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SYSTEMHOUSE

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

THE MATURING OFFSHORE DELIVERY MODEL

By Samad Masood

Samad Masood
Analyst

The rise of offshore services provision to the UK market means that the distinction between offshore and onshore vendors is blurring. This is particularly the case amongst the larger IT services vendors who have invested in multiple offshore, nearshore and onshore operations. In this part of the market, the convergence between onshore and offshore vendors' business models is closer than ever. But what are the new challenges that both Western and Indian vendors are facing as the offshore model matures? Our latest research into vendors' best practices around offshore delivery has highlighted some of the new trends worth keeping an eye on.

Changing staff dynamics

The top end of the offshore IT services market is moving steadily away from the "body shopping" model, whereby clients pay by the number of IT professionals used, and towards a more solution-oriented model. This is driven by both push (vendor) and pull (client) factors.

The pull comes from clients demanding more solution-oriented and innovation-driven services from their offshore providers, the most experienced of which are rapidly becoming entrenched in their clients' core IT systems and increasingly responsible for business outcomes rather than just technical throughput. Meanwhile, the demand for IT skills in India (and increasingly other low-cost geographies) is so high that vendors are increasingly being forced to hire lower performing graduates just to make up the volumes required. This has led to a push on the part of the leading offshore vendors to move away from body shopping (where volume of skills is important) towards solution-focused services, where they can differentiate on domain expertise and quality of staff.

All of this is driving leading Indian players, such as TCS, Infosys, Wipro and HCL, to

Figure 1 **The emerging model for offshore sales and delivery**

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(changes in August 2007)

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techMARK 100	**+1.6%**	**1691**

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change their hiring patterns. Entry barriers for graduates are being raised, and the quality of new joiners is being scrutinised much more closely. Vendors are also looking to new disciplines and sectors for new and lateral hires. For instance, hiring ex-banking staff and training them up in IT skills. The resulting staff are much more domain savvy, and able to engage with financial services clients' needs and understand the technical challenges of solution design in equal measure.

While Western vendors continue their Indian offshore expansion, Indian IT vendors are now much more focused on hiring onshore staff in the UK and Europe. The result is that we hear increasing claims of reducing cost differences between hiring experienced UK employees and training up Indian graduates to work in the UK. It makes sense once you account for the fact that Indian graduates undergo at least 6 to 12 months of training internally before being released to clients – and by this stage they will still lack the domain expertise of their experienced onshore colleagues. And of course there is also the cost and administration overhead of travel and the all important visa to factor in.

A model for global distributed sales

Connecting client requirements with delivery capability across different time zones, cultures and countries can be a significant challenge to sales growth. To date, selling offshore bodies for straightforward IT projects has been possible within these limitations. But developing complex business-oriented solutions and deep client relationships is more challenging. And it's a challenge that must be overcome if IT vendors with offshore services capabilities are going to be able to build long-term and growing relationships with their onshore clients.

No longer can proposals and scopes of work be designed purely onshore and then "chucked over the wall" to the offshore teams to deliver on. The increasing demands from clients for high-quality services, and the growing pressure on offshore resourcing means that solutions developed by sales teams must correlate with the capability and availability of staff in the delivery centres. If not, vendors risk disappointing the customer.

The solution lies in building a collaborative structure across sales and delivery divisions globally. Vendors all have individual approaches to this, but we see a general model emerging across the industry (see Figure 1). This involves building three points of management control for each client engagement.

The account director focuses purely on the client, typically sitting exclusively onshore, building and managing the client relationship. Exclusively offshore is the delivery director, who is responsible for managing broader resourcing issues across one or more delivery centres. Often this will involve managing specific vertical focused delivery teams or centres-of-excellence. Delivery directors can also be responsible for ensuring cross-fertilisation between delivery teams in order to aid "innovation" in delivery processes or the solution design.

Finally, the project director is in charge of delivering a specific project to the client. They will typically travel back and forth between the client site and offshore delivery centres, and are the lynchpin between onshore relationship and offshore delivery functions. Project directors are regularly charged with growing the revenue line through cross-sales and upsales, and also by identifying areas where innovation can improve quality or efficiency of a solution or service.

Only the relationship stays onshore?

The sharing of sales responsibility between account and project directors is part of a larger shift of sales responsibility to offshore locations. For instance, many offshore vendors are basing more sales support work offshore. These teams can remotely research prospects and work with the offshore delivery teams to develop proposals before handing over to the onshore account director to "do the deal".

The ongoing shift in sales responsibility from onshore to offshore means that onshore account directors' impact on the sales number is being eroded. But this does not mean they are any less important. Clients need a single point of contact for their relationship, and most vendors accept that the best way to do this is through a dedicated onshore account manager. Additionally, within larger clients, the account director can also be the intermediary between the senior management teams of the client and vendor, and can highlight red-flags to delivery teams and vendor senior management.

In line with the shift in sales responsibilities within offshore businesses is a new drive to invest in tools that support collaborative global sales processes. Vendors are mainly investing in knowledge management and collaboration tools to support communication and knowledge sharing across distributed teams. One particular approach is the development of quote systems that can help salespeople automatically generate quotes for clients based on resource availability, client location and vertical sector – regardless of where the salesperson is sitting at the time.

The final lesson that we'd add is that transparency with the client is crucial. Maintaining clients' trust is vitally important – and more so when the bulk of work is being delivered from the other side of the world. And however a vendor chooses to structure their global delivery model, keeping the client in the loop and fully aware of who is responsible for what, from where, and for what reason, is an important step towards building this trust. As the global delivery model matures, clients must also do their part to push vendors on details of their delivery model and decide if that suits their own needs. The offshore question is rapidly shifting from "how much?" to simply "how".

POWER TO THE PEOPLE AND THE SEARCH FOR THE NEXT BIG THING

Richard Holway

My first twenty years working in IT was a wholly corporate affair. The first time I experienced "user power" was in 1986 when my salesmen wanted company mobile phones. But surely mobile phones were just for self-employed trades-people and would never be relevant in a corporate environment? I lost the battle, of course.

Since then I've seen user power increase dramatically – email, use of the internet at work, use of Google search and, in the early part of this decade, Google Desktop search, demand for laptops and then mobile connectivity. In practically every case, the corporate IT "powers that be" sought:

1. to ban it
2. to suggest that it was only of use to "young people" and certainly had no business relevance.

Time and time again, of course, they were proved to be wrong.

People are always asking me "What will be the Next Big Thing?". The internet has produced two NBTs already and is on the cusp of a third.

NBT#1 was the web browser. It made the web accessible to all and, although Netscape was the early winner, it was Microsoft who won the NBT#1 race.

NBT#2 was the monetisation of search. Yahoo! was an early winner. But NBT#2 seems to have been won by Google; now used everyday by 88% of internet users.

NBT#3 is often referred to as Web 2.0. It's really all about the "Me-Centrix" web. Early winners included MySpace and YouTube. But neither of these really went mainstream by breaking out of the sub-24 year-old user age group.

Facebook looks to many to be the site that finally takes social networking mainstream.

Facebook's growth makes the word "stellar" seem inadequate. It's less than a year since Facebook opened up to all comers and will boast over 50m users by the time you read this article. 41% of those users are over 35. It may irk some college students to find their mum on Facebook. But I'm afraid they might well find their grandmother there too!

YouTube's rise in value to the $1.65 billion paid by Google in October 2006 seemed exceptional at the time. But Mark Zuckerberg, the 23 year-old founder of Facebook, has already turned down an offer of $1 billion from Yahoo! and has seen Bear Stearns put a $6 billion value on his business. Many reckon it might be worth $10 billion within a year.

The reaction of the IT "powers that be" to Facebook is exactly the same as it always has been. Ban it!

The headlines this month are all about firms banning Facebook. At a recent IT conference I addressed, only 50% of the audience had even heard of Facebook and only 5% had a Facebook Profile. They clearly felt it was not relevant to them.

