

Wednesday, Feb. 28, 2007
Vol. 23, No. 04

Soft•letter

BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS

Second Life and Software: Two Avatars Meant for Each Other?



Google bests Microsoft in the Operating Income sweepstakes but SaaS as a category fails to impress
See pages 4-5.

In the 01/31/2007 issue of Softletter we quoted Sun CEO Jonathan Schwartz as saying that if he wanted to sell software, he'd set up shop on Linden Labs "Second Life." Shortly afterwards, we received a call from Stu Sjouwerman, founder and VP of Marketing of Sunbelt Software, which is busily establishing an online presence in the much talked about virtual world. Sunbelt has its own island in Second Life (Sunbelt Island), virtual buildings, and several other things going on. Founded in 1994, Sunbelt sells a wide variety of desktop and server antivirus and antispam products and is currently a \$20m firm. Of particular note is Sunbelt's massive (for a company of its size) forum community; over 30k participants broken down into a wide variety of special interest groups. He invited us to take a look at his island and discuss what Sunbelt thought it could accomplish by making an investment in this 3D, avatar-driven web world. As of this writing, we believe Sunbelt is the only major software firm with a significant presence in Second Life (Dell, IBM, and Sun are all involved in setting up stores and meeting areas in the system).

First, some personal observations. If you're not a paying customer, gaining access to Second Life can be a problematic experience. The underlying infrastructure of Second Life, called "the grid," is not able to scale up like an EverQuest or World of Warcraft (not surprising, since the system has about 10k to 20k paying customers (approximately 4m have signed up for free accounts) paying between \$6 to \$10 per month. Contrast that with EverQuest's monthly 350k user base and WOW's incredible 8m. All that monthly cash means a lot larger server farms. In Second Life, pay as you go means you can usually go somewhere quickly. At any one time, there will currently be about 30k of Second Life's citizenry in the world, and though there are about sixty "welcome" islands, each supports only sixty or so people at a time. Paying members seem to get in more rapidly, so if you're there on a freebie account, expect to sometimes drum your virtual fingers as you wait in a virtual line to get in (or log out, log in, and hope the server gods smile at you as you attempt to enter.) Once in Second Life, you can walk, fly, and teleport to various locations. The type of people you'll meet range from the incomprehensible to the bewildered to the experienced denizen who firmly believes in the value of what they're doing (and what that is can sometimes be hard to explain. We still don't quite get the virtual bars with virtual cocktails, wines, and beers).

Also, Second Life demands up-to-date hardware; the client you download to your desktop that allows you to connect (continued on page three)

Publisher & Managing Editor
Merrill R. Chapman
rickchapman@softletter.com
860/663-0552

Editor
Donald K. Rosenberg
don@softletter.com
919/687-4172

Editor Emeritus
Jeffrey Tarter
jtarter@softletter.com
617/668-0028

Editorial office
Soft•letter
34 Sugar Hill Rd.
Killingworth, Conn.
06419
Voice: 860/663-0552

Subscription office
Aegis Resources
34 Sugar Hill Rd.
Killingworth, Conn.
06419
Voice: 860/663-0552
Fax: 860/663-0553
info@softletter.com

www.softletter.com

CD Cover Mount Placement Programs, Part II of II

by Mark Haskell, Strategic Connexions

Negotiating with Publications

The obvious first port of call for discussions is the DVD or CD editor. If the publication doesn't have someone with this title, an editor is generally the next best person. The people you should be looking to avoid are sales and marketing as their natural instinct will be to quote you a price. If your offer is free "lite" software valued at \$X plus a discount on the full product, most magazines will view this as adding value to their publication. How much value will largely depend on how the magazine is financed (subscribers or advertising) and the perceived value of your product to their readers. Of course a bigger \$X value for the lite version and discount on the main should increase its appeal, especially if most of the other products on the CD cover mount is trialware.

Costs and ROI

Below I list some typical figures based on my own experiences of quotes I have received from IT publications. Excluding giants such as the German magazine "Computer Bild" (circulation 4m) the average figure for circulation is about 40,000.

- **CD cover mount or insert:** \$400 per 1000 CD's or \$16,000 total for a 40,000 circulation publication. With negotiation, you can hope to drive this down to around \$250.
- **Article/advertising half page full color:** \$4,000 for a 40,000 circulation publication. Negotiations can drop this to around \$2500.
- **Newsletter download link:** \$70 per 1000 or \$700 per average 10,000 circulation newsletter.
- **Web banner and download link:** (250 x 250 pixel) \$500 per month.

