January 2008

Available by Subscription Only

ISSN 0967-2583

ovum

SYSTEMHOUSE

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

THE YEAR AHEAD: PREDICTIONS FOR 2008

As is traditional at this time of the year, the Ovum IT services team has pooled its thinking on the trends that we believe will shape the IT services industry in the coming twelve months. Here we offer you a selection of some of our views.

Economic slowdown will impact market growth

We join the consensus of predictions for a slowdown in economic activity this year. On the balance of current evidence, a reduction in GDP growth (to 1-2%, from last year's c.3%) in the UK seems more likely than a full-blown recession. This will impact growth prospects in S/ITS, but the impact will not be entirely negative.

Firstly, demand for project services such as consulting and system development will soften, particularly as more discretionary projects are delayed or shelved. But we expect this to be partly balanced by a slight strengthening in demand for IT and business process outsourcing, as more enterprises come under cost pressure, and opt to use outsourcing as a way to address cost, but also performance, issues.

Consolidation (of sorts) continues

We expect the pace of the vendor consolidation to quicken this year. Softening in demand will put pressure on mid-sized and smaller players to seek M&A opportunities, and most of the action will remain in this segment. We also expect M&A activity from larger IT services vendors. However, there's no great desire in the upper echelons of the industry for the sorts of costly and potentially disruptive mega-mergers that keep being rumoured but quite never seem to happen (EDS + T-Systems, Capgemini + Wipro, to cite two recent examples). The likelihood of deals on this scale taking place in 2008 remains low, especially given the dwindling capacity of the private equity sector (and indeed banks more broadly) to support large transactions.

From green IT to "greener IT"?

There are three near-certainties this year:

- IT vendors will spend more dollars than ever trying to convince users to buy 'greener' products and services,
- energy costs will continue to rise,
- European governments will start to act on carbon footprints.

IT departments will be caught between a rock and a hard place: needing to reduce energy consumption, but not trusting the 'green' technology and services vendors throw at them. The vendor bombardment will result in a fourth near-certainty – user scepticism of 'green IT' will grow.

We'd like to replace 'green IT' with 'greener IT' and suggest that IT vendors start to acknowledge the scepticism now. Vendors should continue to tailor their offerings with an eye on helping global customers rise above this scepticism, demonstrating the business benefits (not least in a period of tougher economic conditions) of greener IT practices.

Global resource management reaches full force

There is no single global resource management model. Most efforts thus far have rightly focused on building industry or domain-based centres of excellence, in specific locations and using collaboration

[continued on page two]

Contents

INDICES
(changes in December 2007)

Ovum S/ITS Index	**-1.32%**	**5714**
FTSE IT (SCS)	**+2.91%**	**545**
techMARK 100	**+1.21%**	**1641**

[continued from front page]

and social networking tools to connect experts around the globe. This, however, is the easy part.

Development of an effective and cost-efficient model will require globally integrated skills databases, skills-migration plans and career paths. It will also require extensive hiring, training and utilisation of industry and domain experts in low-cost countries and the seamless and efficient plugging of these new resources into projects in any part of the globe. Vendors must then "re-task" duplicate resources into specialised disciplines that ensure differentiation in an increasingly competitive market.

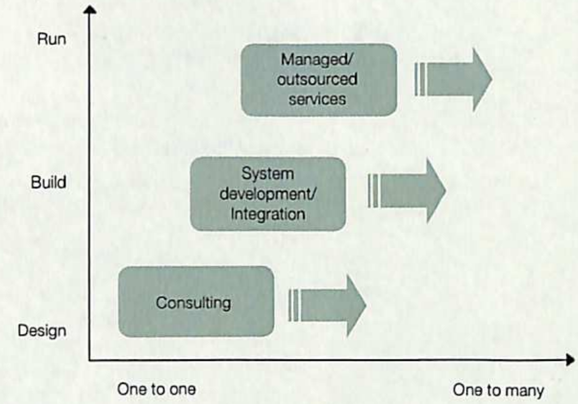
The result will be a boom for customers: lower costs, faster implementations and increased access to specialised capabilities. Some vendors will ride this model to competitive advantage. But others will not be able to meet these very new demands and will be forced to either retreat into a defensible niche or be acquired.

The focus on emerging markets will be redefined

Western IT vendors will continue to redefine their approach to emerging markets this year, from suppliers to developed markets and customers, to markets in their own right. Virtually all vendors have devoted extensive resources to capitalise on the growth potential of BRIC countries (Brazil, Russia, India and China). But now, with developed country economies heading for a slowdown, a handful are focusing efforts on a broader range of emerging economies (including the Philippines, Vietnam, Mexico and even some of the larger African countries).

A new, replicable approach to emerging markets will leverage these vendors' deep focus on Indian and Chinese markets, their growing R&D bases in these countries and the lessons learned from a handful of mega-deals in these and other emerging countries. The goal—learn what the big emerging countries need, use the Indian and Chinese labs to develop offerings tailored to the needs of these markets, adapt and leverage these offerings into other emerging countries, and then gradually and selectively migrate versions of these optimized, low-cost emerging country offerings to developed countries. In this way, these globally-sourced products and services will emerge as disruptive technologies and agents of change in developed countries.

IT service delivery industrialisation



Source: Ovum

Industrialisation will accelerate

We will see an acceleration of industrialisation of IT services, with many vendors attempting to move the whole lifecycle of IT service delivery from craftsmanship to a factory model; from one to one, to one to many service delivery. The reasons are simple: customers demand value (i.e quality at lower cost) and reliable solutions with predictability on a global scale. Only by fostering the capture and the reuse of best practice tools, process maps, assets and methodologies can vendors deliver on this.

