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BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS

Apple's New Orchards

by Rick Chapman, Softletter

In its heart, Apple Computer never wanted to be a computer company. Apple co-founder Steve Wozniak certainly wanted it to be, but while Wozniak served as the firm's early technical brain, it was the other Steve, Jobs, who defined what would be the ultimate cast of Apple's DNA. And that DNA says the Apple soul should be proprietary, high design, and high margin. What Apple has always wanted is for the Macintosh to be the McIntosh, a high-end audio receiver much prized by 70s and 80s audiophiles, a unit that sported ultra high performance accompanied by a major price tag (the company is still in business today, producing high-end audio equipment in its boutique facility in upstate New York). Apple's iPod is the digital reincarnation of the first Macintosh: beautifully designed and completely locked up (you're not even supposed to change your little white slab's battery.) Thus it has always been at Apple, and as long as Steve Jobs guides the company, thus it must always be. Apple would not be Apple if it were any other way.

Google's G&A performance leaves us somewhat wide eyed. See pages 4-5.

Unfortunately, the problem with all of this is that while it remains a computer company, Apple's growth is sharply bounded by history and its DNA. Despite the misstatements of young tyros who haven't studied the industry's history, it didn't have to be that way. From 1986 till the release of Windows 3.0, Apple made significant inroads into broad corporate markets. The product was clearly superior to anything to be found on the PC platform and many businesses stanardized on it. Had Apple made the decision to license the Macintosh OS, Apple would now be Microsoft. But Apple couldn't ignore its DNA and the world is now as it is.

And in computers, Apple's world consists of about 4% to 5% of new computers sold. When I was writing the first edition of ***In Search of Stupidity: Over 20 Years of High-Tech Marketing Disasters***, I noted that Apple had about 3% to 4% market share of new computers sold worldwide (an observation that carries over to the Apple OS, which still runs only—officially—on Apple boxes). Actually, I was generous; by the time the book went to print, Apple's share had slipped to less than 3 percent in some analyses. And today, after the iPod's stunning success, Apple's worldwide market share of PCs/operating systems worldwide is now about…3% to 4% (the company has climbed to almost 5% in some studies, but

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Advisory Board

Analyst Marketing Services: Think Hard Before You Buy

By Anonymous, CEO of a Software Firm

In many markets, including mine, analyst firms have a tremendous impact on IT and corporate acceptance. Often, as part of a PR campaign, you approach the analyst firms with offers of information about your market in the hope that they will begin to cover your company and product line and provide favorable commentary. The quid pro quo underlying all such contact is that the analysts will use your expertise to sell themselves as experts to their IT customers in return for this coverage. The other (often spoken) expectation is that in return for continuous coverage and access to key analysts covering your market, you will purchase a package of the firm's services.

Our company faced a situation similar to the one above, and made a decision to purchase a Marcom package from The Gartner Group. The package included a 30-minute video piece on our market in which I appeared, as well as selected customers and a Gartner analyst, and three white papers focused on discussing various aspects of our market and the problems our customers face. The total cost of the package was $120K; this reflected a 20% discount for paying up front.

Once the program was paid for, Gartner did not exactly swing into action with the alacrity we were expecting. Production of the white papers was agonizingly slow, and early drafts of the documents were marred by:

- Obvious spelling and grammar mistakes and amateurish writing. There were frequent times when while reading a white paper, the narrative would simply fly from one topic to another with no logical transition.

- Outright mistakes on our market and technology. At first we were puzzled by these, because the Gartner analysts we were working with were very knowledgeable about our market. We eventually realized that it was not the analysts, but "stringers" who were doing the actual work.

Gartner's response to these problems was slow and the process dragged on. After months, we finally developed a white paper that we thought was very good, but I'd ended up writing 80% of it. Then, as work was to begin on the next pieces, Garter abruptly announced it was discontinuing this particular Marcom program "because it put them [Gartner] too close to the companies." However, instead of offering to rebate us back the cost of the non-delivered white papers, Gartner ***attempted to backdate the price on the delivered white paper to cover most of the cost of the canceled pieces.*** They also offered us a $15k "credit" for future services and gave us a month to decide what we want to purchase. We declined the offer and when they balked about returning our money, turned to legal counsel. We eventually recovered about $30k of the $120k.