Occasionally magazines may ask for a percentage of the upgrade sales as a means of payment. One benefit to percentage promotions is that you should receive more "get the word out" effort from the publication and a bigger and more prominently placed accompanying article. What percentage of the sales you'll hand over depends on your negotiating skills and the perceived value of your offering; negotiations typically range between 20% to 40%.

Conversion to sales will depend on numerous factors, including the appeal and appropriateness of your product to readers of a given publication, the readership profile of the publication, the accompaniment of an article (very important!), its position in the publication, the discount you offer on your promotion, and whether your software is one of five, 10 or 100 titles on a disc. Typically, you can expect to see an install to sales conversion rate of approximately .5% of the total number of a single product placed via a cover mount program. Another important factor is localization; an American English product will normally perform at 80% of baseline in another English speaking country such as Australia; expect at most 40% in a non-English speaking locale.

Mark Haskell, managing director, Strategic Connexions, 14/15 Ngo Tat To Street, Bin Thanh District, Ho Chi Minh City (Saigon), Vietnam; +84 (0)8/899-0143. E-mail: mark@sconex.co.uk.

to the system checks your hardware and is very picky about letting you proceed if your system is not up to snuff. We also recommend a direct wire connection to the Internet; Second Life crawls on most G-level wifi connections.

Why are you investing in Second Life?

First of all, I see this as a “Virtual Marketing Pilot” to learn from, and benefit when a 3D Internet becomes a reality. I see that as a “when” not an “if”. And it will become movie quality in just a few years! However, HTTP is a worldwide standard, but up to now, SL is more like a walled garden, like the early AOL and Compuserve. Until SL becomes a distributed grid with an open protocol, and thousands of companies hosting servers, worldwide penetration will not happen. But since Linden Labs has gone Open Source and other companies will soon be able to host SL servers too, this might become reality. We have the potential makings of another Amazon or Google here.

From a more practical standpoint, we think Second Life meshes well with our community system. We believe a significant portion of our forum will, over time, be interested in integrating into Second Life and we want to provide them with a means to do so. Second Life, by its nature, attracts a leading edge user. We want to be in touch with that segment of the market; they’re a valuable cohort of influencers and pioneers.

Do you see Second Life as an opportunity to sell product online? An alternative to today’s 2D online E-commerce model, as exemplified by eBay and Amazon.com?

As opposed to other physical products, software could be sold in Second Life, but it’s way too early to think about that. Virtual products in Second Life have no actual connection to their physical counterparts, other than the name and the appearance. A virtual pair of Nikes does not contribute to the brand experience, and there is no actual connection between the physical product and a Second Life graphical mockup. Trying to create one is likely to be unsuccessful, at least given today’s hardware and software environment.

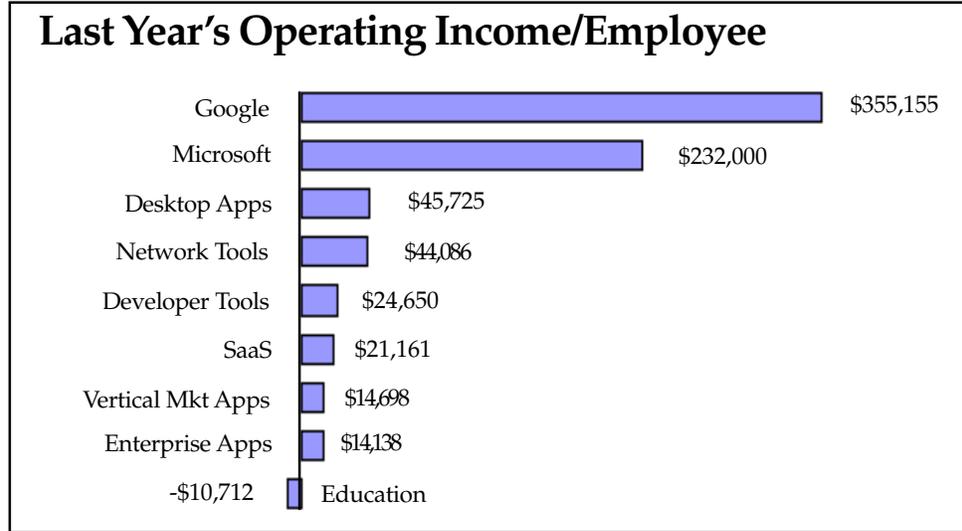
Marketing software in Second Life is to some degree a logical extension of the environment, but you’d be surprised about the resistance even software still encounters. When we have tens of millions of SL residents online, things will become more like the Real World.

