

Improving CIO sentiment

CIOs less pessimistic than in March

European CIOs seem to be less pessimistic than at the beginning of the year. We see first signs of hope that optimism is returning, although starting from a very low base. Our survey reveals that the 2009 IT budgets are down for many companies but not at the same magnitude feared in March/April.

No signs of a big 2010 pick-up yet

It does not appear that European CIOs significantly “underspent” in 1H 09 which dampens the hope of a seasonally stronger 2H 09. A first look at 2010 seems to indicate flattish IT budgets vs 2009. We would hope for more positive numbers when budgets get finalised in October / November but note that the current CIO expectations do not support a strong rebound.

Market share gains for large vendors like SAP

We can still observe software spending delays due to the recession but note improved spending intentions for the larger vendors like SAP, Oracle or IBM. The most bullish data points can be seen for Microsoft, probably ahead of the new product cycle.

Micro Focus - entering an interesting market

Through the recent two acquisitions, Micro Focus is entering the software testing market. Our survey shows that HP and IBM are the main players but that there is still a good market opportunity as one third of the market is still only addressed by in-house solutions.

Logica - less aggressive on pricing than feared

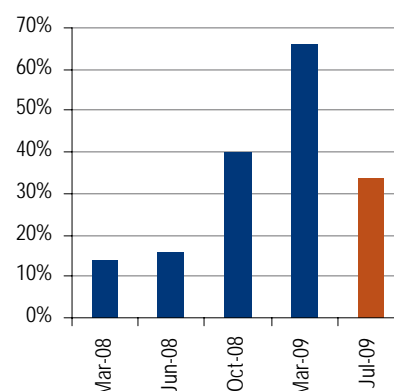
Our survey seems to disprove the theory that Logica's stable revenues are a result of a very price aggressive, long term margin-dilutive sales approach. We continue to believe that management does not get enough credit for its turnaround efforts and see further upside potential in this name, especially when considering that it still trades at a discount to the sector.



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Chart 1: Percentage of CIOs that are less bullish than 3 months ago



Source: Datamonitor

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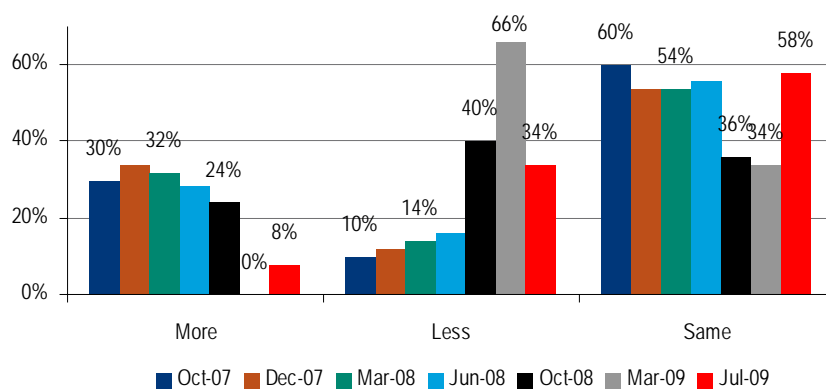
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Improved sentiment

Our July/August 2009 CIO survey shows that CIO sentiment is improving compared to the extreme levels from March/April of this year. A much smaller number than in the last survey is less bullish than 3 months ago (Chart 2) and we have first signs of hope again with a small number of IT managers being more positive again.

France (16%) and UK (15%) have the highest number of more positive CIOs while in Spain (60%) the majority of CIOs are still bearish. Looking at the different verticals we can see that Materials (25% more positive) stands out while banking (50% of CIOs still less bullish) has not fully turned the corner.

Chart 2: Are you more or less positive re IT spending than 3 months ago?



Source: Datamonitor

2009 budgets less negative than seen in March

Similar to the March survey there is no CIO among the 50 IT managers we interviewed that sees his 2009 IT budget growing. However, we can see that the expected rate of decline is less dramatic than anticipated in March (Table 1). In our view, this is another sign that the situation is stabilising.

