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SYSTEMHOUSE

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

UK MARKET UPDATE: SUBTLE CHANGES AHEAD

By Phil Codling

Phil Codling
Principal Analyst

As SystemHouse readers will know, our research schedule accommodates two major re-assessments of our UK software and IT services forecasts each year – one in July/August, one in December/January. However, between those times the team does of course keep a close watch on the market and, based on the indicators we uncover, is constantly gauging whether conditions are set for a change.

In this context, we are currently at an interesting juncture. Since we released our last set of forecasts three months ago, a number of broader indicators and possible influencing factors have come to pass.

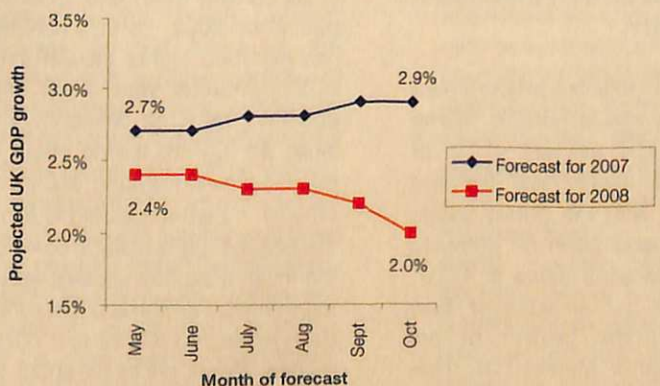
For example, we've seen a further downgrading of the UK's macro-economic growth outlook. HM Treasury's latest (October) round-up of independent projections now puts GDP growth for 2008 at 2.0%, compared to the 2.4% forecast as recently as June. Over the same period, the estimate for the current year has edged up from 2.7% to 2.9%.

Economy hits projects

On the face of it, 0.4% may not seem like a big forecast revision in GDP. It equates to about £6bn less new value being generated in the economy as a whole in the year than previously expected. But this inevitably has an effect on IT spend. Specifically, we expect to see private sector software and project services markets (i.e. systems integration and consulting), in particular, become tighter as we go into 2008.

When economic conditions become slightly less helpful and business profits come under more pressure, companies are, on average, less willing to spend on the types of new initiatives that tend to drive project spend. Suddenly that major customer service centre upgrade that

Figure 1 **Changes in the forecast for UK GDP since May**



Source: HM Treasury

[continued on page two]

Contents

ARTICLES

COMPANY RESULTS

REGULAR FEATURES

INDICES
(changes in October 2007)

Ovum S/ITS Index	**+0.97%**	**6220**
FTSE IT (SCS)	**+4.88%**	**629**
techMARK 100	**-3.49%**	**1631**

[continued from front page]

requires a big CRM project can look like a lower priority.

None of this change will be dramatic and neither the UK economy as a whole nor the S/ITS market is heading for anything like a recession. However, we feel that S/ITS providers would do well to bear in mind the likely swing of the pendulum over the coming months towards a more cost-focused customer agenda. To put some numbers against our outlook, we continue to expect a short-term fall in private sector project spending growth, with a drop from 3.7% in 2007 to 2.5% next year.

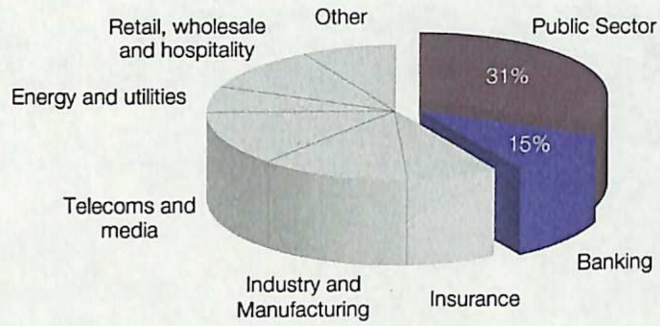
Financial crisis to make an impact

The financial services sector, the largest vertical within the commercial market for the UK's S/ITS providers, presents a particular and complex set of changeful circumstances. The crisis that started with defaults on sub-prime mortgages in the US and spread to financial institutions globally already sounds like old news. But in the S/ITS market, we are yet to see its effects fully.

Reporting on the July to September quarter, IBM said it was experiencing "weakness in Financial Services", with revenues "down year-to-year". IBM is always one of the first major S/ITS players to report its quarterly results, and we expect more indications of this type from other sector bellwethers in the coming weeks. Again, we expect project services to be affected, along with (as IBM found out) technology and systems spend.

These effects won't be confined to the US. Banks in the UK have reined in lending rapidly in response to recent events. Mortgage approvals were down by 20% year-on-year in September, for example. Not only does that contribute to the house price slowdown; it also means corporate activity levels are down in the sector, leading to less pressure to upgrade systems and less volume for mortgage processing services.

Figure 2 **UK S/ITS market in 2007 split by vertical**



Source: Ovum

More broadly, it seems clear that financial institutions are entering a more risk-averse phase, and indeed adopting a more conservative approach to pricing risk, all of which again tends to suggest less spending on new initiatives and the IT that supports them. Given that 15% of the UK S/ITS market is in the banking sector, the effect will be felt by many players.

Public sector budgets get squeezed

The much-heralded Comprehensive Spending Review (or CSR07) finally saw the light of day in early October. It confirmed that government departments, local authorities and the regions will be operating with more restricted budget growth in the years to 2011, compared to the first ten years under the Blair/Brown administration.

A focus on efficient procurement practices was a notable theme of the CSR as well. IT is of course a major cost element in these, with the public sector set to spend £9bn on software and IT services alone in 2007. You also get an idea of how important the growth of the public sector market has been to S/ITS suppliers when you consider that, just four years ago, that figure was only £6bn.

On the plus side, CSR07 underlined the growing impetus behind transformational government programmes, suggesting that policy is at last catching up with more of the benefits IT could bring to the functioning of government and its interaction with its "customers" in particular. Add to this the continuation of some major policy initiatives (not least ID cards, around which eight IT services suppliers were shortlisted last month), and it's clear that the public sector S/ITS market is not about to dry up. Nonetheless, we do expect growth to begin to drop off next year and to trend downwards for the rest of the decade (to reach 4% by 2011, compared to 11% this year).

A new phase in the market

All in all, the days of rising growth in the UK S/ITS market appear to be coming to an end. In every year since 2002, Ovum's analysis has recorded higher growth than in the previous year. 2008 and 2009 will be a bit different. And while we are still talking about a market growing around 6% year-on-year, it's worth bearing in mind this change, particularly in some of the major customer sectors we've highlighted. For some players that have prospered thanks to a rising market, things could be about to get rather tougher.

MARKET CONSOLIDATION: CONSEQUENCES FOR SALES

David Mitchell
SVP IT Research

The past three years have seen a remarkable degree of consolidation in global S/ITS markets, particularly on the software side. Global players such as HP, IBM and Oracle have made major acquisitions, with their total spend soaring into the tens of billions of dollars. At a more regional level, LogicaCMG, Sopra, TietoEnator and others have made strategic purchases. Within the UK we have also witnessed buoyant M&A activity, driven in part by the roll-up strategies of companies such as Maxima and 2e2.

The Pareto principle suggests that eight out of ten acquisitions fail to deliver the promised returns to shareholders. I have never been a fan of this rule, believing that properly managed M&A integration can deliver much better success rates. While not all of the M&A activity has generated immediate shareholder value there has generally been strong delivery. The stock performance of Oracle (where the share price is up 70% over the past two years) shows what a well executed M&A strategy can do. At a UK level, Maxima provides an illustration of the same point (with a share price rise of just under 100% over the same period).

Product strategy or sales strategy: which leads?

In the excitement of an M&A announcement, much interest focuses on the future of the product and services portfolio of the company. Questions such as 'Will you carry on developing all products in the future?' or 'Will you consolidate the portfolio of services that you provide and the staff base that provides them?' are all asked. Much less frequently asked are questions about the integration of the sales teams. Ovum thinks such sales integration issues have a major influence on whether value is ultimately delivered from M&A, no matter the scale of the operations. There are two strong arguments for this belief.

Firstly, a sales community that is uncertain about its future, which clients to target and (ultimately) how it will be paid soon loses motivation and revenue decline is inevitable. These issues need to be resolved within 30 days of an acquisition closing.

