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SYSTEMHOUSE

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

VISTA HELPS MICROSOFT TO A STRONG Q3

By David Bradshaw

David Bradshaw
Principal Analyst

While there's no denying that Microsoft has had an excellent quarter, it's not quite as good as the headline numbers (revenue up 32% on 2005, operating margin up to 45.8%), and the headlines in the press, indicate. We reckon that the 'real' revenue growth was actually 15%, and while this is still an excellent performance for such a large company, it isn't quite the same as 32%.

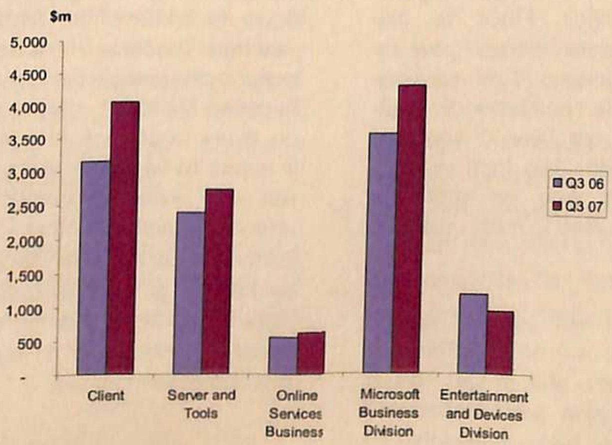
Revenue in detail

How did we get to this growth number? Revenue and operating profit were both boosted by $1.67bn of revenue that was deferred from earlier quarters. These revenues related mainly to Microsoft's technology guarantee programme, which enabled certain buyers of Windows XP and Office 2003 to upgrade to Vista and Office 2007 at no additional cost. To account for this obligation, a portion of the revenue from buying Windows XP and Office 2003 was deferred until Vista and Office 2007 were made available to consumers in January 2007. Another source of deferred revenue was pre-loaded copies of Vista and Office 2007 that the channel had paid for but which could not be sold to consumers until the launch.

Figure 1 shows our estimates for the different group's revenues after the deferred revenues have been taken out from the Client and Business divisions.

Microsoft also benefited from the fall in the dollar compared to the euro and the pound. Microsoft doesn't publish its European revenues but our best estimate is that it provided a 22% contribution. We estimate that currency effects added

Figure 1 **Microsoft Corp: Segment revenue excluding deferred revenue**



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(changes in April 2007)

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techMARK 100	**3.4%**	**1659**

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around $210m to the revenue, which is in line with Microsoft's figure of 2%. However, we haven't taken this into account in the figure above since we don't know the detail of its effect on different business groups. You therefore need to bear in mind that the constant-currency growth rates are around 2% lower in the business groups.

Windows Vista – a glowing success?

The big story, though, is that the uptake of Windows Vista has been at least as good as Microsoft anticipated. The Client division, which is responsible for Vista, saw the strongest gain, obviously due to the consumer launch of Vista, increasing its revenue by 67% and operating profit contribution by 70%. While these numbers look a bit more modest if we deduct its share from the deferred revenue (Figure 1), there's still a very healthy 27% gain in revenue and (not shown on the chart) 26% rise in operating profit contribution. So is this "Sayonara, Baby" to Apple's ambitions of growing its share of the desktop, or is this just a blip around the launch? We'll have to wait and see.

CFO Chris Liddell said that 85% of the desktop operating systems shipped in the quarter were Vista and only 15% were Windows XP. One key missing piece of information is how well this compares to the launch of Windows XP. Liddell would only say that the current mix was "very healthy" and that "faster adoption of Vista is likely to be the result." Revenue recognition may seem a very theoretical issue, and it can make a complex picture even more confusing, but it can also give new insights into the business. In this case, Microsoft defers some of the up-front licence revenue from Vista licences to pay for updates and service packs that it makes freely available to everyone over the lifetime of products. The faster rate of revenue recognition shows that Microsoft anticipates providing far fewer updates to Vista than it did for Windows XP. This demonstrates Microsoft's belief that Vista is far less buggy than XP was at launch. Let's hope that Microsoft is right!

While we didn't get any answers regarding adoption speed in business, it appears that there has been no rush yet – if there had, we're sure Microsoft would have said so. Another piece of indirect evidence comes from the comparatively high level of renewals on Microsoft's Software Assurance programme, which amongst other benefits entitles clients to upgrade from other Microsoft operating systems to Vista at no additional charge, suggesting that users are giving themselves a breathing space of up to three years.

Microsoft Business Division also grows healthily

Microsoft Business Division (MBD), where Office lives, saw a revenue increase of 34% to $4.83bn with contribution rising 42% to $3.42bn. Taking off the $470k deferred revenue reduces the revenue growth to 'just' 21% and contribution increase to 23%. While Office is by no means the only revenue generator for MBD, Liddell said the product had been a real success story in the quarter and exceeded its expectation.

Dynamics no longer reports revenues but Liddell did say that customer billings grew by an encouraging 20% year-on-year. This corresponds with what we are hearing from the market, especially from systems integrators who are stretching their resources to meet customer demand.

Dynamics will see the launch of version 4.0 of its CRM suite towards the end of Q4. This is an interesting product because it is built to be multi-tenanted so that it can be used by Microsoft and Service provider partners to cost-effectively offer software-as-a-service as well as deployed on-site by customers themselves.

Other divisions – a mixed bag

The Servers and Tools division was up 15% and its contribution by 31%. While still a good result, this does suggest that the strong growth we have seen from SQL Server DBMS has slowed down. We suspect that this is due to increased competition; some of this is from the open source market but we suspect that both Oracle and IBM are fighting back on price.

Revenue at the Online Services division went up 11% in revenue but its loss went up to $200m compared to $24m a year ago. Advertising revenue at Online Services grew by a healthy 23%, helped by improved monetisation from Microsoft's adCenter platform which serves up targeted paid ads to end users. Results from the replacement of the advertising platform have taken a while to come through, and the advertising business is now growing in line with the market – which was not the case a year ago. However, the division's overall growth and profitability continue to be hit by the inevitable decline in the dial-up business.

The Entertainment and Devices division was down by 21%, though its operating loss went down to $315m from $402m a year ago. The Xbox 360 is a major factor in this group's performance, because Microsoft makes a loss on every console sold – a loss it hopes to win back in the long run with sales of games and (eventually, perhaps) other sorts of software. Last quarter Microsoft said it was going to increase the price of the Xbox and that would explain the reduction in revenue but decrease in losses.

WHY UK GRADUATES ARE IMPORTANT TO INFOSYS

Kate Hanaghan
Analyst

We met recently with Sudhir Chaturvedi, Associate VP at Infosys and head of UK and Ireland sales. The UK is a very significant market for the Indian firm and was worth £215m (Ovum estimate) to it in the year to March 2006 – representing growth of 18%. That is an enviable growth curve but Infosys also recognises that what is absolutely key to its future growth is its relationship with customers: "[Suppliers] need to be close to customers and understand how they work. Technical capability is almost secondary," says Chaturvedi. Just like every other SITS firm, Infosys is fighting a war for talent – to attract and retain the right people, and that includes both graduates and experienced professionals.

Employing graduates

But can Infosys (and the other players, of course) get the talent they need to serve the UK market from within the UK itself? There are well-documented concerns both inside the S/ITS industry and outside (in government) that the UK is not producing the right kind of talent to sustain the competitiveness of the industry on a global stage. Those concerns have centred on students of UK universities, mainly whether the UK can produce enough high-quality graduates in numerate courses such as Computer Science and Maths.

Our research suggests that other Indian players are looking to recruit thousands more staff, with a heavy emphasis on graduates. So how does Chaturvedi think UK graduates compare with Indian graduates? Pretty well, it seems. Infosys has been running a graduate recruitment scheme in the UK and it's been very successful – to the extent that the company has ended up recruiting more graduates than it had originally planned. We note that Indian firms tend to invest more in training graduates and have longer training schemes, and this is attractive to graduates. Hence while recruitment is not an issue, a far bigger challenge is getting them to stay. Six months seems to be quite a significant milestone (i.e. most tend to leave much sooner than this), so if Infosys can use a formal training scheme to encourage graduates to stay, it then has a good chance of developing them into long-standing employees (and getting a return on its investment).