In the "interests of research", I have a Facebook profile and have collected many friends. 80% are business contacts and three quarters of those are over 40. Indeed my oldest Facebook friend is 69!

Employees from almost every company in the IT world now have Facebook groups. Microsoft has over 18,000 members. E&Y's has 16,000. Even BT has around 8,000.

The more forward-looking companies are starting to embrace Facebook to replace their corporate intranet employee forums. Indeed, if you are recruiting graduates, or any young skilled staff, they will expect you to have a Facebook presence so they can ask your current employees what it's like to work for you!

I have joined several Facebook groups relevant to my work and am finding them increasingly valuable. I can ask questions directly of other members and get top quality responses. Indeed, companies like Gerson Lehrman Group (GLG) have turned this into a business model which may well, in time, rival the established consultancies/ market research companies.

In an FT interview on 15 July, John Chambers, CEO at Cisco, said:

"The introduction of consumer-driven Web 2.0 technologies into businesses is set to usher in a new phase of productivity growth that could surpass that achieved during the late-1990s internet boom."

You need look no further for the Next Big Thing.

Power to the People is the title of Richard Holway's annual ICT Leaders presentation for The Prince's Trust where Richard is currently chairman of the Technology Leadership Group. Richard sits on the advisory Board of BT Global Services and Elderstreet and is a non-executive director of Regent Associates and RCM Technology Trust plc.

OVUM'S LATEST UK RANKINGS REFLECT INDUSTRY EVOLUTION

Phil Codling
Principal Analyst

We have recently published our annual UK software and IT services industry top 50 rankings. There's good news for EDS, which takes back the no.1 spot thanks to a year of MoD-driven growth.

Rank	Company	HQ	UK S/ITS rev, £m
1	EDS	US	2,700
2	IBM	US	2,590
3	FUJITSU	J	1,599
4	CAPGEMINI	F	1,450
5	CAPITA	UK	1,288
6	BT	UK	1,260
7	ACCENTURE	US	1,207
8	CSC	US	1,190
9	HP	US	1,019
10	MICROSOFT	US	887
11	LOGICACMG	UK	718
12	ATOS ORIGIN	F	696
13	ORACLE	US	668
14	SIEMENS	D	590
15	TCS	I	470

Source: Ovum

But the most striking recent success story in the upper echelons is Capgemini, which jumps to no.4 in the table. As recently as 2003, the French firm was on the verge of dropping out of our top 10 altogether. Its challenge now is to find another growth engine to replace its HMR&C mega-deal, which is beginning to mature and generate less growth for the business. EDS faces a similar issue: massive though they are, the DII engagements will not drive growth indefinitely.

Big names humbled

Two leading IT services firms stand out for their significant drop in revenue (and rank) in our latest rankings. Accenture's fall of 15% in its FY06 UK revenues can be attributed to the charge it took on exiting its two huge NHS contracts. Meanwhile Atos Origin suffered from a lack of new business, low consulting utilisation and the end of a handful of major contracts. Both firms, under new UK management, appear to be doing rather better in the current year.

Inorganic growth a factor, but not much big M&A

Many players in our rankings show the positive effects of acquisitions on growth. This is especially noticeable in the software industry, where Oracle has shown the way and the likes of Symantec and IBM Software also show inorganic revenue rises.

In the services space, players continue to avoid large, hard-to-digest acquisitions, opting instead for smaller, niche purchases that bolt easily onto the existing business. Capita exemplifies this strategy, and added 5% to its 17% organic growth in 2006 with a string of small-scale acquisitions. It continues to climb our rankings and remains no.1 in the UK BPO market by some distance.

Subsector leaders hold on

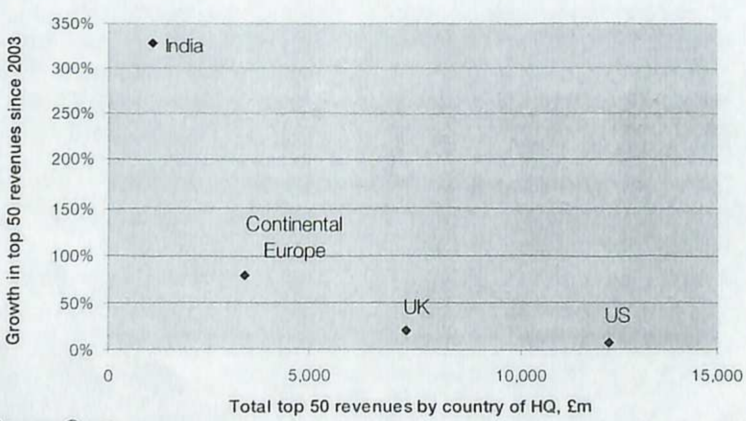
As for the other main S/ITS subsectors, our analysis shows that Microsoft continues to lead the UK software market from closest rivals Oracle, IBM and SAP. In the project services and app-led outsourcing segment, IBM Global Services is no.1, while EDS keeps its infrastructure services crown.

US giants losing share

Looking at changes in market share by country over time, it's the US that has really lost out. Its corporations have under-performed the UK market in the last three years and have consequently seen their share of top 50 revenue fall (from 54% to 47%). That's despite the acquisition-fuelled expansion of a number of major software firms and reflects the challenges that face large global outsourcers in a mature, multi-sourcing environment.

India on the rise, from a small base

As for the growing nations, India not surprisingly stands out. Driven by sustained demand for offshoring capability and lower prices, the country has tripled its share of top 50 revenues since 2003 and now has four representatives (TCS, Wipro, Infosys and HCL) in our rankings. But for all the growth of such players, it's worth noting that their market share remains pretty low - at just 5% of the combined revenues of the top 50. Indeed, Japan with just one representative in rankings -Fujitsu - still claims a bigger slice of the top 50 than India!



Source: Ovum

REGENT FINDINGS INDICATE TECH M&A IS 'PAST THE PEAK'

Kate Hanaghan
Analyst

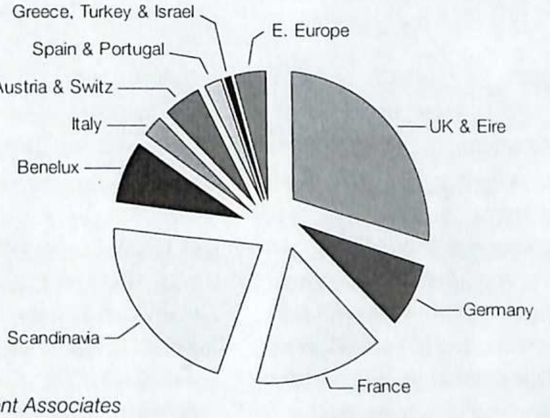
Findings published by Regent Associates indicate that M&A activity in the technology sector is slowing down. While activity (in terms of volume of deals) in H1 07 was roughly even with activity in the past couple of years, there was a decline in Q2 07 over Q1 07. In terms of value of M&A deals, there was a decrease from $221bn to $184bn.

In software and IT services specifically, the number of deals was down 10% Q1 over Q2. The number of UK S/ITS firms sold in the UK was down 8%.

Comment: For the last 24 months, M&A in the European tech sector has flourished. Activity levels have rivalled the dot-com era thanks to improving profitability in the sector, increased confidence of buyers (including private equity firms), and modest market growth (which has forced firms to look at acquisitive growth).

But across the whole of the European tech sector, and in the UK S/ITS market more specifically, there are signs that the tide is turning. Furthermore, compared with other sectors, S/ITS M&A is fairing the worse (see the chart for a comparison with telecoms and media). The issue is not that we are about to see a sudden halt to M&A activity, but rather a gradual slow-down. Within this trend, there will remain demand for companies that enable IT services firms to either move up the value chain, or create opportunities for cross-sale. A focused M&A strategy remains at the heart of the aims of many IT services companies as they look to improve their global presence, vertical sector expertise and offshore capability. Recent examples include Wipro buying Infocrossing (a US firm) and Steria targeting Xansa. So while we might see an easing of acquisitions as the year progresses, we certainly do not expect to see a large reduction in the short term.