This process will go across all service lines but from different starting and end positions: the services at the end of the design-build-run cycle are already some way down this road, whereas others are further behind.

A new wave of mid market emphasis

With an economic slowdown looming, we will see another wave of emphasis on the mid market, with many larger vendors broadening their go to market scope towards mid market clients (enterprises in the 200-5000 employee range), and contracts in the $5-50m range.

Successful vendors will adapt their go to market and delivery models to the diverse user requirements in this segment. The key will be not simply winning work in this segment (which is hard enough for firms that have evolved to sell big and complex deals to big and complex customers) but delivering profitably on it. The last bit will be a major challenge, and will act as another driver behind the industrialisation and globalisation priorities highlighted above.

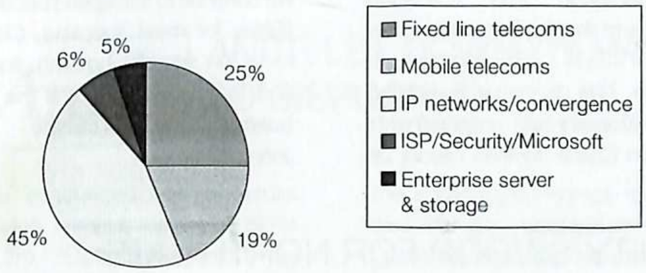
With contributions from Ovum's IT services team, including Angel Dobardziev, Tom Kucharvy, John Madden, Ian Brown and Phil Codling.

REDSTONE MINES NICHES TO GREAT EFFECT

Kate Hanaghan
Senior Analyst

In December, Redstone (a provider of communications and IT solutions) announced its results for the six months to end September 2007. Revenue doubled to £96.6m, with organic revenue growth coming in at 10%. Adjusted EBITDA increased 131% to £6.5m, taking the margin to 6.7% (from 5.9% in the previous year). During the period, significant contract signings included a £13m project with White City retail centre and a £13.4m contract with JP Morgan.

Revenue by activity in H1 2008.
Total revenue = £96m



Comment: Over the past 30 months, Redstone has made five acquisitions and transformed itself from a fixed telecoms firm into a broader provider of comms and IT services into the SME market (10-2000 employees). With this range of services, Redstone can provide services spanning a customer's phone (fixed and mobile), network, desktop and server needs. Indeed, the 're-sculpted' Redstone is doing quite nicely across a range of verticals, but particularly in education and fit-outs in new commercial buildings.

The company is a beneficiary of the Building Schools for the Future (BSF) programme, having cemented a managed services contract with Lancashire, worth £5-6m per annum. Redstone will take charge of just about every technology requirement the specified Lancashire schools will have - not just network and desktop management, for example, but other technology requirements as diverse as cashless vending machines and CCTV. Meanwhile, larger BSF providers, such as RM, subcontract the delivery of these types of technologies.

As well as turning itself around from being loss-making, Redstone is now of a scale where it can compete for larger, national contracts. (We saw 2e2 go through a similar transformation in terms of growing its scale via acquisition in order to tap into larger managed services contracts.) With Redstone's enlarged size, the coming months will be about identifying and winning more of those larger deals.

A key challenge for the firm will continue to be cross-sale between the divisions within the group. By its own admittance, "internal politics" have thus far represented its biggest barrier to excelling here. But if the company is to take full advantage of the range of services (i.e. telecoms through to IT services) it has acquired over the past two years, it really needs to start selling more services into its existing customer base. It now has a sales director in place, employed for the sole purpose of managing the cross-sale effort. We'll be disappointed if it doesn't make a notable improvement here over the coming months.

Not surprisingly, much of Redstone's growth has come from the provision of converged solutions (this is also the company's biggest division). But there is room for growth elsewhere, and we'd like to see it increase the scale of its business outside of telecoms and convergence (i.e. in IT solutions). There are without doubt opportunities in the mid-market for suppliers of Redstone's profile; and cross-sale is the obvious way to progress this.

We note that Redstone says it is not seeing any evidence that IT projects are being delayed. This is in line with what we saw in 2007 across the market more broadly – but we do expect this situation to change as the macro-economic climate tightens as 2008 progresses.

In all, we like Redstone's positioning. Its size, combined with the range of services it can offer, potentially make it attractive to smaller customers, and its 10% growth rate reflects this. Now the focus must be on improving profitability, with the firm wanting to get the EBITDA margin up to 10% from the 6.7% achieved in this first half (5.9% in the equivalent period last year). Given the number of acquisitions that have been made, there's probably still some related 'fat' to be cut. However, more sustainable growth in profitability will have to come partly from improved cross-and upselling. Redstone is at the beginning of its journey as an ICT provider and we think that with good execution it can continue to grow both the top and bottom line.

17%
195p

CIVICA REPORTS A FLAT FY07

Civica, the public sector-focused software and services group, posted its full year results, with revenue of £126.9m, up 1% on 2006. Operating profit before goodwill amortisation, exceptional items and LTIP charges was up 16% to £21.6m.

Comment: Although the top line is showing slow growth, Civica's underlying business continues to perform very well. Demand for Civica product continues to be strong, with revenue related to its own software up 25% to £92.3m, of which 7% was attributable to organic growth. Likewise Civica is seeing strong double-digit growth across its other key service lines of consulting, managed services and support. The only factor dragging down growth was sales of third party products, which fell 48% to £34.6m – this, however, has been a strategic decision by Civica's management.

