

# ANNEX BULLETIN

Annex Bulletin 2007-12

March 19, 2007

A **CONFIDENTIAL** client edition

Recent...

## HEADLINES

[The Value of pi \( \$\pi\$ \)](#) - System p and System i market and IBM product strategies

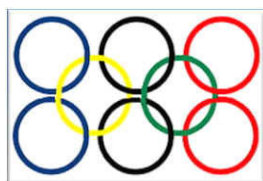
[IBM Profit to Grow Faster Than Revenue](#) - Update to 5-yr IBM forecast [[Annex clients click here](#)]

[Home](#)

## INDUSTRY TRENDS

Updated 3/20/07, 10:10AM PDT, adds [All-time chart...](#)

*Annex Research's 2007 Global IT Services Octathlon*



## HPS, Capgemini Tie for Overall "Gold"

### *EDS Wins "Bronze" after Delivering Real Turnaround*

BEIJING, China, Mar 19 - It seems only appropriate that this year's annual Octathlon results should come to you from the city that will be hosting the next Olympic Games - Beijing, China. The 2008 Olympic signs were already everywhere even during my last visit here, including near the Great Wall (see right photo). The winners of our annual Global IT Services Octathlon may not rate as much pomp and ceremony as the Olympic sports stars, but their Octathlon medals are certainly worth a lot more money.



Also check out...

[Index 1993-2007](#)

[IBM Profit to Grow Faster Than Revenue](#) - Update to 5-yr IBM forecast [[Annex clients click here](#)]

[The \(T\)ides of March Sink Markets Again](#) - Analysis of global economic & investment trends

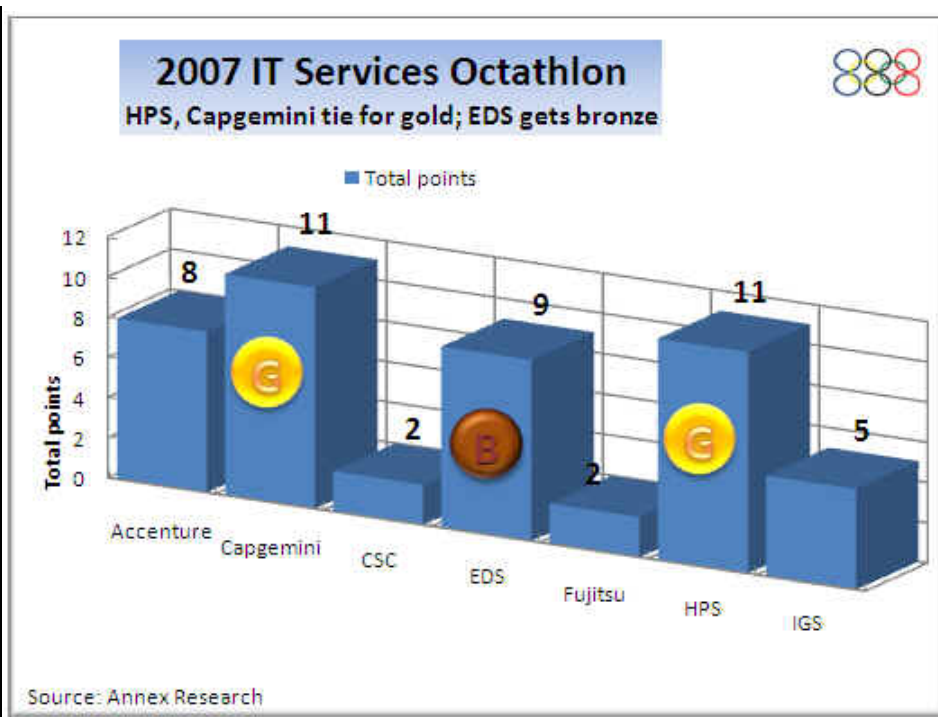
[IGS: Growth Slows, Profit Surges](#) - Analysis of IGS 2006 business results [[Annex clients click here](#)]

[HP: Toward New Highs?](#) (Excerpts from analysis of HP's first quarter FY07 business results) [[Annex clients click here](#)]

[Capgemini Caps Great Year, Saves Best for Last](#) (Analysis of Capgemini's fourth quarter business results)

[EDS: On Sunny Side of Street](#) (Analysis of EDS' fourth quarter business results & turnaround, Act II)

[CSC: Where Less Seems More](#) (Analysis of CSC's third quarter fiscal 2007)



The two companies whose stars shone the most brightly in the 2006 global IT services arena were Hewlett Packard Services (HPS) and Capgemini. By the time all the scores were in, they ended up in a tie for Octathlon "gold" with 11 points each (see the chart and [table](#)). HPS won three gold medals in individual competitions, along with one silver. Capgemini, on the other hand, earned its 11 points with two gold, two silver and one bronze medal (click on the right chart).