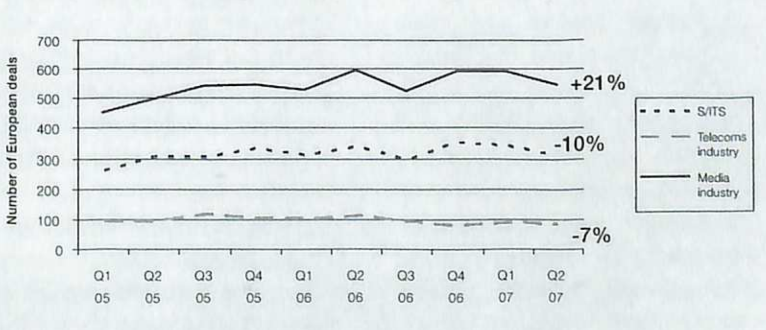
European buyers of S/ITS companies



Source: Regent Associates

In addition, it will come as no surprise that the private equity firms have been making their presence felt. The percentage of acquisitions they have completed in the tech sector as a whole has reached an all time high (16% of transactions). However, PE firms have done an awful lot of sniffing around and perhaps now view IT services as a less target-rich environment than they did say eighteen months ago. Moreover, the current situation in the credit market means their influence, although it will remain a factor, could be on the wane. Certainly this appears to be the case outside of tech, where the hunger for M&A has reduced.

A comparison of European acquisitions by industry



We would like to thank M&A specialists Regent Associates for the use of their data.

FUJITSU SERVICES LOSES GFI BUT WINS AT REUTERS

Kate Hanaghan
Analyst

We recently met with Fujitsu Services' CEO, David Courtley for an update on the company's strategy. Readers will be aware that the company recently inked a £500m, 10-year deal with Reuters, but lost in its bid to acquire French services firm, GFI.

Comment: Fujitsu's failed bid for GFI must be a bitter disappointment to management as the purchase would have given its Continental ambitions a real (and complementary) boost in capability and client relationships. We have criticised Fujitsu in the past for being too UK centric, and certainly this failure is a set-back. It has, however, made progress in other quarters, notably its recent deal with Germany's Allianz following the TDS acquisition. In addition, Fujitsu announced in August a £500m, 10-year global IT outsourcing deal with Reuters. Fujitsu will take on the role of prime contractor in a consortium of players including Dell, Satyam and BT. The scope of the contract includes desktop, data centre, network, and applications development and maintenance elements. The deal is not only significant because of its size, but also because it is global (17,000 Reuters employees in over 100 countries) and allows Fujitsu to leverage the assets of its Asian and North American sister companies.

Despite this, Fujitsu still faces some significant challenges, not least re-thinking its options post the failed GFI bid. In tandem, Fujitsu has a 'thin' global sourcing story. While it has been building capability in Russia (it has just under 1,000 people doing infrastructure and apps support work there), its presence in India is very thin indeed - based on partnerships rather than a direct presence following its disposal of its 30% stake in Zensar. It argues (rightly) that because it is weighted more so towards infrastructure services - with a large portion of UK revenues in the public sector - this has not been a significant problem thus far.

However, as it looks to expand into the application services market, it is going to need more weight in India, and the company recognises that. Courtley says he hopes to make progress on this front this year, and we suspect this will be via acquisition rather than organic expansion. Fujitsu needs to catch up with other US and European-based IT services players who have already made significant investments in their Indian capability, if it is to realise its ambitions to expand beyond its infrastructure services stronghold and public sector.

Fujitsu, which has demonstrated some impressive wins in the public sector, realises that it needs to boost its revenue from the commercial sector. It has been working at building out capability in financial services and retail, and we understand the pipeline for financial services is currently healthy (certainly the Reuters deal is a major boost for it in this sector). We see no change or evolution in the commercial strategy over the past nine months, and the company still aims to be a leading player in both sectors.

Fujitsu will find it challenging to loosen IBM's grip on the financial services sector, but it will be able to pick up contracts by emphasising its industrialised approach to outsourcing (Triole), particularly in desktop outsourcing and data centre services. Indeed, Fujitsu claims that by standardising these services, it has already been able to sustain margins (in the UK), implement services more quickly, and speed up its bid process. There is no question, however, that Fujitsu needs to move beyond its desktop heartland and deepen its capability in applications, consulting and BPO. We see green shoots here, for example the development of a consulting-led approach to F&A BPO, but much more needs to come, and a lot of the success in these service lines will be closely linked to its progress on global sourcing capability.

Overall, Fujitsu's approach has been cautious over the last few years, which to some extent has enabled it to avoid some of the challenges its competitors are now faced with. The question is whether it has been too cautious. We would argue that this is the case in certain areas - in particular its approach to expansion into mainland Europe. It needs to make some substantial headway this year in order to keep up with the moves fellow European players (such as Capgemini and Steria) are making to build out their offshore capability.

5%
319p

maxima

MAXIMA PUSHES MARGINS UP IN FY07

Software solutions and IT services firm, Maxima, has released its results for the year to end May 2007. Revenue is up 66% to £31.8m and operating margin improved from 17.5% to 19.7%. During the period the company made (and integrated) four acquisitions.

Comment: Maxima has registered good improvement on numerous fronts during the year. Firstly, it has pushed operating margin up, predominantly by raising utilisation (to +70%) and keeping costs tightly under control. Given that the firm has been acquisitive during the year, it is particularly encouraging to see it has been able to do this in parallel. Across the company's two business divisions - software solutions and managed services - profitability is roughly evenly split. Within the former, margins can be low, but are lifted by on-going support work. In managed services, good margins can be achieved (c20% net margin) if the support service is well run.

Maxima targets the mid-market, and is increasingly pushing its services downwards into smaller and smaller firms. The company's underlying growth is 8%, which sounds about right given that we view the mid-market as a relatively healthy area. We consider Maxima to be an attractive option for mid-market firms (anything in the £100m-£500m revenue range) as it can deliver on a wide range of capabilities: from enterprise software through to infrastructure support. For smaller firms, a supplier that is something akin to a "one-stop-shop", and has the capacity to engage in a way that perhaps the larger outsourcers cannot, is very attractive.

The current financial year shows signs of good health too, and we expect to see further progress - although there will be a limit to just how much further it can realistically push margins. What wouldn't surprise us is if a larger services or infrastructure firm took an acquisitive interest in Maxima. With its good financial performance and its strong position in the mid-market, we expect firms like Computacenter or Dell are watching closely.

Kate Hanaghen

EDS

EDS FAILS TO IMPRESS WITH Q2 NUMBERS

EDS has posted its Q2 numbers. Reported revenues of $5.45bn were up by 5% year-on-year, but up only 1% on an organic basis (i.e. stripped of the effects of acquisitions, divestments and exchange rate fluctuations). Operating income rose by 51% to $234m, raising EDS's operating margin to 4.3%. Net income rose 32% to $144m, while free cash flows more than halved at $156m, compared to $362m a year ago. Contract signings for the quarter were $4.3bn, down 20% compared to the same period a year ago.

Comment: Investors were not impressed with these numbers - sending EDS's share price down 3% - and neither are we. Current COO Ron Rittenmeyer, who takes over from Mike Jordan in September as CEO, projected an air of confidence in his ability to ensure EDS delivers on its growth and cash flow projections, but investors will take some convincing. The fact that EDS has reduced its full year free cash flow guidance by around 10% to $900m - $1bn clearly didn't help.