What I see as the most effective use of Second Life right now is as brand or image enhancement. Providing interesting lectures, a “Sunbelter” last name (in Second Life, your last name is supplied by the system. Sunbelt offers its community members the ability to assign their own last names), events, both Second Life and real world giveaways, and a place where existing and new customers can hang out gives our community an experience that is generally enhancing, educational and enjoyable.

(continued on page six)

“Commit to staffing your online location in Second Life; a deserted location creates a terrible image for your company.”

—Stu Sjouwerman
Sunbelt Software



Benchmarks: Operating Income per Employee

Operating Income per employee measures efficiency in use of personnel; the figure is the result of subtracting operating costs from revenues, and does not count payments for taxes or interest on debt.

Generally, larger firms have a definite advantage over smaller firms, as the table below shows; it gives the median operating income per employee for firms in different size categories, based on the most recent revenue reports:

>\$1b	\$75,720
\$500m-\$999m	\$32,824
\$100m-\$499m	\$17,169
<\$99m	\$ 7,152

Although the Soft•letter Benchmark 50 contains eight firms besides Google and Microsoft with 2006 revenues greater than \$1 billion, only one of these, Adobe, manages to exceed \$100,000 per employee (\$135,000). The runner-up, Symantec, manages to achieve only \$80,022.

Although Microsoft has the advantage of larger size (\$44.3 billion, or 7.1 times the revenue of Google's \$6.1 million), and extracts greater operating profit from its revenues (37% vs. 33%), its large number of personnel (71,000, or 12.5 times Google's number of people) appears to put it at a disadvantage on our chart: Google manages to extract from the market 53% more operating profit per employee than Microsoft is able to do. Google apparently does this by leveraging both the ability of its developers and the efforts of its sales force by using the power of its server farms as it executes its worldwide information-domination strategy.

Other software companies must make do with less operating profit per employee than Microsoft or Google, but Google's SaaS-focus, leveraging increasingly cheaper processor cycles and the Internet, should give everyone else ideas. But note that for smaller firms, the SaaS figures are not impressive.