A much-improved EDS won the "bronze" with nine points. It was the first time since 2003 that the second largest company in the IT services business earned an Octathlon medal.

[business results](#))

[Fujitsu: Sales Up, Profit Down](#) (Analysis of Fujitsu's third quarter fiscal 2007 business results)

[IBM Shatters Records](#) (Analysis of IBM's fourth quarter business results)

[IBM Stock Passes Century Mark](#) (Analysis of Big Blue's Stock Performance)

[Happy Days Are Here Again](#) (Analysis of Top 20 IT leaders' latest stock market and business performances)

["Excellenture" Excels Again](#) (Analysis of Accenture's first quarter fiscal 2007 business results) [[Annex clients click here](#)]

[Hedging the Bets](#) (Analysis of latest institutional shareholdings of leading IT companies: IBM, HP, Accenture, EDS, CSC, BearingPoint, ACS, Perot) [[Annex clients click here](#)]

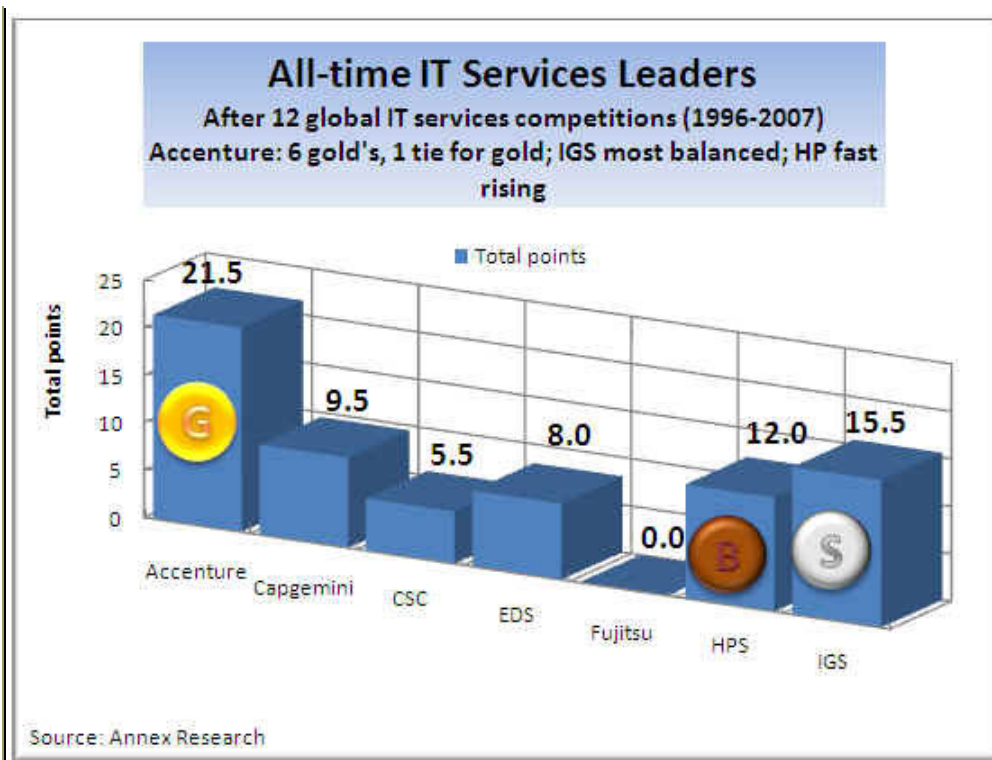
[Globalization Accelerates](#) (Analysis of United Nation's annual survey of global investments)

[IBM: A \\$125-Stock?](#) (An update to "From Small Acorns Mighty Oaks Grow")

[Capgemini: Longest Sustained Stock Price Rise](#) (An update to "By Leaps and Bounds")

[HP: New King of the Hill](#) (Analysis of HP's fourth quarter business results)

[IBM: From Little Acorns Mighty Oaks Grow](#) (Analysis of IBM's "State of the Union")



As for the all-time results, after 12 years of global Octathlon competitions, Accenture continues to lead with 21.5 points, followed by IGS with 15.5 points and HPS with 12 points. Capgemini and EDS are fourth and fifth respectively (see above chart).

### Octathlon Scoring

Just to recap quickly for our new readers the IT Services Octathlon scoring... The overall medal standings are determined by awarding three points for a “gold,” two points for a “silver,” and one point for a “bronze” in each of the eight competitions of the top global IT services vendors.