The biggest cuts seemed to have happened in the UK with almost 50% of CIOs seeing their budget down by at least 5%. The Southern European countries (Italy, Spain) were more stable with 80% of budgets unchanged compared to 2008.

The strongest industry, in terms of spending power, seems to be consumer discretionary (80% of CIOs are seeing their 2009 budget flat or up). The weakest industries are not surprisingly industrials (75% of CIOs see 2009 budget down) and utilities (100%).

Table 1: What YoY IT budget growth do you expect for 2009?

	Jul-09	Mar-09
>10%	0%	0%
0-10%	0%	0%
Flat	38%	38%
down 0-5%	38%	18%
down 5-10%	8%	16%
down >10%	16%	28%

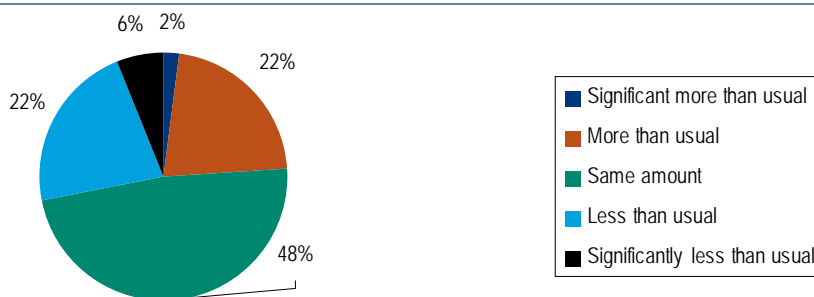
Source: Datamonitor

No evidence for 2H budget flush yet

Increased confidence and a larger than expected 2009 budget could, theoretically, mean a seasonally strong 2H 09. We tried to prove this with our next question but as can be seen in Chart 3 there seems to be no strong evidence.

Looking at the different verticals there seems to be some upside potential for the consumer discretionary (40% of CIOs see a higher than usual 2H 09 budget), Utilities (33%) and FS (28%) sectors but we fear we will probably only get confirmation with the Q4 results season in Jan 2010.

Chart 3: How much of your IT budget is left to be spent in 2H 2009 compared with previous years



Source: Datamonitor

No conclusive evidence for big 2010 spending acceleration

Table 1 shows that so far we have not seen an increase in CIOs seeing an acceleration in spending in the coming quarters. 40% of IT managers are seeing an increase in spending in the coming 5 quarters. This is down from the 50% in our March survey. This is not a positive data point and hence we need to monitor the feedback from CIOs in future surveys. However, we would also highlight that CIOs surveys are usually seen as late cyclical data points.

Table 2: When will IT spending accelerate again?

	2H 2009	1H 2010	2H 2010	No change	Decline
July 09	2.0%	18%	20%	42.0%	18.0%
March 09	10.0%	20%	20%	26%	24.0%

Source: Datamonitor

The most positive CIOs can be found in Germany (50% see an acceleration of IT spending in the coming 15 months) and Scandinavia (60%).

2010 budgets seen flattish

A first look at the 2010 budget growth plans shows that so far the recovery potential seems limited (Table 3). The majority of CIOs see a flat 2010 IT budget. We would argue that this number could still change meaningfully given that IT budgets are usually set between September and November.

Table 3: What YoY IT budget growth do you expect in 2010?

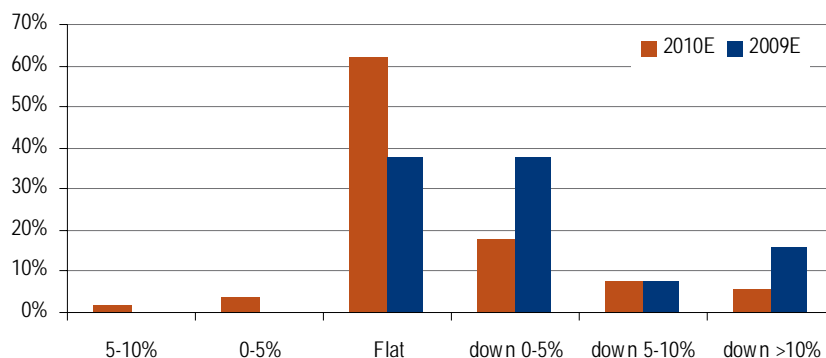
>10%	0%
5-10%	2%
0-5%	4%
Flat	62%
down 0-5%	18%
down 5-10%	8%
down >10%	6%

Source: Datamonitor

The most positive trend seems to be in Germany where over 90% of IT managers see at least a flat budget. French CIOs seem to be very cautious with their spending intentions as 58% see their 2010 budget down on 2009.