The video shoot was also problematic; at one point, the company shooting the piece has to reshoot the segment I was appearing in because my clothing appeared rumpled and disturbed, something the film crew should have caught and corrected. (Gartner attempted to charge us for the reshoot).

My advice? If you decide to purchase analyst services, buy some research and hire professional writers and Marcom specialists to develop higher end collaterals. Avoid using the analysts for these tasks.

some of this gain reflects the use of Apple computers as Wintel boxes).

It isn't as if Apple hasn't tried to change this. After Steve Jobs returned to Apple, the company launched several "switch to the Mac" campaigns, all of which have had little impact on the market. (Apple doesn't even pretend to try hard in the server market, despite its product's excellent performance). In computers, Apple has been able to hold onto its installed base, but little more. People seem quite content to connect their Apple iPods to their Wintel machines. Apple's growth is coming from consumer electronics, not computers, and thus it is very appropriate that Apple is no longer Apple Computer but simply "Apple."

Now, moving forward as a lone fruit, what are the company's plans for continued growth? They rest on four pillars the company must put in place to enable it to build continued revenue growth. These are:

Build more and more consumer "metal." Steve Jobs has always liked coming up with ideas for cool things he can sell at a high markup and as the Macintosh, iMac and iPod demonstrate, he's good at it. But in computers, cool designs and stunning metal finishes, backed up by one of the most powerful brands in the industry, buys you about 4% market share. However, in consumer electronics, the early transistor radios, the Sony Walkman, and the uber device to rule them all, the iPod, demonstrates that if you hit the market at the right time with the right gizmo, you can make billions and rule an industry segment with the right proprietary gadget.

Apple, of course, wants to repeat this success in other markets, such as phones and the audio visual market (TVs, video recording, radios/ receivers and so on). Whether it can do so is an open question. Apple **did** hit the MP3 market at just the right time with just the right device but there are limits to how far the iPod can take you. Everyone will soon have one, and it can be hard to continually repeat a runaway success (look at what happened to Sony's Walkman line). And cell phones have been around for a long time and there are already companies, such as Motorola with its Razr lines, that have shown they know how to make pretty cool gizmos too. And unlike iPods, they're fairly contentless devices quickly discarded (which explains why Apple made sure the Rockr failed). This brings us to the second pillar of Apple's long range plan.

Create a true portable consumer/personal entertainment environment. Now, by portable, we don't mean free; Steve Jobs is no Open Source apostle, the Darwin project (the Open Source version of the Unix that underlies the Mac OS) notwithstanding. But while Microsoft wastes its time with Zune (as Apple already knows, attempting to retake a market in which your opponent holds 90%+ marketshare is pointless), struggles with the leaden thud that is the Vista rollout, and fends off the Feds, the Euros, and everyone else who has taken advantage of the soft underbelly the company was forced to expose when the DOJ achieved

(continued on page six)