The eight categories are:

1. Revenue Growth – current year
2. " " " ...and 5-year
3. Market Share Gain/Loss
4. Net Margin
5. Gross Margin
6. Frugality
7. Sales Productivity
8. New Contract Sales

All these figures are for the prior calendar year results, 2006 in this report. We also wish to remind our readers that the only competitors among the Top 7 that don't publish their new contract sales are HPS and Fujitsu. As a result, we treated them as “no shows” in this Octathlon category.

And now, here's a “play-by-play” report from this year's competition.

[Capgemini: By Leaps and Bounds](#) (Analysis of Capgemini's preliminary third quarter business results)

[Fujitsu: Good Performance Gets Better, More Global](#) (Analysis of Fujitsu's first half FY2007 business results)

[IBM: A Slam Dunk Quarter](#) (Analysis of IBM third quarter business results)

[Accenture's Emphatic Year-end Accents](#) (Analysis of Accenture's fourth quarter results) [[Annex clients click here](#)]

[IBM: Services in a Box](#) (Analysis of IBM Global Services' Ground-shifting Announcements)

[Strong Comeback by IT Stocks in Third Quarter](#) (Analysis of top 20 IT companies' market and business trends)

[Stock Buybacks: A Fading Fad](#) (Dell, erstwhile "King of Fluff," suspends its stock buybacks)

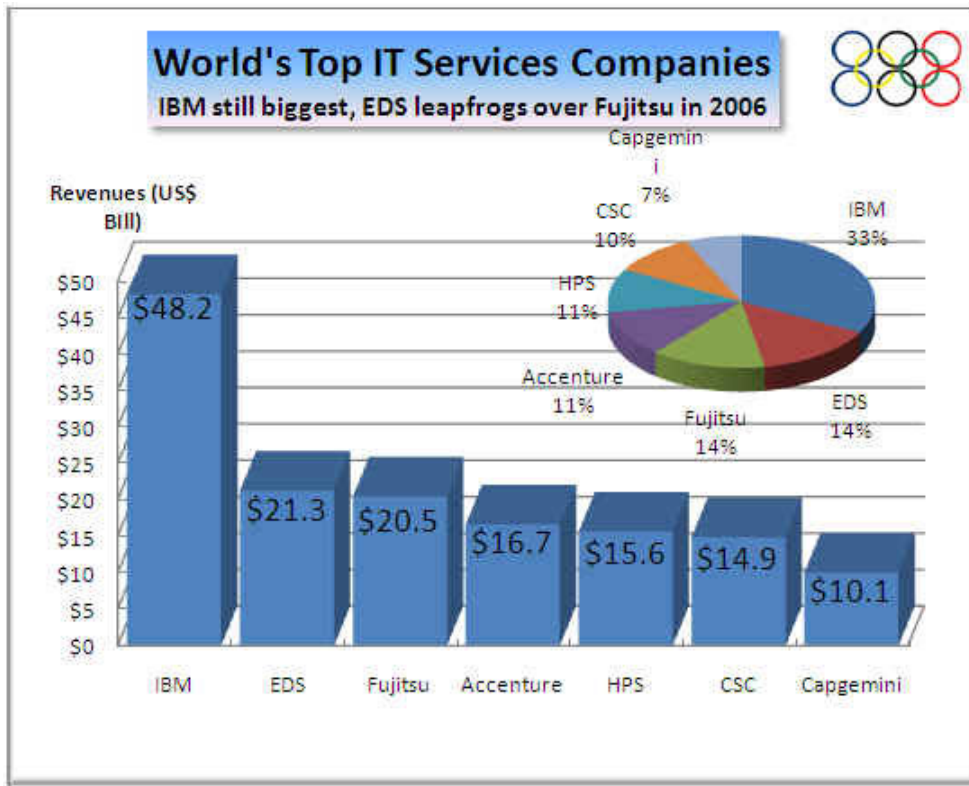
[Capgemini: Growth Continues](#) (Revenues, net profit up in double digits, margins also improve)

[HP Firing on All Cylinders](#) (Stock sets new multi-year record following excellent third fiscal quarter results) [[Annex clients click here](#)]

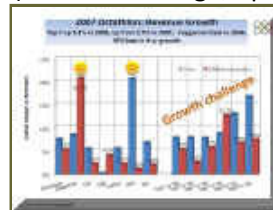
[Power of Manpower](#) (While others move to India, Russia... AMD invests in New York, hailing "phenomenal" quality of its labor force)

[Ebb Tide Lowers Most Boats](#) (Analysis of EDS' and CSC's latest quarterly

1.-2. Revenue Growth (2 Medals)



The “gold” medal for revenue growth in 2006 went to Capgemini (with a 21% surge; up 10% in constant currency - right chart). Just like last year, Accenture won the “silver” with a 5.2% increase, while EDS earned the “bronze” with a 4% rise.