The comparison of the current 2010 and 2009 forecast (Chart 4) shows the slight YoY improvement. We need to see if the next survey will show a stronger improvement in 2010 expectations as otherwise there is a risk that investors are getting ahead of reality in terms of the speed of recovery.

Chart 4: Comparison of 2010 vs 2009 budget growth expectations

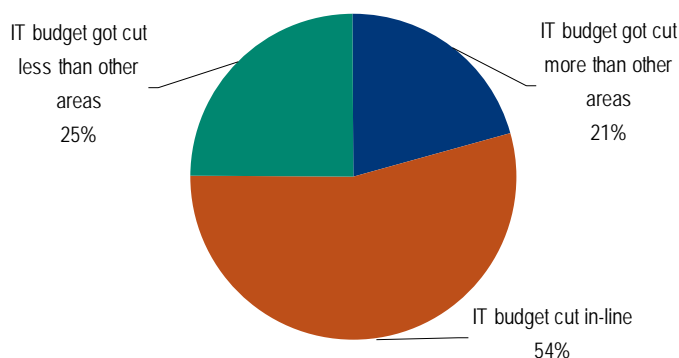


Source: Datamonitor

IT - a normal capex segment

Chart 5 shows that, in contrast to the last recession, IT is now a “normal” capex item and is not being treated any different than other capex investments.

Chart 5: IT budgets were cut in-line with rest of corporate spending



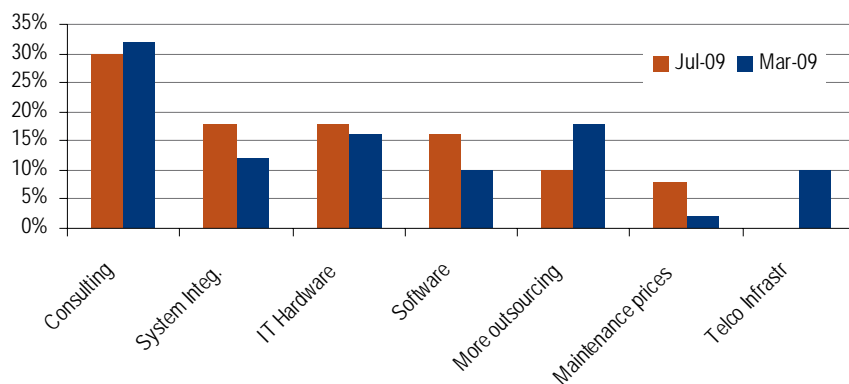
Source: Datamonitor

A look at the detail shows that France saw a lower decline in Tech vs other Capex items (42% of CIOs) compared to the rest of Europe. It appears that the Industrial sector (38%) saw a bigger focus on reducing IT spending vs other capex items compared to other industries.

Consulting still the main source of savings

The areas that are most impacted by budget cut decisions are mostly unchanged (Chart 6). Consulting expenditure continues to suffer most, especially in Germany where 58% of CIOs are focusing on cuts in this area.

Chart 6: What areas of IT will be cut?



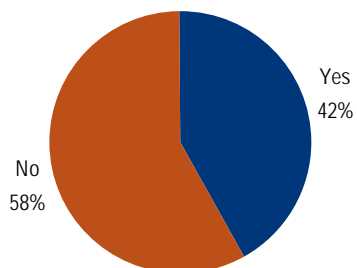
Source: Datamonitor

Interestingly, we can see that there is still a large gap between the UK and Mainland Europe in the attitude towards outsourcing as a means to drive down IT costs. 39% of UK CIOs see outsourcing as a proper step to cut IT spending. Not a single CIO in the other European countries shared this view.