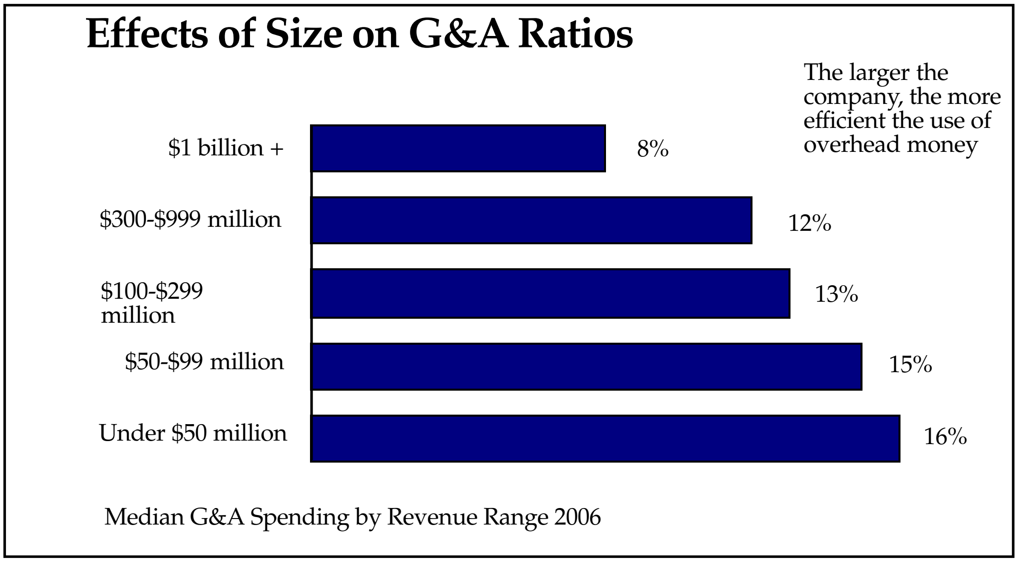
"Software companies, if they haven't already, should abandon the dream of the Apple platform ever supporting a large and lucrative staple of vertical and traditional business applications. Personal content management, transferral, access, and preservation of the software enviroments created are where future opportunities lie."

—Rick Chapman
Softletter

"Apple has studied Sony carefully, both its successes and mistakes. The PlayStation, where Sony controls its hardware and software destiny, appeals greatly to Apple. But the company believes Sony has never learned the value integrating software into industrial design."

—Rick Chapman
Softletter

Benchmarks



Benchmarks: General and Administrative

General and Administrative costs are the corporate and front-office overheads not allocated to activities such as sales and R&D. Our Benchmark 50 summary divides G&A costs by revenues for the most recent three fiscal years, and then averages the results. For each sector the median G&A percent-of-revenue is given for each year, along with the three-year average; each sector's results are sorted in ascending order by this average.

12% is the median G&A ratio across all sizes and sectors in the Benchmark 50

The four companies marked by an asterisk (*) folded their sales costs into their G&A reporting, giving them the highest G&A figures reported, and so they were not counted in calculating the sector figures, nor in the final figures for all companies at the bottom of the page.

The median figure across all companies is 12%, and varies fairly closely by size of company (see chart above). At 8%, overhead is smallest among the giants ($1 billion+); Google is holding steady at 6% or 7%, but Microsoft has been slashing large G&A costs to reach 8%.

Other companies can expect their overheads to dwindle as they grow, and Bitstream and Smith Micro have done exceptionally well in lowering theirs. Based on the small companies in it, the SaaS sector could be expected to have high overheads, but actually weighs in at 12 or 13%.

On closer examination we see that companies fall into two broad categories, high G&A (salesforce.com and WebSideStory) at 17% or 18%, and very low G&A (RightNow and WebEx) at 8% or 9%. While not counted in the SaaS sector figures, Google with 6% or 7% is also a SaaS company and a G&A standout.

