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# Soft•letter

BUSINESS INSIGHTS FOR SOFTWARE DEVELOPERS & PUBLISHERS

*Our CFO survey conjured up nice rises in all three compensation categories surveyed See pages 4-5.*

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## Building a SaaS Channel

*In the September 15th, 2006 issue of Softletter we looked at the development of the SaaS channel in broad terms. The debate over the role of the channel in SaaS is vigorous and ongoing, with some observers believing the channel will be disintermediated by SaaS and others proclaiming channels will be alive and well in the future. In this issue, we talk to a SaaS provider who believes strongly in channels and is busy working to develop and expand them.*

*Siamak Farah is the CEO of InfoStreet, publisher of StreetSmart 7 (www.infostreet.com), a SaaS-system now in its seventh generation that offers everything a small to medium-sized business needs to operate, including blogs, CRM, file sharing, calendaring, E-mail management, etc. The company was founded in 1994 and has seen revenue grow 21% per anum over the last four years. Prior to founding InfoStreet in 1994, Siamak worked at NeXT Computer as a district sales manager, as COO at Microstat Development Corporation and began his career at Vertigo Systems International.*

**Did InfoStreet make a conscious decision to pursue channel sales?**

Yes. We felt we needed a channel and partnerships to help capture marketshare.

**How many resellers do you have?**

About two dozen active resellers; we have more, but this number reflects the ones who are proactively signing up new business.

**How are you recruiting your channel?**

Word of mouth and via a direct sales effort.

**Let's breakdown your channel structure. What type of resellers do you have?**

We divide our resellers into three categories:

- **Private label (OEM).** This is currently our strongest reseller component. With these sales, we lose our corporate identity. We're flexible in terms of how we structure these deals. In some cases, our private label customers resell our entire system under their label; in other cases, they may embed *(continued on page three)*

Advisory Board

## The Aggregators

While many (including Softletter), have been quick to pronounce the retail markets dead, there's still some life in the shelfware beast yet (though we stand by our prediction that the retail market will mostly disappear within five years). But to make the lives of software developers and publishers even more interesting, the last several years have seen the introduction of yet another entity into the channel mix: aggregators. Well known firms in the industry include Channel Sources and Victory Multimedia.

Aggregators do exactly what their name implies. They aggregate software companies into product portfolios that they in turn pitch to a distributor with which they have a good relationship. Aggregators have sprung into existence for two reasons. One is that as the desktop software market has undergone consolidation, the new companies appearing tend to be small and unknown. Distributors, who increasingly regard shelfware titles as a side business, are reluctant to extend credit and terms to these firms and also wish to avoid the setup and overhead costs associated with adding vendors into their accounting systems. The other is that in the event that a distributor purchase is not made on consignment terms (an increasingly rare event, as we've noted previously) the distributor can stock balance poor selling titles with other products in the aggregators portfolio (the largest aggregators carry hundreds of products).

A company that's a good candidate for aggregators fits the following profile:

- You've been in business for two to five years.
- You're a multi-product company with at least two products that have an established sales track record.
- You're at least $2M in revenue; $5m is probably optimum before beginning your initial approach.
- You can provide completely finished product. Unlike affiliate label publishers, aggergators do not build products, though the best of them can provide timely advice on current channel packing trends, color schemes, and promotions.
- You can provide a barcode sell sheet. This will list out the SRP, box size, weight, case count, case size, and case weight. It will also list out unique features, provide a bar code sample, and provide a picture of the box and a brief description of the product's core functionality.

If an aggregator picks up your product (s), they'll take 10% off your distributor price in return for their services (assuming your product sells for $100 and you're giving away 30 points to the distributor or reseller, the aggregator fee will be $7.00) This 10% comes off the top and before any additional distributor or reseller "packs" such as stocking fees, compulsory MDF, and all the rest of it.

Unlike distributors and major resellers, aggregators by contrast are fairly easy to work with. You can contact them via E-mail, phone, or by sending a sample product over the transom (though we strongly suggest calling first). If they request a meeting, be prepared to provide an informative, to-the-point demonstration and good research on why consumers will be inclined to buy your software. Certain tradeshows, such as CES, E3, Retail Vision, Staples Symposium, etc. are useful for meeting aggregators.

a component of our product into theirs.

- **Agents.** Our agents are recommenders and influencers who have helped us close a sale. In these sales, StreetSmart 7 retains its product identity.

- **Resellers.** These are traditional channel partners, though we do offer a wide variety of rebranding options.

**Let's look at your channel segments in greater detail. How do you handle OEM sales with a SaaS product? Who manages the infrastructure? How is support handled?**

In most cases we manage the infrastructure. But SaaS companies need to be very flexible in how you approach this. For example, some of our OEMs are CLECs (competitive local exchange carriers) who offer our system to their customers. A group of servers is stored in their data centers but fully managed by us. The reason is that they save bandwidth costs by not having to transfer their customer telecomm bandwidth to another service but instead keep it in their datacenters running on their pipes. In almost all cases, the customer handles customer support; we normally deal only with the OEMs.