EDS is doing a number of things right. Its push into application services is well articulated and well supported, and will help it lift its margins once it starts to execute on the many signed deals and strong pipeline - application outsourcing accounted for 43% of its overall signings in Q2 while only 30% of its revenues. Its Mphasis and RelQ acquisitions are supporting this drive, and EDS talks about another 7-8 potential acquisition targets it is talking to in this space at the moment. EDS continues to sign a good number of sizeable deals, including the $1bn deal with KarstadtQuelle AG during Q2.

Fundamentally, we think EDS is yet to fully adapt to an environment of fewer mega-deals, growing customer preference to multisourcing, and ever more intense price competition. EDS has made some progress to adapt both its sales and delivery organisation to this environment, but the thin signings, low organic growth numbers and the still thin margins suggest that more needs to be done.

Angel Dobardziev

-37%
14p
MONITISE

MONITISE RELEASES FIRST RESULTS SINCE IPO

Mobile banking technology firm Monitise has released its first results since demerging from Morse and floating on AIM two months ago. In the year to June, the company doubled revenue to £470k and saw its operating loss deepen to £8.7m (FY06: loss of £3.3m). Following its IPO, which raised net £20.2m, the company had cash of £20.4m on its balance sheet at year end.

Comment: This is one small and growing company where the traditional revenue and profit metrics are still far from the most important indicator of performance. Monitise's IPO has given it a cushion of cash to invest in growing its business and developing its products in what remains a market space with great potential.

A better way to judge Monitise right now therefore is the growth of the network of mobile service providers and banks it is bringing together, and the growth in user numbers (i.e. how many people are signing up to use - and actually using - mobile phone-based banking services enabled by Monitise's technology). Thus far in the UK, the firm has signed up the seven mobile phone providers (i.e. the 4 big networks plus 3, Tesco and Virgin) and three banking groups (HSBC (inc First Direct), RBS (inc Natwest) and Alliance & Leicester). So it's on the banking side of things that the firm needs to ramp things up. That said, it already reckons 35% of all current account holders in the UK will have the option to access its services within a matter of weeks. And that's before any additional banks are signed up, something it says it is "confident" of achieving "in the coming months".

Phil Codling

6%
163p
logicaCMG

LOGICACMG'S EUROPEAN GROWTH OFFSETS UK LOSS

IT services vendor LogicaCMG announced an increase in first half FY 2007 revenues of 36.2 percent to 1.53bn ($3.07bn), up from 1.12bn ($2.26bn) for the same period in FY 2006. Pre-tax profits were up 9.0 percent at 29.2m ($58.8m) for the period, compared with 26.8m ($54.0m) the previous year. The interim dividend was raised 4.5 percent to 2.3 pence. LogicaCMG also announced that Deputy Chairman David Tyler will replace Chairman Cor Stutterheim, who is retiring.

Comment: On the face of it, LogicaCMG's results look pretty good, but they hide some less favourable aspects. In an update on trading published in July 2007, LogicaCMG indicated that organic growth was a more modest 3.3 percent.

On the bright side, LogicaCMG's European revenues are progressing well and it's still managing to increase profits in the region. The fly in the ointment is the UK, where H1 revenues declined 8.3%. LogicaCMG blames weakness in the UK commercial sector (its public sector revenues continued to grow) and the termination of a contract with Transport for London, which hit H1 revenues hard. But we think LogicaCMG has also taken its eye off the ball and has become over-reliant on the public sector in the UK. It needs to win more repeat business with existing commercial-sector customers, as well as winning more new customers.

LogicaCMG has had an eventful FY 2007 so far to put it mildly. Poor Q1 results forced the CEO to retire early - the company is still going through the process of finding a new CEO. There have been boardroom changes and the share price has languished. The company is UK listed so poor performance close to home is usually seized upon by investors.

LogicaCMG made the right moves in moving from a two-pronged Anglo-Dutch entity to the more European four-pronged strategy. It now needs to get a new CEO and team in place and to focus on three or four vertical markets and a handful of solutions in each, where it has or could have a leadership position.

Ian Brown

4% 28p patsystems

PATSYSTEMS IN DANGER OF MISSING THE PARTY

Patsystems has announced its interim results. In the six months to June, the AIM-listed provider of trading, risk and exchange systems grew revenue by 10% to £7.8m. Operating profit was up 49% at £580k, while increased tax charges meant EPS was in line with H1 of 2006 at 0.2p.

Comment: Patsystems' overall performance continues to improve. And for a company that is a relative newcomer to profitability, the improvement in H1 operating margin (to 7.4%, from 5.4% last year) is welcome. We also acknowledge that Dollar and Yen depreciation have taken some of the shine off the results, since US and Asian sales account for 60% of its turnover.

Nonetheless, we can't help feeling that the business should have been doing even better. Financial markets have proved favourable for many software and project services suppliers in recent times, thanks to the buoyant nature of global markets. However, this is a highly cyclical, market-driven IT spending environment. And the balance of the indicators in recent months suggests a tougher time ahead for both financial markets and the IT providers operating in them.

As a small player deriving most of its revenue from the typically volatile trading systems space, Patsystems is exposed to such downside risks. So while the firm has undoubtedly progressed and stabilised itself during the good times of 2006 and 2007, we think it may find the going somewhat trickier ahead.

Phil Codling

Capgemini CONSULTING TECHNOLOGY OUTSOURCING

CAPGEMINI IN THE UK: NEW REVENUE NEEDED

Capgemini recently announced its results for H1 2007. UK (including Ireland) revenues reached €1,174m in H1, up by 13% year on year and by 10% organically. Capgemini's operating margin in the UK reached 6.7%, up from 5.9% year on year.

Comment: The slowdown in revenues at Capgemini UK does not come as a surprise. As Nicolas Durfourq (CFO) mentioned during the analyst call, "Capgemini UK is about outsourcing". 80% of UK revenues are related to outsourcing. Capgemini has not signed a large deal in the UK for more than 15 months and the effect of the Aspire and Met Police contracts is now waning. HMRC/ Aspire, which accounted for 52% of the company's revenues in the UK, certainly is Capgemini UK's most blatant success - driving not only outsourcing work but also application development and consulting work in 2006. The challenge for Capgemini is therefore to find a new growth driver to balance the decline (estimated at €50 to €70m this year) in revenues from HMRC.

The company seems confident it can rely on other smaller outsourcing contracts to fuel growth (+16% excluding Aspire in Q1). The other good news is that Capgemini has been able to absorb its systems integration and consulting staff released from HMRC. Systems integration is up by 13% in H1 while consulting is flat. The company has reiterated the IT services business environment is favourable in the UK and it can rely on its good mix of services in systems integration, consulting services and Indian offshore.

Nevertheless, we are slightly concerned about Capgemini in the UK. If the operations in the country are so oriented towards outsourcing, then the key performance indicators are not so much year-on-year but sequential. What do the sequential numbers tell us? Well, sequentially the operating margin is under pressure (from 9.5% in H2 06 to 6.7% in H1 07) and revenue growth is slowing down. Clearly, this is a transition time for Capgemini in the UK and one quarter will not tell a full story given the size of the Aspire contract. Despite the fact that Capgemini has an improving offshore story and capabilities in project services, we feel that its recent lack of outsourcing wins could become a big issue for the company in the times ahead.

Dominique Raviart

-1%
102p

STATPRO USES ORGANIC GROWTH AND ACQUISITION TO BOOST PROFITS

Statpro, which sells analytical software and data services that enable global asset management companies to evaluate portfolios of financial instruments, has grown both revenue and profit in the six months to June 2007. Compared to a year ago, revenue rose by 79% to £11.3m, operating profit by 126% to £2.28m and net profit by 114% to £1.59m. Operating margin climbed to 20.2% from 12.4%. Cash generated by operations was up 48% to £2.89m.

Statpro has also announced that it is to buy Canadian competitor Initram Data, for up to C$3m (£1.41m).