Software specific questions

We still see some reluctance to spend money for new software projects (Chart 7). 42% of CIOs are currently delaying software purchasing decisions due to the recession. This number is almost unchanged from the 44% we observed in March 2009 and in October 2008. France, Germany and Southern Europe are the countries that are standing out (50% of CIOs are delaying decisions).

Chart 7: Are you currently delaying software spending decisions?



Source: Datamonitor

Focus on Microsoft

The clear focus in terms of future software spending intentions for European CIOs seems to be on Microsoft (Table 4), probably ahead of the launch of Windows 7. In particular, the Industrial (88% of CIOs named Microsoft) and the FS sector (71%) seem to be focused on this event.

Table 4: Are you planning to increase your spending with the following software vendors?

	Q107	Q207	Q307	Q407	Q108	Q208	Q308	Q1 09	Q2 09
Microsoft	46%	62%	60%	62%	70%	42%	52%	14%	62%
SAP	34%	42%	34%	44%	34%	36%	24%	30%	40%
Oracle apps	18%	23%	22%	30%	26%	12%	8%	42%	22%
Oracle database	20%	22%	26%	32%	32%	12%	12%	26%	26%
IBM	20%	23%	20%	12%	14%	18%	14%	16%	44%

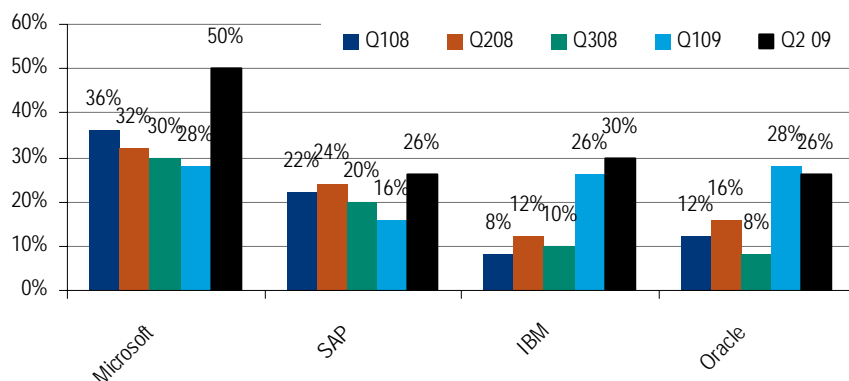
Source: Datamonitor

SAP saw improvements in terms of spending intentions across the board with the exception of France where only 17% saw a focus on SAP spending. A positive indicator for SAP is that 38% of FS CIOs expect more SAP spending going forward – a good indicator that SAP continues to show momentum in this vertical.

Market share gain for Microsoft and IBM

Microsoft is also seen as the software vendor that is gaining a larger share of CIOs IT spending (Chart 8). The company showed particular strength in France (58% of CIOs) and Spain (80%). SAP saw a turnaround of the recent downtrend but continues to have weak readings in France (there only 8% of CIOs see SAP gaining a larger percentage of the IT spending).

Chart 8: Which vendor is gaining a larger proportion of your IT spending?



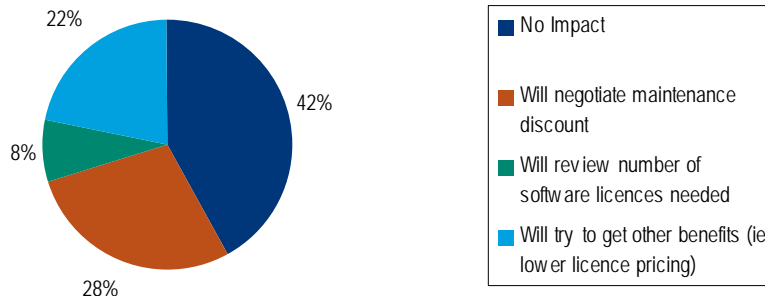
Source: Datamonitor

Maintenance discussions ongoing

As expected, given the severe recession, there are ongoing discussions re maintenance pricing (Chart 9). We believe this is the area in which software companies will fight the hardest to maintain pricing power.

