p), but it was followed very closely by Dicom (down 6% at 185p) and Morse (down 5% to 95p).

There are a few other specific performances worthy of note. Alphameric had to announce a profits warning during June for its full year to end November. It is expecting profit to "materially under-perform the current market expectations". It lost a massive 33% to 41p. Its share price performance for the first half of the year is nowhere near so bad, but still 14% off.

The acquisitive Microgen also faired poorly with the market seeming to disapprove of its raised offer for Trace. It lost 8% to hit 48p. Our view is that Microgen, although built on an aggressive acquisition strategy, has reached a stage in its evolution where organic growth should be its priority. On the flip-side, Trace benefited from a share price increase of 17% during the month, to 178p. Not unlike the effect Spring's purchase has had on Glotel's share performance.

SYSTEMHOUSE

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