How graduates are used

Meanwhile, we note that many Western S/ITS players have reduced their commitment to graduate recruitment schemes, choosing to focus on recruiting more experienced staff instead. In the past we have raised our concern that with less emphasis on developing graduate talent, the UK S/ITS industry could face a skills crunch with fewer people rising through the ranks to become the senior IT workers and managers of tomorrow. Infosys believes graduates and training are worth investing heavily in and Western firms need to be aware of the competition they face from the India firms in the battle for the UK's best graduates.

What is also interesting about Infosys' approach to graduate employees is the way it uses them within the company. Chaturvedi told us: "It is easy to over-romanticise how skilled you have to be to do software engineering work." Infosys has put far greater emphasis on standardised processes to achieve quality of delivery. This enables it to use less experienced employees for certain tasks than in less standardised environments.

We accept that there will always be certain staff that are over-qualified for the job they are doing – meaning that the service is costing the supplier more than it should do. But at the same time, Indian firms must be extremely careful with how they handle this issue with customers. Yes, offshore companies have been able to establish themselves in the UK market, and yes the concept of offshoring is now just a part of the landscape in the UK private, and increasingly public, sector. But Infosys and the other leading Indian firms must not become complacent. Their conversations with customers must be precise and clear. The last message customers should go away with is that Indian suppliers are putting IT systems at risk by handing them over inappropriately to inexperienced staff.

CSC: EVOLUTION NOT REVOLUTION

Phil Codling
Principal Analyst

CSC remains a top five IT services player in the UK and runs some of the largest outsourcing deals in the market, not least its expanded commitments at the NHS. But it has lived through interesting times of late, including zero topline growth in FY06 and the first three quarters of FY07, as well as unsettling take-over interest from private equity firms during last summer. Such challenges proved that CSC had no choice but to rethink and globalise the way it does business. Put succinctly, the company was struggling to compete profitably because its cost base was too high.

This comment on the company's strategy assesses its progress and outlook in addressing the challenges it faces in a highly competitive, and increasingly mature, UK IT outsourcing market. It also considers how CSC might draw on some existing strengths to evolve its positioning and differentiation.

Restructuring to lower costs

Execution of the restructuring strategy, as kicked off in April 2006, has been rapid. 4,100 lay-offs had been enacted by December 2006, with the majority in the UK/Europe. The other side of the plan - growing the offshore workforce - is proceeding too. By April 2007, CSC had 8,000 people in India, with annual headcount growth there being sustained at 75%. This means the company still has less offshore capacity than some of its key rivals, not least IBM, EDS and Accenture. Clearly it needs to keep bolstering its offshore resources if it is to stay competitive. It's not all about India, however, and CSC should continue to extend the geographic scope of its global sourcing strategy in the coming years by growing and linking up its delivery resources in countries such as Malaysia, Canada, Spain, Czech Republic and South Africa.

The effects of the restructuring strategy changes are significant. CSC expects globally to achieve $300m of total savings in FY08, which equates to 2% on the corporation's full-year operating margin. This will help CSC get its margins up towards double-digit levels, which is where, in our view, they should be for a large IT services firm.

Figure 1 **CSC retains its top 5 UK IT services position (by revenue)**

1 EDS
2 IBM
3 Accenture
4 Fujitsu Services
5 CSC
6 Capgemini
7 BT
8 Capita
9 HP
10 Atos Origin

Source: Ovum, Company data and estimates of IT services revenue in the UK

Competitive benefits?

A lowered cost base and increased offshore capability should also help CSC to stay competitive and grow the topline. There are some positive indicators. Global signings are significantly up on the previous year, with contract value of $12.6 billion in the bag in the first three quarters of FY07 (compared to $12.1 billion for the whole of FY06).

In the UK business, FY07 will see at best a flat revenue performance, but contract wins, not least the two NHS contracts taken over from Accenture, plus wins late in the year at Urenco, Transport for London and UK Visas, suggest topline growth should return at CSC UK in FY 2008. CSC tells us that the restructuring process has enabled it to bid on more opportunities and to bid more aggressively. This tallies with what we hear from some customers. One thing's for sure: CSC UK needed to make itself more competitive because growth was on a downward trajectory. The painful and ongoing restructuring process gives it a chance to achieve this.

Extending the reach of the business

CSC UK remains primarily an outsourcer providing infrastructure and applications services to large organisations. However, this is an increasingly mature and commoditising addressable market characterised by price pressure (as CSC has experienced on many of its contract renewals) and a lack of large new deals. The company is therefore right to look to open up other avenues for growth.

BPO has been problematic for some IT services providers (for example, Unisys). But it can drive revenue growth and profits, so long as the strategy is focused on service offerings where the provider can add value and build scale. Xansa's experience, for example, shows how this can work. In CSC's case, it is focusing its UK BPO efforts on growth opportunities in life and pensions.

In its favour, CSC has L&P administration experience from its US business and a software platform that is widely used in the industry. But this is a tough segment to enter. Capita enjoys a significant scale advantage. And TCS has emerged as the other main contender, following its deal with Pearl. It is far from guaranteed that

CSC can win deals against such competition. If it cannot, the UK business will have incurred some losses on bidding and marketing and missed out on a potential growth engine. That's disappointing but not a fatal blow for a business of CSC's size.

Targeting the mid-market

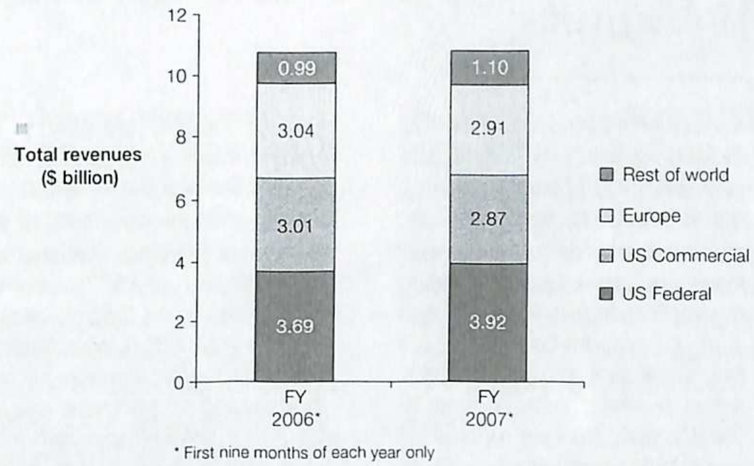
CSC has traditionally targeted large (i.e. primarily FTSE100) firms and government. However, in the search for growth, it is addressing other groups. We do not expect to see it attempt to win business with many sub-1,000 employee organisations. But it is developing interesting propositions for the 1,000 to 10,000 employee band. In particular, we like the look of its cost-conscious offshore-centric offerings (branded "Offshore Direct"), which attempt to bring the benefits of global sourcing to smaller customers by stripping out much of the onshore cost usually involved in its service delivery.

Growing consulting

CSC UK is adding 20-30 business and/or technical consultants per month. However, we do not expect CSC to start selling consultancy as a standalone service in the way that IBM, Accenture and Atos Origin do in the UK. Rather, it will employ its consultants to support the overall growth of the business - i.e. in pre-sales and in transformational elements of outsourcing contracts and projects.

This is the right approach. Demand for consulting is growing, as customers shift towards a revenue-growth agenda for IT once again. However, CSC UK's consulting capability is still relatively small (with 350 consultants at the end of 2006), so it makes sense to deploy these scarce resources in support of CSC UK's core outsourcing and projects businesses. Moreover, we do not think CSC has the "brand permission" to operate in the business consulting market. Investing to get there would be risky, given the presence of well-

Figure 2 **CSC globally: a distinct lack of growth**



Source: CSC

established competitors such as Accenture and IBM.

Differentiating the business

Standing out from the crowd is hard in an IT services market that has matured but barely started to consolidate. The question is how CSC can present itself as different from IBM, EDS, Fujitsu, Accenture et al.