The Benchmark 50: Operating Income Per Employee

	2004	Employees 2005	2006	Operating Income/Employees			Avg. '04-'06
				2004	2005	2006	
Microsoft	57,000	61,000	71,000	\$158,491	\$238,705	\$232,000	\$209,732
Google	n/a	3,021	5,680	n/a	\$211,914	\$355,155	\$283,534
Desktop Applications				\$62,609	\$68,079	\$45,725	\$58,805
Adobe	3,142	5,734	6,082	\$188,349	\$127,038	\$90,643	\$135,344
Cyberlink	n/a	290	310	n/a	\$68,079	\$75,955	\$72,017
Intuit	6,700	7,000	7,500	\$62,609	\$74,871	\$74,606	\$70,695
Smith Micro	55	52	91	-\$17,400	\$66,596	\$45,725	\$31,640
Symantec	5,300	6,500	16,000	\$96,903	\$126,041	\$17,123	\$80,022
Bitstream	54	55	62	-\$32,722	-\$13,364	\$16,742	-\$9,781
Nuance Commo. (Scansoft)	n/a	1,112	1,681	n/a	\$1,827	\$4,979	\$3,403
Vertical Market Applications				\$13,797	\$21,035	\$14,698	\$16,510
Ansys	610	550	600	\$49,700	\$83,596	\$98,067	\$77,121
Autodesk	3,493	3,477	4,813	\$30,404	\$67,558	\$76,834	\$58,265
Kronos	2,500	2,900	3,400	\$27,841	\$28,117	\$18,617	\$24,858
MapInfo	800	903	903	\$13,374	\$17,389	\$14,698	\$15,153
Dendrite	2,524	2,549	2,793	\$13,797	\$18,762	\$12,955	\$15,171
Advent	764	752	736	-\$51,910	-\$24,021	\$8,609	-\$22,441
Moldflow	291	318	331	\$10,148	\$21,035	\$553	\$10,578
Enterprise Applications				\$4,997	\$14,148	\$14,138	\$11,094
Business Objects	3,924	3,834	4,418	\$9,989	\$21,323	\$29,922	\$20,411
SPSS	1,252	1,165	1,129	\$102	\$5,645	\$24,822	\$10,190
Manhattan Associates	1,117	1,400	1,600	\$27,300	\$22,578	\$18,923	\$22,934
Concur Technologies	350	395	500	\$4,997	\$12,916	\$14,138	\$10,684
Pegasystems	422	406	458	\$34,773	\$14,148	\$1,116	\$16,679
Witness Systems	497	485	619	-\$45,777	\$16,049	-\$3,889	-\$11,205
Knova Software (ServiceWare)	51	106	95	-\$19,728	-\$157,225	-\$56,286	-\$77,746
SaaS				\$23,765	\$10,332	\$21,161	\$18,419
Digital Insight	741	761	800	\$23,765	\$37,039	\$50,334	\$37,046
WebEx Commo.	1,241	1,826	2,091	\$34,731	\$38,040	\$38,223	\$36,998
WebSideStory	n/a	135	214	n/a	\$12,163	\$26,907	\$19,535
Salesforce.com	n/a	767	1,304	n/a	\$8,501	\$15,416	\$11,958
RightNowTechnologies	n/a	403	530	n/a	\$8,444	\$12,311	\$10,378
Savvis	993	1,858	2,124	-\$87,187	-\$51,910	-\$1,731	-\$46,943
Network Tools				\$17,406	\$32,972	\$44,086	\$31,488
Novell	5,734	6,000	5,100	-\$4,852	\$10,949	\$84,831	\$30,309
Citrix Systems	1,885	2,656	3,171	\$81,904	\$59,861	\$64,488	\$68,751
McAfee (Network Associates)	3,700	2,950	3,290	\$17,406	\$109,380	\$48,064	\$58,283
iPass	330	402	406	\$67,748	\$72,055	\$44,086	\$61,296
NetManage	236	225	204	-\$19,758	\$6,698	\$11,926	-\$378
Altiris	600	750	878	\$21,305	\$32,972	-\$3,485	\$16,931
Tumbleweed	133	270	320	-\$74,511	-\$29,496	-\$15,213	-\$39,740
Developer Tools				\$27,329	\$25,054	\$24,650	\$25,677
BEA Systems	3,122	3,353	3,878	\$55,957	\$58,118	\$53,078	\$55,717
Red Hat	681	940	1,100	\$4,326	\$28,666	\$52,802	\$28,598
Sybase	3,660	3,568	3,715	\$28,505	\$25,054	\$32,824	\$28,794
Progress Software	1,552	1,593	1,661	\$27,329	\$37,633	\$24,650	\$29,871
Pervasive Software	245	251	165	\$31,718	\$14,805	\$7,152	\$17,892
Raining Data	142	143	133	-\$1,324	\$1,441	-\$3,917	-\$1,267
Borland Software	1,358	1,361	1,269	-\$29,406	\$13,721	-\$27,561	-\$14,416
Education				\$11,229	-\$4,594	-\$10,712	-\$1,359
Apollo Group	8,036	10,487	11,302	\$48,191	\$41,787	\$63,073	\$51,017
Renaissance Learning	988	942	956	\$52,757	\$41,394	\$35,444	\$43,198
Scientific Learning	130	160	173	\$22,569	-\$4,594	\$30,682	\$16,219
American Education Corp.	73	70	57	-\$10,902	\$18,224	-\$10,712	-\$1,130
Saba Software	258	334	516	-\$47,946	-\$9,219	-\$12,362	-\$23,176
SumTotalSystems	n/a	447	628	n/a	-\$35,725	-\$17,033	-\$26,379
Plato Learning	787	598	540	-\$112	-\$45,841	-\$43,669	-\$29,874
All companies (median)	800	835	930	\$11,544	\$23,004	\$20,442	\$18,330

Source: Company 10-K filings for most recent fiscal years. "Years" may not correspond to company fiscal years.