Civica's largest sector, UK local government, is operating in a tough market - revenue here grew just 1% during the year. Civica continues to see demand for financial and environmental health systems, however, and secured a number of wins during the year.

Civica's operations division, which provides consulting, implementation and managed services to the public sector, grew revenue 23% (5% organic) to £32.3m. This division is benefiting from efficiency-led engagements in which Civica advises clients on getting cost effectiveness from new systems.

Of Civica's other divisions, Education is a key area of investment for the company and grew organically by 48% to £9.6m. This reflects wins in the multi-billion pounds Building Schools for the Future programme at Sheffield, and a 3-year deal with Essex County Council.

Our view is that Civica is well placed to continue benefiting from efficiency-led drives by local authorities and the broader public sector. Although we continue to see spend becoming tighter for most suppliers, Civica's focus on security, housing, finance and the environment tick the right boxes in the current climate.

John O'Brien

37%
92p

PRIVATE EQUITY SWOOP FOR NORTHGATE

On 11th December, Northgate Information Solutions released first half results showing 49% growth in revenue to £246m, thanks to a boost from the acquisition of Belgian HR outsourcer Arinso in May. Organic revenue growth was 6.6%. Operating profit, excluding exceptional and acquisition related costs, was up 23% to £31.5m.

Comment: Operating margins across the Public Sector and Managed Services were stable, but declined to 16.3% from 26.8% in the largest division (HR), due to acquisition costs. Nonetheless, its organic growth (of 7.5%) was respectable in H1, and the acquisition of Arinso broadens its target market in the HR outsourcing market.

Later in the month, the board of Northgate recommended an offer of 95p in cash for the business from private equity firm Kohlberg Kravis Roberts (KKR). The offer values Northgate at £593m.

Rumours of a Northgate takeover first emerged in the third quarter of 2006. Back then we were cautious about the prospects for the company, stating that, 'To regain momentum Northgate needs a broader breadth and depth of capability, and this inevitably means greater scale. This may be more easily achieved by breaking Northgate's business up and realigning the strategy'.

KKR is betting on the potential for Northgate to combine its mid-market payroll services depth with Arinso's enterprise level, global solution and become an HRO powerhouse. Northgate could be on the cusp of something really big here. If KKR can help it get to the next level in HRO then it may well have bought into the company at just the right time.

But Northgate is not just HRO. UK public sector business accounts for 22% of the business, while managed services account for a further 24%. These two divisions are healthy, but their performance is hardly stellar. More importantly, with Arinso driving HRO growth going forward, the overlap between these parts of the business will reduce. We have yet to hear what KKR plans to do with Northgate once it has bought it. But it is not unreasonable to think that a new owner would consider divestments.

Samad Masood

-22%
35p

FOCUS SOLUTIONS MAKES GOOD PROGRESS

New contract wins from HSBC and Openwork Ltd helped Focus Solutions to increase its revenue by 43% to £4.0m for the six months to end September. The company turned last year's operating loss of £296k into an operating profit of £305k. Net profit was £357k, compared to a loss of £202k a year ago.

Comment: With its portfolio of front-office solutions for the financial services sector, Focus has made considerable progress over the last year. As well as the contract wins, it saw further business from existing customers such as Lincoln Financial Group, Irish Life and Home Choice.

Focus is productising its key offerings. To do this, it is turning its point-of-sale solutions into a product set called focus:360. This is a single end-to-end solution for larger financial intermediaries that manages training and competency, sales performance management information, compliance monitoring and pipeline tracking along with an updated point-of-sale capability. It is also developing its underlying technology suite into a new generation that it calls focus: technology 2007.

For many growing companies there is a key decision point: are you going to be a product company or are you going primarily to provide professional services around a core set of flexible solutions? Focus Solutions is going the former route which, if successful in the relatively fickle software market, will lead to higher margins, albeit from a smaller revenue base than the professional services-oriented route.

David Bradshaw

23%
53p

ANITE LET DOWN BY HANDSET TESTING, POINTS TO DISPOSALS

Anite announced interim results showing revenue up by 11% to £71.2m. Operating profit was £10.6m, up 3%. Anite's operating margin fell from 14.5% in H1 of FY07to 13.4%. PBT was down 54% at £4.4m and EPS fell to 1.4p (from 2.4p).

Chief Executive Steve Rowley also stated that "We have been aware for some time that the ownership of several businesses has led to a stock market valuation that reflects a structural discount. We are therefore working actively, with our advisors, to explore a variety of strategic alternatives to remove or at least significantly reduce the scale of this discount."

Comment: Anite has seen positive performances in the first half from two of its three businesses. In Travel, revenue was up 20% to £16.6m. And in Public Sector, revenue was down slightly but a reduction in losses associated with the company's Pericles revenues and benefits application helped operating margins improve from 3.9% to 5.6%.

But it's in the Wireless segment that Anite has faced challenges. Growth in handset testing revenues has weakened, although network testing (from the company's acquired Nemo business) has fared better. Coupled with a planned increase in R&D spend, the weakness in handsets has brought operating margins down from 27.7% to 18.3%. Given the current outlook in the handset market (with vendors under huge pressure and 4G revenues yet to kick in), this area looks set to remain challenging.

The statement about "strategic alternatives" points to the strong possibility of further disposals at Anite. We wouldn't find this surprising. We said in the summer that a sale of Anite's local government business would be in the best interests of shareholders. Now that Anite has confirmed that all options are being considered, does this remain a sound view?