The long-term revenue growth "gold," however, went to HPS, also with a 21% compound annual growth. Just as foreign currency translations aided Capgemini's in 2006, the Compaq acquisition boosted the HPS revenue rise in the last five years (the Compaq deal was announced in September 2001, and consummated in mid 2002).

The long-term revenue growth "silver" went to Capgemini, while Accenture earned the "bronze" ([click here](#) to see a detailed table).

As with previous Octathlons, all revenue figures used in this year’s competition were either the reported numbers for companies whose fiscal year-end ends Dec 31, or were our estimates of other competitors’ calendar year 2005 results.

**Slow Growth: A Chronic Problem**

It should be noted that most revenue growth medal winners grew by acquisitions (except for Accenture). Among some major deals, CSC acquired DynCorp (2003), HP acquired Compaq (2002), while IBM acquired PwCC (2002). Lacking any major acquisitions in 2006, revenue growth of the Top 7 contenders slowed down to 4%. So once one of the fastest growing industry segments, the top of the global IT services

results)

[IBM Stock Grossly Undervalued? \(Analysis of stock market valuations of IBM and its major competitors\)](#) [[adds latest Fujitsu, Capgemini results](#)]

[IBM vs. HP: A Tale of Two Blues \(Both companies are doing well in business, but only HP is favored by Wall Street; Big Blue trying to change that now with its new "India Opus"\)](#) [[Annex clients click here](#)]

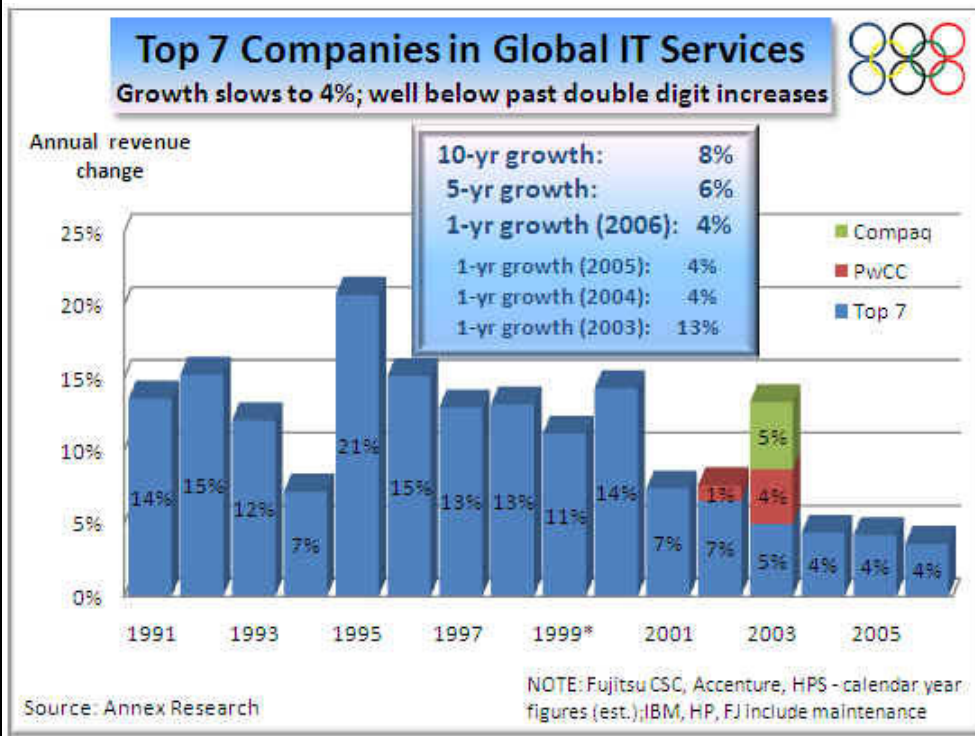
[Go East, Young Man! \(A speech delivered in St. Petersburg, Russia, May 25, 2006; click here for slides\)](#)

[IBM 5-Yr Forecast: Steady As She Goes \(Emphasis on quality continued\)](#) [[Annex clients click here](#)]

[Octathlon 2006: Accenture Again Wins "Gold!" \(HP gets "Silver," IBM "bronze"\)](#) [[Annex clients click here](#)]



market is now showing sub-par performance.



The currency- and acquisitions-aided growth of our two gold medal winners this year barely masks a chronic problem that has enveloped the top 7 players in the global IT services game. It is a lack of growth. For the last three years, it has averaged only 4%. Which is four to five times less than their average growth rates of in the 1990s (see above chart and the thumbnail below).

Maturation of the high-end of the IT services market is clearly one reason for it. The low hanging fruit has been picked. As a result, it is now harder to extract more business from the same client base.