Moreover, a deficient sales integration will leave accounts unserviced, or with multiple account relationships – potentially with conflicting objectives. Again this will lead to a decline in revenue.

Sales model challenges: the multi-acquisition effect

The merger of two companies, each of which has different products, can result in a very simple sales integration. Simply put, both sales teams remain independent and continue to sell the products that they have always sold, but with an element of loose co-ordination. However, as companies make multiple acquisitions the questions become more complex and challenging, for example:

- how should accounts be segmented, such as between strategic accounts and others, and what is the sales model for each account segment?
- how should international and global accounts be managed?
- what is the role of the specialist sales representative versus the generalist account representative?
- should industry vertical be the prime axis or should it be product or service-line led?
- how can account teams be helped to co-operate rather than compete with each other?
- how does the balance of direct versus indirect sales get altered by the integration, and how can channel velocity be maximised?
- how can the cross-sell and up-sell opportunities be maximised, without a burgeoning cost of sales?

None of these are simple questions, and no single organisation that we have studied has produced and implemented a comprehensive and successful set of answers to all of them. If there is a best-practice model it is likely to be built from a hybrid of the lessons learned from many different post-M&A integrations.

However, as the pace of M&A continues, there is a pressing and growing need for some answers.

The single biggest question

The single biggest strategic challenge when integrating multiple sales organisations is that of sales commission. The single easiest way to destroy both actual and potential future value in an integration programme is to mess up the sales commission arrangements. Commission is the ultimate behavioural motivator for sales teams, and it can encourage the right behaviour or the wrong behaviour – if handled incorrectly. Focusing on designing commission schemes that maximise the ability to cross-sell and up-sell, that remove obstacles that stop revenue expansion and reward early growth is among the most important activities in any M&A integration effort, and the one that will deliver handsome returns when properly executed.

REVITALISE IT – WILL THE UK GET SKILLS RIGHT?

Samad Masood
Analyst

Shortages in IT skills have been an ongoing concern for UK plc for more than a decade. The response to date by the public and private sector has often been underwhelming. But last month, the latest initiative to spur skills development was launched by e-skills, marking a noteworthy step in the right direction.

Revitalise IT

Under 'Revitalise IT', companies including Accenture, Apple, the BBC, John Lewis, LogicaCMG, Microsoft and Vodafone will work with a number of universities (including Reading, Kent, Oxford Brookes, Greenwich, City and UCL) to support and strengthen the links between IT and education.

Focused on London and South East England, it will run until 2009. It aims to involve more than 40,000 students. The two "themes" of the initiative – "Ambition" and "Catalyst" – focus respectively on transforming the attitudes of young people to IT-related education and careers, and supporting universities in developing and promoting courses that reflect the needs of IT careers and employers.

Is it enough?

This is a really positive move because it is an attempt to co-ordinate the buyers, suppliers and educators in order to tackle the looming IT skills crisis faced by UK plc. It's taking a grass roots approach to transforming two key problems in the UK IT market – falling interest in technical and IT related courses, and the mismatch between the market's skills requirements and course content.

According to e-skills, while the IT professional workforce has almost doubled in the past 12 years from 550,000 to 1 million, the number of students choosing to take an IT-related degree has halved since 2001. In fact, the number of students who sat A-level Computing in 2007 was just 5,610. This was down 10% on 2006 (which was itself down 14% on 2005). The UK needs to encourage students back onto computing courses, and needs to be training them up into an employable state. Working in partnership with clients and vendors under Revitalise IT will surely help.

But there is a rather more immediate need for the industry – and it can tackle this by starting to focus further up the chain, at more senior levels. The IT Job Board reports that there has been a 35% increase in demand for project managers over the past year. This hits at the crux of the matter. It is senior talent and experience that is needed in the UK industry. CIOs we speak to report skills shortages around high-level architecture and design roles. The demand in the upper end of the market (i.e. CIOs and IT executives) is particularly strong, driven partly by the need for experience in specific verticals and their specific business priorities.

Interestingly, the demand for offshore resources is also indirectly creating a squeeze on more senior talent. Indian giants such as TCS, Infosys, Wipro and HCL are rapidly hiring and training staff in the UK to manage the onshore portions of their rapidly growing UK businesses. Their need for project managers, consultants and senior sales people is helping to stoke demand at the senior end of the market. Revitalise IT alone will not be able to reduce the pressure at this end of the market, at least not in the short-term.

Developing talent

The IT industry and market, not academia, must take a leading role to tackle this problem holistically. And the first place to look is inwards. Internal IT training can release a lot of potential locked away in organisations. It is also particularly effective at developing the holy grail within a senior IT employee – the ability to understand both business and technical issues. The UK already leads much of continental Europe in investment into IT training, but more needs to be done.

Quite simply, IT needs to be taken seriously within an organisation. Recognition of IT's strategic value to an organisation, and UK plc, should help to encourage both students and professionals to consider IT as a long-term career option. If IT is sidelined within an organisation then it's simply not going to be able to attract the brightest and best into its organisation.

Revitalise IT is a sign that UK plc is getting organised to tackle the challenges of the IT skills market in a flat world. But it can not do it alone. IT users, buyers and vendors must also contribute by re-shaping the standing and prospects of IT staff within their organisation.

UNISYS: FIND THE FOCUS, FIND THE GROWTH?

Kate Hanaghan
Senior Analyst

Under its "One Unisys" strategy, the $5.7bn US outsourcing firm is hoping to turn its fortunes around. By addressing problem points and sharpening its focus around offerings, customers and partnerships it plans to drive growth and leave its losses way behind.

Thus far, it has made notable headway. For example, it's cut back on non-core business, fixed 'pain points' (including its problem BPO contracts and expensive retirement plans) and reduced costs by shifting more work offshore. Generally, things are looking a lot more positive than they were this time last year, but there is a long way to go yet. Wall Street also appreciates this; the firm's share price currently sits slightly lower than a year ago.

The need for growth in services

What Unisys needs is revenue growth. In FY2007, it is likely to be modest (services revenues were flat in Q3) because declines in the hardware business continue to hold back overall growth. The overall numbers hide the fact that Unisys actually saw c10% growth in outsourcing in Q3 2006. Indeed, Unisys has been quite successful at signing mid-size infrastructure outsourcing deals in Europe, with notable new deals from the Belgian government, European Commission, German healthcare company BSN Medical, and Lux-Airport.

It's clear the problem area is the infrastructure services and maintenance business, where revenues declined. While these markets are generally tough and declining in parts, both IBM and HP have turned struggling businesses around (HP through its campaign to increase attach rates, and IBM with it productised services offerings). Unisys needs to do similar otherwise it will continue to see any gains in outsourcing and systems integration/ consulting wiped out.

Seeking sustained, profitable growth

So how does Unisys plan to achieve overall revenue growth and sustained profits? The company is in the throes of a strategy to reduce its cost base and become more focused. It wants to get more focused around the geographies it addresses (by focusing on 10 countries), around clients (focusing on its top 500 accounts), around alliance partners and around just five main offerings (outsourcing, enterprise security, open source/Linux, Microsoft services and solutions and real-time infrastructure). The end goal is to hit an operating margin of 8-10% in 2008 – which is ambitious given it's currently only hovering around the break-even mark. The use of global sourcing (in contracts such as the Ciba deal) is a crucial part of driving delivery costs out - but Unisys also intends to improve profits by fixing problem contracts and, of course, growing revenues.

Currently, contracts in the $10-$50m range are Unisys' bread and butter. But it is precisely these deals that are increasingly under threat from larger services firms who are pushing downwards into the mid-market. If Unisys is to achieve its financial objectives, it will need to ink more large deals that are run through a truly globally-sourced model. That is easier said than done – and will require Unisys to successfully hone its mega deal bid teams to be able to compete with those larger outsourcers who have more advanced global sourcing strategies.

What we're seeing in Europe (but certainly not in the US) is an increase in the number of larger deals on the table. But Unisys will face stiff competition from those larger suppliers who have suffered during a period of reduced mega deals and who are hungry to take full advantage of the market improvement.

We like the focused approach Unisys is taking and the recently-announced Ciba deal is evidence that it can win global deals. Our concern is whether it can ink enough of the right deals to accelerate growth and improve profitability.