The Benchmark 50: General & Administrative

	Revenues (000)			General & Administrative			Avg.
	2004	2005	2006	2004	2005	2006	’04-’06
Microsoft	**$36,835,000**	**$39,788,000**	**$44,282,000**	**14%**	**11%**	**8%**	**11.4%**
Google	**$3,189,233**	**$6,138,560**	**$10,604,917**	**6%**	**6%**	**7%**	**6.4%**
Desktop Applications				**9%**	**11%**	**12%**	**10.6%**
Symantec	$1,870,129	$2,582,849	$4,143,392	5%	4%	5%	5%
Cyberlink	$48,966	$65,141	$74,926	6%	5%	6%	5%
Adobe	$1,666,581	$1,966,321	$2,575,300	8%	8%	9%	9%
Intuit	$1,802,224	$2,037,703	$2,342,303	10%	11%	12%	11%
Nuance Commo. (Scansoft)	na	$232,388	$388,510	na	14%	14%	14%
Bitstream	$9,726	$11,632	$15,653	20%	15%	14%	16%
Smith Micro	$7,216	$13,316	$20,258	32%	22%	23%	26%
Vertical Market Applications				**13%**	**12%**	**13%**	**12.6%**
Kronos	$450,694	$518,658	$578,203	7%	8%	8%	8%
Autodesk	$951,600	$1,233,800	$1,523,200	13%	8%	6%	9%
Ansys	$113,535	$134,539	$158,036	11%	11%	11%	11%
MapInfo	$124,673	$149,424	$165,495	12%	12%	13%	12%
Advent	$149,990	$168,701	$184,093	18%	20%	18%	19%
Moldflow	$48,673	$64,418	$65,558	18%	19%	19%	19%
Dendrite	$321,107	$399,197	$437,240	34%	33%	33%	33%
Enterprise Applications				**11%**	**12%**	**12%**	**11.9%**
Business Objects	$925,631	$1,077,151	$1,253,760	9%	9%	10%	9%
Manhattan Associates	$214,919	$246,404	$288,868	9%	9%	10%	9%
Pegasystems	$99,313	$96,461	$102,007	11%	13%	12%	12%
SPSS	$224,074	$236,063	$261,532	11%	12%	13%	12%
Concur Technologies	$56,550	$71,831	$97,145	13%	14%	15%	14%
Knova Software (ServiceWare)	$11,511	$12,502	$23,595	18%	19%	17%	18%
*Witness Systems	$108,037	$141,335	$185,328	56%	47%	46%	50%
SaaS				**12%**	**12%**	**13%**	**12.6%**
RightNowTechnologies	$61,764	$87,148	$110,388	7%	7%	9%	8%
WebEx Commo.	$249,133	$308,422	$380,012	8%	8%	10%	9%
salesforce.com	$176,375	$309,857	$497,098	17%	15%	17%	17%
WebSideStory	$22,602	$39,452	$64,527	17%	16%	22%	18%
*Digital Insight	$154,362	$188,891	$213,971	28%	24%	24%	25%
*Savvis	$616,823	$667,012	$763,971	28%	23%	26%	26%
Network Tools				**12%**	**12%**	**12%**	**12.4%**
Novell	$1,105,496	$1,165,917	$1,197,696	10%	9%	10%	10%
iPass	$136,078	$166,319	$169,273	10%	11%	10%	10%
Altiris	$166,565	$187,640	$229,434	9%	12%	11%	11%
Tumbleweed	$43,438	$50,001	$61,994	12%	12%	17%	14%
McAfee (Network Associates)	$936,336	$910,542	$987,299	14%	15%	12%	14%
Citrix Systems	$588,625	$741,157	$908,722	15%	14%	14%	14%
NetManage	$50,663	$47,666	$43,434	23%	19%	19%	20%
Developer Tools				**11%**	**11%**	**14%**	**11.9%**
BEA Systems	$1,012,492	$1,080,094	$1,199,845	8%	8%	9%	8%
Progress Software	$362,662	$405,376	$447,063	11%	11%	13%	11%
Pervasive Software	$49,608	$48,352	$45,580	11%	9%	14%	11%
Sybase	$788,536	$818,695	$876,163	12%	11%	12%	12%
Red Hat	$124,737	$196,446	$278,330	16%	18%	17%	17%
Raining Data	$22,297	$21,483	$20,294	17%	17%	17%	17%
*Borland Software	$309,548	$276,743	$304,660	54%	63%	64%	60%
Education				**14%**	**15%**	**16%**	**14.8%**
Apollo Group	$1,339,517	$1,798,423	$2,251,472	5%	5%	4%	5%
Saba Software	$34,471	$42,210	$71,147	13%	13%	11%	12%
Renaissance Learning	$111,724	$116,283	$111,528	11%	11%	15%	12%
Plato Learning	$141,801	$121,804	$90,719	14%	15%	18%	16%
Scientific Learning	$30,976	$40,139	$40,998	17%	15%	16%	16%
SumTotalSystems	$55,204	$74,970	$105,988	20%	22%	19%	20%
American Education Corp.	$8,599	$10,187	$9,819	28%	19%	25%	24%
All companies (median)				**12%**	**12%**	**12%**	**11.9%**