Certainly Anite has done the required ground work to make its public sector business more attractive to potential purchasers. At the beginning of the current financial year public sector was split into two: Local Government and Secure Information Systems (SIS). SIS is now a separate limited company within the Anite Group, which could make it easier to sell. But being part of the losing consortium in the E-Boarders bid denies it future revenues (even if management was cautious about including these revenues in its medium term forecasts). It may make this up elsewhere; its £3.6m three year deal for the Automatic Number Plate Recognition support contract is a boost but more wins are needed.

Phil Codling / Peter Clarke

-12%
254p

MICRO FOCUS DELIVERS INTERIM GROWTH

Micro Focus, the UK-based software player focused on application management and modernisation solutions, announced its interim results. Total revenue was up 38% at $109m, with organic, constant currency growth of 17%. Operating profit grew by 35% to $41.0m, meaning the operating margin held steady at 38%. Revenue from North America grew by 30% to $46.3m, with the UK/Europe/Middle East up 47% to $44.3m.

Comment: Even stripping out the two acquisitions that impact on these results (HAL KS and Acucorp), organic growth (at 17%) is a market-beating performance. CEO Stephen Kelly and his team must be given credit for the turnaround in fortunes. Sales execution was a problem for the company, the solutions and brand of which remain strong assets. But Kelly's focus on sales, primarily through a partnering model with the likes of IBM, EDS, Accenture and TCS, is now showing real benefits.

Meanwhile, Micro Focus is benefiting from fair winds in the market. Its emphasis on getting more out of existing software assets through application modernisation and management remains in tune with many CIOs' priorities. Indeed, it's a message that is unlikely to be undermined by the macro-economic uncertainties that lie ahead. You wouldn't say Micro Focus was completely 'downturn proof', but the company could even benefit from the likely reinvigoration among corporates of the 'more for less' agenda.

One area where Kelly and Co are yet to deliver much growth is application portfolio management (APM). The problem is that APM typically needs a board-level sell and buy-in from multiple department heads, as well as the CIO. For this reason, APM remains a slow-burner for Micro Focus, as it does for many application management services providers. Nonetheless, as Kelly is keen to point out, when APM does get a foothold in an account, it has the potential to drive a lot of other work and solution sales.

Phil Codling

COMPUTERLAND SERVICES GROWING DOUBLE DIGITS

Reseller and services firm ComputerLand increased services revenue by 13% in H1. Services account for a third of total revenues, which were up 10% to £33.9m. The overall operating profit margin was hit by difficulties in the hardware maintenance business and dropped from 4.2% to 3.9%.

Comment: ComputerLand continues to grow from its relatively small services base at a solid pace. The hardware maintenance business took a knock - and ComputerLand can mostly blame itself and issues relating to the migration to a new system for that. But things look to be back on track - with Q2 said to be "significantly improved".

The story in its remote managed services business, which is small (£6.1m in H1), but growing well (39%) is more positive. We've been impressed with the efficiency of this business and its ability to generate profits. Furthermore, it would be wrong to write ComputerLand off as a minnow, despite its focus on smaller customers. For example, the O2 contract it won last year from Computacenter covers 14,000 users. We're not expecting the total size of ComputerLand's services business to rival that of the major IT services, but we think its appeal to smaller customers will continue to help it grow healthily. Furthermore, we think the investment ComputerLand has made bringing in experienced sales and services directors is well worthwhile.

So what does the future hold for a company with a relatively small services business, focused mainly on the smaller end of the market? Could it be snapped up? Any potential acquirer would have to get past CEO, Graham Gilbert, who owns a 38% stake in the company. And, right now, he's in no mood for selling. The company has £8.7m in the bank, but making an acquisition valued something in that region would hardly represent a step change in terms of ComputerLand's overall scale. Instead, what we expect will happen is more business as usual; good growth and perhaps the odd larger contract.

Kate Hanaghan

13%
34p

INNOVATION GROUP GROWS BY 39% IN FULL YEAR

Insurance-focused BPO player, The Innovation Group (TiG), has grown revenue by 39% to £110.5m in the year ended 30 September 2007. Operating profit grew by 16% to £8.6m, representing a 7.7% margin, down from a 9% margin last year.

Comment: TiG's management have delivered on the two big promises they made three years ago:

- To move into BPO services, which now accounts for 68% of revenue, and
- to increase recurring revenue, now accounting for 77% of the total.

They have done this while driving strong organic growth at home and using acquisitions to expand overseas. TiG is now growing its BPO business organically in all its geographies, and is not over reliant on any single one - impressive for a company in the early days of a new business model.

Of course, there is a raft of challenges ahead - not least the transition in management style and financial controls that is required to manage a BPO business over that of a software business. In conversations with us CEO Hassan Sadiq emphasised the importance of customer service, resource management and global sourcing - all areas that are important in BPO.

Going forward, Sadiq plans more of the same - organic growth bolstered with acquisitions that increase volume or add specific innovative technologies. And based on performance to date we do not expect any big surprises. That said, competition will increase for the company as it gets larger. TiG has managed to get this far without many of the big BPO and offshore IT services players taking notice. But it is these companies that pose the biggest competitive threat as it expands further into the insurance claims administration vertical. This is when Sadiq and the rest of TiG will need to prove they really can do BPO faster, cheaper and more innovatively than the rest of the market.