Application outsourcing

But Unisys' strategy is not just about increasing focus. Like many infrastructure players, Unisys wants to push up the value chain and last year it developed a specific strategy around application outsourcing. It has 1500-2000 people working in this area, which covers development, support, maintenance, testing and operational services.

While the company's capabilities are not new, having a cohesive market strategy is. The approach is to focus on vertical applications around financial services, public sector, transport and telco (revenue is been split: one third financial services, one third public sector and one third combined consumer, telco, and transportation). So far, it says it's seeing "good traction". For example, in Europe it's signed a "sizeable" contract with the EU around tax.

Taking a step back from the strategy, there is another point to note. Unisys is a company with a market capitalisation that is roughly half its annual turnover. Its profitability is, however, improving. Does this therefore make Unisys a realistic acquisition target? Perhaps. But any buyer would have to be prepared to continue the recovery process for quite some time. And at the moment, that might just prove to be a deal breaker for many potential buyers.

STERIA REPORTS A SLOWDOWN IN UK AND FRANCE

For Q3, Steria reported growth of 3.3% to €308.3m compared to Q3 2006. By geography, France grew 1.8% year-on-year to €125m, the UK declined by 5.6% to €73.7m, followed by Germany, up 14.8% at €57.7m and the rest of Europe at €51.6m, up 9.5%.

Q3 saw a slowdown in revenues in Steria's core geographies of the UK and France. Steria claims that the sluggish growth in France was due to increased commercial selectivity, which forms part of its strategy to grow profitability. As a result, revenues from low margin sub-contracted business were 40% lower than in Q3 2006, particularly in the area of onsite outsourcing.

The drop in the UK business was pronounced when compared with a buoyant Q3 2006, as well as being due to Xansa integration costs, which are in line with expectations. As of 17 October, this acquisition was completed and since than it has been integrated into Steria. At the same time, Steria introduced a new management structure with two former Xansa senior executive directors being nominated as new Group Executive Committee members to reflect the newly acquired offshore and BPO capabilities. Steria expects the financial burden of the integration to be short-lived and forecasts growth during the remainder of the year in the UK.

Cornelia Wels-Maug

H2 SEES IMPROVEMENTS AT CHARTERIS

3%
17p

Business and IT consultancy Charteris released FY07 results showing revenues down 4% at £19.3m. Operating profit was £474k, down from £666k in FY06. Charteris's operating margin thus fell from 3.3% to 2.5%. Loss per share was 0.09p, compared to FY06 earnings per share of 0.25p.

But the full-year numbers don't tell the whole story. H1 revenues were down 17%, with an operating loss. But in H2, revenue grew by 11% year-on-year and 17% against H1. H2 also saw an operating profit of £600k, giving a margin of 5.7%.

Explaining this second half pick-up, Charteris is keen to highlight a mini "bubble" in the legal sector, where the firm has built an "IT expert witness" practice. H2 saw a number of such cases coincide, driving revenue and utilisation in this area. Still, going forward, we expect this niche service area to offer healthy - if somewhat unpredictable - growth prospects.

More broadly, Charteris is beginning to see the benefits of its decision to focus on three broad horizontal areas - customer centricity, integrated enterprise and infrastructure optimisation. This is helping Charteris win more business in some growing markets, particularly multi-channel retail (with Tesco and Game, for example) and Microsoft Dynamics AX ERP.

On the latter, Charteris's experiences offer further evidence of the growing acceptance of MS Dynamics. The firm says Dynamics is increasingly winning customers' favour, thanks to its speed-to-implement and ability to inter-operate with existing Microsoft software. One downside here is competition for skills. CEO David Pickering admits that the AX skills market is red hot, and also suggests this is one area where Charteris might look to acquire a smaller UK-based firm.

Overall, Charteris looks to be on an upward trajectory. We like the firm's improved focus and, stemming from this, its growing ability to offer repeatable offerings in targeted business areas. That's in tune with market needs and could help the firm to break (or at least weaken) the traditional link between adding staff and adding revenue, which in turn could help margins. The firm also has the advantage of operating higher up the decision-making chain (typically at CEO/CFO level) than some of its peers, suggesting it has the kinds of relationships that could serve it well in the slightly tougher market conditions that lie ahead for project services firms.

Despite the improving performance, investors appear unmoved. Liquidity remains very low and, with a market cap of just £6m (and an even lower enterprise value, given its £1.6m cash balance), Charteris really needs to get a few more investors interested in its improving story.

Phil Codling

BLINKX UPBEAT DESPITE LOSS

Five and a half months since its de-merger from Autonomy Corporation and floatation on the LSE's AIM, internet video search engine blinkx plc posted a net loss of $1.4 million for the period, but reported revenues ahead of forecast. The company also said it now has over 18.5 million hours of searchable content.

blinkx reported that gross profit for H1 2008 was $2.2 million, with a gross margin of 74%, on total revenues for the period of $2.95 million. The full loss for the period, including one-off, IPO-related and de-merger costs, was $12.9 million. The revenues were approximately 23% ahead of estimates, and reflect both the number of daily searches on blinkx growing by 280%, and the fact it has managed to attract the likes of ABC, BestBuy, General Motors and Nokia to contextually advertise alongside the video shown.

In our view, blinkx has moved rapidly during the period to establish a range of partnerships for content and to gain 'mindshare' for the area of video search. It reports it now has 225 media organisations allowing their audio, video and TV content to be indexed, including CBS, NBC, News Corp, CelebTV and Ministry of Sound. It has partnerships for media search with a range of providers, including Ask.com, RealNetworks, Infospace and MediaCom.

The daily average number of searches on blinkx.com was 4.2 million in September – that's hardly Google or Yahoo! level but a near tripling of activity in less than six months is still respectable.

The phrase 'content is king' says everything about the arena in which blinkx is competing. 18.5 million hours of content is a 160% increase over the period, but if the company is going to continue to grow it will need to keep the momentum on increasing content sources.

Mike Davis

TCS IMPRESSES AGAIN WITH SECOND QUARTER RESULTS

TCS, India's largest offshore IT services vendor, reported Q2 and first half results for the period ended 30 September 2007. Revenue (under US GAAP) grew by 26% to INR 56bn ($1.4bn) in the quarter, reaching INR 108bn ($2.6bn) for the first half. Operating income grew by 19% to INR 13bn ($333m) in the quarter and INR 25bn ($625m) in the half. Operating margins declined by 1.5 percentage points to 23.8% quarter on quarter, but only by half a percentage point to 23.4% in the half.

This was another impressive set of numbers from TCS, which this quarter passed the 100,000 employee mark, and grew UK revenue to 20% of its total. Continental European revenue growth has rocketed ahead as well, reaching $226m in the half, and outpacing UK revenue growth significantly (c55% vs. c40%). Europe and the UK remain the future growth drivers for TCS and its Indian rivals - something that is even more important given the concerns over the sub-prime mortgage crisis in the US.

That said, it seems that the sub-prime issue has not hurt TCS this quarter. Indeed, revenue from the financial services industry grew by 46%. Perhaps the crisis has yet to bite TCS (it has already affected other smaller Indian firms). But we also expect TCS to be resilient given that it remains a low-cost option, and it claims its exposure to discretionary spend in the US financial services sector is low.

More important in the long-term is TCS's gradual re-balancing of its business away from the traditional core application development and maintenance (ADM) business. The more project-oriented ADM business now accounts for just under 50% of all business, and in line with this, fixed-price deals have grown to 44% of all business (up three percentage points). Particularly of interest is the fact that business that brings TCS closer to its clients' strategic needs has also been growing very well. For instance, consulting is up 36%, BPO by 54%, and business intelligence by 46%. All this bodes very well for TCS as it tries to pull itself up the value chain and position itself as a strategic IT supplier to its large clients, rather than just the biggest low-cost option.

Samad Masood

-2%
203p

CIVICA PERFORMANCE IS "MEETING EXPECTATIONS"

Civica, the public sector-focused software and services group, reported "continued progress in profit growth and cash generation" in its pre-close update. Profits for the year to 30 September 2007 will be in line with market expectations and are underpinned by good cash generation from existing operations, Civica said. Restructuring costs from the VT Software Solutions acquisition and the subsequent aborted bid for Civica (by a private equity firm - believed to be Alchemy) will result in a one-off charge of £2.5 million.