Chart 9 shows that a large amount of CIOs (42%) is accepting the current price structure. Especially Germany (60%), Italy (60%) and France (50%) seem content in terms of their current maintenance payments.

Chart 9: Will the recession impact your maintenance payments?



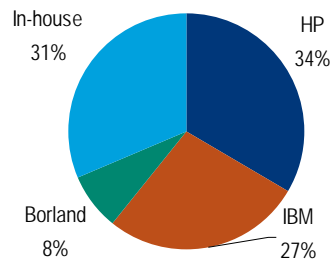
Source: Datamonitor

CIOs in the UK seem to be the most aggressive with 54% of IT managers stating that they are trying to negotiate maintenance discounts.

Testing software market - a good opportunity

In our last software related question we are trying to get a better understanding of the market for testing software. This area has recently come into focus due to the two acquisitions by MicroFocus. We can see (Chart 10) that there are two main players in the market (HP, IBM). It seems that HP has a strong market position in the UK (46% of UK CIOs we interviewed are using HP) and that IBM is better positioned in Germany (42% of CIOs). Borland, one of the two recent acquisitions by MicroFocus was only mentioned by UK (15%) and German (17%) CIOs. However, we still see a good market opportunity for MicroFocus as about a third of the market is still served with in-house developed solutions.

Chart 10: Which vendor are you using for software testing?



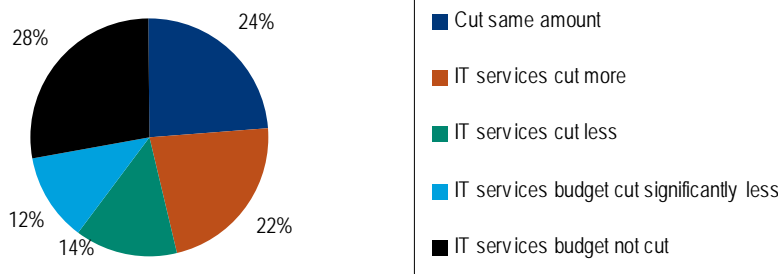
Source: Datamonitor

IT Services specific questions

So far the revenue of the European IT services names has been holding up better than expected, especially when looking at the declines we have seen in the software industry. Chart 11 shows that there has not been movement within the IT budget which suggests that the main European players must be taking market share from their smaller, local rivals.

Interestingly, we can observe that in the more SAP dominated German market significantly more CIOs cut their IT services spending in comparison to software (42%) while in the more services driven French market we can observe the opposite story (42% of CIOs have cut less in IT services).

Chart 11: How do the cuts for IT service spending compare to cuts in software spending?



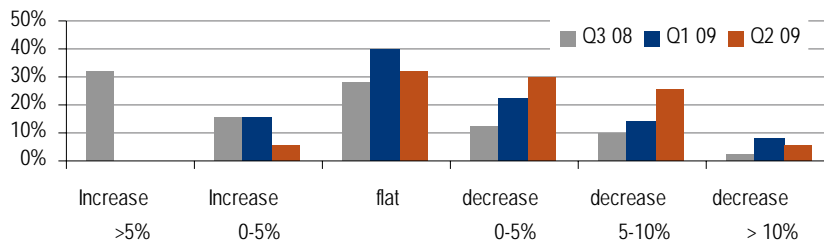
Source: Datamonitor

Pricing pressure is increasing

As expected, at this late stage of the cycle we can observe an increase in pricing pressure for the IT services industry. This is a normal situation and we were able to observe this already in the past recession. Logica, Cap and Atos should benefit from this.

It seems that CIOs in the very competitive German market are especially price aware. Over 40% of CIOs here see price reductions of 5% and more. The UK seems a much more benign market with over 60% of CIOs seeing flat to increasing prices.

Chart 12: What price reductions for IT services consultants are you expecting in the coming 6 months?



Source: Datamonitor

Logica not as price competitive as feared

Given the ongoing market concerns that Logica is very price aggressive to win business we tested this theme with the European CIOs. The 50 IT managers that we interviewed did not seem to share this view (Chart 12). Only some German CIOs named Logica but no CIO in Logica's main markets (Scandy, UK, France) saw the company as particularly aggressive on price.