A couple of positive attributes to build on come to mind. Firstly, CSC has shown itself capable of delivering big, difficult IT programmes. In an industry tainted in recent years by high-profile failures, CSC has handled some of the world's largest IT outsourcing deals and largely retained its big customers (such as Motorola, Dupont and BAE Systems). Some customers have gone away (e.g. Sears and Nortel) but by and large CSC's retention rate is good.

CSC's role in the mega-project to modernise IT at the NHS potentially - but not yet - adds weight to its "big and difficult" credentials. The signs are positive (with some high-profile implementations completed) and Connecting for Health has largely been impressed by CSC's ability to deliver thus far. However, such an expansion of commitment on this high-profile, complex engagement undoubtedly entails risks, both for CSC's reputation and its finances.

Relationship issues

CSC's relatively good record of contract renewals and extensions in recent years suggests another potential differentiator. This performance can be attributed to a number of factors, including strong project management skills in the UK business and effective use of partnering, such as the "Prism Alliance" (incorporating BT and Xansa) at the Royal Mail. We also see an emphasis on customer proximity and representation in the business (for example, all accounts, no matter how small, have a board-level representative at CSC UK) and an openness to flexibility in contracting, as exemplified by its "Dynamic Sourcing" initiatives.

None of these attributes is unique to CSC. But taken together they suggest a business that is as well prepared as any to retain and grow its outsourcing customers in a tough market. We also think these attributes - particularly the ability to connect with accounts of all sizes - bode well for its push into the mid-market. All in all, whoever is eventually appointed to replace Keith Wilman as the head of CSC UK (he left to join Atos Origin in December) will inherit a business that has turned a corner and put itself on a more competitive footing, but whose necessary evolution remains very much a work in progress.

6%
92p

xansa

XANSA GROWS BUSINESS AT CO-OP AND NHS

Xansa recently announced contract expansions with two of its largest customers, Co-operative Financial Services and the NHS. The Co-op deal, worth 'up to £100m over five years', sees Xansa extending its application development and support responsibilities to the insurance side of the business. It has delivered such services to the Co-op's banking operations since 1994, and continues to do so under this new deal. Over at the NHS, Xansa has secured a £19m, six-year contract to deliver F&A and payroll services to NHS Professionals, a staffing operation that provides temporary workers for 124 NHS Trusts.

One of Xansa's strengths is its ability to retain and grow its existing customers. That's evidenced in its revenue mix: just over 40% of the company's revenues - at the last count (i.e. H1 of FY07) - comes from relationships that are eleven or more years old. A focus on large accounts is a key strand in Xansa's strategy and it continues to pay off. It's also a sensible approach for a multi-service company that, due to its relatively small scale compared to its competitors, lacks the sales and marketing resources to do broad prospecting for new customers.

Both of these contract announcements show this client retention and extension characteristic in operation. The Co-op Insurance deal is a significant add-on to the banking business, even if it did take 13 years to achieve! It's not hard to see the potential benefits for the customer in combining application services in a unified, offshore-heavy model. Meanwhile the addition of NHS Professionals is a sizeable boost to Xansa's NHS Shared Business Services initiative. Having brought in 113 NHS organisations in its first two years of operation, Xansa needs to make sure that NHS SBS keeps signing up new customers beyond the early adopters.

(Phil Codling)

-5%
21p

CHARTERIS

CHARTERIS REPORTS A LOSS, SUGGESTS BETTER OUTLOOK

Business and IT consultancy Charteris has announced its interim results. Revenue was down 17% to £8.9m. The company made an operating loss before goodwill amortisation of £149k, compared to a profit of £532k in H1 of FY06. Loss per share was 0.67p (H1 FY06: earnings per share of 0.51p).

The headline numbers from Charteris still don't make for cheerful reading. But there are signs that the business may have turned something of a corner, following the profits warning that hit its share price in June last year and the disappointing FY06 performance overall. Firstly, this fall in revenue and profits in H1 was expected. Moreover, it looks as though Q2 was better than Q1. Specifically, utilisation, that critical measure for any consultancy, has improved. According to CEO David Pickering, utilisation is now running at "a bit above the levels we normally plan for" (that level being in the mid-70s). This performance, driven by improving sales, has given Charteris cause to get hiring again. Pickering tells us he is aiming to expand the current headcount of 130 by 10-15%. That's not a huge number but it's another sign that confidence has picked up, despite the falling headline revenue in H1.

Charteris's performance is, we feel, beginning to show the benefits of the strategic changes implemented last year. The move to begin presenting the company by three key service lines was one cause of its poor FY06 showing. But the idea of grouping the company's capabilities more logically - both internally, with each led by an expert head, and externally to customers - is now bearing fruit. The Customer Centricity service line appears to be doing especially well, with Pickering citing increased business at Tesco, Game and Debenhams.

Market conditions are helping too, as Charteris appears to be a beneficiary of the continuing push among retailers for improved online commerce facilities. Meanwhile in the "Intelligent Integration" and "Infrastructure Optimisation" service lines, Charteris reports good recent demand for its Microsoft-based consulting, notably around Dynamics AX but also Exchange, Office and Vista.

In our view, Charteris is taking the right approach for a small consultancy by focusing its services on niche areas rather than trying to take a broad-based business + IT proposition to market. The outlook suggests conditions will begin to get tougher in both the public and private sectors, possibly before the end of 2007. It is only by focusing on areas where they have differentiated expertise and track records that project services firms will be able to sustain sales and fee rates.

(Phil Codling)

Atos Origin

ATOS ORIGIN'S ROAD TO UK RECOVERY

In April we met Keith Wilman, who left CSC to become CEO of Atos Origin UK in December. Atos Origin's UK operation, which accounts for one-fifth of its revenues, has been a key problem geography for the company, with 2006 revenues down 12.5% year-on-year, and barely breaking even at the operating level. We were keen to hear his plan to turn the business around, following Atos Origin's corporate transformational plan announced in February. This comes in the context of Atos holding discussions with potential private equity (PE) investors - a bit of a déjà vu for Keith after CSC's ultimately unrealised brush with PE investors last year.

Atos Origin's problem in 2006, despite some notable wins towards the end of the year, was a lack of new business to counteract contracts (Metropolitan Police, MOD) coming to an end. Understandably, Wilman has focused much of his attention on enhancing Atos UK's ability to win business. He is reorganising Atos UK's accounts team, taking central control of strategic accounts which were previously managed by separate service line teams. In addition, he has changed the incentive structure to foster more collaboration and pull-through work between the service lines. Specifically, he has implemented a policy whereby his top 150 people receive bonuses on Atos Origin's overall UK performance. In addition, consultants are rewarded for pull-through business in SI and outsourcing.

In short, Wilman has taken on board a point we have made about Atos Origin for some time: that it needs better linkage between its consulting, outsourcing and SI operations if it is to experience the cross-fertilisation benefits of these different areas of its broad services capability. In particular, the failure to harness the power of Atos UK's 500 consultants for the good of the overall business has contributed to its poor sales performance. Confirmation of positive effects in the shape of UK contract wins is, Wilman assures us, on its way. The changes seem to be helping UK consulting too, with utilisation now rising above 60%. That's still too low, but it is progress.

Will Atos shift greater focus towards the UK private sector? Wilman believes Atos still has massive opportunities in its public sector stronghold (defined in the widest possible sense), and we left with the impression that he plans to maintain the business's weighting towards public sector work. We suspect that part of his focus is constrained by Atos's modest offshore presence, and yet more modest future ambitions: Atos Origin group leadership has plans to build up a base of 6,000 offshore staff by 2009. This is one of the least ambitious offshore programmes among the major IT services players. Even when taking into account Atos's weight towards French and Dutch businesses, and public sector UK clients, we believe Atos needs to plan for a greater offshore presence.

In terms of Indian competition Wilman does not see them as direct competitors in light of Atos's focus on the public sector, as well as its emphasis on higher value consulting and transformational work. We agree that that may be the case today, but we suspect that it may not hold true too far into the future. Although the 'Indians' have their own share of challenges, their very strong growth and outstanding profitability enable them to steadily realise their ambitions for higher value work (e.g. consulting) and new geographies (i.e Continental Europe).