Another reason, however, is vendor-related. It is complacency that success breeds. None of the top 7 global IT services companies has gone out of its way to find and develop new markets. Even the fastest growing sub-segment - BPO (Business Process Outsourcing) - is a 10-year old trend. And it is still largely focused on the same client base as the traditional infrastructure outsourcing.

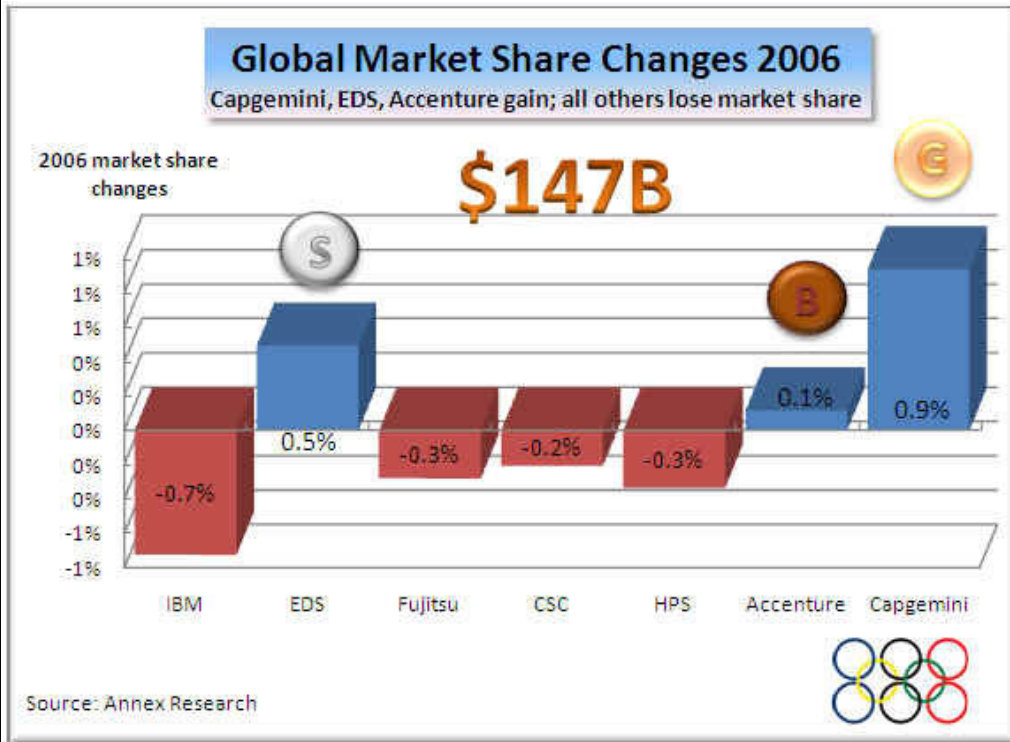
None of the leaders has ventured into SMB (Small & Medium Business) market in any discernible way. Or developed a strong presence in big emerging countries (China, India, Russia, Brazil...). Nor have they followed our "amoeba syndrome" advice - split up in order to grow.

So if the top 7 revenue growth chart looks boring, if not alarming, they have only themselves to blame. As long as they nurture complacency, sooner or later some newcomer will upset the apple cart (GoogleServ, anyone?). Just as IBM did in the late 1980s and early 1990s, for example, when it took over the IT services industry by storm.

Of course, doing it prophylactically, rather reactively, would serve today's IT services leaders better. Alas, that's not how human nature or market works. Most companies wait till their feet are held to the fire to get moving quickly. That's when they will all start to scramble in an effort to reinvent themselves.

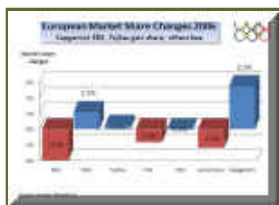
### 3. Market Share (1 Medal)

Capgemini, EDS and Accenture were the market share gainers among the Top 7 in a year that did not see much movement in this Octathlon category. None of the competitors won or lost more than a point of market share in 2006.



The three medal winners gained 0.9%, 0.5% and 0.1% respectively. IBM, the biggest market share loser, dropped only 0.7 of a point.

In the U.S. market, Accenture gained share in 2006, mostly at IBM's expense. The rest of the competition more or less treaded water (right chart)



In Europe, Capgemini and EDS were the big gainers, while IBM, Accenture and CSC lost share (left chart).

In 2004, Capgemini and Accenture had surpassed EDS, dropping the former "Euro star" to the fourth place (right chart). But as we predicted a year ago, EDS is staging a comeback, after it had won the big British defense contract.