It is good to see that the aborted bid for Civica and the inevitable distraction it will have caused have not had a significant impact on profitability. There is no mention of revenue growth in Civica's trading update, which suggests that revenues have not increased at the same rate as profits (if at all), but that is no real surprise. Operating margins have continued to improve thanks to Civica's strategy of focusing on its own software and associated services rather than the resale of third-party software. Software resale has traditionally accounted for a large proportion of its revenue from the education and health sectors, and this is now declining.

However, Civica has also found it harder to sell its own software into some areas of the UK public sector market recently: the management team noted softer demand for local government back office system replacements in particular. Civica will be hoping for continued success in other areas of the UK public sector - including in social housing, and with Building Schools for the Future projects in education - to counter tougher markets in its traditional local government and enforcement stomping grounds in the year ahead.

Tola Sargeant

TESSELLA TARGETS GROWTH AND DELIVERS IT

Privately-held IT services firm Tessella Support Services plc released its results for FY07 (to March). The Abingdon-based company, which focuses on software solutions for public sector and commercial R&D customers, grew revenue by 34% to £12.8m. Operating profit more than tripled from £290k to £1.06m. Earnings per share rose from £3.13 to £11.68.

It was the dramatic improvement in Tessella's growth performance that attracted our attention to this set of results. After a number of years in which it has been profitable but low-growth, the firm now appears to be seeing some real benefits from its growth acceleration strategy. So we spoke to Alan Gaby about the company's trajectory. Gaby was formerly the COO at Vega and is one of the directors brought into Tessella recently by founder, MD and main shareholder Kevin Gell to support the push for expansion.

Gaby confirmed a number of sources of growth for the firm. Firstly, there's the addition of Analyticon, a mathematical and analytical modelling specialist that Tessella bought in late 2005. We'd expect more acquisitions in this vein (i.e. of small, specialist firms) to come from Tessella.

But most of the growth is coming from organic means. A push into the US is helping. The offices in Boston and Washington now seem well bedded in and delivered £2.3m of revenue in the year, compared to just £900k in FY06. Meanwhile, Tessella is expanding its service range. Traditionally it has focused on delivering application development projects. As Gaby says, the company was good at "delivering and walking away". It's now seeking to consult on requirements (i.e. before the app development project) and work on apps support (i.e. after the app development), thus growing its sales potential with each customer. More generally, and to back up such service extension, we get the impression the firm is boosting its sales and business development capability in order to become more proactive with its customers.

The strategy is not exactly rocket science, unlike some of the software work Tessella does in highly technical environments in markets such as space/defence, life sciences and energy/chemical. But it is clear from this latest set of results that the firm has woken up to the opportunities around it and is executing well on its renewed growth ambitions.

Phil Codling

PROFITS FALL AT LOGICALIS

Logicalis, the acquisitive UK-based reseller and support firm, reported its results for the six months to end August (along with those of parent company Datatec, which listed in London a year ago). Logicalis's revenue grew by 28% in the period to $396m, with organic growth excluding acquisitions of 9%. Operating profit, however, fell from $8.6m to $3.3m.

The problems on profitability appear to stem from Logicalis's large US business. Having made five acquisitions in the last three years, Logicalis US found itself with too many salespeople, especially when it hit a "slower" Q2. Having shed 12% of its stateside workforce, the firm claims it can now deliver an improvement in EBITDA for the full year.

Meanwhile in the UK, things appear to have gone more smoothly. Particularly noticeable is the seven-year, £74m contract the company agreed with the Welsh Assembly government in October. The deal sees Logicalis building and supporting a broadband network designed to link up 5,500 public sites across Wales. It's an important step for the firm, not just in revenue terms, but also given the emphasis on longer-term, service-based business, as opposed to its traditional reliance on IBM and Cisco reselling.

Phil Codling

STRONG QUARTER FROM MICROSOFT IS GOOD NEWS ALL ROUND

Microsoft reported growth of 27% in total revenue to $13.8bn and 32% in operating income to $5.9bn in Q1 (to end September). Net profit was $4.3bn, a 23% increase.

The strong performance was seen across nearly all of Microsoft's businesses. Client revenue grew 25% year-on-year to $4.14bn, Server and Tools grew 16% to $2.90bn, Microsoft Business Division grew 20% to $4.11bn, Entertainment and Devices grew 91% to $1.93bn, and Online Services grew 25% to $671m.

A lot of attention has been focused on the growth of consumer revenue, from two sources: Entertainment and Devices, which is seeing a lot of success with the Halo 2 game, which in turn is boosting sales of Microsoft's Xbox games console, and the client division which has seen strong sales on the growth in consumer PCs and laptops. An interesting side issue here is that Microsoft says it has seen strong growth in client sales in BRIC countries (Brazil, Russia, India and China) which it attributes in part to lower levels of software piracy. EMEA was also strong, but Microsoft described the US and Japanese markets as 'recovering'. Overall it said it had sold 85m copies of Vista compared to 45m copies of XP during the equivalent period of XP's launch.

One market where Vista hasn't yet been a runaway success is the enterprise, where very few businesses have adopted Vista so far - Microsoft didn't produce an estimate. However, Microsoft CFO Chris Liddell said that an increasing number of companies are signing multi-year agreements with Microsoft that include the right to upgrade to Vista. As there are now three certainties in life - death, taxes and an upgrade to your desktop operating system - this seems a prudent move.

Microsoft did see good growth in both the Business division and in the Servers and Tools division - the latter has a big launch coming up in February of new versions of Windows Server, SQL Server and Visual Studio. One small disappointment was the growth rate of 'only' 18% in customer billings for the Dynamics applications group, which is part of the Business Division. Billings growth has been running at over 21%, though this is probably a minor and temporary blip.

The (even) bigger picture from these results is that this is not just good news for Microsoft. Almost all Microsoft's sales are indirect via partners, and it has by far the largest partner network of any software vendor, with partners of all shapes and sizes. But even beyond this, whether you love or hate Microsoft, when it is doing well, most of the rest of the industry will also be doing well.

David Bradshaw

GOOGLE PULLS EVEN FURTHER AHEAD

Google's revenues rose 57% to a total of $4.23bn in the quarter to September. Operating income was $1.32bn, 42% higher than a year ago. Operating margin was 31% of gross revenue. Net profit was $1.07bn, up 46%. Revenue from Google websites rose 68% to $2.73bn and revenue from partner sites rose 40% to $1.45bn.

As the numbers demonstrate, Google continues to pull ahead of its rivals. For example, despite new leadership, Yahoo! managed growth of just 12% year-on-year in its latest quarterly revenues.

Traffic acquisition costs (TACs) were slightly down as a proportion of revenue from partners, running at 84% of Adsense revenue. Yahoo! saw a slight rise in the revenue it paid out, so we still see fierce competition for partners caused by Microsoft gearing up its own partner programme.

All the same, Google continues to generate large amounts of cash, with $4.1bn added so far this year. Does this mean we can expect more acquisitions? Well, Google plans to spend $3.1bn on DoubleClick - provided the regulators on both sides of the Atlantic let this happen, by no means a certainty - and it has offered the FCC 'surety' of up to $4.6bn in the complex struggle over wireless net neutrality. The latter payment would not fall due until next year if at all, so by our reckoning Google still has plenty of acquisition capacity.

Business in "licensing and other sources", though only 1% of Google's turnover at present, is one of the key bets on the future and is growing strongly (up 60% in the quarter). We know that Google has major ambitions here, and continue to believe it will be a significant business over time - and an important source of revenue when Google's advertising revenue growth begins to match the growth of the overall advertising market.

David Bradshaw

14%
34p

InTechnology

INTECHNOLOGY ANNOUNCES INTERIMS AND DE-LISTING

InTechnology, the voice and data managed services provider, announced its interim results. In the six months to September, total revenue was £23.2m, or £13.7m excluding discontinued operations. Organic growth was 22%. Operating profit excluding discontinued operations was £1.0m, up £0.8m on H1 last year.