The likes of IBM, CSC, EDS and Accenture are continuing to increase the use of offshore elements in their services deals in the private sector (and, in some still limited areas, the public sector too). This is enabling them to take cost out of the commodity elements of higher value contracts without harming their margins. In some cases, they are even sourcing significant quantities of higher value skills - e.g. accounting professionals - in India, China and elsewhere. So even on contracts that involve, for example, IT-led business transformation, Atos UK's relative lack of global sourcing capability could still prove disadvantageous.

Overall, Atos has done well to bring in such an experienced executive at the helm of its UK operation, and we believe he will make improvements in the UK operation. We suspect that these improvements may end up being more modest and happening more slowly than expected - partly because we feel that Atos Origin as a group still maintains a Continental European viewpoint on IT services markets, offshoring and global competition. Perhaps this will be something that will change if its ownership changes in the coming months.

(Angel Dobardviez and Phil Codling)

9%
748p

SHORT AND SWEET FOR AUTONOMY

In what is now becoming its customary practice, UK-based software infrastructure company Autonomy has issued two one-line press releases about new contracts.

The Cambridge-based company, which is most well known for its enterprise search and discovery capabilities, announced that is has entered into an OEM deal with HP allowing the Palo Alto-headquartered computer manufacturer to embed Autonomy's Intelligent Data Operating Layer (IDOL) software into any of its products. It has further agreed with McGraw Hill Companies to embed IDOL within the range of information service offerings that it provides to customers.

The IDOL technology will process both structured and unstructured data, and in Autonomy's language extracts the 'meaning' from information. The benefit when embedded in other software is the ability it gives to apply high levels of automation to business processes.

This will nicely complement HP's governance and service management products, and the future offerings from its recently announced Business Information Optimisation division.

McGraw Hill is best known for its brands which include Standard & Poor's, BusinessWeek and JD Power and Associates. The integration of IDOL could enable greater levels of contextually relevant information to be provided to customers.

The lack of detail in Autonomy's recent press releases, most notably their values, belies the undoubted success it is currently having in its organic growth. Unaudited revenues for the year ending 31 December 2006 were up by 161% on 2005, and since the beginning of the 2007 financial year it has also announced new contracts with T-Mobile, the SAAB-Ericsson defence consortium, and GlaxoSmithKline, again without figures.

(Mike Davis)

14%
7p

BCS HAS A BUSY YEAR

Business Control Solutions (BCS), risk and cost control software and services provider to the financial services market, recently released its results for the year to 31 December 2006. Revenue was £8.0m (2005: £8.2m), with an operating loss (before interest, taxation and amortisation) of £703k (2005: -£467k). We met with CEO Nigel Walder to discuss the development of the company and how it's to spend the £3m it raised in October.

These results are hardly worth shouting about but there are circumstances that have contributed to this fall in revenue and profit. In 2006 BCS switched its software pricing model. Instead of paying a one-off fee for a software licence with unlimited users, clients are now charged on an annual, per user, basis. This change has cut revenues in the short term and, according to BCS, the profit loss is directly related to revenue loss.

The switch in the software pricing model is a good move for BCS. Not only because it can potentially gain more from the software licence (due to it being sold on a stricter user basis), but also because it should contribute to reducing the lumpiness of revenues.

The company can be divided in a number of ways. The key elements are its software and consultancy, accounting for £1.9m and £6.1m of revenues respectively. Traditionally, BCS consultants were employed on a consultation basis, recommending a menu of software modules to the client. Increasingly companies are identifying weak spots in their processes and asking for BCS software, buying it off-the-shelf, already aware of its capabilities, with implementation and further consultancy charges as a secondary add-on.

BCS can also be divided along its product offerings: risk control, including regulatory compliance (for which BCS is probably best known) and cost control. Changes in the EU regulations relating to operational risk (Basel II) and the securities market (MiFID) have created a market opportunity for companies willing to grapple with the complexity of regulatory compliance.

BCS is currently half-way through its three-year strategy plan to grow the company. In October it raised £3m from the sale of shares, which it is spending on bringing in more consultants, and developing its strategically important products, namely BCS Control Surface (a 'dashboard' interface that wraps around the other products, giving senior managers a personalised interface from which to get a minute-by-minute view of the company), Metrics (continuous, quantitative measurement tools) and Continuous Control Monitor (providing qualitative analysis, such as monitoring task completion).

With the size of the company in relation to its clients (such as Deutsche Bank), and the sort of money available in the financial services market, anything can happen with BCS. However, the long-term stability of the company will depend upon its ability to recognise revenue on a more continuous basis and develop the BCS brand.

(Ed Lycett-Marquez)

45%
29p

INVU GROWS VERY PROFITABLY

Document management specialist Invu had turnover of £6.49m for the year ending 31 January 2007, an increase of 36% over the previous year. Operating profit increased 66% to £1.93m, with an operating margin rising to 29.7% from 24.3% the previous year. Net profit was £2.02m, an increase of 67%. Net cash from operating activities was £1.71m compared to an outflow of £2k in the previous year.

This is an excellent result for a small company in any market, but it is especially good in a market like content management, which has seen slow growth and a high degree of vendor consolidation. Invu has been smart, making good use of its two key partnerships with Sage and Panasonic. Revenue was also helped along by the launch of its next generation of products after some delays.

Despite the state of the content market, managing content is a vital activity for companies of all sizes - it's not just for large enterprises. As Invu's client base in small and medium-sized businesses shows, with the right offer and the right channels you can sell into smaller companies as well. Any company that uses documents to store its knowledge (such as instruction manuals, sales and marketing literature, business plans, etc) will be drowning in a sea of content. Properly applied, content management systems can help you keep your head above water.

Most remarkable of all is Invu's operating margin; small software companies rarely reach the 30% mark, but Invu has. We congratulate the company on a job well done, and hope it will continue to do more of the same in the current year.

(David Bradshaw)

IBM WINS £400M SOMERSET BPO DEAL

IBM has been selected as preferred bidder for a major IT and business process outsourcing contract with Somerset County Council and Taunton Deane Borough Council that will be worth approximately £400m over the next ten years.

Under the terms of the deal, IBM will lead the Improving Services in Somerset (ISiS) transformation programme, which will see it create a joint venture with the two councils, and take over and manage the human resources, finance, procurement, ICT, property services, customer services, facilities management, and support services for both councils. The revenues and benefits service will also be delivered by the partnership for Taunton Deane.

The announcement draws to a close 12 months of negotiations between Somerset/Taunton Deane and the three short-listed suppliers BT (with its partners CGI Group and Carillion), Capita and IBM (with its partners HBS and support services provider Mouchel Parkman). IBM's selection ahead of hot favourite BT shows that there are still opportunities for other suppliers if they can innovate and prove capability.

This is a landmark contract in local government outsourcing in being the first joint procurement of its kind by two authorities to set up and create a regional shared service in England. This covers councils and related organisations in the South West region including Cornwall, Devon, West of England, Dorset, Gloucestershire and Wiltshire. Some 30 public sector organisations within the region have now signed up to a framework agreement, which will enable them to purchase services from the partnership without having to go through the usual procurement process.

We believe that getting other organisations to sign up to the shared service was a key factor in choosing the eventual supplier. Indeed the Avon and Somerset Police Authority is considering joining the service which, if they decide to go ahead, will be a real coup for the IBM partnership. This would be a big tick in the box for joining up points of contact across local authority and emergency service boundaries with the aim of delivering both efficiencies, and a better service for citizens.

Overall this award is a major boost to IBM and its ambitions in the local government software and IT services market. It also goes to show that despite the recent run of big awards to Capita and BT, they aren't the only players in the market.

More importantly the award is justification of IBM's decision to keep plugging away at the local government market. It has major programmes at Bradford and Surrey, won several years ago but, after its disappointment at Birmingham last year, its patience and commitment to the market have finally delivered.

The ISiS programme is likely to become a test case of regional shared services at the local government level. Securing such a key win will put IBM's capability firmly under the spotlight. So while the award suggests that innovation around shared services capability is becoming a differentiator among suppliers, actually delivering the required capability has yet to be proven.