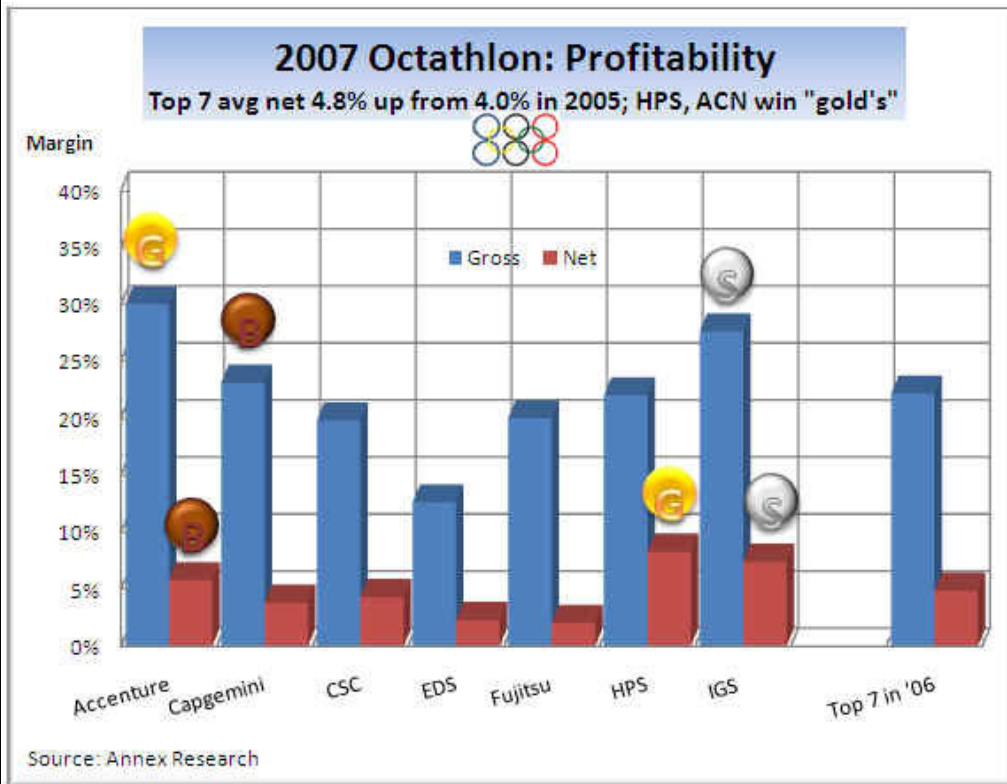


In the Asia/Pacific market, IBM and

Accenture gained share, CSC inched forward a bit, while rest of the competitors lost share (left chart).

#### 4.-5. Profitability (2 Medals)

Just like in the last two years, Accenture again won easily the gross margin “gold,” followed by IGS and Capgemini, which claimed the “silver” and the “bronze” respectively.



The net margin “gold” went to HPS this year for its vastly improved profitability in 2006. IGS and Accenture claimed the “silver” and the “bronze” respectively.

Octathlon	Net Margin
Top 7 in '06	4.8%
Top 7 in '05	4.0%
Top 7 in '04	1.8%
Top 7 in '03	2.3%

What the top 7 global IT services industry leaders may be lacking in revenue growth, they have evidently more than made up in improved profitability. Net profit margins have more than doubled in the last three to four years. And a major factor in this has been "offshoring," "rightshoring," "nearshoring" or any other new term that has sprung

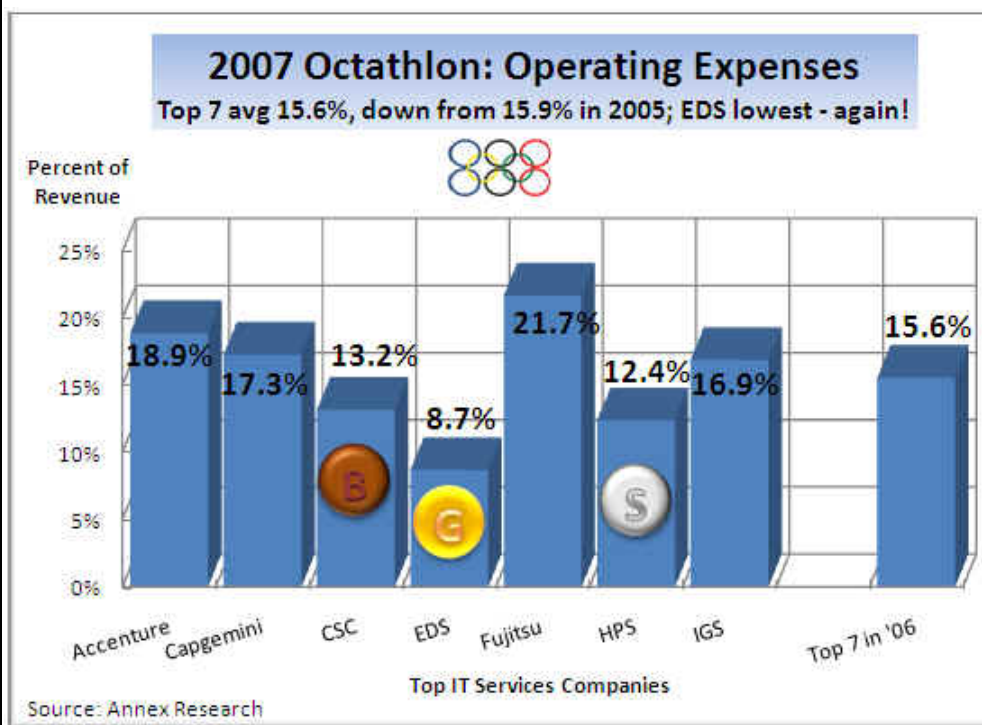
up in the last four years that connotes "[A Passage to India](#)" (and to other places with lower labor costs).