Samad Masood

1%
274p

VEGA ANNOUNCES RESULTS AND POTENTIAL TAKEOVER

Vega Group, provider of professional services to the government, defence and aerospace sectors, announced interim results with revenues up 14% to £35.8m, helped by the acquisition of Anite Deutschland in July. Organically, revenues fell by 1.3%. Adjusted operating profit declined to £1.5m from £2.5m. Pre-tax profits declined by 51% to £886m.

The results came a few days after Finmeccanica, the Italian aerospace & defence company, made an offer to buy Vega for £61.6m. Vega's directors have undertaken to recommend the offer.

Comment: Vega's results are a mixed bag. The company's aerospace business, with a 16% fall in revenues, is predominantly blamed for the organic revenue decline. Government and Defence revenues fared much better.

The decline in operating profit reflects the investment the Group has made to get its three service lines (Consulting, Technology and Managed Solutions) working more effectively together. It is still early days, but the managed solutions business achieved organic growth of 8% in the period, and consulting revenues were up 29%. However, Technology revenues declined by 26% due to low order intake in the company's last financial year and delays on a couple of major projects. Looking ahead, Vega cites a strong order pipeline for Technology, particularly in France and Germany.

Should Vega end up in the hands of Finmeccanica (which reported revenue of €12bn in FY06), the firm would become a small fish in a big pond. There is therefore a high risk that the potential of the Vega business would not be fully realised going forward. In particular, the strength of Vega's defence consulting business lies in its positioning as a 'trusted advisor' to the UK's Ministry of Defence. In acquiring Vega, Finmeccanica is hoping to reinforce its core competencies as a systems integrator and, consequently, achieve growth in its UK defence & security business. If it is to achieve this, it will have to approach the integration of Vega into its business with extreme care.

Georgina O'Toole

Mergers and Acquisitions – December 2007

Buyer	BT
Seller	Frontline Technologies Corporation
Seller Description	Singapore-based provider of IT outsourcing and project services
Acquiring	100%
Price	€95m
Comment	Acquiring 5,000 people headquartered eight time zones away is a major move for any firm, even a large global one like BT. But the rationale is not hard to fathom. First of all, Frontline gives BT a boost in some of the fast-growing "BRIC" markets, notably China and India. What's also really interesting about this acquisition is the genuine IT services flavour it will bring to BT in Asia, a region where it is predominantly a network services player today. This is because Frontline is a genuine IT services player. It focuses on IT consulting, software development and managed IT infrastructure services for large corporates and government. The addition of Frontline thus helps to take BT into the end-to-end ICT space in Asia, arguably to an extent that it cannot claim even in the UK (where, for example, it tends not to deliver IT outsourcing and software development services itself, but rather through partners) and certainly can't claim in continental Europe.
Buyer	nCipher
Seller	NeoScale
Seller Description	Californian VC-backed provider of storage encryption products under the CryptoStor brand
Acquiring	"majority"
Price	n/a
Comment	This acquisition brings two successful companies together. Its main benefit to nCipher is that NeoScale has achieved a strong position in the US market. Encryption of stored data is a critical issue for large organisations and has become the focus of growth for nCipher. Although there is some overlap in the two companies' product coverage in this area, nCipher should be able to build on the best bits of each. Independent vendors have a strong position in encryption key management because every large data centre has a heterogeneous collection of storage systems and therefore proprietary key management regimes do not provide coherent management.
Buyer	Epicor
Seller	NSB Retail
Seller Description	Retail software
Acquiring	100%
Price	$160m cash
Comment	NSB claims that one significant driver was for it to become part of a US business. Having been listed in the UK, the company was suffering significantly from the depreciation of the US dollar in comparison to the British Pound. Going forward, NSB will now be part of a larger US business that, while there are some overlaps, will still provide it with cross-sell opportunities and back office synergies in its core market.
Buyer	K3 Business Technology Group
Seller	Index Computer Systems
Seller Description	UK-based manufacturing software company
Acquiring	100%
Price	£2.75m in cash and shares
Comment	K3's acquisition serves to further extend its coverage as a Microsoft-based ERP solutions provider. Index has developed modules for the food manufacturing industry based on the Dynamics AX software and supported by Microsoft, and these should complement K3's existing manufacturing and retail sector solutions. K3 gains even closer ties to Microsoft, and a broader mid-market ERP solution.

Mergers and Acquisitions – December 2007

Buyer	Maxima
Seller	The trade and assets of Eclectic Group Limited, a subsidiary of Glen Group
Seller Description	Software, consultancy, support and training in the areas of Business Intelligence and Corporate Performance Management (CPM).
Acquiring	100%
Price	Total consideration of up to £3m in cash
Comment	Glen Group bought Eclectic at the beginning of 2006. It has clearly had a change of heart and decided to revert to its core ICT services. Meanwhile, the acquisition in theory makes sense for Maxima. Maxima has an acquisitive history; it was only in July that it made its last purchase (Centric Networks, a provider of managed services around infrastructure software). It provides a wide-range of IT services, which makes it an appealing provider to mid-market firms. Business Intelligence and Corporate Performance Management are both worthy capabilities to invest in. Managing and understanding internal knowledge/data, customer information and so on are priorities for mid-market and large corporate firms alike. For that reason, adding more depth here is a sensible move. We know Maxima is an experienced buyer and we like the way CEO Kelvin Harrison and FD Linda Andrews have worked like a 'dynamic duo' in seeking out suitable acquisitions. In its last financial year, Maxima registered improvements on numerous fronts. It pushed the operating margin up and grew organic revenues by 8%. This is good evidence that management can juggle acquisitions/integrations and organic development at the same time. We would add a word of warning, however. Maxima's offerings are wide-ranging - the result of numerous acquisitions. The longer-term goal must be about making those entities work optimally together (i.e. through cross-sales). This is perhaps something the firm's new COO (Boris Huard, ex-LogicaCMG) can help it to achieve.