Source: Company 10-K filings for most recent fiscal years. “Years” may not correspond to company fiscal years.
An asterisk indicates companies that combine Selling Costs and G&A.

its guilty verdict in its antitrust suit against Microsoft, Apple is betting on its own version of convergence, a model that enables consumers to take their music, movies, entertainment preferences, and related items with them with wherever they are. In this model, iPods, iPhones, iTVs, etc., etc. are just way stations, attractive transmitters that facilitate the job of providing personalized content 24/7/365 to consumers. What becomes important is the environment, and the fact that if you're single and can flash the latest iPod in your local bar, you may get luckier than you deserve to. But to tie it all together, you need an operating system, one that enables your fancy hardware to provide that enjoyable, "get it right the first time" experience that has made the iPod such a success. Apple has that operating system; anyone who has suffered through the experience of trying to build a home theatre system built on Windows Media Edition (I have) knows that Microsoft doesn't. At least, not at this time.

"Steve Jobs' recent "Road to Damascus" revelation that DRM is not a good thing certainly helps smooth the creation of a portable consumer enviroment built around the Mac OS and a new generation of iThingies. And Jobs has no current stake in defending the recording industry's rapidly deteriorating pricing system. If content prices drop right now, so much the better for Apple."

—Rick Chapman
Softletter

Gain control over the company's content future. This is the most challenging pillar to put in place, and its ultimate success depends a great deal on Apple's ability to play its hardware cards just right. For a brief moment, Apple with the iPod's assistance, has achieved something rarely seen in consumer electronics, a situation where a hardware firm has the content players by the neck (to get a feeling of how unusual this is, just imagine the turntable manufacturers of the 60s and 70s attempting to dictate album prices to the record companies). Increasing numbers of consumers now think of Apple as some sort of record company despite the fact that probably the only tunes Apple has copyrights to are its company song.

Where is this content to come from? Well, Steve Jobs now sits on Disney's board and is its largest shareholder; I doubt he's there just because he wants to make sure his kids don't have to wait on those long lines for the "E" rides. Disney owns ABC and other media properties and iPods across the nation are starting to fill up with Disney-owned content. And a merger or purchase of a major recording company would also help; after years of snarling and bickering, EMI and the group that manages the Beatles franchise are suddenly very friendly and becoming friendlier. And what iPod out there can't use some "Help!"?

"My guess is that Apple's traditional PC business lasts for three more years. The Mac then morphs into an AV center that controls the iEnviroment."

—Rick Chapman
Softletter

Gently, ever so gently, escort Apple's traditional computer business out the door. Apple will fervently deny it's leaving PCs behind, but the company's adoption of Intel and quick embrace of dual boot technologies that enable purchasers to use Windows on Macs, gives the game away. Apple could have worked harder to prevent this, but didn't. Apple is no hurry to abandon its computer business; it's profitable, holds its installed base in place, and both internally and externally serves as a useful test platform for the new computing environment it hopes to create. But ultimately, PCs are a high volume, low margin business and Apple's DNA hates that game. And it has no prospects of creating its own lucrative and highly scalable software monopolies in the traditional business and OS markets. The dismissal of the word "Computer" from the company's corporate banner tells us the clock is ticking.

Equities

Q1 Analysis: M&A Hits New Record

By Lynda Tripp, Corum

Last year was a record for one M&A and not since the dot-com peak have the M&A markets shown such strength. 2007 began with record first quarter activity that is showing no signs of slowing. Across the globe, $1.1 trillion of company value was traded between January and March, **27% higher** than the same period in 2006 according to data provider Thomson Financial. All eyes were on the volatility in global financial markets in mid-March, but the upheaval would have to last longer than it did to threaten the current M&A boom.

Last year, 1,726 software companies were acquired, the highest number since 2000. Software dominated all technology sectors, accounting for 40% of the $298 billion in technology M&A deals done last year, and half of the $306 billion in deals in 2005. The runner-up: Internet companies, which accounted for 18% of last year's technology M&A volume. The most active technology buyer was Cisco Systems, which made seven first quarter deal announcements.