Marketing research is just as important in Second Life as in the real world. And do not be surprised if a person who is surveyed as a Second Life resident responds differently than if they were asked the same questions in real life. I see Second Life brand enhancement as showing our community that we're a cool, fun company, and reminding them we are ready to serve them when they choose a commercial product.

There do seem to be more practical uses for Second Life. For example, I noticed that Sunbelt Island had an extensive meeting place with virtual whiteboards that could display PowerPoint presentations.

If one's company is geographically dispersed, using Second Life for meetings is simply a new, cheap alternative for expensive teleconferencing systems. Some groups in IBM are doing this now. One is still on the POTS conference call, but has a semblance of a real meeting room including the obligatory PowerPoint slides. Move over, Webex! And, obviously, this productivity strategy is part and parcel of the brand enhancement. Companies that have no 'virtual marketing clue' will be left far behind while early adopters in Second Life will have a significant advantage. When the time comes, they will be able to move forward confidently, using the right media and message. All this will take time and some thought. That's the investment that needs to be made as having a presence in Second Life itself is not very expensive. And it will take an ongoing **in-world** commitment; you'd be surprised at the number of large company "deserted" islands in the system.

You mentioned your investment in Second Life; what did Sunbelt Island cost?

Sunbelt Island is 450k square feet (47k meters) and to buy that real estate costs about \$1500. Of course, you pay in "lindens," Second Life's internal currency. The current exchange rate is about 250 lindens to the dollar. That was just for the land alone; the cost of building all the facilities on the island came to an additional \$10k which covered about 360 hours of work. Monthly rental of the supporting server is \$300.

How many visitors to the island?

We opened on February 5th and haven't begun heavily promoting the island; we did hold a press conference there announcing a new product release (and the establishment of Sunbelt Island). We had about 30 people in attendance for that event and over 2300 walk ins since the opening. About half of those, judging from guest book entries, were interested in Sunbelt specifically.

What are you going to do to build traffic?

That's a good question and one that's key to success in Second Life (in our opinion). Right now, Second Life attendees are more focused on enhancing their virtual experience than in browsing through virtual stores. Visitors to Sunbelt Island are offered several goodies, including a daily drawing for free software, two games they can play (editor's note: we played the firewall game), and two Second Life aids they can use in the world (both branded with our logo). The first is a heads-up radar you can carry with you that locates and tells you the name of everyone within 100 meters of your position. The second are security doors you can use in your own domicile to keep out intruders; a nice tie-in to our products, we think. We also provide an underseas (virtually) tutorial designed to help you learn how to navigate Second Life.

Stu Sjouwerman, founder and VP of marketing and sales, Sunbelt Software, 33 North Garden Avenue, Ste. 1200, Clearwater, Flor. 33755; 727/562-0101-218. E-mail: stus@sunbelt-software.com. Second Life: Sunbelt Island.

Negotiating Your Non-Compete Agreement, Part I of III

By Mark Reed, Corum Group

Non-compete agreements or covenants not to compete are usually part of an M&A transaction. This is especially true in the sale of technology companies because intangible assets—such as know-how, trade secrets, and proprietary methods—are the company's most important assets. Although enforceability of such agreements in the US varies from state to state, they are generally binding on equity owners when made in connection with the sale of a business (sale of stock, assets or merger), **even in California**, a state recognized for not strictly enforcing non-competition agreements.

There are many issues to consider when negotiating a non-compete agreement in connection with the sale or merger of your company; in Part I and II, we'll cover the basic ones.

Who Signs? All management and shareholders should not necessarily have the same non-compete restrictions. Agreements may be tailored to individuals and vary based on ownership interest, responsibilities, and management authority. For example, a passive, non-management owner of a small number of shares should have a much less restrictive non-compete agreement (or none at all) than the majority shareholder who also serves as chairman and CEO.

Scope. Understand what the buyer is trying to protect. The range of covered activities should be reasonable in order for the agreement to be enforceable. Reasonable scope generally includes the seller's products or services currently offered or contemplated at the time of sale, not all possible future business activities. Provisions covering non-solicitation of customers and employees and confidentiality are generally enforceable without restriction. You may seek to limit the scope to specific industries; however, the buyer may reasonably object because part of their rationale for making the acquisition could be to expand the markets for your products. If you have business plans to pursue after closing, negotiate language to specifically exclude those activities if they are questionable. Avoid ambiguity and don't make assumptions about activities you think would be permissible.