Comment: So far Statpro has pursued a very smart acquisitions strategy that has reaped considerable benefits, not least profitably growing its revenue by 59% from acquisitions on top of 20% organic growth. It has increased its range of offerings, extending into the data services that feed into the analytical software. It is combining the existing and acquired capabilities in new ways, for example moving into complex asset pricing as the financial market dreams up ever more ingenious products, like derivatives and securitised debt.

Overall Statpro is doing well in combining the data services with its software and extending into software-as-a-service to supply smaller financial services companies with few internal IT resources. The bit that the company has to watch is the professional services piece - this seems to be only loosely connected to the other elements of the business and we think that has to change so that the professional services play a strong role in feeding the product business rather than vice-versa, because the product business has far higher margin potential.

David Bradshaw

ATOS ORIGIN UK LOOKS TO A BETTER SECOND HALF

We caught up with Keith Wilman, CEO of Atos Origin UK following the announcement of the company's H1 results in August. Revenue in the UK in the six months to June was down 4% and the operating margin fell from 5.1% to 2.9%.

Comment: My estimates suggest Atos Origin should deliver better UK numbers in H2 and should return some (albeit low) topline growth for the full year for the first time since the acquisition-fuelled growth witnessed in 2004. It needs to: over this period the firm, which once targeted a top three spot in the UK market, has slipped outside our UK top 10.

Wilman confirmed that revenues from newer contracts such as DCA and NFUM would start to have a bigger impact in the rest of the year, while H1 was the last time the loss of the significant Met Police contract had a negative impact on revenues. During his seven months at the helm of Atos UK, it's also clear that he's brought in a few changes. One bit of progress is the rising utilisation in consulting. Granted that's partly because the business has let go of some consulting personnel, but it's also because consultants are increasingly involved in bidding for and delivering outsourcing deals for Atos Origin. That said, utilisation remained below 60% in H1, so there is still plenty of room for improvement.

We also see Atos UK becoming more focused in the markets it addresses, with growing emphasis on some key verticals (health, transport, national security and the financial services sector), as well as horizontal services around ERP (principally SAP) implementation. These are necessary and bold bets, especially in financial services, where Atos UK remains one of the smaller players in the game. Given its win at NFUM, we expect it to focus on tier two and three customers, particularly where there is a low (or even non-existent) offshoring requirement. That's a market with a low level of outsourcing take-up and one where the likes of IBM, EDS and Accenture have typically struggled to win customers over. So the opportunity is clearly there.

Phil Codling

22%
115p

XPERTISE CONFIRMS FIRST HALF GROWTH

IT trainer Xpertise Group has posted revenue growth of 35% (to £10.6m) in the six months to June. Operating profit grew from £111k to £189k, with EPS up from 2.36p to 3.61p.

Comment: Xpertise has enjoyed a better first half, with some eye-catching topline growth. The core technical and professional training part of the business grew by 19%, a decent level of organic growth compared to a slight decline in 2006 as a whole. Xpertise has also benefited from the ramp-up of two large, managed contracts that kicked off earlier in the year - one with an unnamed government body and the other with Computacenter. The catch is that the company has needed to call on third party trainers to deliver these broad engagements, and this tends to hit the gross margin (which fell from 38% to 35% year-on-year).

Readers may recall the oft-quoted remarks of John Chambers of Cisco, circa 2000, that "Education over the internet is going to be so big it is going to make e-mail usage look like a rounding error". Sadly e-learning has never quite lived up to such hype, and firms like Xpertise have wisely opted for a blend of classroom (or "fully equipped training room") learning, backed up by online methods.

Phil Codling

HP REVENUES ARE CAPITAL

HP has announced strong Q3 earnings. Revenue was $25.4bn - a growth of 16% year-on-year. Net non-GAAP earnings grew from $1.5bn to $2.1bn. Non-GAAP EPS rose 71% to 71 cents and non-GAAP operating margin grew to 9%, against 7.6% a year ago.

Comment: HP's results were positive again - across all geographies and lines of business, with very strong organic revenue growth and margin improvement. A number of Hurd's priorities have been financial: ensure effective use of capital, establish a best in class cost structure, etc... Delivering these priorities has allowed HP to invest rather than achieve margin growth through cost cutting alone. This strategy means that there is still plenty of growth potential within HP. Several of the detailed line items within the results provide leading indicators.

Some day future MBA students will study the reinvigoration of HP that Mark Hurd has led. It is already a textbook case. However, the really interesting section of the case study will be the section written about the 2007 to 2010 period, and how the competition between HP and IBM evolved. Although operating expenditure control will, of course, be important, the absolutely differentiating factor will be the effectiveness of the capital investment strategy. M&A strategy will be important for both HP and IBM, with IP-led and market-penetration-led strategies both being significant. However, just as important will be the effective R&D investment of both organisations - focusing their guns on producing innovation that heightens their ability to use capital as an advantage, and further reduce the reliance on labour. Neither HP nor IBM will disappear but the one that manages its capital portfolio better will inevitably grow more quickly and overshadow the other in scale.

The resurgence of capital over operating expenditure in technology companies is important beyond the technology markets alone. Other IP-heavy industries, such as publishing and other professional services, are likely to feel the impact of that switch in the years ahead, although that change will be over a much longer term.

David Mitchell

Mergers and Acquisitions – August 2007

Buyer	**Wipro**
Seller	**Infocrossing**
Seller Description	Monaco-based provider of consultancy for the telecoms and media industries
Acquiring	100%
Price	$550m cash
Comment	This is one of the largest acquisitions made by an Indian IT outsourcer in recent times. Having built strong bases in application development and maintenance (ADM) services with many clients, all of the Indian IT services players are keen to achieve deeper penetration and larger share of wallet by expanding their service portfolio into infrastructure and business process outsourcing, and consulting services. So far this expansion has been done with a mix of organic and very small scale acquisitions, but this move by Wipro demonstrates the elevated boldness of the Indian firms to make much more aggressive moves that will deliver step increases in capability, resources and client credibility in these service lines. Discussions that we have had with a number of Indian firms suggest that we should expect similar moves by other Indian players in Europe over the coming months. Small to mid-sized players in the US and Europe should expect knocks on their doors in the near future. All of this suggests that both onshore and offshore consolidation in the IT Services space is set to continue in full swing. Indian outsourcers are demonstrating their willingness to play a much bigger part in it, as they seek to build fuller service lines and more rounded onshore capability sets - while many Western firms are racing to build or buy Indian offshore capability.
Buyer	**Mouchel Parkman**
Seller	**HBS**
Seller Description	London-based provider of back office technologylocal government BPO player
Acquiring	100%
Price	£46.2m
Comment	This move has created a new and potent force in the local government services market. We believe the combination of HBS' white collar BPO and IT services in areas such as SAP systems integration, revenues and benefits, customer contacts and back office administration will complement Mouchel Parkman's property, facilities management, highways, consultancy and waste management services. This broad array of service offerings should help Mouchel Parkman bid on more local government outsourcing mega-deals. The company has also stated that it wants to continue building up its S/ITS capabilities through investment in "value-added areas of IT consulting and outsourcing", and HBS helps here. HBS has been under pressure since it lost its £260 million contract with Bedfordshire County Council in 2005. Though few of the details are known, this rupture dented the company's reputation. HBS remained in the red, although losses had been cut from £9.1 m in 2006 to £5.4 m in 2007. Success at Oldham in 2006 with Mouchel Parkman was welcome news for HBS, but it also underlined the fact that the firm needed a strong partner in order to compete with other BPO players, and Capita in particular.
Buyer	**BT**
Seller	**Basilica**
Seller Description	SME-focused IT services provider
Acquiring	100%
Price	n/a
Comment	This is another piece of the growth jigsaw for BT: Basilica not only adds a welcome (if small) shot to its top line growth, but it also strengthens its capability and client base in the IT services space. BT still confuses many with its ICT strategy, in that it isn't always clear to see consistency in both its M&A moves and communication around ambitions in the IT services space. We have seen greater clarity from BT on this issue over the last year: when it comes to large multinational outsourcing deals, BT recognises that it will struggle to move far beyond its network infrastructure and service heritage. To this extent it began to build and develop a number of partnerships with IT services players, and in particular with HP. But in the mid-market space, which is largely untouched by large IT services players, BT sees many opportunities in providing converged ICT services, and this move is aimed to give a boost to this drive. It won't be easy: providing ICT solutions to the mid-market customers profitably remains a holy grail for large service providers, as their set-up remains unsuited to low spending, fickle customers which often prefer to deal with an organisation of similar (smaller) size. With a string of acquisitions of such players in both the UK and internationally over the last year or so, it remains to be seen how close BT gets to reaching this holy grail.