In his accompanying statement, CEO and majority shareholder Peter Wilkinson also outlined plans to de-list the company from AIM. InTechnology's shares rose 25% to 35p on the day of the announcement, in line with the price at which InTechnology is proposing to buy back its own shares.

Comment: The results are complicated by InTechnology's disposal of its reselling business (which accounted for 90% of turnover) in December 2006. But the bottom line is that the business is now functioning well as a more focused managed services provider, with growth looking strong in the year to date and operating margins beginning to pick up.

We can understand InTechnology's decision to go private. Despite this year's improving operational performance, its share price has disappointed. Before the buyback-induced rally, it was down 35% in 2007, compared to a 15% gain from the Techmark 100 over the same period. The fact that InTechnology will only need to spend a maximum of £8.5m (which equates to roughly one fifth of its current market cap) to repurchase its shares underlines the restricted free float and fundamental lack of liquidity that has contributed to the drift downwards. It's a common problem for smaller cap shares, particularly where employee/founder ownership is high.

InTechnolgy's ability to go private is boosted by its vastly improved cash position. Following the sale of its reselling business, it now has net cash of £15.5m, compared to net debt of £10.1m at the end of H1 of FY07. This means that it can afford to de-list without running up large debts and also forego the ability to raise money on the markets by issuing new shares. Not all smaller listed tech firms are in such a fortunate position.

Phil Codling

WIPRO STARTS BUILDING CONFIDENCE WITH Q2

Wipro has released its unaudited second quarter results for the period ended 30 September 2007. Revenue from its global IT services and products division (excluding Asia-Pacific) grew 19% to INR 32bn ($799m). Operating profit for this division grew 7% to INR 7.1bn ($177m). Within this division, IT services revenue grew 19% to INR 29.5bn ($730m) with operating profit up 7% to INR 6.5bn ($161m). Operating margins for IT services fell 2 percentage points to 22%. BPO revenue grew 22% to INR 2.8bn ($69m), with operating profit up 15%, resulting in a 22% margin - down 2 percentage points. Revenue from Europe (for Wipro's total business - including consumer care and lighting) grew 49% to INR 11.7bn ($290m).

Comment: This has been a good quarter for one of India's most diversified offshore IT services vendors. But as in the first quarter, Wipro's top and bottom line growth still lags behind that of TCS and Infosys - apart from in Europe where it has really shone. However, we've mentioned before why Wipro is becoming less of a comparator to its two largest rivals - due to differences in growth strategy and business mix - so we won't dwell on this issue. That is apart from saying that Wipro shares the same challenge of moving up the value chain and generating "non-linear" growth.

Wipro has shown some strong success in doing this already however. Over the past year and a half it has transformed its BPO operation from a focus on labour intensive call centre related work, into a business that sells more end-to-end back office solutions that are less labour intensive and don't expose it to the high competition and attrition existing in the Indian employment market. As such, profits are strong, and Wipro has proved it can rise to the challenge of moving up the value chain when needed.

Samad Masood

IBM Q3 AND THE SUB-PRIME MARKET

IBM posted its third quarter results in October. Revenues increased from $22.6bn to $24.1bn, a 3% rise when currency gain effects are removed. Net income also rose, moving from $2.22bn to $2.36bn - equating to an EPS increase from $1.45 to $1.68 per share. Gross profit margin fell marginally, from 42.0% to 41.3%.

Comment: The market always looks to IBM for signals about the overall health of the technology sector, as IBM is one of the most significant players in that market. As such, many were looking to see whether the issues in the US sub-prime market were going to damage the recent strong performance that IBM has shown. Although there are some real positives in the results, there are also some signals that the sub-prime issues have had an impact.

Global Services provided the highlight of the quarter, with 14% growth (10% after currency adjustments). Global Business Services and Global Technology Services each grew well, notching up 16% and 13% revenue growth. There is also a substantial services backlog for IBM to work through - an estimated $116bn - indicating that there is still considerable strength going forward.

On the minus side, there was a 10% decline in revenues from Systems and Technology. The biggest blow here was the 31% decline in System z server products. Two factors need to be kept in mind. First, this product line has a strong customer base in financial services, making its revenues more susceptible to issues in the sector. Clearly, the sub-prime problem has had an impact then, with financial services clients delaying new purchases. Second, the comparative quarter last year was strong, meaning that comparisons were always likely to be difficult.

Within Software the results are varied. Middleware products (WebSphere, Information Management, Tivoli, Lotus and Rational, primarily) grew 6%. They account for $3.6bn out of total software revenue of $4.7bn - still the majority of IBM Software. Beneath that headline the growth rates varied - Information Management (up 9%), WebSphere (up 10%), Tivoli (up 5%) and Rational (up only 3%). Stronger growth for WebSphere and Information Management is a reflection of overall sector strength around these areas. Likewise the relatively low growth in Rational is more a reflection of the overall market, rather than a reflection of IBM-specific issues.

David Mitchell

Mergers and Acquisitions – October 2007

Buyer	RM
Seller	SpaceKraft
Seller Description	Specialist education resources provider
Acquiring	100%
Price	£3.9m
Comment	This acquisition shows that RM is continuing to drive forward its strategy of building its position in a number of key educational markets. In May RM acquired DACTA, which supplies branded learning products to educational establishments in Europe. (It is, for example, the leading distributor for Lego Education). Last year RM acquired Music Education Supplies Ltd, a specialist music education supplier. The strategy, devised in 2003 in the wake of the BBC's decision to create BBC Jam, has served the company well. Involvement in specialist educational resources demonstrates RM's ability to find an education rather than IT focused solution to the sector's resource needs. However, in the wake of the BBC's decision earlier this year to suspend BBC Jam, RM has to decide how far it wants to build its position in non-IT areas of the educational market. At the moment RM seems to be succeeding in each of its chosen markets. But it must not lose sight of the fact that its involvement with Building Schools for the Future and management information systems in education has taken it into some highly competitive markets.

Buyer	Accenture
Seller	Corliant
Seller Description	Network integrator and Cisco channel partner
Acquiring	100%
Price	n/a
Comment	This has all the hallmarks of a typical Accenture acquisition. As with the George Group purchase and the H.B. Maynard deal it involves a small (150 employees privately-held firm with a clear specialisation. Such specialisation helps Accenture to slot the acquired operation into one of its vertical or horizontal business units. In Corliant's case, it'll join Accenture Technology Consulting. Accenture will thus aim to leverage the IP/Cisco expertise of Corliant's people across the unit. That said, we'd expect the initial impact on operations in Europe to be negligible, given Corliant's US/Asia focus. This deal underlines Accenture's drive to expand its technology consulting capabilities. The firm announced back in June that it would invest $250m in the area. The emphasis on infrastructure, and network specifically, is interesting too. At present, Accenture rarely goes for the sorts of enterprise network integration deals that the likes of Corliant, Dimension Data or indeed a telco would typically deliver. However, like other large IT services firms, it is acutely aware of the need to bolster its networking skills and capacity (especially in IP and convergent technologies) in order to support the IT and business processes that can only work with the help of the network. Meanwhile, we see an important opportunity for IT services players in the growing network integration market itself and expect them to become more and more active in this large and growing area, even if this is not Accenture's priority right now.

Buyer	BT
Seller	Net2S
Seller Description	Listed French IT and network consulting firm
Acquiring	100%
Price	€5.27 per share (which values Net2S at 68.5m)
Comment	Buying Net2S is financial small-fry for BT and the firm is hardly a prominent name in IT services. But the choice of France is interesting, since it's a market where BT already has a presence in consulting and SI, having bought the French operations of KPMG Consulting in 2002 to add to its (now-rebranded) Syntegra interests in the country. The addition of Net2S hardly delivers tier one status in France but it undoubtedly boosts scale and the range of capability BT can offer in that market. Secondly, and more generally, this proposed acquisition underlines BT's continued blurring of the lines between telecoms services and IT services. Under the "networked IT services" banner, it is building more and more capability to address the convergent areas of services and technology that rely on network infrastructure but have nonetheless tended to be seen as part of "IT". That doesn't mean it is about to take on IBM and EDS in large-scale ITO and SI (the NHS remains its "exception to the rule" in this regard) but it does mean that in the UK and further afield it is trying to chip away at corporate wallet share by expanding the range of services that it is able to sell.