(John O'Brien)

-15%
35p

GBGROUP

CONTRACT DELAYS HIT PERFORMANCE AT GB

GB revenue for the year to end March will be below market expectations (at £15.0m) and loss before tax will be £1.2m (around £0.8m worse than previous estimates). GB says that extended lead times in closing contracts at its fast-growing DataAuthentication business are the primary cause, coupled with increasing competitive pressure in its more mature CRM and data analysis businesses.

Overall, the picture remains bright on DataAuthentication. This online identity check system has still more than doubled its revenues (from £1.9m to £4.8m) in FY07, despite the delays in signing contracts. That's just as well, because GB is putting the vast majority of its development and marketing effort behind making DataAuthentication a success. Nothing in this statement suggests this long-term strategy has been knocked off course, particularly as GB has been able to sign up growing numbers of large banks and retailers to the service (including DSG in a five-year contract).

Meanwhile, it is hoped that the investment the company has made to put its CRM and data analysis solutions online during the year will help safeguard profits. Looking at broader trends in these markets, online delivery certainly seems a sensible way forward. Nonetheless, this is a delicate balancing act for GB. Given the demands of the DataAuthentication growth engine, it cannot invest too heavily in these more mature products. However, it needs to make sure they keep contributing profits, at least until DataAuthentication can contribute some of its own.

(Phil Codling)

SAP GROWTH MASKED BY DOLLAR SLIDE

SAP recently reported total revenue of €2.17bn for the first quarter of 2007, an increase of just 6% over the previous year. However, SAP said that at constant currencies the growth was actually 11%. Revenue consisted of software licences of €563m (up 10% as stated/16% at constant currencies), support services (up 8%/12%), subscription and other software-related services of €39m (up 63%/70%), and professional services revenue of €640m (down 1% as stated but up 3% at constant currencies).

SAP saw an excellent year-on-year revenue growth of 15% in the Americas at constant currencies, but the slide in the dollar reduced this to a pedestrian 5%. In EMEA growth was still a very good 14% at constant currencies, reduced to 12% as stated revenues. As with the last quarter, growth outside the euro zone was stronger than in it. Germany in particular saw only 4% growth, though this is not such a bad result considering SAP's high penetration in its home country. Asia-Pacific grew 10% at constant currencies, 4% as stated.

One has to have some sympathy for SAP here. It's been through a turbulent time, with the under-performance in Q4 followed by the departure of Shai Agassi and the law-suit from Oracle - and though neither of the latter have any real commercial impact on the company, it has lowered perceptions in some quarters of the company. The slide in the dollar has masked what would otherwise have been a strong riposte to all that has gone before.

Another element that makes the picture look less positive than it might otherwise be is the relatively low growth in professional services, only 3% in constant currency. We don't see this as a particular issue when the software side is growing at 15% in constant currencies. Software companies have to strike a balance between offering their own professional services and directing customers to those of its service partners. Indeed a radical view of software vendors' professional service is that they exist only to ensure customers implement the software and then pay the software maintenance fees.

On this basis therefore, the true test of a conventional software company is growth in maintenance, and there is good news - growth of 12% in maintenance revenues year-on-year suggests a growth of around 12% in users. Some of this extra maintenance will come from existing users using a wider range of SAP products, but some will also come from more users - especially as products like 'Duet' extend SAP's range into light users away from its more usual base of heavy users that spend all day, every day doing their work in SAP.

One final element we are pleased by is that SAP is now publishing a separate revenue line for subscription and other software-related services, and that this shows growth of 70% at constant currencies. Regular readers will know that we believe that software-as-a-service is going to play a strong role in the overall software market, so we welcome SAP's move toward itemising out this kind of revenue.

(David Bradshaw)

5%
79p

HARVEY NASH

HARVEY NASH GROWS REVENUE AND PROFITS IN FY07

Harvey Nash, the recruitment company with offshore development capabilities, recently released its results for the year to end January 2007. The news was good but not unexpected, following a preview in January. Revenue increased 24% to £251.7m, and operating profit increased 33% to £7.0m. Operating margin improved from 2.61% to 2.78%. In the UK, revenue increased 16% to £92.2m, while the operating margin improved from 3.15% to 3.79%.

This set of results demonstrates improvements at the top and bottom line. The UK business showed greater margin improvement than the group as a whole, thanks to profit improvements driven from both its offshore development business and its staffing business. We think Harvey Nash's portfolio and approach is well-shaped for today's mature market. Its focus on more senior IT staff (for example developers with niche skills or sector-specific experience) is helping it to benefit from the shift in IT spend we're seeing towards growth-driving projects. In addition, the company's ability to supply staff with the very desirable skillsets and experience of offshore project management from the UK provides it with a nice boost.

The other side of the story is Harvey Nash's offshore development business, which is based in Vietnam. The company aims to pump increased value into its clients' services by not only taking certain services offshore, but by carefully managing the client end. Harvey Nash has a set of about 20 top accounts where it's claiming significant success in the cross-sale of its full range of services. We think that if it can continue to emphasise the value of its services (e.g. in terms of the staff it can supply, the quality of its development work and the quality of the way the whole offshore element is managed at the customer contact point), it will be able to improve margins further. Those staffing companies that are positioned in generic, lower-value areas (e.g. desktop support) will continue to struggle and to find life in the UK market tough.

(Kate Hanaghan)

Infosys

ANOTHER IMPRESSIVE YEAR FOR INFOSYS

Revenues of Indian offshore player Infosys reached $3.1bn in FY07 (under US GAAP), up 44%. Infosys' operating margin is stable at 27.6%. European revenues are up by approximately 33% and reached around $820m in FY07 or 26.4% of worldwide revenues. The company now has a headcount of around 72,000, up from 52,000 the previous year. Revenue guidance for FY08 is $3.9-4.0bn or growth of 37%.

Quarter after quarter, the tier-one Indian vendors are showing that they can keep on growing at amazing speed while maintaining margins that are three times as much as the industry average in Europe. What is striking is that Infosys keeps on growing in geographies where it is already well established: revenues in North America still grew by around 40% in FY07 to around $2bn. In our estimate and based on discussions with Infosys management, revenues from the UK now account for around 60% of European revenues, up from 50% last year. Infosys is also seeing continued growth in its key vertical markets i.e. financial services and telecoms, from which it derives around 57% of revenues, up from 52.5% in FY06. Infosys is growing even faster in countries and verticals where it already has a presence. This can also be seen across other leading rivals such as TCS and Wipro, and highlights the significant traction that offshore players have in growing existing customer accounts.

Infosys remains an application-centric organisation. The company still derives around 50% of its revenues from application development and maintenance, with newer related offerings such as testing and package implementation growing by around 55% and 68% respectively. Today software testing accounts for around $210m in revenues. That's more than consulting or BPO – areas where Infosys is investing in Europe.

Needless to say, key statistics are healthy. Its revenues coming from fixed-priced projects declined from 28.1% to 26.7% in FY07. That's a good sign for margins. Utilisation rate is at 68%, down from 70% the previous year. Considering that the firm is in hyper-growth mode and recruiting intensively - it added 20,000 net employees last year – this number looks healthy. The beauty of the offshore business model means that Infosys can accept utilisation rates that are much lower than a European firm can accept if it wants to stay profitable. In short, this is a strong performance by Infosys. Next year, the company will be roughly the size of a CGI or an ACS!