So it is clear that the executives' focus has been on the bottom line, even if the growth at the top line is sagging. Good defense can will ball games as can good offense. But it is rarely a way to grow the fan base and fill ballpark seats.

The ideal combinations is, of course, having both (good growth and high profitability). But that's easier said than done. Maybe when our three-year old Holy Grail trend finally gets untracked, and the client companies do start to reinvent themselves (see "[IT Industry: Whither Goeth It?](#)", Jan 2004), IT leaders' shareholders can hope to see both.

## 6. Frugality (1 Medal)

Just as Accenture seems to be pre-subscribed to profitability medals, EDS has been a perennial winner of frugality competitions. One of the most beleaguered competitors in the 2002-2005 time frame, EDS still continued its unfettered grip on the "gold" for the lowest operating expenses. At 8.7% of revenues (down from 9.2% the year before), EDS' 2006 operating expenses were by far the lowest among the Top 7 competitors.



The "silver" medal winner HPS came in at 12.4% of revenues, while the third place finisher CSC clocked in at 13.2%. The top 7's operating expenses averaged averaged 15.6% in 2006.

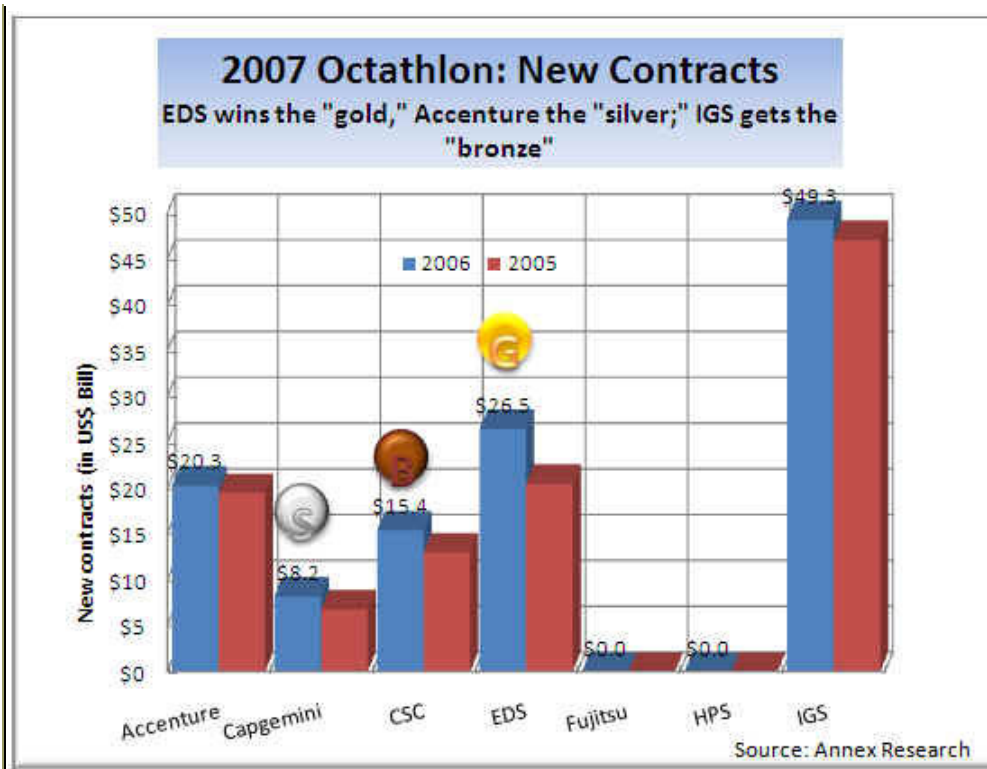
## 7. Sales Productivity (1 Medal)



HPS edged out Fujitsu and IBM by a nose in 2006 to win the "gold" in the sales productivity category (revenue per capita). The "silver" and the "bronze" medal winners were virtually in a dead heat. It was the same lineup of medal winners as in last year's Octathlon. The aggregate average sales productivity of the Top 7 competitors was flat with 2005 at about \$196,000 per capita.