Buyer	Kohlberg Kravis Roberts (KKR)
Seller	Northgate
Seller Description	UK services firm
Acquiring	100%
Price	An offer that values Northgate at £593m
Comment	Rumours of a Northgate takeover first emerged over a year ago, in the third quarter of 2006. Back then we were cautious about the prospects for the company, stating that, 'To regain momentum Northgate needs a broader breadth and depth of capability, and this inevitably means greater scale. This may be more easily achieved by breaking Northgate's business up and realigning the strategy'. Since then, the May 2007 acquisition of Belgian HR outsourcer, Arinso, has given the company more bulk in HR services - deepening and broadening both businesses capabilities and reach in the HR outsourcing market. The post-acquisition HRO win with Cadbury-Schweppes has already gone some way to proving that Northgate, through Arinso, can move up the HR value chain. KKR is betting on the potential for Northgate to combine its mid-market payroll services depth with Arinso's enterprise level, global solution and become an HRO powerhouse. Northgate could be on the cusp of something really big here. If KKR can help it get to the next level in HRO then it may well have bought into the company at just the right time. But Northgate is not just HRO. UK public sector business accounts for 22% of the business, while managed services account for a further 24%. These two divisions are healthy, but their performance, while respectable, is hardly stellar in comparison to the HR division. More importantly, with Arinso driving HRO growth going forward, the overlap between these parts of the business will reduce. We have yet to hear what KKR plans to do with Northgate once it has bought it. But it is not unreasonable to think that a new owner would consider divestments of these two areas.

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

	SCS Cat.	Share Price 31-Dec-07	Capitalisation 31-Dec-07	Historic P/E	PSR Ratio Cap./Rev.	S/ITS Index 31-Dec-07	Share price move since 30-Nov-07	Share price % move in 2007
@UK plc	SP	0.08	2.93	NA	2.02	122.14	0%	-56%
Alphameric	SP	0.31	69.88	14.6	1.06	142.20	11%	-35%
Alterian	SP	1.16	50.40	20.9	3.60	580.00	-15%	2%
Anite Group	CS	0.53	185.17	10.2	1.08	309.94	23%	-35%
Ascribe	SP	0.31	36.40	NA	6.81	1,631.58	11%	-21%
Atelis plc	SP	0.02	0.47	NA	NA	87.21	-38%	-72%
Atlantic Global	SP	0.14	3.09	59.5	1.45	474.58	8%	4%
Autonomy Corporation	SP	8.84	1882.30	90.5	14.67	269.84	11%	73%
Aveva Group	SP	9.66	651.18	36.7	9.88	4,830.00	5%	18%
Axon Group	CS	5.27	332.02	21.4	2.41	3,011.43	-9%	-14%
Belgravium Technologies Plc.	SP	0.10	10.09	21.4	1.93	666.67	-9%	-23%
Bond International	SP	1.64	50.03	9.3	2.91	2,523.08	11%	-5%
Brady	SP	0.44	11.89	12.3	4.89	543.21	-12%	21%
Business Control Solutions	CS	0.03	7.12	24.7	0.89	480.00	0%	-52%
Business Systems	CS	0.12	10.31	NA	0.30	100.84	0%	-4%
Cantono	CS	0.06	17.69	NA	2.46	1,109.09	-3%	11%
Capita Group	CS	6.98	4250.55	30.6	2.50	188,683.53	-6%	15%
Centrom	CS	0.01	2.61	NA	0.41	166.67	0%	-33%
Charteris	CS	0.22	9.25	32.0	1.04	244.44	10%	38%
Chelford Group	CS	1.40	10.00	136.6	0.54	243.48	1%	-16%
Civica	CS	1.95	122.77	10.9	1.16	1,113.99	17%	-29%
Clarity Commerce	SP	0.27	6.60	NA	0.50	216.00	-16%	-50%
Clinical Computing	SP	0.03	3.04	NA	1.84	24.19	0%	-57%
CODA Plc.	SP	1.75	134.32	17.3	2.51	1,080.25	9%	8%
Computacenter	R	1.89	299.70	15.1	0.13	282.09	11%	-30%
Corero	SP	0.06	2.91	29.1	0.46	80.00	-14%	-59%
Dealogic	SP	1.75	118.24	11.6	2.94	760.87	-4%	11%
Delcam	SP	2.38	14.67	6.4	0.61	915.38	-10%	-24%
Detica	CS	2.20	254.85	22.1	1.63	2,750.00	-4%	-40%
Dicom Group	R	1.75	147.20	14.9	0.92	536.48	-8%	-25%
Dillistone Group	SP	2.13	11.48	NA	NA	1,556.78	-3%	45%
Dimension Data	R	0.62	959.95	22.1	0.69	110.12	0%	44%
DRS Data & Research	SP	0.24	7.68	46.1	0.62	218.18	4%	-35%
eg Solutions	SP	0.24	3.36	NA	0.62	163.27	-20%	-71%
ELCOM	CS	0.02	8.28	NA	23.91	400.00	0%	-52%
Electronic Data Processing	SP	0.59	14.31	29.9	2.05	1,806.49	16%	-9%
FDM Group	A	1.25	29.03	13.9	0.65	1,533.74	14%	34%
Ffastfill	SP	0.07	24.99	NA	9.43	58.33	-13%	17%
Fidessa Group Plc.	SP	8.30	287.41	NA	3.04	4,882.35	-13%	-20%
Financial Objects	CS	0.48	21.11	7.7	1.06	208.70	2%	-12%
Flomerics Group	SP	0.55	11.90	13.6	0.84	2,115.38	20%	-27%
Focus Solutions Group	CS	0.35	10.31	6.2	1.04	179.49	-22%	-28%
GB Group	CS	0.25	20.52	NA	1.37	161.25	9%	-46%
Gladstone	SP	0.19	9.78	7.0	1.28	475.00	-5%	-25%
Gresham Computing	CS	0.56	29.33	67.3	2.10	602.15	-25%	-62%
Group NBT	CS	2.04	51.29	16.7	6.11	1,020.00	-11%	-2%
Harvey Nash Group	A	0.54	38.76	8.2	0.15	308.57	-4%	-26%
Highams Systems Services	A	0.05	1.59	NA	0.12	138.89	-17%	8%
Horizon Technology	CS	0.74	60.92	10.4	0.32	272.14	-8%	7%
IBS OPENSystems	CS	1.64	65.60	13.3	4.20	1,075.41	-4%	-10%
I S Solutions	CS	0.22	5.33	18.6	0.97	819.84	0%	40%
IDOX	SP	0.12	40.18	35.0	2.84	15.40	0%	88%
ILT Solutions	SP	0.03	2.46	NA	1.35	30.82	4%	16%
Imaginatik	SP	0.04	4.52	NA	3.23	456.47	-9%	-54%
In Technology	CS	0.32	45.40	NA	0.24	1,280.00	4%	-26%
InterQuest Group	A	0.86	25.82	NA	0.94	1,495.65	-3%	-2%
Innovation Group	SP	0.34	217.30	29.5	3.56	148.47	13%	9%
Intelligent Environments	SP	0.09	13.84	23.8	4.44	95.74	15%	44%
Intercede Group	SP	0.35	12.45	NA	6.89	583.33	-3%	-41%
Invu	SP	0.30	30.92	15.2	4.76	3,157.87	3%	0%