(Dominique Raviart)

Mergers and Acquisitions – April 2007

Buyer	Capita
Seller	CMGL Group
Seller Description	Outsourced claims and insurance management services provider
Acquiring	100%
Price	£32m
Comment	Acquisitions like this support Capita's successful model in two ways. They enable the company to balance the lumpy revenue from large long-term "mega-deal" wins with smaller but more consistent revenue streams from niche back-office services. In terms of profitability, the acquired company should also benefit from the economies of scale that Capita can provide. But the second, and perhaps more important, benefit is that these acquisitions also help Capita broaden and deepen its services into specific markets. So, for example, where CMGL boosts Capita's insurance services offerings, the February acquisition of Harry Weeks Travel helps give it another string to its bow in HR outsourcing services. Large BPO deals are often an amalgamation of niche skillsets and processes that come together to form a larger service. By bringing these skills together through acquisition, Capita is also supporting its potential to increase large deal wins. For this reason we expect many more mid-size acquisitions like this one from Capita. Indeed, other UK and European BPO players are catching on to the Capita model, and interest in this sort of M&A across the market is increasing.
Buyer	COA (CedarOpenAccounts)
Seller	Version One
Seller Description	Document management and imaging software provider
Acquiring	100%
Price	Undisclosed
Comment	COA's overall strategy has two coupled aims, firstly to increase share of customer wallet and secondly to seek higher growth. As we've remarked before, while software companies can expect a steady income from corporate financial software they can't expect strong growth, because pretty much every company that needs accounting software will already have it, so it's a maintenance and substitution market. Areas like document management, workflow and business intelligence are going mainstream by being incorporated into core business applications. COA hasn't articulated its precise strategy for the products to us, but a common tactic is to provide some basic capabilities with the core business applications, then require an additional licence payment for the most useful and sophisticated capabilities. Since the extra capabilities effectively come ready-integrated with the business applications, implementation is trivial (when compared to a new standalone system) and this improves the velocity of sales for the vendor.
Buyer	Computacenter
Seller	Allnet
Seller Description	Network integration and structured cabling company
Acquiring	100%
Price	Undisclosed
Comment	This acquisition comes just three months after the acquisition of Digica, the outsourcing firm focused on the mid-market, for a total consideration of £28m. Allnet bolsters CC's network integration and cabling capabilities, enlarging a part of its Technology Solutions business (essentially project services) that was lacking scale. So Allnet will complement some of CC's existing business in converged IP-based networks and related security and managed services. CC will also gain a range of skills by taking on the 180 or so Allnet staff (most are technical staff) that are based both on and off customer site. All in all, we consider this purchase to be a sound way for Computacenter to broaden its capability in network services and bring more balance to its project services revenues. We think there will also be opportunities for CC to leverage Allnet by combining it with existing CC skills. For example, it plans to marry its existing Microsoft skills with Allnet's capabilities to provide unified communications services. CC is not a very acquisitive company so we're really keen to know how well it can create synergies across CC and Allnet.
Buyer	Experian
Seller	Hitwise
Seller Description	Privately-owned Internet marketing intelligence company
Acquiring	100%
Price	£240m (cash)
Comment	Via its relationship with 30 large ISPs, Hitwise gathers anonymous data from 25 million consumers daily (it claims this is the largest sample base of Internet users) and 1 million websites. It does this using IP addresses and not tracking cookies - which is just as well as most recently sold anti-virus products now strip out tracking cookies from their users' computers. From this data, it constructs analytical reports that enable customers to optimise their own websites and benchmark them against competitors. One interesting service is the analysis of which website its visitors were viewing immediately before (the 'feeder') and where they go to (the 'bleeder'). Many companies offer similar services, but what distinguishes Hitwise is the fact that it tracks the smaller websites as well as the large. With the 'long tail' effect of the Web making it a far more diversified place, the ability to track the smaller sites is becoming far more critical. Hitwise's data complements the data that Experian already provides to its customers, and forms part of Experian's re-positioning of its marketing solutions business. That Hitwise's 1,200 clients pay on a subscription basis is also a good fit. Experian plans to cross-sell and upsell between its current and Hitwise's services, which seems well founded, as are its plans to offer Hitwise's services in new markets in Europe and Asia. In summary, while $240 million might seem a pretty big price to pay for a marginally profitable company with only $40 million in revenue, we are impressed with the fit and strong potential synergies between Hitwise and Experian. The only criticism we can think of is that after four years of working together, Experian should have known to buy Hitwise when it was cheaper - but we presume the financial strictures placed on Experian by former owner GUS discounted this.

Mergers and Acquisitions – April 2007

Buyer	**Google**
Seller	**Doubleclick**
Seller Description	Online advertising agency
Acquiring	100%
Price	$3.1bn
Comment	Much of the recent analysis has focused on just how much Google is believed to have paid for DoubleClick, with many commentators saying that Google has overpaid. We disagree. Advertising is where the overwhelming majority of Google's revenues comes from, and will continue to do so for the foreseeable future. Its most important strategic imperatives for the near term and for some time to come are to defend and extend that revenue stream. The purchase of DoubleClick meets both these objectives. Firstly, by keeping DoubleClick out of Microsoft's hands, Google keeps Microsoft out of its back-yard. Some people write off Microsoft in the advertising market. However, we don't think it's ever safe to write off a company with as much patient money and such a large footprint in the Internet as Microsoft. If there's one company that Google needs to defend itself against, it's Microsoft. Secondly, DoubleClick's display advertising expertise complements Google's existing business. Google was already getting into the payment-by-impression business where DoubleClick is best known. If there is any company that can boost DoubleClick's revenue, it is Google. There are signs that display advertising is coming back into fashion, and Google needs to be in the market. Google is currently cash-rich so spending $3 billion to further both these aims seems well worth it.
Buyer	**The Innovation Group**
Seller	**Conversant Data**
Seller Description	Provider of fraud detection services
Acquiring	Rest of the 75% (TIG purchased 25% in January 2006)
Price	£3.0m
Comment	TIG initially acquired 25% of Conversant in January 2006 at a cost of £1.0 million. The consideration of £3.0 million comprises £1.6 million in cash with the balance of £1.4 million satisfied by the issue of 4,301,980 new ordinary shares. In addition, a further 762,199 shares will be issued in connection with the purchase of minority interests in a subsidiary of Conversant and an associated transaction. All of the shares will be issued at a price of 32.8p. Established in 2003, Conservant principally services the UK market, but also provides services to Eastern Europe. Conversant enables insurers to outsource the whole or parts of their anti-fraud activities. All of Conversant's revenue is earned on a transactional basis. The existing management team will continue to manage Conversant after the completion of the transaction.
Buyer	**Royalblue**
Seller	**LatentZero**
Seller Description	Specialist in equities trading
Acquiring	100%
Price	£38m up-front plus £25m in earn-outs over the next two years
Comment	The rationale of this acquisition is that it makes it easier to integrate the processes of buying and selling financial assets. There is increasing convergence between the buy-side and sell-side in asset management companies. In the press release, Royalblue says that the acquisition will benefit both sides by "providing, for the first time, the potential for true integration of multi-asset buy-side and sell-side trading flows on a significant scale". Both companies were on the verge of developing capabilities in each others' territories, so this saves them the trouble. Overall, this looks a good purchase for Royalblue and one that it can easily afford. One could quibble over the price being paid, but the promised synergies should make LatentZero well worth it.
Buyer	**Xploite**
Seller	**Anix Group**
Seller Description	Provider of storage area networks and tiered storage infrastructure
Acquiring	100%
Price	£4.35m in cash, plus repayment of £6.1m of debt
Comment	This is fast work. When we spoke to Xploite CEO, Ian Smith, in February (after the acquisition of Posetiv), we knew more was in the pipeline. It's great to see this coming to fruition so rapidly. Those who know Xploite will be aware that it was previously called Fujin and before that Matrix Communications. Through these various guises, Xploite has navigated its way through a successful buy and build strategy - which resulted in the sale of the 'end product' for a tidy sum. Now the process is starting all over again (Posetiv was the first acquisition), this time in a more focused way (i.e. the concentration on storage solutions suppliers). We think that given the company has been through this process before (and has inevitably learned valuable lessons along the way) it stands a very good chance of repeating its success.