Mergers and Acquisitions – August 2007

Buyer	Steria
Seller	Xansa
Seller Description	Application services and F&A BPO
Acquiring	100%
Price	£472m cash
Comment	The acquisition of Xansa will strengthen Steria's presence in the UK. Despite €290m in 2006 UK revenues, Steria has largely been an infrastructure management player working for local government. Xansa is well-known in the UK for its work in application services and F&A BPO with the largest firms in the private sector, largely with banks, retail and utilities. Thanks to Xansa, Steria will therefore greatly improve its services range, and will jump from a ranking of 38 to a ranking of 15 among the largest S/ITS providers in the UK, with £580m in sales, after Siemens and right before Tata Consultancy Services. We think the timing of the operation is right. Xansa has a well-established offshore presence, and it now has a successful delivery model that blends onshore and offshore capability for its customers. Despite its tremendous reinvention, Xansa still has to increase its exposure to solutions and consulting in order to move away from direct competition with the Indian vendors. Steria's traditional and growing focus on solutions may help here. Finally, one of the great benefits for Steria is the 5,000 Indian headcount that Xansa brings to the deal. Steria had already engaged in setting up a presence in India and the Build Operate Transfer contract was to be finalised this year. Xansa will therefore accelerate the growth of Steria in India to a point where the French company has more Indian presence than players such as Atos Origin, Fujitsu Services Europe or LogicaCMG. Steria now needs to demonstrate that it can avoid attrition in India and make its Continental European clients use Indian offshore.

Buyer	K3
Seller	Lansteinar Nederland
Seller Description	Microsoft-based retail solutions
Acquiring	100%
Price	£9.87m in cash and shares
Comment	K3 has put itself firmly behind the Microsoft Dynamics platform after selling off its non-MS based product, Elucid, to Sanderson earlier this year. And Landsteinar, which distributes Microsoft-based retail solutions to 40 customers in 12 countries, complements this strategy. With turnover of €6.1m and profit before tax of €2.2m for the year ended 31 December 2006, Landsteinar should tip K3's revenues over the £30m mark this year, and the directors of K3 expect the acquisition to be immediately earnings enhancing. K3 is one of many mid-size UK S/ITS companies getting more involved in consolidating the market with a "buy and build" strategy. Like the infamous Torex Retail before it, it's taking a vertical approach, bringing together businesses that help it create a depth of understanding in retail. But unlike Torex Retail, K3 is not hedging its bets behind a range of different legacy and current product sets. K3 has staked its claim in the Microsoft world and is sticking to it. Conversely, Torex (regardless of the issues being investigated by the serious fraud office) was always going to face the enormous challenge of integrating its go-to-market message and competitive positioning, even if it never got round to the even bigger headache of technically integrating its platforms. Microsoft's Dynamics product set is starting to blossom now as more mid-market companies look to it as a credible ERP system. And as interest in the platform grows, we will see more companies like K3 take decisions about committing to a single or multi-vendor ERP suite strategy. Our advice has always been that business focus leads to growth in the UK S/ITS market, and therefore we'd tend to favour K3's approach. But this does not mean a multi-platform strategy is unworkable. Indeed, with strong management a horizontal or multi-platform buy-and-build strategy can work very well. Whatever the choice for S/ITS firms, in the current "buy or be bought" atmosphere, this is not the time to be sitting on the fence.

Buyer	IBM
Seller	WebDialogs
Seller Description	Web conferencing and comms services
Acquiring	100%
Price	n/a
Comment	The unified communications market is certainly hotting up. This acquisition is undoubtedly IBM's response to Cisco's purchase of WebEx which disappointed IBM on two counts: IBM itself had been eyeing up WebEx for purchase and it regarded Cisco as a key Sametime partner who was now moving into IBM's space. With the acquisition of WebDialogs, IBM is adding a much needed software-as-a-service delivery model to the Lotus Sametime family of products. This will expand IBM's offerings in the Web conferencing space, particularly for the small-to-medium-sized business (SMB) segment and departments within larger organisations.

