

Mid-tiers tap the right sources

Joshua Gliddon

The listed technology sector has had a strong year, with the mid-tier services companies, including Oakton, SMS Management and Technology, UXC and ASG, doing particularly well.

"There's no visibility of a turnaround in the sector," Pengana Capital analyst Ed Prendergast said. "There is no nervousness in the corporate world or from government about budgets in the sector."

Driving the strong performance of the services companies has been the ongoing trend towards the break-up of monolithic outsourcing deals into smaller, more multi-sourced deals.

UXC has done well in the multi-sourcing area, winning contracts that include a \$10 million deal to maintain the Department of Defence's personnel and management system, PMKeyS.

It also won a 10-year contract to upgrade the Department of Foreign Affairs and Trade's voice communications system, together with an earlier contract to upgrade and maintain the Department of Health and Ageing's communications infrastructure.

"Multi-sourcing favours the mid-tiers over the multinationals," Mr Prendergast said.

Oakton has also done well, following its \$45 million acquisition of Acumen Alliance, an outsourcer with a strong presence in the lucrative Canberra-based federal government sector. The deal sent

IT'S HOT

Weight in index %	Company
2.29	Bravura Solutions
2.49	Commander Communications
52.57	Computershare
1.79	Infomedia
8.34	Iress Mkt Technology
3.06	MYOB
4.04	Oakton
3.32	SMS
3.78	UXC
13.85	Silex Systems

Oakton's stock to a 12-month high, and is expected to add \$60 million in revenue and \$5.5 million in earnings.

SMS also put a shine on its business when it paid \$4 million in cash and shares as well as a further \$1 million performance payment for Sydney-based applications developer AVOGA.

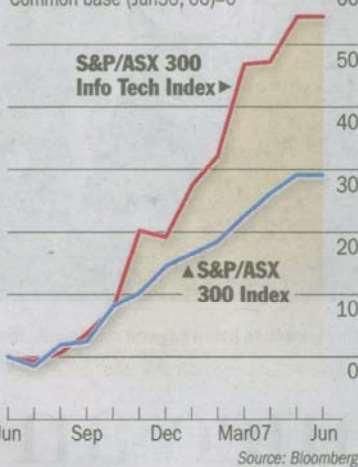
At the time of the acquisition, SMS chief executive Tom Stianos said it was the last piece in the puzzle for the company's five-year plan.

The question is whether there's further room for growth in the services sector. Some analysts feel the stocks are fully priced, while others think their multiples are only justified as long as earnings keep pace.

"The earnings have been

Comparative returns

Common base (Jun30, 06)=0



incredible," Paradise Investment Management portfolio manager David Paradise said. "But it is the price that is interesting. They are all trading at 18 to 20 times multiples. And that is fine as long as the earnings keep coming through and they are seeming to justify the valuations."

Smallco partner Rob Hopkins agrees. He suggests there's already a large amount of performance built into the share prices. "If they hit their earnings numbers, then the share price will do well," Mr Hopkins said.

"However, it has been a good year. You have seen all those services companies go for huge runs."

Mr Prendergast said that the share prices could still rally, based on

earnings. "It's also worth noting that if you look at their balance sheets, then they are very low geared. There's not a lot of debt there. So the P/Es might look highish, but there's no debt behind it."

Another possible hiccup for 2008 is the tightness of the labour market. "Companies that can access the skills will get some degree of pricing power," Mr Prendergast said.

Looking ahead, the internet sector should also continue to perform well in 2008, Mr Hopkins said. "Wotif continues to perform well, as does Seek," he said.

Mr Hopkins said that Seek's performance should run strongly on the back of its China business. Melbourne IT has also performed well, although not as a traditional internet business: its acquisition of hosting company Web Central was received positively by the market. But Mr Hopkins cautioned that the company's price might have run as far as it could go.

Pure software plays are rare on the Australia market, but Altium has been a quiet achiever. It develops software aimed at computer engineers. The software runs on desktop PCs instead of high-end work stations, making its offering price-competitive.

"They were a profitable company before the tech boom, and after the tech boom they kept their costs under control," Mr Hopkins said. "They have focused on getting their sales force right, and this is starting to pay off."

"We should see that performance continue for another few years."