Though different sectors within IT are subject to unique market situations, confidence, competition, globalization and financing trends are the prime forces driving M&A and none of those were in short supply as we entered 2007. The current M&A environment is producing strong activity by both financial and strategic buyers across nearly every sector, with total deal values on the rise. There is a good degree of balance in the current environment and it appears that growth in technology M&A will keep the deal pipeline full through the first half of 2007.

Hot sectors for Q1-2007 included:

- Internet (commerce, advertising, social sites, games, communications, speech, and search).
- Networking and infrastructure
- Wireless/mobile
- Software as a Service (SaaS)
- Vertical markets, especially healthcare, gaming, and property management

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Company/Description	Acquired by	Price/Terms	Revenues	Multiple
Infinite Conferencing	Onstream Media	$17,200,000	$6,100,000	**2.82**
• Audio and web conferencing		*Terms: Cash*		
First Data Corporation (FDC)	Kohlberg Kravis Roberts	$2,800,000,000	$7,080,000,000	**3.95**
• Credit card transaction processor		*Terms: Cash*		
webMethods (WEBM)	Software AG (SWDAF.PK)	$546,000,000	$208,800,000	**2.61**
• SOA and business process management		*Terms: Cash*		
Embarcadero Technologies (EMBT)	Thoma Cressey Bravo	$200,000,000	$71,200,000	**2.81**
• Strategic data management solutions		*Terms: Cash*		

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MERGERS & ACQUISITIONS

CardFile

Virtualization Resources

- **Microsoft Virtual PC** (www.microsoft.com): Not as powerful as VMware, but price is "Netscape" right.
- **Qemu** (www.qemu.com): Not truly a virtualization system but an emulator, one that makes your software believe it's running on a native machine. Supports a wide variety of operating systems including Windows, but as with many Open Source products, be prepared for extensive tinkering.
- **Thinstall** (www.thinstall.com): Package pours your software into a single EXE that runs without installation or changes to the local desktop's registry and file system. We will be looking at this software and the issues that surround its use in greater detail in an upcoming Softletter issue.
- **VMware** (www.vmware.com): Leading virtualization software on the market.
- **ZaphodsMap** (www.zaphodsmap.com). Open Source application virtualization system; in limited use in several companies. Allows you to wrap applications in a virtual configuration file that allows, in theory, a high degree of portability.

BLOGGER JOE WILCOX ON VISTA SALES: "Signs continue to indicate that Vista is doing little if anything to lift U.S. retail PC sales, supporting last week's Harris Interactive poll about consumer buying intentions....

Last month, Microsoft made big hype about 20 million Vista licenses sold in one month. But license sales going into the channel almost certainly cannot equate to PC sales, because nowhere near 20 million computers were sold in February, the first month of Vista availability.

If sales are slowing, the logical question to ask: Will there be too much Vista PC inventory on stores' shelves? Those Vista licenses had to go somewhere." (Quoted on http://www.microsoft-watch.com, 04/11/2007)

WSJ COLUMNIST WALT MOSSBERG ON LAPTOP "CRAPLETS": "The problem is a lack of respect for the consumer. The manufacturers don't act as if the computer belongs to you. They act as if it is a billboard for restricted trial versions of software and ads for Web sites and services that they can sell to third-party companies who want you to buy these products." (Quoted in The Wall Street Journal, 04/05/2007)

MICROSOFT CHIEF TECHNOLOGIST RAY OZZIE ON THE SAAS MODEL: "I am not one to believe that suddenly you snap fingers and everything that you do on the PC is doable on the web. You shouldn't just take things [you do on the PC] and put them [on the web]. You should figure out what they're good for [on the web] and what they are good for [on the PC] and weave them together. Based on my experience, I believe that this represents more opportunity than risk." (Quoted on http://knowledge.wharton.upenn.edu/article.cfm?articleid=1698, 04/04/2007)

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