### 8. New Contract Sales (1 Medal)

EDS won the "gold" in new contract sales in 2005 with a 38% improvement (to \$20.5 billion) over the dismal 2004 results. And in repeated that feat last year with a 29% surge to \$26.5 billion despite, what Wall Street calls, a "difficult comparison." Capgemini got the "silver" with a 21% jump, while CSC earned a "bronze" with an 18% increase.



Overall, the aggregate new contract sales of the companies that report them surged by 12% in 2006 to \$120 billion. Which bodes well for future revenue growth of the industry leaders (assuming, of course, the "rescoping" and cancellations do not reduce the backlog at the other end).

As we pointed out in our last year's Octathlon report, we think that monitoring the changes in the IT services vendors' *backlog* would be a more accurate way of gauging their net sales performance. Alas, only IBM publishes its backlog. So we've settled for the next best thing – measuring the change in gross new bookings.

### Summary: The Growth Problem

As you have seen, the largest global IT services companies suffer from the same ailment. It's called the growth problem. And it's a chronic condition. The five-year annual growth rates have dropped from 17% to 4%.

If this sounds like a *deja vu* conclusion, it is. It is pretty much the same thing we said a year ago about the [Octathlon 2006 results](#). So what's to be done?

Some IT leaders are looking to supplement indigenous growth with big acquisitions. Capgemini's and EDS's purchases of Kanbay and Mphasis respectively (see "[By Leaps and Bounds](#)," Oct 2006, and "[On Sunny Side of Street](#)," Feb 2007), would certainly qualify as "big" ones. But they happened late in 2006, and thus did not affect the Octathlon 2007 results very much.

EDS's new acquisitiveness, however, heralded by its executives in February and fortified by a \$3 to \$4 billion war chest, could certainly make a difference in this year's growth results. And if IBM extends its buying spree from software to services, we could see a

growth spike among the top 7 this year.

### Break Up and Diversify

Our next piece of advice to the IT services industry leaders (especially the biggest, IBM Global Services), will again sound like a broken record: **Break up and diversify**. We have been recommending these two things for over 11 years now.

Break up in order to grow faster (see "amoeba syndrome" in "[Break Up, IBM!](#)", Mar 1996). Diversify, so as to open up new markets (SMB, emerging countries).

Alas, as long as the top 7's bottom line margins keep improving, as they have been, and the Indian and other labor markets keep producing enough cheap and skilled engineers to feed the offshoring machine, we won't be holding our breath for such bold moves any time soon. As we've said earlier, usually such actions are born out of fear - of hearing competitive footsteps right behind. Alas, we see no such incentive at the moment.

So back to deja vu; "same old, same old" blocking and tackling...

[Click here](#) for detailed tables and charts (Annex clients only)

*Happy bargain hunting!*

*Bob Djurdjevic*

NOTE: Growth by acquisitions applies to all revenue medal winners except for Accenture. As we also [noted in 2003](#), Accenture is the only company among the Top 7 whose growth has been mostly organic (internal). The only exception was its [last year's acquisition of Capgemini's North American healthcare](#) operation. But the purchase of a \$170 million revenue-unit (based on its 2004 results) was a relatively minor move on Accenture scale of things that did not have a material impact on the company's growth rates.

 [Click here for PDF \(print\) version](#)



For additional Annex Research reports, check out... [Annex Bulletin Index 2007](#) (including all prior years' indexes)



Or just click on [SEARCH](#) and use "company or topic name" keywords.

Volume XXIII, Annex Bulletin 2007-12  
March 19, 2007

Bob Djurdjevic, Editor  
(c) Copyright 2007 by Annex Research, Inc. All rights reserved.  
e-mail: [annex@djurdjevic.com](mailto:annex@djurdjevic.com)

8183 E Mountain Spring Rd, Scottsdale, Arizona 85255  
Tel/Fax: +1-602-532-7789

The copyright-protected information contained in the ANNEX BULLETINS is part of the Comprehensive Market Service (CMS). It is intended for the exclusive use by those who have contracted for the entire CMS service.

[Home](#) | [Headlines](#) | [Annex Bulletins](#) | [Index 1993-2007](#) | [Special Reports](#) | [About Founder](#) | [Search](#)  
| [Feedback](#) | [Clips](#) | [Activism](#) | [Client quotes](#) | [Speeches](#) | [Columns](#) | [Subscribe](#)