Mark Reed, executive vice president, Corum Group, 10500 NE Eighth St., Bellevue, Wash. 98004; 425/455-8281. E-mail: mreed@corumgroup.com.

Company/Description	Acquired by	Price/Terms	Revenues	Multiple
Corillian (CORI) • Internet banking software	CheckFree (CKFR)	\$245,000,000 <i>Terms: Cash and debt</i>	\$60,960,000	4.02
VantageMed (VMDC.OB) • Practice management software	Nightingale Info. (NGH.V)	\$13,000,000 <i>Terms: Cash</i>	\$11,600,000	1.12
E-Tech Solutions • IT services company	Perficient (PRFT)	\$12,200,000 <i>Terms: Cash and stock</i>	\$10,000,000	1.22
BeVocal • Self-service customer care solutions	Nuance Comm. (NUAN)	\$140,000,000 <i>Terms: Cash and earnout</i>	\$22,000,000	6.36

Second Life Resources

- **Beta Technologies** (<http://betatechnologies.info/>): Development house that specializes in developing Second Life “properties”; built the Sunbelt Software island.
- **New York Times columnist David Pogue** video piece on Second Life: (http://www.cbsnews.com/sections/i_video/main500251.shtml?id=2496361n)
- **Recent critical article by Alice Laplante** on business prospects for Second Life: (<http://www.informationweek.com/news/showArticle.jhtml?articleID=197001839>)
- **Second Life Blog** (<http://blog.secondlife.com/>): The official blog for Second Life (in 2D). Discusses infrastructure issues of the site, among other topics.
- **Second Life Herald** (www.secondlifeherald.com/slh/): Website that reports on the goings on in Second Life.
- **Second Life Insider** (www.secondlifeinsider.com): Blog site that tracks Second Life goings on. Also links to an interesting selection of “high-trend” blogs.

FORBES COLUMNIST HENRY BLODGET (YES, THAT HENRY BLODGET) ON GOOGLE APPS: “It has been obvious for some time that my theory of a year ago—that Google and Microsoft weren't really going to go to war with each other (because Microsoft had already lost the Web game and because Google wasn't going to be stupid enough to take aim at Microsoft's crown jewels)—was wrong. I was right about the first part—Microsoft is still nowhere on the Web—but wrong about the second: Google clearly has its sights set on that pot of Office gold.” (Quoted in *Forbes*, 02/23/2007)

Colleagues made off with your last issue? Go to www.softletter.com. Click Subscriber Login in the upper right of the home page. To view the current issue and to search archives of hundreds of articles by keyword, topic, or issue date, log in and enjoy!

Soft•letter is published 24 times per year; entire contents copyright © 2007 by Soft•letter. All rights reserved. Reproduction by any means, without permission of the publisher, is prohibited. ISSN: 0882-3499.

Subscription rates: \$395 worldwide.
Subscription office: Aegis Resources
34 Sugar Hill Rd.
Killingworth, Conn. 06419
Voice: 860/663-0552
Fax: 860/663-0553
info@softletter.com

www.softletter.com

MICROSOFT WATCH REPORTER JOE WILCOX ON GOOGLE APPS: “Microsoft has a huge fragmentation problem, where businesses aren't quickly upgrading to new versions of Office. According to JupiterResearch, in 2006 more medium and large businesses used Office XP than Office 2003. Interestingly, there was no change statistically in Office 95, 97 and 2000 usage in 2006 compared to 2005. Most businesses run multiple Office versions, hence the fragmentation. (Confession: My corporate-issue laptop has Office XP.) These upgrade laggards form part of a Long Tail of computing that Google could capture as Apps customers.” (Quoted on http://www.microsoft-watch.com/content/business_applications/google_and_long_tail_computing.html, 02/22/2007)

REPORTER MICHAEL VIZARD ON CHANGES IN MDF ACCOUNTING: “But according to the new SEC rules, companies will no longer be able to treat that as an expense they can write off. Instead, they will have to record that spending against deferred revenue. The only way around this rule appears to be if the vendor decides to distribute MDF dollars through a third-party not directly involved in the transaction.” (Quoted on http://www.channelinsider.com/article/Enforcement+of+SEC+Rule+Threatens+MDF+Dollars/201303_1.aspx?kc=CITCIEMNL021607STR1, 02/05/2007)