In our view, it appears that the price competition is partly driven by the smaller local vendors. We also see, not surprisingly, the Indian vendors mentioned, especially in Scandinavia (66% of CIOs). This could be an issue for the incumbent Tieto.

Table 5: Which IT services vendor do you see competing most aggressively on price at the moment?

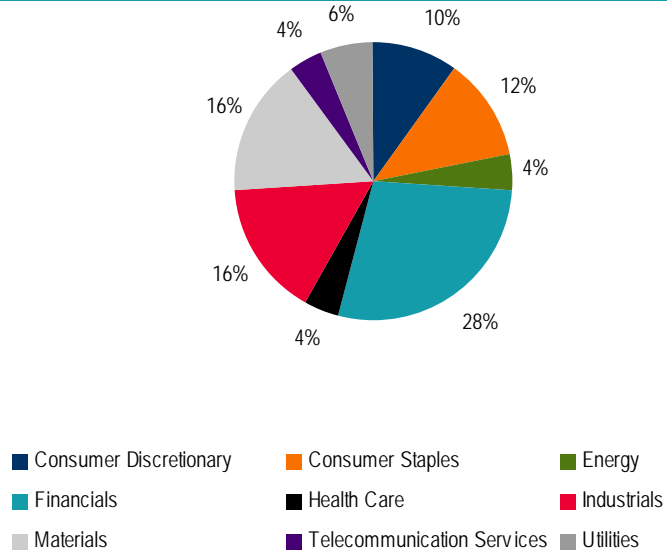
Cap	Atos	Logica	Tieto	US players	Indian vendors	Smaller local vendors
10%	2%	2%	12%	48%	10%	16%

Source: Datamonitor

Survey constituents

Our CIO survey is based on a panel of 50 companies interviewed in July 2009. We classify the companies across verticals according to the Global Industry Classification Standards (GICS), with the breakdown provided below.

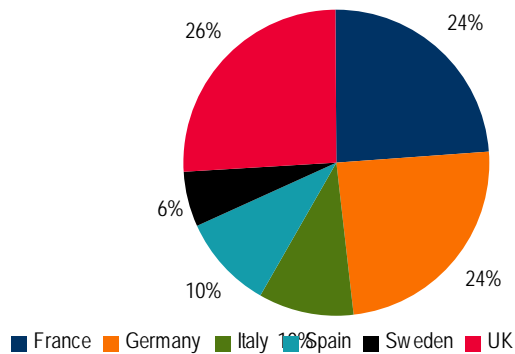
Chart 13: Survey industry breakdown



Source: Datamonitor

Note that the survey has a greater focus on France, Germany, and the UK, so we break the responses down into those regions where relevant. We have also interviewed CIOs from Italy, Spain, and Sweden.

Chart 14: Country split of CIO survey



Source: Datamonitor

Table 6: Companies mentioned table

Company	ML code	Currency	Price	Rating	Analyst
Atos Origin	AEXAF	EUR	34.7	B-2-9	Jonathan Tseng
Capgemini	CAPMF	EUR	35.6	B-1-7	Raimo Lenschow
Hewlett-Packard	HPQ	USD	45.7	B-1-7	Craig Scott
IBM	IBM	USD	118.9	B-1-7	Craig Scott
Logica	LGIAF	GBP	127.0	B-1-7	Raimo Lenschow
Micro Focus	MCFUF	GBP	338.9	C-1-7	Raimo Lenschow
Microsoft Corp	MSFT	USD	25.0	B-1-7	Kash Ragan
Oracle	ORCL	USD	22.7	B-1-7	Kash Ragan
SAP A.G.	SAPGF	EUR	35.2	A-1-7	Raimo Lenschow
Software AG	SWDAF	EUR	55.8	B-2-7	Raimo Lenschow
TietoEnator	TCYBF	EUR	13.4	B-3-8	Jonathan Tseng

Source: Banc of America Securities - Merrill Lynch estimates.

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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