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

	SCS Cat.	Share Price 31-Aug-07	Capitalisation 31-Aug-07	Historic P/E	PSR Ratio Cap./Rev.	S/ITS Index 31-Aug-07	Share price move since 31-Jul-07	Share price % move in 2007	Capitalisation move since 31-Jul-07
@UK plc	SP	0.10	3.59	NA	2.47	152.67	-23%	-44%	-£1.32m
Alphameric	SP	0.32	41.77	11.4	0.63	146.79	-1%	-33%	-£0.99m
Alterian	SP	1.46	61.68	26.4	4.41	730.00	-13%	29%	-£11.96m
Anite Group	CS	0.80	282.54	16.1	1.64	467.84	-5%	-2%	-£13.90m
Ascribe	SP	0.40	45.95	NA	8.59	2,078.95	4%	1%	£2.51m
Atelis plc	SP	0.05	1.19	NA	NA	220.93	-5%	-30%	-£0.06m
Atlantic Global	SP	0.17	3.89	74.9	1.82	576.27	-13%	26%	-£0.58m
Autonomy Corporation	SP	9.27	1949.09	96.1	15.19	282.97	11%	81%	£195.65m
Aveva Group	SP	9.29	625.50	35.3	9.49	4,645.00	-1%	14%	-£5.75m
Axon Group	CS	7.42	457.33	30.1	3.33	4,240.00	-7%	22%	-£12.72m
Bond International	SP	2.11	64.21	19.2	3.73	3,246.15	-2%	22%	-£1.37m
Brady	SP	0.56	14.60	23.1	6.00	691.36	1%	53%	-£0.56m
Business Control Solutions	CS	0.04	10.18	NA	1.27	600.00	-12%	-40%	-£1.36m
Business Systems	CS	0.12	10.10	NA	0.29	100.84	-8%	-4%	£0.11m
Cantono	CS	0.09	26.54	NA	3.69	1,636.36	-10%	64%	£11.26m
Capita Group	CS	7.51	4643.31	32.8	2.73	203,010.50	4%	24%	£186.41m
Centrom	CS	0.01	1.57	NA	0.25	166.67	11%	-33%	-£0.31m
Charteris	CS	0.18	7.64	17.3	0.86	200.00	0%	13%	-£0.10m
Chelford Group	CS	1.53	10.93	149.3	0.59	266.09	-13%	-9%	-£1.57m
Civica	CS	1.97	123.91	12.5	1.17	1,125.41	-23%	-28%	-£38.06m
Clarity Commerce	SP	0.36	8.84	4.9	0.66	288.00	-22%	-33%	-£2.62m
Clinical Computing	SP	0.04	1.45	NA	0.88	32.26	-20%	-43%	-£0.21m
CODA Plc.	SP	1.77	135.86	NA	2.54	1,089.51	7%	9%	£9.24m
Compel Group	CS	1.49	50.42	22.6	0.80	1,192.00	0%	26%	£0.00m
Computacenter	R	1.80	287.28	14.3	0.13	268.66	-13%	-33%	-£45.55m
Computer Software Group	SP	1.50	85.19	19.3	6.05	1,276.59	0%	23%	£0.00m
Corero	SP	0.11	5.13	NA	0.81	150.00	-8%	-22%	-£0.45m
Corpora	SP	0.06	12.32	NA	4.74	157.89	20%	7%	£1.05m
Dealogic	SP	1.85	128.77	12.4	3.20	804.34	8%	17%	£8.30m
Delcam	SP	3.83	23.62	11.5	0.98	1,473.08	-7%	23%	-£8.17m
Detica	CS	3.15	364.32	31.5	2.34	3,937.50	-14%	-14%	-£60.82m
Dicom Group	R	1.71	151.86	20.8	0.95	524.22	3%	-27%	£4.68m
Dillistone Group	SP	2.98	16.07	NA	NA	2,179.49	40%	103%	£4.59m
Dimension Data	R	0.56	862.50	43.2	0.62	99.47	-1%	30%	-£17.19m
DRS Data & Research	SP	0.30	9.81	58.8	0.79	272.73	-10%	-19%	-£1.14m
eg Solutions	SP	0.44	6.29	NA	1.16	299.32	-2%	-46%	-£0.14m
ELCOM	CS	0.02	6.54	NA	18.88	400.00	0%	-52%	£0.00m
Electronic Data Processing	SP	0.67	16.39	38.0	2.35	2,051.44	-9%	4%	-£1.71m
FDM Group	A	1.25	29.03	14.3	0.65	1,533.74	-16%	34%	-£5.34m
Ffastfill	SP	0.07	21.86	NA	8.25	58.33	-10%	17%	-£7.30m
Financial Objects	CS	0.60	26.65	8.0	1.34	260.87	3%	10%	£0.65m
Flomerics Group	SP	0.52	11.14	10.4	0.78	2,000.00	-4%	-31%	-£0.54m
Focus Solutions Group	CS	0.48	13.99	8.4	1.41	246.15	-10%	-1%	-£1.77m
GB Group	CS	0.27	22.82	NA	1.52	174.15	-7%	-41%	-£1.63m
Gladstone	SP	0.23	11.87	8.7	1.55	575.00	-3%	-10%	-£0.52m
Glotel	A	0.69	26.81	20.3	0.30	358.44	1%	10%	£0.29m
Gresham Computing	CS	1.25	63.06	151.8	4.51	1,344.09	1%	-16%	£0.63m
Group NBT	CS	2.86	71.91	25.6	8.56	1,430.00	3%	38%	£1.88m
Harvey Nash Group	A	0.72	51.93	11.0	0.21	411.43	-8%	-1%	-£4.87m
Highams Systems Services	A	0.06	1.91	NA	0.14	166.67	3%	30%	£0.04m
Horizon Technology	CS	0.63	52.33	13.3	0.27	231.69	5%	-9%	-£3.55m
IBS OPENSystems	CS	1.92	76.80	15.6	4.92	1,259.02	-1%	5%	-£1.00m
I S Solutions	CS	0.23	5.64	19.7	1.02	857.10	5%	46%	£0.29m
ICM Computer Group	CS	5.43	115.74	34.6	1.53	3,016.67	0%	88%	£0.00m
IDOX	SP	0.10	35.05	NA	2.48	12.83	-5%	57%	-£0.85m
Imaginatik	SP	0.07	8.56	NA	6.11	868.24	-2%	-13%	-£0.19m
In Technology	CS	0.31	43.28	NA	0.23	1,240.00	-1%	-28%	-£1.06m
InterQuest Group	A	0.98	29.02	NA	1.05	1,695.65	-13%	11%	-£3.70m
Innovation Group	SP	0.32	206.03	25.5	3.38	139.74	-5%	2%	-£11.27m
Intelligent Environments	SP	0.09	14.66	25.3	4.70	95.74	-6%	44%	-£1.09m
Intercede Group	SP	0.40	14.44	NA	8.00	666.67	10%	-33%	£1.27m
Invu	SP	0.28	31.58	NA	4.87	2,921.03	-13%	-7%	-£1.98m
iSOFT Group	SP	0.69	159.25	36.8	0.91	627.27	6%	22%	£8.13m
iTrain	SP	0.03	2.11	NA	1.15	29.41	0%	11%	£0.00m
IX Europe	CS	1.39	251.85	NA	6.75	4,557.38	-1%	184%	-£1.35m
K3 Business Technology	SP	1.53	33.25	14.6	1.22	1,169.02	3%	32%	£0.85m
Kewill	SP	0.86	69.39	47.2	1.67	1,699.60	-4%	9%	-£3.04m
Knowledge Technology Solutions	SP	0.01	3.66	NA	2.93	200.00	-13%	-38%	-£0.16m
LogicaCMG	CS	1.63	2440.10	20.4	0.91	2,232.26	6%	-12%	£95.29m
Lorien	A	0.99	18.44	41.5	0.12	990.00	22%	133%	£3.26m