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

	SCS Cat.	Share Price 30-Apr-07	Capitalisation 30-Apr-07	Historic P/E	PSR Ratio Cap./Rev.	S/ITS Index 30-Apr-07	Share price move since 30-Mar-07	Share price % move in 2007	Capitalisation move since 30-Mar-07
@UK plc	SP	0.14	5.29	NA	3.64	213.74	-3%	-22%	-£0.16m
Alphameric	SP	0.60	80.88	22.1	1.23	275.23	21%	26%	£14.91m
Alterian	SP	1.87	76.02	58.0	7.15	935.00	20%	65%	£10.27m
Anite Group	CS	0.77	273.38	76.8	1.44	450.29	-6%	-6%	-£16.01m
Ascribe	SP	0.59	66.88	NA	12.51	3,078.95	2%	50%	£1.14m
Atelis plc	SP	0.05	1.31	NA	NA	244.19	-9%	-22%	-£0.13m
Atlantic Global	SP	0.16	3.55	68.3	1.66	542.37	3%	19%	£0.00m
Autonomy Corporation	SP	7.48	1432.50	72.3	11.17	228.33	9%	46%	£135.71m
Aveva Group	SP	8.56	573.97	70.8	8.71	4,280.00	4%	5%	£20.92m
Axon Group	CS	7.40	469.36	30.9	3.41	4,228.57	14%	21%	£88.20m
Bond International	SP	2.27	67.36	20.3	3.92	3,492.31	9%	32%	£4.54m
Brady	SP	0.60	16.12	25.6	6.63	740.74	-5%	64%	-£0.11m
Business Control Solutions	CS	0.07	19.34	NA	2.42	1,139.20	14%	14%	-£0.00m
Business Systems	CS	0.11	9.15	12.2	0.26	92.44	0%	-12%	£0.69m
Capita Group	CS	7.00	4401.49	31.0	2.59	189,224.17	2%	15%	£187.80m
Centrom	CS	0.01	1.34	NA	0.21	166.67	0%	-33%	£0.00m
Charteris	CS	0.21	9.03	20.5	1.01	233.33	-5%	31%	-£0.22m
Chelford Group	CS	1.55	11.07	152.0	NA	269.57	8%	-7%	£0.87m
Civica	CS	2.59	163.07	14.8	1.54	1,479.61	4%	-6%	£7.34m
Clarity Commerce	SP	0.69	11.20	9.6	0.84	552.00	29%	29%	£0.33m
Clinical Computing	SP	0.07	2.07	NA	1.25	56.45	0%	0%	£0.02m
CODA Plc.	SP	1.92	147.98	NA	2.77	1,186.73	-1%	19%	-£2.12m
Compel Group	CS	1.49	50.42	22.6	0.80	1,192.00	0%	26%	£0.00m
Computacenter	R	2.58	423.01	21.1	0.19	385.07	-8%	-4%	-£21.82m
Computer Software Group	SP	1.51	85.47	19.3	6.07	1,285.10	3%	24%	£2.27m
Cornwell Management Consultants	CS	0.38	6.74	NA	0.38	272.89	124%	230%	£3.75m
Corpora	SP	0.05	8.54	NA	3.28	131.58	0%	-11%	£1.71m
Dealogic	SP	1.85	128.99	12.3	3.21	804.34	-3%	17%	-£4.72m
Delcam	SP	4.28	26.15	12.8	1.09	1,644.23	-1%	37%	-£0.40m
Detica	CS	4.18	442.58	44.6	4.36	5,225.00	1%	14%	-£19.00m
Dicom Group	R	2.32	203.99	28.3	0.98	711.22	2%	0%	£5.36m
Dillistone Group	SP	1.62	8.78	NA	NA	1,186.81	25%	11%	£1.76m
Dimension Data	R	0.49	731.58	36.5	0.53	87.03	-2%	14%	-£42.36m
DRS Data & Research	SP	0.37	11.38	72.6	0.91	336.36	0%	0%	-£0.63m
eg Solutions	SP	0.45	6.43	NA	1.19	306.12	-17%	-45%	-£1.22m
ELCOM	CS	0.02	7.08	NA	20.44	400.00	0%	-52%	£0.54m
Electronic Data Processing	SP	0.67	17.25	40.0	2.47	2,051.44	0%	4%	£0.88m
FDM Group	A	1.17	27.17	13.4	0.61	1,435.58	-9%	25%	-£2.78m
Ffastfill	SP	0.07	18.81	NA	7.10	58.33	4%	17%	-£0.72m
Financial Objects	CS	0.69	31.31	9.5	1.57	300.00	-1%	27%	£0.22m
Flomerics Group	SP	0.90	13.36	18.3	0.94	3,461.54	-2%	20%	-£0.23m
Focus Solutions Group	CS	0.63	20.05	52.5	3.69	323.08	16%	30%	£4.08m
GB Group	CS	0.35	29.04	NA	1.94	225.75	-15%	-24%	-£4.73m
Gladstone	SP	0.25	13.30	9.7	1.74	625.00	4%	-2%	£0.92m
Glotel	A	0.59	22.99	9.3	0.25	306.49	0%	-6%	£0.00m
Gresham Computing	CS	1.25	63.69	NA	4.56	1,344.09	2%	-16%	£2.36m
Group NBT	CS	3.28	78.92	28.5	9.40	1,640.00	3%	58%	£1.53m
Hamsard Group (Renamed Cantono	CS	0.06	16.81	NA	2.34	1,000.00	0%	0%	£0.00m
Harvey Nash Group	A	0.79	51.30	12.7	0.20	451.43	5%	8%	£4.25m
Highams Systems Services	A	0.06	1.87	16.5	0.14	166.67	20%	30%	£0.24m
Horizon Technology	CS	0.75	88.75	15.2	0.47	397.18	-4%	8%	£34.64m
IBS OPENSystems	CS	1.97	78.60	15.8	5.03	1,291.80	3%	8%	£2.00m
I S Solutions	CS	0.20	4.81	NA	0.87	735.99	-14%	25%	-£0.79m
ICM Computer Group	CS	4.94	104.91	31.4	1.39	2,744.44	11%	71%	£9.53m
IDOX	SP	0.08	15.38	NA	1.09	10.27	0%	25%	-£0.73m
Imaginatik	SP	0.09	10.64	NA	7.60	1,073.53	-1%	7%	-£0.15m
In Technology	CS	0.39	72.34	NA	0.26	1,560.00	1%	-9%	£17.38m
InterQuest Group	A	1.10	31.48	NA	1.14	1,904.35	-23%	25%	-£9.78m
Innovation Group	SP	0.32	202.40	NA	3.32	139.74	-3%	2%	-£6.18m
Intelligent Environments	SP	0.12	19.09	NA	6.12	127.66	50%	92%	£4.67m
Intercede Group	SP	0.51	16.30	NA	9.03	850.00	-7%	-14%	-£2.38m
Invu	SP	0.29	32.06	16.2	4.94	3,052.60	45%	-3%	£5.22m
iSOFT Group	SP	0.39	97.06	NA	0.37	354.55	-17%	-31%	-£12.21m
iTrain	SP	0.02	1.82	9.6	0.99	23.53	0%	-11%	£0.00m
IX Europe	CS	0.89	160.80	NA	4.31	2,909.84	1%	81%	£2.26m
K3 Business Technology	SP	1.43	31.95	14.2	1.17	1,092.61	13%	23%	£9.68m
Kewill	SP	0.84	67.07	24.7	2.51	1,660.08	6%	6%	£4.69m
Knowledge Technology Solutions	SP	0.01	3.66	NA	2.93	200.00	-13%	-38%	-£0.16m
LogicaCMG	CS	1.83	2831.01	23.1	1.06	2,506.16	3%	-2%	£96.99m
Lorien	A	0.82	15.27	34.4	0.10	820.00	23%	93%	£2.89m
Macro 4	SP	2.14	47.36	8.2	1.43	862.90	-2%	1%	-£0.89m