Buyer	The Innovation Group
Seller	Nobilas Claims and Fleet Solutions
Seller Description	Claims management
Acquiring	From parent company, Akzo Nobel
Price	£590k
Comment	This acquisition further solidifies TiG's position as a pan-European specialist in insurance claims BPO, adding coverage in France, Spain, Netherlands and Belgium, to existing operations in the UK, Germany and US. Nobilas also more than doubles the volume of TiG's motorcare claims to 450k claims per annum, and spreads it from its traditional client base of insurers, into the rental, leasing and fleet management sector. This combination of a multi-national base with a niche focus on the claims servicing segment, backed up by an established software platform, gives TiG an edge that is lacking from many BPO and IT services players targeting this market. But TiG must turn Nobilas into a profitable business fast if it is going to convince investors that its asset-led BPO model generates consistent growth and profits. That said, with revenue growth at TiG rocketing ahead (30% in the first half of 2006), it shouldn't be too much of a problem to fill any extra capacity that Nobilas brings. All in all, it seems that TiG has done a pretty good deal considering the price.

Mergers and Acquisitions – October 2007

Buyer	Autonomy
Seller	Meridio
Seller Description	Search technology
Acquiring	100%
Price	$40.8m
Comment	Meridio is privately-held and Belfast-based, with 150 staff. It has US offices in Washington DC, Boston, and most notably a satellite research team based in Redmond. The latter is significant because it has a very strategic relationship with Microsoft, where it provides a Records Management (RM) 'back-end' to enterprise-scale SharePoint deployments. The biggest example of this is the UK Ministry of Defence with 340,000 licensed seats for the product. As with the acquisition of Verity, in Meridio Autonomy is gaining not only US DoD approved software, it is gaining security cleared sales and engineering staff, enabling further penetration into that lucrative market. The description of "technology infill" I believe is right, but completely minimises the potential of the acquisition. The recently-completed acquisition of Zantaz gave Autonomy a significant presence in email archiving - particularly for the financial services sector where eDiscovery for litigation purposes is an increasingly important factor - with US legislation such as SEC Rule 17a3/4, FRCP 2006, and of course the Sarbanes-Oxley Act. But archiving information is not Records Management, it does not offer the latter's functionality of having controlled disposal after a defined retention period, and the Meridio solution has standards approval for that functionality on both sides of the Atlantic - DOD in the US and National Archives in the UK. Meridio functionality makes an Autonomy offering delivering archiving, search/discovery, and certified records management in a single platform a very compelling proposition to the largest of organisations.

Buyer	Microsoft
Seller	Facebook
Seller Description	Social networking site
Acquiring	1.6%
Price	$240m
Comment	Much is being made of the implied valuation of Facebook of $15 billion. We think this is one time when simple arithmetic (240x100/1.6=15,000) is misleading. What really counts here is that Microsoft has tied down the advertising partnership with Facebook. Since it is one of the most rapidly growing web properties, this is a landmark deal for Microsoft which was a late starter in the syndicated advertising business. We also set aside thoughts that by taking a mere 1.6% stake, Microsoft has somehow 'locked out' Google from eventually taking ownership of Facebook. There's a very good reason why Facebook can't allow Microsoft to have a free-run: it would severely damage its valuation when it does eventually float. As my finance lecturer drilled into me at business school, the market for shares is a market for control. Our longer term concerns about Facebook are that it clearly has a way to go in its development, and this is one area that Microsoft may be able to both teach it and learn from it. Current use of sites like Facebook at work is more like social 'notworking' than networking, yet these tools clearly have a long term role in making organisations of the future get far more from their peoples' skills and knowledge.

Buyer	Sage
Seller	KCS
Seller Description	UK-based payroll firm
Acquiring	100%
Price	£20m cash
Comment	Sage's diversification of its slow-growing UK business through the addition of processing services continues. KCS follows the acquisition of another small payroll provider, Snowdrop, earlier this year, as well as online payments processor Protx in 2006. The attraction of such firms is not just that they help to dilute Sage's reliance on its traditional packaged accounting software market but also that they help to provide sales opportunities and "stickiness" for its other solutions. That said, Sage has rarely been content to operate as an also-ran in its markets. As things stand, it remains behind the likes of ADP, Northgate and Ceridian in the UK payroll processing/outsourcing market. Whether it will therefore step up its consolidation efforts (with a larger purchase in this area) remains to be seen.

Buyer	SAP
Seller	Business Objects
Seller Description	BI solutions
Acquiring	100%
Price	42 per share or around €4.8bn
Comment	Why is SAP buying Business Objects? Most obviously it is retaliation to Oracle buying Business Objects' competitor Hyperion, which specialised in adding financial and performance management tools for SAP systems. This is deeply uncomfortable for SAP. We therefore expect SAP to work with Business Objects - which only recently acquired performance management vendor Cartesis itself - to provide an alternative for its customers. Another factor is the business growth that SAP can get from the combination. Large suppliers are attracting ever larger shares of customer spend, as customers try to reduce the number of suppliers to bring some order to their IT buying. In some accounts, the purchase might turn SAP from being an 'also ran' into a strategic supplier. However, our experience is that SAP tends to be either a strategic supplier to its customers, or to have such a small footprint that it is barely on the corporate radar screen. But a much more important and longer term objective is what we call 'operationalising' the intelligence from the business data, and here Business Objects brings great breadth of BI and performance management capabilities to SAP.