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Macro 4	SP	1.98	43.89	7.5	1.33	798.39	-2%	-7%	-£2.97m
Manpower Software	SP	0.53	23.61	24.1	5.45	546.39	-18%	104%	-£5.34m
Maxima Holdings	CS	3.19	77.81	16.7	2.45	2,320.00	5%	39%	£1.69m
Mediasurface	SP	0.21	20.26	NA	2.10	1,525.74	-14%	22%	-£2.92m
Micro Focus	SP	2.91	582.51	25.4	7.70	0.00	-3%	40%	-£18.02m
Microgen	CS	0.47	48.25	12.3	1.28	200.85	-1%	-14%	-£0.25m
Minorplanet Systems	SP	0.28	8.07	6.8	0.34	571.78	-19%	-50%	-£3.05m
Misys	SP	2.31	1160.83	27.6	2.06	2,873.91	-4%	7%	-£46.53m
Monitise	CS	0.14	33.10	NA	0.07	627.91	-37%	-37%	-£5.00m
Morse	R	0.95	149.07	11.2	0.41	380.00	-3%	-12%	-£3.94m
NCC Group	CS	3.60	117.41	22.7	4.62	2,155.69	-3%	29%	-£4.24m
Ncipher	SP	2.14	61.38	11.3	3.53	856.00	-7%	-16%	£22.89m
Netcall	SP	0.30	19.65	54.9	5.93	606.06	0%	76%	-£0.17m
Netstore	CS	0.26	32.29	NA	1.61	173.33	-24%	-13%	-£16.77m
Networkers International	A	0.39	35.46	NA	1.86	1,203.13	0%	10%	£0.00m
Northgate Information Solutions	CS	0.73	422.19	11.9	1.20	280.77	-8%	-15%	-£37.80m
NSB Retail Systems	SP	0.27	110.01	11.6	2.27	2,347.83	-6%	-21%	£0.55m
OneclickHR	SP	0.05	7.44	NA	1.26	125.00	-11%	25%	-£0.92m
OPD Group	A	3.77	100.00	NA	2.29	1,711.36	-7%	-23%	-£7.57m
Parity	A	0.83	31.48	NA	0.20	768.52	1%	6%	£0.19m
Patsystems	SP	0.28	45.38	35.9	2.97	261.68	4%	62%	£0.48m
Phoenix IT	CS	4.25	316.34	19.2	2.50	1,574.07	-4%	39%	-£13.79m
Pilat Media Global	SP	0.50	29.60	12.3	2.28	2,500.00	-7%	-39%	-£2.47m
Pixology	SP	0.41	8.26	NA	1.83	293.75	0%	44%	£0.00m
Portrait Software	CS	0.19	18.42	NA	1.28	124.75	1%	27%	£0.24m
Proactis Holdings	SP	0.64	19.32	NA	10.17	1,319.59	-12%	1%	-£2.57m
Prologic	CS	0.90	9.00	10.5	1.30	1,084.34	-12%	6%	-£1.25m
QinetiQ Group	CS	1.78	1175.65	17.9	1.02	810.93	1%	-7%	£13.39m
Qonnectis	CS	0.01	2.62	NA	23.97	320.00	76%	60%	£1.15m
Quantica	A	0.46	31.82	10.1	0.82	370.97	3%	51%	£5.27m
Red Squared	CS	0.10	2.69	NA	1.10	521.98	3%	46%	£0.07m
Revenue Assurance Services Plc	SP	1.91	81.52	26.3	1.82	1,273.33	-2%	55%	-£1.49m
RM	SP	1.93	178.79	16.7	0.68	5,514.29	-7%	-1%	-£13.93m
Royalblue Group	SP	10.24	354.11	33.1	3.74	6,023.53	-1%	-1%	-£4.36m
Sage Group	SP	2.36	3076.29	20.1	3.29	90,769.23	2%	-13%	£63.65m
Sanderson Group	SP	0.48	20.07	NA	1.24	960.00	3%	-2%	£0.63m
SciSys	CS	0.61	15.59	NA	0.61	470.93	-18%	-31%	-£3.17m
SDL	CS	3.96	294.71	41.7	3.11	2,640.00	-3%	68%	-£9.48m
ServicePower	SP	0.15	13.60	NA	1.71	150.00	0%	-9%	£0.23m
Sirius Financial	SP	2.25	39.64	21.8	1.82	1,500.00	0%	53%	£0.00m
SiRViS IT plc	CS	0.04	4.79	7.3	0.60	34.78	18%	3%	£0.34m
smartFOCUS plc	SP	0.17	16.01	25.9	1.74	1,837.84	-24%	11%	-£4.87m
Sopheon	SP	0.18	25.48	NA	4.25	258.99	-1%	-20%	-£1.09m
Spring Group	A	0.71	115.72	22.9	0.28	788.89	-12%	3%	-£14.12m
SSP Holdings	SP	1.46	120.59	NA	6.74	1,377.36	-2%	21%	-£1.57m
StatPro Group	SP	1.02	53.55	17.6	4.22	1,275.00	-1%	-2%	-£1.14m
SThree Group plc	A	3.46	478.44	16.9	1.97	1,679.61	-18%	-10%	-£106.97m
Stilo International	SP	0.02	1.75	NA	0.76	40.00	25%	-16%	£0.13m
Strategic Thought	CS	0.59	15.35	NA	1.34	431.73	-12%	-42%	-£2.04m
SurfControl	SP	6.92	199.07	NA	3.48	3,460.00	2%	33%	£2.60m
Tadpole Technology	SP	0.05	17.90	NA	3.71	120.71	11%	400%	-£0.38m
Tikit Group	CS	3.18	40.80	19.8	1.74	2,765.22	-5%	24%	-£2.43m
Total Systems	SP	0.31	3.21	NA	0.92	584.91	-5%	-14%	-£0.20m
Touchstone Group	SP	1.60	19.71	58.5	0.65	1,523.81	0%	-11%	£0.39m
Trace Group	SP	1.56	22.16	17.5	1.55	1,248.00	-12%	57%	-£3.13m
Triad Group	CS	0.28	4.17	NA	0.10	207.41	-13%	12%	-£0.75m
Ubiquity Software	SP	0.37	75.39	NA	10.10	929.65	0%	85%	£0.00m
Ultima Networks	R	0.01	2.30	28.9	1.21	24.39	-17%	14%	-£0.00m
Ultrasis Group	SP	0.01	14.63	NA	11.77	20.41	-9%	-30%	-£1.78m
Universe Group	SP	0.09	10.18	NA	0.23	400.00	18%	-36%	£1.43m
Vega Group	CS	2.36	48.04	13.3	0.75	1,934.43	-2%	12%	-£0.92m
VI group	SP	0.16	5.87	7.9	0.61	320.00	-3%	12%	-£0.28m
Xansa	CS	1.28	445.89	NA	1.17	3,282.05	1%	48%	£3.80m
Xchanging	A	2.83	598.58	NA	NA	926.35	5%	-8%	£26.44m
Xpertise Group	CS	1.15	6.10	19.2	0.38	4,600.00	22%	184%	£1.09m
XploITe	CS	0.39	14.41	NA	0.49	1,200.00	-5%	18%	-£0.75m

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

BIG DIPPER

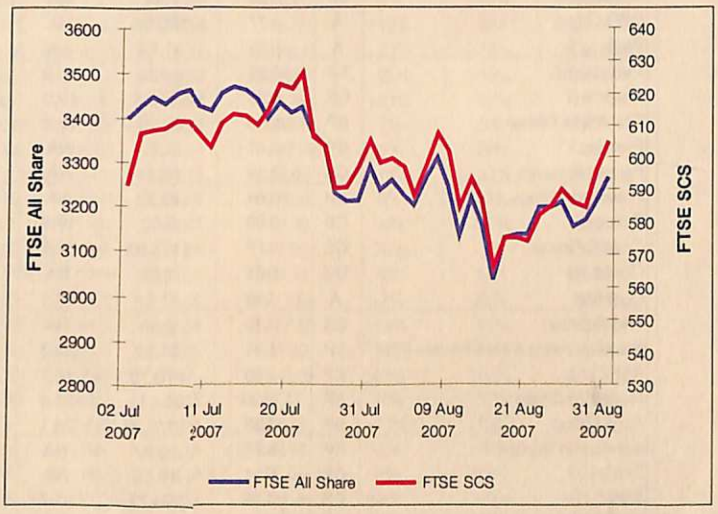
Samad Masood
Analyst

August was a roller coaster ride for stocks of every variety thanks to the jitters caused by the now infamous US sub-prime mortgage crisis. Indeed, the IT industry is lucky to have ended August in the region where it started. The FTSE IT SCS only fell by a fraction (-0.08%) month on month, the Ovum S/ITS index fell by -2.64%, while the techMARK 100 was up 1.6%.

Comparing the FTSE SCS to the FTSE All Share, it's clear that macro-trends (i.e. sub-prime crisis) are to blame for this volatility in S/ITS. Right now the only good news is that it seems (although it is still early days) that at the end of August, the indices have started to climb out of the slump and head back to pre-July levels.

It should come as no surprise, given the macro conditions, that individual S/ITS stocks have fared pretty poorly over this period. Of the 136 company stocks that we track in the Ovum S/ITS index, only one third of them saw a rise in share price between the end of July and end of August. And only 12% of them saw their shares rise higher than the Bank of England base rate.

FTSE All Share and FTSE IT SCS between July and August 2007



Amongst the strongest performers we have a mixed bunch, with mixed reasons for managing to buck the trend. For example, IT staffing agency Lorien was up 22% to 99p in August thanks to the acquisition bid it received from Contracting Solutions group at £1 per share. Meanwhile, IT training firm Xpertise also saw its share price rise by 22%, due to some strong interim results (revenue up 35%). Though it is worth pointing out that due to the downturn suffered over August, it took a few days before investors reacted to Xpertise's announcement and started buying its shares. Apart from penny shares, there weren't many more companies that achieved this sort of growth.

Amongst the losers it is not easy in this situation to differentiate between which companies deserved to suffer in August, and which just were pulled under by the rush to sell. But there are a few that we think should have had a better month. BPO company Xchanging was only up 5% to £2.83, despite winning a large strategic deal with Allianz, which in our opinion should have given investors a lot of confidence in the newly listed company's ability to execute on strategy. Another example is software and IT services aggregator, Maxima, which was also only up 5% - to £3.19 – despite raising its margin by more than two percentage points to 20%. And in a year when it integrated four acquisitions, helping boost revenue by 66%.

Clearly, with a third of the S/ITS companies we cover having yet to regain their former share prices, the effects of the sub-prime crisis have yet to fully play out. It seems that most players that had reasons to expect share increases only managed to keep their heads above water, while others without any good news this month suffered badly. Only long-term strong stocks such as Autonomy (up 11%) could really be considered safe. Most S/ITS shares can be expected to regain their value once these macro-economic jitters have blown over. Once that happens, the question will be: which companies didn't make it back, and why?