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Manpower Software	SP	0.79	34.99	NA	8.08	811.86	40%	203%	£9.96m
Maxima Holdings	CS	2.70	50.05	17.5	4.03	1,963.64	-5%	17%	-£2.32m
Mediasurface	SP	0.24	18.15	NA	1.88	1,727.94	-2%	38%	-£0.39m
Micro Focus	SP	2.53	514.18	62.9	6.80	0.00	11%	21%	£58.43m
Microgen	CS	0.54	54.92	14.0	1.46	230.77	6%	-1%	£3.20m
Minorplanet Systems	SP	0.56	16.15	13.5	0.68	1,143.56	0%	0%	£0.15m
Misys	SP	2.49	1259.14	27.7	2.69	3,097.85	4%	15%	£61.66m
Mondas (Renamed Corero)	SP	0.16	7.29	NA	1.16	213.33	-18%	10%	-£0.18m
Morse	R	0.93	143.64	10.8	0.39	372.00	-4%	-14%	-£7.43m
NCC Group	CS	3.37	109.75	24.7	5.29	2,017.96	7%	21%	£6.85m
Ncipher	SP	2.40	68.69	NA	3.95	960.00	1%	-6%	£0.58m
Netcall	SP	0.24	16.35	45.7	4.93	484.85	9%	41%	£1.65m
Netstore	CS	0.31	39.18	13.7	1.96	206.67	-3%	3%	-£1.26m
Networkers International	A	0.39	35.46	NA	1.86	1,203.13	-4%	10%	-£1.39m
Northgate Information Solutions	CS	0.89	470.89	22.9	1.42	342.31	7%	3%	£25.49m
NSB Retail Systems	SP	0.28	111.97	11.7	2.31	2,434.78	-3%	-18%	-£8.06m
OneclickHR	SP	0.06	9.30	145.4	1.57	150.00	0%	50%	£1.12m
OPD Group	A	4.46	118.33	NA	2.71	2,025.00	4%	-9%	£6.21m
Parity	A	0.72	27.88	NA	0.18	666.66	-1%	-8%	£0.38m
Patsystems	SP	0.29	46.78	37.2	3.06	271.03	7%	68%	£2.46m
Phoenix IT	CS	3.25	199.50	15.9	1.83	1,203.70	-6%	7%	-£9.70m
Pilat Media Global	SP	0.78	45.60	17.2	3.51	3,900.00	1%	-4%	£0.29m
Pixology	SP	0.39	7.91	NA	1.75	279.42	63%	37%	£3.08m
Portrait Software	CS	0.20	17.27	NA	1.49	131.32	11%	33%	£1.95m
Proactis Holdings	SP	0.75	22.44	NA	11.81	1,536.08	19%	17%	£3.62m
Prologic	CS	0.73	7.25	8.4	1.05	879.52	1%	-14%	£0.00m
QinetiQ Group	CS	1.90	1259.33	22.4	1.20	865.60	2%	-1%	£23.49m
Qonnectis	CS	0.01	1.91	NA	17.48	234.67	0%	17%	£0.53m
Quantica	A	0.40	28.55	9.0	0.73	322.58	-6%	31%	£3.04m
Red Squared	CS	0.08	2.37	NA	0.97	460.44	-4%	29%	-£0.11m
RM	SP	1.89	174.69	16.4	0.67	5,400.00	-1%	-3%	-£1.13m
Royalblue Group	SP	11.01	370.75	35.6	3.92	6,476.47	-1%	6%	-£2.05m
Sage Group	SP	2.65	3442.85	NA	3.68	101,730.77	2%	-2%	£52.07m
Sanderson Group	SP	0.54	22.58	NA	1.40	1,080.00	8%	10%	£1.67m
SciSys	CS	0.94	23.91	NA	0.94	728.68	1%	7%	£0.28m
SDL	CS	3.72	235.24	39.3	2.48	2,480.00	9%	58%	£23.08m
ServicePower	SP	0.13	10.54	NA	1.33	130.00	8%	-21%	£1.25m
Sirius Financial	SP	1.66	29.81	19.5	1.37	1,106.67	-2%	13%	£0.17m
SiRViS IT plc	CS	0.03	3.57	NA	0.45	26.09	-4%	-23%	£0.00m
smartFOCUS plc	SP	0.17	15.77	25.8	1.71	1,837.84	1%	11%	£0.23m
Sopheon	SP	0.20	27.05	NA	4.51	287.77	-20%	-11%	-£5.94m
Spring Group	A	0.64	108.46	21.9	0.27	711.11	2%	-7%	£7.67m
SSP Holdings	SP	1.42	102.12	NA	5.71	1,341.98	16%	18%	£14.33m
StatPro Group	SP	0.84	43.79	14.4	3.45	1,050.00	-2%	-19%	-£1.45m
SThree Group plc	A	4.71	664.68	23.4	2.74	2,286.41	8%	22%	£64.38m
Stilo International	SP	0.02	1.47	NA	0.64	40.00	0%	-16%	-£0.34m
Strategic Thought	CS	0.80	20.92	NA	1.82	590.41	-10%	-20%	-£2.22m
SurfControl	SP	6.59	188.85	65.8	3.30	3,295.00	39%	27%	£52.32m
Tadpole Technology	SP	0.05	21.11	NA	4.37	120.71	0%	400%	£1.51m
Tikit Group	CS	3.25	40.21	19.9	1.71	2,826.09	-2%	27%	-£1.57m
Total Systems	SP	0.40	4.21	18.9	1.21	754.72	0%	11%	£0.00m
Touchstone Group	SP	2.09	25.60	13.7	1.48	1,990.48	12%	17%	£3.18m
Trace Group	SP	1.31	18.60	14.7	1.30	1,048.00	52%	32%	£6.42m
Triad Group	CS	0.25	3.71	NA	0.09	185.19	0%	0%	£0.00m
Ubiquity Software	SP	0.37	75.39	NA	10.10	929.65	0%	85%	£0.00m
Ultima Networks	R	0.01	3.85	NA	2.02	24.39	0%	14%	£1.71m
Ultrasis Group	SP	0.01	19.88	NA	15.99	27.55	-9%	-5%	-£2.00m
Universe Group	SP	0.08	5.66	NA	0.13	355.56	-11%	-43%	-£0.99m
Vega Group	CS	2.75	55.98	18.6	0.90	2,254.10	7%	30%	£3.56m
VI group	SP	0.18	6.99	9.4	0.72	360.00	20%	26%	£1.40m
Xansa	CS	0.92	318.52	26.3	0.89	2,358.97	6%	6%	£15.63m
XKO Group (renamed Revenue Assi	SP	1.23	53.14	72.3	1.18	820.00	-1%	0%	£0.22m
Xpertise Group	CS	1.06	5.57	17.5	0.35	4,240.00	23%	162%	£1.01m
XploITe	CS	0.38	14.05	3.2	0.48	1,169.23	15%	15%	£14.05m

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 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

ACQUIRERS - THE SMALLER THE BETTER?

Samad Masood
Analyst

UK IT indices continued to slowly climb in April, with the Ovum S/ITS index once again ahead of the pack. Our S/ITS index rose by 5% in April (matching the growth in March), as compared to the 3.3% rises experienced by both the techMARK 100 and FTSE IT SCS index. In general the IT sector outperformed other sectors, with the FTSE 100 growing only 2.2%, the FTSE AIM up 2.9% and the FTSE small cap up 2.0%.

It is rare to have such a differing performance between the Ovum S/ITS index and the techMARK/FTSE IT SCS. Usually this is evidence of a trend affecting smaller and medium sized IT companies, which have a bigger effect on the average in the un-weighted Ovum S/ITS index. The difference we see today is probably due to the fact that the merger and acquisition activity that drives most share price growth these days is predominately affecting the share prices of small and medium sized IT companies.

Looking at four of the acquisition announcements that occurred in April, we can see how this has had an effect on the S/ITS indices in the month. For example, the largest S/ITS company to be involved in an acquisition in April was trading software specialist Royalblue group. It announced an agreement to acquire privately-owned LatentZero, also a specialist in equities trading, for £38m up-front plus £25m in earn-outs over the next two years. But by the end of the month its shares had fallen by 1%.

Figure 1 **Share price growth by market capitalisation for three acquisitive UK S/ITS companies in April 2007**

Source: Ovum

This compares with translation software and services specialist SDL International, which is almost £150m smaller in market cap than Royalblue. SDL announced it is to buy web content management solution provider Tridion Holdings BV for €69m (£47m) in cash, or around €53m (£36m) once cash held by Tridium is taken into account. Its shares were up 9% to £3.72 by the end of April. Even further down the scale we have XploITe (formerly Fujin) which bought Bristol-based Anix Group for a total consideration of £10.45m (£4.35m in cash, plus repayment of £6.1m of debt). By the end of April, XploITe's shares had jumped by 15% to £0.38.

Of course, this is a crude comparison, as there are many complex factors to take into account with each of these acquisitions, including their valuations, strategies, the sectors in which they do business, and their underlying financial performance. But the fact remains that if you invested £100 in XploITe and the same in Royalblue at the start of April, it would have been the smaller firm (and its smaller acquisition) that would have made you the best return. As M&A increasingly has an effect on S/ITS stock performance, its worth remembering the minnows out there – they may well provide the best returns.