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

	SCS Cat.	Share Price 31-Oct-07	Capitalisation 31-Oct-07	Historic P/E	PSR Ratio Cap./Rev.	S/ITS Index 31-Oct-07	Share price move since 30-Sep-07	Share price % move in 2007	Capitalisation move since 30-Sep-07
@UK plc	SP	0.09	3.21	NA	2.21	129.77	21%	-53%	£0.47m
Alphameric	SP	0.22	28.51	7.8	0.43	98.62	95%	-55%	£14.26m
Alterian	SP	1.33	58.47	24.0	4.18	665.00	6%	17%	£5.45m
Anite Group	CS	0.64	223.02	12.8	1.30	371.35	-12%	-22%	-£29.73m
Ascribe	SP	0.40	46.97	NA	8.78	2,105.26	-8%	3%	-£3.64m
Atelis plc	SP	0.03	0.75	NA	NA	139.53	-33%	-56%	-£0.38m
Atlantic Global	SP	0.14	3.21	61.7	1.50	474.58	-18%	4%	-£0.57m
Autonomy Corporation	SP	9.83	2066.91	104.9	16.11	299.91	14%	92%	£255.61m
Aveva Group	SP	11.54	777.42	43.9	11.80	5,770.00	26%	41%	£158.99m
Axon Group	CS	8.83	519.79	35.8	3.78	5,045.71	5%	45%	£2.63m
Belgravium Technologies Plc.	SP	0.11	11.33	NA	2.17	750.00	-12%	-13%	-£1.51m
Bond International	SP	1.89	61.98	14.2	3.60	2,907.69	3%	10%	£6.31m
Brady	SP	0.40	10.80	22.5	4.44	487.65	4%	8%	£0.28m
Business Control Solutions	CS	0.03	7.46	NA	0.93	440.00	-2%	-56%	£0.00m
Business Systems	CS	0.12	9.23	NA	0.27	100.84	0%	-4%	-£0.87m
Capita Group	CS	7.49	4487.70	32.8	2.64	202,469.86	3%	23%	-£5.50m
Cantono	CS	0.07	20.45	NA	2.85	1,281.82	-3%	28%	-£0.72m
Centrom	CS	0.01	2.61	NA	0.43	166.67	0%	-33%	£1.04m
Charteris	CS	0.17	7.10	24.6	0.80	183.33	3%	3%	£0.32m
Chelford Group	CS	1.49	10.64	145.4	0.57	259.13	4%	-11%	£0.43m
Civica	CS	2.03	127.89	12.0	1.21	1,159.69	-2%	-26%	-£2.44m
Clarity Commerce	SP	0.31	7.72	NA	0.58	248.00	-6%	-42%	-£0.38m
Clinical Computing	SP	0.03	1.00	NA	0.60	24.19	-25%	-57%	-£0.32m
CODA Plc.	SP	1.69	130.28	NA	2.44	1,044.75	-9%	4%	-£13.66m
Compel Group	CS	1.49	50.42	22.6	0.80	1,192.00	0%	26%	£0.00m
Computacenter	R	2.06	329.24	16.4	0.15	307.46	2%	-23%	£8.79m
Computer Software Group	SP	1.50	85.19	19.3	6.05	1,276.59	0%	23%	£0.00m
Corero	SP	0.08	3.76	NA	0.60	110.00	-21%	-43%	-£1.03m
Corpora	SP	0.07	14.74	NA	5.95	184.21	0%	25%	-£0.73m
Dealogic	SP	1.84	123.98	12.7	3.08	797.82	0%	17%	£0.05m
Delcam	SP	3.45	26.62	9.3	1.11	1,326.92	-8%	11%	-£1.77m
Detica	CS	3.33	385.75	33.4	2.47	4,162.50	7%	-9%	£25.48m
Dicom Group	R	1.92	163.61	16.4	1.02	588.60	4%	-18%	£5.71m
Dillistone Group	SP	2.22	11.88	NA	NA	1,626.37	-27%	52%	-£4.46m
Dimension Data	R	0.62	965.87	49.4	0.70	110.57	4%	45%	£49.46m
DRS Data & Research	SP	0.31	10.14	60.8	0.81	281.82	0%	-16%	-£0.09m
eg Solutions	SP	0.35	4.93	NA	0.91	234.69	-8%	-58%	-£0.43m
ELCOM	CS	0.02	8.28	NA	23.91	400.00	0%	-52%	£0.00m
Electronic Data Processing	SP	0.59	14.47	33.5	2.08	1,806.49	-12%	-9%	-£1.80m
FDM Group	A	1.28	29.72	14.3	0.67	1,570.55	-3%	37%	-£0.93m
Ffastfill	SP	0.09	31.95	NA	12.05	71.83	8%	44%	£8.61m
Financial Objects	CS	0.53	23.56	8.6	1.18	230.43	15%	-3%	£3.13m
Flomerics Group	SP	0.60	12.98	14.8	0.91	2,307.69	20%	-20%	£2.16m
Focus Solutions Group	CS	0.44	12.82	7.7	1.29	223.08	-5%	-10%	-£0.58m
GB Group	CS	0.24	20.24	NA	1.35	154.80	0%	-48%	£0.00m
Gladstone	SP	0.22	10.91	8.5	1.43	556.25	-3%	-13%	-£0.37m
Glotel	A	0.69	26.81	20.3	0.30	358.44	0%	10%	£0.00m
Gresham Computing	CS	1.16	61.44	140.9	4.39	1,250.00	8%	-21%	£4.62m
Group NBT	CS	2.27	56.95	18.5	6.78	1,132.50	-5%	9%	-£3.14m
Harvey Nash Group	A	0.67	48.17	10.2	0.19	380.00	-8%	-9%	-£3.99m
Highams Systems Services	A	0.07	2.19	NA	0.16	191.11	-2%	49%	£0.00m
Horizon Technology	CS	0.98	80.67	13.8	0.42	360.41	38%	42%	-£0.83m
IBS OPENSystems	CS	1.89	75.60	15.3	1.00	1,239.34	-1%	4%	-£0.80m
I S Solutions	CS	0.23	5.52	19.7	4.84	847.79	-1%	44%	-£0.08m
ICM Computer Group	CS	5.43	115.74	34.6	1.53	3,016.67	0%	88%	£0.00m
IDOX	SP	0.12	40.18	NA	2.84	15.08	18%	84%	£6.41m
Imaginatik	SP	0.04	4.37	NA	3.12	441.18	-41%	-56%	-£3.06m
In Technology	CS	0.34	48.60	NA	0.26	1,370.00	14%	-20%	£6.03m
InterQuest Group	A	0.99	29.72	NA	6.69	1,721.74	-7%	13%	-£2.28m
Innovation Group	SP	0.34	220.51	27.3	1.08	149.56	14%	10%	£26.56m
Intelligent Environments	SP	0.09	15.14	25.9	3.61	98.40	3%	48%	£0.08m
Intercede Group	SP	0.34	12.09	NA	4.85	558.33	-1%	-44%	-£0.18m
Invu	SP	0.29	24.40	14.7	3.76	3,078.92	6%	-3%	£1.46m
iSOFT Group	SP	0.69	161.04	37.2	0.89	627.27	1%	22%	£2.37m
iTrain	SP	0.02	2.11	NA	1.15	23.53	-11%	-11%	£0.00m
K3 Business Technology	SP	1.80	42.15	17.2	1.54	1,375.32	-4%	55%	£1.40m
Kewill	SP	0.92	74.47	50.6	1.79	1,813.24	8%	16%	£5.89m
Knowledge Technology Solutions	SP	0.01	3.96	NA	3.17	162.00	-19%	-50%	-£1.17m
LogicaCMG	CS	1.63	2375.63	20.4	0.89	2,228.84	8%	-13%	£123.94m
Lorien	A	0.99	18.44	41.5	0.12	990.00	0%	133%	£0.00m