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

	SCS Cat.	Share Price 31-Dec-07	Capitalisation 31-Dec-07	Historic P/E	PSR Ratio Cap./Rev.	S/ITS Index 31-Dec-07	Share price move since 30-Nov-07	Share price % move in 2007
K3 Business Technology	SP	1.61	38.17	15.4	1.40	1,230.14	3%	39%
Kewill	SP	0.82	66.84	45.4	1.61	1,620.55	-10%	4%
Knowledge Technology Solutions	SP	0.01	3.79	NA	3.03	200.00	0%	-38%
LogicaCMG	CS	1.18	1715.20	14.8	0.64	1,615.99	-5%	-37%
Macro 4	SP	1.46	32.22	5.0	0.97	588.71	-8%	-31%
Manpower Software	SP	0.54	24.13	24.5	5.57	556.70	0%	108%
Maxima Holdings	CS	2.45	61.05	12.8	1.92	1,781.82	3%	7%
Mediasurface	SP	0.05	4.88	5.2	0.50	367.65	-29%	-71%
Micro Focus	SP	2.54	508.90	21.9	6.73	0.00	-12%	22%
Microgen	CS	0.47	47.84	12.2	1.27	200.85	31%	-14%
Minorplanet Systems	SP	0.25	7.07	5.7	0.30	510.52	-14%	-55%
Misys	SP	1.85	930.45	22.1	1.65	2,301.62	-8%	-14%
Monitise	CS	0.14	35.00	NA	0.07	91.67	-7%	-36%
Morse	R	0.67	86.41	4.7	0.24	268.00	-4%	-38%
NCC Group	CS	3.80	123.93	24.0	4.88	2,275.45	6%	36%
Ncipher	SP	2.17	36.39	NA	2.09	868.00	-11%	-15%
Netcall	SP	0.22	14.53	19.6	4.38	444.45	-12%	29%
Netstore	CS	0.25	42.29	11.5	2.11	166.67	-4%	-17%
Networkers International	A	0.31	28.10	12.8	1.47	968.75	0%	-11%
Northgate Information Solutions	CS	0.92	537.31	15.2	1.53	353.85	37%	7%
NSB Retail Systems	SP	0.38	155.79	16.1	3.22	3,304.35	65%	11%
OneclickHR	SP	0.04	5.39	NA	0.91	100.00	0%	0%
OPD Group	A	1.88	49.93	5.9	1.14	854.54	-15%	-62%
Parity	A	0.55	20.91	NA	0.13	509.26	-15%	-30%
Patsystems	SP	0.27	46.99	34.6	3.07	252.34	-4%	57%
Phoenix IT	CS	3.19	237.60	14.4	1.88	1,181.48	7%	5%
Pilat Media Global	SP	0.42	24.57	10.2	1.89	2,100.00	-2%	-48%
Portrait Software	CS	0.14	13.58	35.1	0.94	91.92	-7%	-7%
Proactis Holdings	SP	0.68	20.77	NA	10.93	1,391.75	5%	6%
Prologic	CS	0.89	8.90	10.4	1.28	1,072.29	0%	5%
QinetiQ Group	CS	1.97	1301.14	19.8	1.13	897.49	8%	3%
Qonnectis	CS	0.02	4.97	NA	45.42	533.33	0%	167%
RM	SP	2.20	203.84	21.6	0.75	6,285.71	6%	13%
Sage Group	SP	2.30	2999.85	19.5	25.86	88,461.54	6%	-15%
Sanderson Group	SP	0.47	19.87	15.6	1.23	940.00	-6%	-4%
SciSys	CS	0.46	13.17	9.5	0.52	356.59	12%	-48%
SDL	CS	2.73	204.69	28.7	2.16	1,820.00	-2%	16%
Serpower Technologies	SP	0.14	12.50	NA	1.57	140.00	-7%	-15%
SiRViS IT plc	CS	1.74	5.74	8.7	0.72	1,513.04	4%	12%
smartFOCUS plc	SP	0.12	10.90	19.9	1.18	1,297.30	-25%	-21%
Sopheon	SP	0.14	20.75	NA	3.46	201.44	-14%	-38%
Spring Group	A	0.49	79.62	15.8	0.20	544.44	5%	-29%
SSP Holdings	SP	1.38	114.00	13.2	6.37	1,301.89	-6%	15%
StatPro Group	SP	0.87	46.20	15.1	3.64	1,087.50	2%	-16%
SThree Group plc	A	2.23	305.04	10.9	1.26	1,082.52	14%	-42%
Stilo International	SP	0.01	1.44	NA	0.63	20.00	-20%	-58%
Strategic Thought	CS	0.41	10.65	NA	0.93	298.89	-19%	-60%
Tadpole Technology	SP	0.03	11.46	NA	2.37	72.42	-25%	200%
Tikit Group	CS	2.61	33.42	16.0	1.42	2,269.57	6%	2%
Total Systems	SP	0.24	2.47	NA	0.71	443.40	-19%	-35%
Touchstone Group	SP	1.38	16.89	8.5	0.56	1,314.29	-13%	-23%
Triad Group	CS	0.25	3.71	NA	0.09	185.19	4%	0%
Ultima Networks	R	0.01	1.79	22.4	0.94	24.39	0%	14%
Ultrasis Group	SP	0.01	9.76	NA	7.85	20.41	0%	-30%
Universe Group	SP	0.06	7.31	NA	0.17	266.67	-14%	-57%
Vega Group	CS	2.74	55.78	15.5	0.87	2,245.90	1%	30%
Vero Software Plc.	SP	0.16	5.87	NA	0.61	315.00	-2%	11%
Xchanging	CS	2.80	643.28	39.4	NA	916.53	-1%	-8%
Xpertise Group	CS	1.14	6.42	19.7	0.40	4,560.00	5%	181%
XploITe	CS	0.59	23.41	2.3	0.79	1,815.38	26%	79%

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

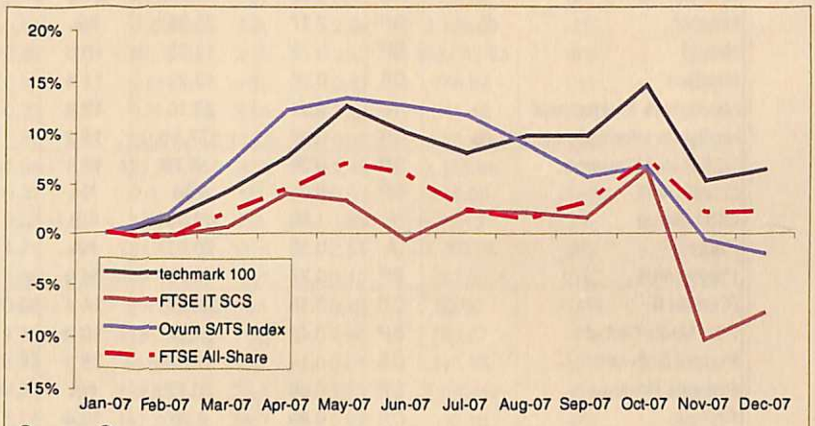
SEASONAL SPIRITS LIFT S/ITS SHARES FOR YEAR END

Samad Masood
Analyst

Shares in UK IT companies did not fare too badly in December – surprising given the incessant doom-mongering going on in the economy as 2007 came to a close. Although performance was a bit of an unspectacular and mixed bag, UK S/ITS indices definitely stopped the sudden decline that began in November. During December, the techMARK 100 rose by 1.2%, the FTSE IT SCS was up 3% and the Ovum index was down 1.3%.

Performance since the start of 2007 wasn't as bad as one might have expected either. The techMARK 100 was up 8.5% and the Ovum index was up by 2.6%. The FTSE IT SCS was still 6.9% down on the start of the year. However, the growth in December suggests that it is starting to regain some of the losses incurred when it fell by 16% in November. As the graph shows, overall performance has not been spectacular this year, and may well have been a lot better if not for the falls in November.

Performance of selected UK indices in 2007



Source: Ovum

We would suggest that this reflects the perception that IT services vendors – and particularly outsourcers – tend to do well out of any economic downturn because their services can bring immediate short-term cost savings for clients. But when budgets are tight, clients cut back on new systems, projects and software first – hence the decline in other areas of the industry.

But of course, this is not a rigid rule – or one that applies to all vendors equally either. For instance, of the top three performers in 2007 (excluding companies with a market capitalisation below £100m) we had software company Autonomy (up 73%), reseller Dimension Data (up 43%), and only then comes services company NCC (up 35%). At the bottom of the pile we have two services companies: LogicaCMG (down 37%) and Detica (down 42%), joined by staffing services player SThree (down 42%).

Last month we said we wouldn't speculate on how long the fall in IT share prices which began in November would continue. Based on recent performance this month, it may seem that things have already reached a nadir. But we'd be very cautious of suggesting that the threat of a downturn has been averted.