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

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Macro 4	SP	1.71	37.75	5.8	1.14	687.50	-3%	-20%	-£2.43m
Manpower Software	SP	0.65	28.84	29.4	6.66	667.53	10%	149%	£2.56m
Maxima Holdings	CS	3.07	76.37	16.0	2.40	2,229.09	-1%	33%	-£0.62m
Mediasurface	SP	0.08	7.73	NA	0.80	569.85	-60%	-54%	-£11.46m
Micro Focus	SP	2.94	587.84	26.4	7.77	0.00	-2%	41%	-£9.19m
Microgen	CS	0.48	48.82	12.4	1.30	202.99	-1%	-13%	£0.06m
Minorplanet Systems	SP	0.33	10.64	8.0	0.45	673.88	27%	-41%	£3.14m
Misys	SP	2.42	1219.29	29.0	2.17	3,007.03	9%	12%	£106.23m
Monitise	CS	0.16	39.46	NA	0.08	103.33	-11%	-28%	-£5.07m
Morse	R	1.06	167.74	7.5	0.46	424.00	19%	-2%	£26.90m
NCC Group	CS	3.94	123.44	24.9	4.86	2,359.28	4%	41%	£0.00m
Ncipher	SP	2.62	44.12	NA	2.54	1,048.00	8%	3%	£3.53m
Netcall	SP	0.31	20.15	27.2	6.08	616.16	-2%	79%	-£0.00m
Netstore	CS	0.28	39.68	12.9	1.98	183.33	2%	-8%	£6.14m
Networkers International	A	0.35	32.24	NA	1.69	1,093.75	-7%	0%	-£2.30m
Northgate Information Solutions	CS	0.79	458.63	13.0	1.30	302.69	11%	-8%	£46.59m
NSB Retail Systems	SP	0.23	93.43	10.1	1.77	1,956.52	-13%	-34%	-£15.54m
OneclickHR	SP	0.04	6.14	NA	1.04	103.00	-18%	3%	-£0.74m
OPD Group	A	2.76	73.37	NA	1.68	1,255.68	-7%	-44%	-£5.91m
Parity	A	0.67	25.48	NA	0.16	620.37	-18%	-15%	-£5.63m
Patsystems	SP	0.26	46.09	33.9	3.01	242.99	-4%	51%	£1.10m
Phoenix IT	CS	3.93	292.68	17.7	2.31	1,455.56	3%	29%	£7.92m
Pilat Media Global	SP	0.46	26.93	11.2	2.07	2,275.00	1%	-44%	£0.58m
Pixology	SP	0.41	8.26	NA	1.83	291.60	-1%	43%	£0.00m
Portrait Software	CS	0.16	15.03	NA	1.04	101.77	-14%	3%	-£2.67m
Proactis Holdings	SP	0.69	20.83	NA	10.96	1,422.68	12%	9%	£2.26m
Prologic	CS	0.90	9.00	10.5	1.30	1,084.34	0%	6%	£0.00m
QinetiQ Group	CS	1.88	1224.69	18.9	1.06	857.63	8%	-2%	£67.20m
Qonnectis	CS	0.02	4.26	NA	38.96	533.33	122%	167%	£2.30m
Quantica	A	0.47	32.16	10.2	0.83	379.03	0%	54%	£0.00m
Red Squared	CS	0.10	2.76	NA	1.13	535.71	0%	50%	£0.00m
Revenue Assurance Services Plc	SP	2.02	90.84	27.8	2.03	1,346.67	4%	64%	£7.61m
RM	SP	2.04	188.98	17.7	0.72	5,828.57	6%	5%	£11.58m
Royalblue Group	SP	11.55	399.52	38.0	4.22	6,794.12	17%	11%	£57.17m
Sage Group	SP	2.42	3155.94	20.6	3.37	93,076.92	-3%	-11%	-£89.63m
Sanderson Group	SP	0.50	21.14	NA	1.31	1,000.00	-2%	2%	-£0.42m
SciSys	CS	0.47	13.24	NA	0.52	360.47	21%	-47%	£2.28m
SDL	CS	3.00	224.93	31.6	2.38	2,000.00	-10%	27%	-£25.11m
ServicePower	SP	0.17	15.18	21.8	1.91	170.00	-6%	3%	-£0.42m
Sirius Financial	SP	2.25	39.64	21.8	1.82	1,500.00	0%	53%	£0.00m
SiRViS IT plc	CS	1.79	5.91	9.0	0.74	1,556.52	-13%	4519%	-£0.86m
smartFOCUS plc	SP	0.16	14.38	26.2	1.56	1,675.68	-14%	2%	-£2.32m
Sopheon	SP	0.19	28.02	NA	4.67	276.26	7%	-15%	£2.18m
Spring Group	A	0.69	112.44	22.3	0.28	761.11	2%	-1%	£2.46m
SSP Holdings	SP	1.54	127.61	NA	7.13	1,452.83	5%	28%	£6.20m
StatPro Group	SP	0.96	50.91	16.7	4.01	1,200.00	7%	-8%	£3.43m
SThree Group plc	A	2.48	343.42	12.1	1.42	1,203.88	-15%	-36%	-£62.32m
Stilo International	SP	0.01	1.44	NA	0.63	27.60	-31%	-42%	-£0.06m
Strategic Thought	CS	0.53	13.78	NA	1.20	387.45	-9%	-48%	-£1.31m
SurfControl	SP	7.00	197.97	NA	3.46	3,500.00	1%	35%	-£0.53m
Tadpole Technology	SP	0.04	18.67	NA	3.86	105.74	44%	338%	£5.74m
Tikit Group	CS	2.79	35.66	17.1	1.52	2,421.74	-8%	9%	-£3.19m
Total Systems	SP	0.29	3.00	NA	0.86	537.74	-2%	-21%	-£0.05m
Touchstone Group	SP	1.69	20.42	61.8	0.68	1,609.52	-1%	-6%	-£0.52m
Trace Group	SP	1.55	22.09	17.4	1.55	1,240.00	0%	56%	£0.00m
Triad Group	CS	0.28	4.17	NA	0.10	203.70	2%	10%	£0.08m
Ubiquity Software	SP	0.37	75.39	NA	10.10	929.65	0%	85%	£0.00m
Ultima Networks	R	0.01	1.79	22.4	0.94	21.46	-12%	1%	-£11.51m
Ultrasis Group	SP	0.01	13.30	NA	10.70	20.41	25%	-30%	£4.55m
Universe Group	SP	0.08	8.89	NA	0.20	344.44	2%	-45%	£7.35m
Vega Group	CS	2.08	42.79	11.8	0.67	1,704.92	0%	-2%	£0.55m
VI group	SP	0.16	6.06	8.0	0.62	320.00	-6%	12%	-£0.18m
Xansa	CS	1.30	452.06	31.1	1.19	3,333.33	1%	50%	£3.56m
Xchanging	CS	2.71	573.20	NA	NA	887.07	-4%	-11%	-£21.15m
Xpertise Group	CS	1.32	7.04	22.9	0.44	5,280.00	4%	226%	£0.33m
XploITe	CS	0.44	17.39	NA	0.59	1,353.85	0%	33%	£0.00m

Note: We calculate PSR as market capitalisation divided by sales in the most recently announced financial year.
Main **SYSTEMHOUSE** S/ITS Index set at 1000 on 15th April 1989. Any new entrants to the Stock Exchange are allocated an index of 1000 based on the issue price. The Ovum Index is not weighted; a change in the share price of the largest company has the same effect as a similar change for the smallest company. **Category Codes: CS** = Computer Services **SP** = Software Product **R** = Reseller **A** = IT Staffing Agency

OVUM INDEX REFUSES TO BE SPOOKED IN OCTOBER

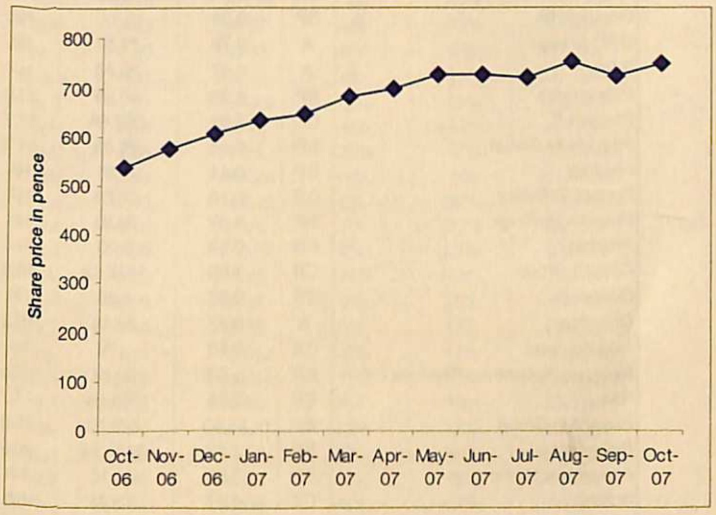
Kate Hanaghan
Senior Analyst

While October was an unremarkable month in terms of gains for Ovum's index of software and IT services firms, it was at least a month of growth – albeit just 0.97%. A 4.0% average increase for IT services firms offset the 5.4% decline experienced in the IT staffing sector to pull the index into growth overall.

Despite this, the Ovum Index was out-performed by both the FTSE (+3.9%) and the FTSE SCS Index (+4.8%). The techMARK 100 under-performed during the month and finished it down 3.5%.

The big contract news in October was Capita's loss of the congestion charge deal with Transport for London. Capita's share price fell by as much as 7% following the announcement and ended the day at 700p (down 5%). But by the end of the month it had recovered and indeed gained 3% on the previous month. Why so? In financial terms, Capita has two years to make up the c£60m in revenue and c£10m in profit that the CC contract currently contributes. Given its market leadership of a BPO space that continues to grow at c10% per annum, it certainly looks capable of doing so. Capita's loss is, of course, IBM's gain (which incidentally has seen its share price gain 18.5% in 2007); Big Blue's congestion charging experience in Stockholm clearly helped it to victory.

Capita's 12-month share price performance



At the other end of the size spectrum is Qonnectis (a provider of services to the utilities sector - including technology that automates meter readings and data collection). In October the tiny firm received a £198k order from Thames Water, doubling the value of shares to nearly 2 pence. This is hardly big fry, but it is at least the strongest the shares have been all year.

Alphameric, the gambling and hospitality sector software and services firm, also saw its share price almost double in October. Not a spooky coincidence – but the result of news that a number of third parties had expressed an interest in the firm. This comes as no surprise. Alphameric is going through very troubled times and has been ripe for takeover. Its share price fell 60% in one day (21 September) thanks to a profit warning and news of legal actions against its Amalgamated Racing Limited joint venture.

A big loser in October was Mediasurface, the web content management specialist. It warned that results would come in below market expectations for the year to end September 2007. Shares lost 60% of their value during the month as a result. In June, the value of shares hit a one-year high of almost 26p. But the company experienced its very own hellish Halloween with shares plummeting to 7.7p by 31 October.

Mediasurface is facing problems on several fronts. Its historic product Morello has seen a "difficult" second half thanks to the launch of Microsoft's Office Sharepoint Server. Secondly, its efforts to establish a customer base for its Pepperio hosted web content management service have not met with the success it hoped for. In addition, it has suffered as the financial services customers have tightened the purse strings in light of the US sub-prime crisis. To compound the situation, investor BlackRock cut its stake in the firm a few days after the initial announcement.