**"OEM margins on embedded software sales range from 85% to 95% All our OEM deals involve us sharing in recurring revenue."**

*—Siamak Farah*
*InfoStreet*

In the case of companies who want to embed a component of StreetSmart 7, we've encountered several situations where companies have wanted buy a product component or use their own with our product. One firm, for example, didn't want to build their own authentication system; ours is very strong. Another customer, a medical company, has their own calendaring system optimzied for the needs of that industry; they were able to plug their module into StreetSmart 7. But to be able to support these sales situations your product has to be architected for it in advance. The medical company was able to go through our API to achieve integration; it's very transparent. We've spent a lot of time splitting off UI and menuing from our code via CSS and templates. Everything is dynamic and 100% XML-driven.

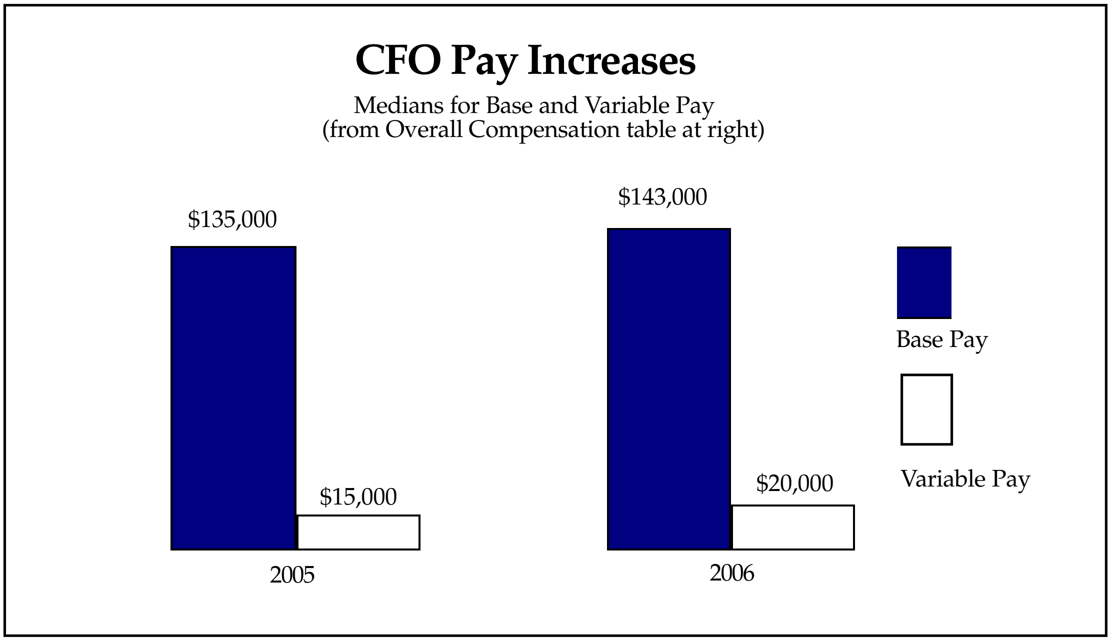
**How does your agent program work?**

Our agents function in a fashion similar to the insurance business and most bring in under-200-employee types of sales. They're typically consultants and IT specialists. Their commissions range from 14% to 30% and it's a recurring stream. Every quarter they receive a commission check; also they need to generate $250 in new quarterly revenues to remain in the program. We think our program is very attractive; not all agent programs allow participants to share in the ongoingrevenue stream, but we think it's the right way to go.

**What about reseller margins? And how do you handle billing and revenue disbursements?**

Our reseller margins also range from *(continued on page six)*

Benchmarks




## Benchmarks: Chief Financial Officer Compensation

CFOs are doing well this year.

At the star-performer level, the Top 50 CFOs are taking home median base pay of $ 258,750, sweetened by median variable pay of $144,499, for a median total pay of $410,275. Nineteen of the Top 50 exercised stock options this year (the Long-Term column), with a median exercise value of $322,416.

Total realized from the stock sales ($28,897,767) was equal to a little more than the total pay of *all* the CFOs in the Top 50 ($28,374,569), and the 19 option-exercising CFOs as a group received a stock-sale sum equal to more than twice their combined base and variable compensation.

**About half of the CFOs surveyed received no variable pay**

Median pay rates collected in the Soft•letter CFO survey showed nice rises in all three compensation categories surveyed (see table opposite). Median base pay for the those answering the survey rose 6% from $135,000 to $143,000; variable pay rose 33% from $15,000 to $20,000, and total pay rose 8% from $148,500 to $160,000.

In last year's CFO compensation survey we saw a big increase in base and variable pay, a sign of the recovering software industry. This year's gains are respectable in a steadily-growing economy and industry. Interestingly, the upper quartile of our current survey (the Top 25% column) saw base pay raises in line with the median for all CFOs; it is their variable pay raise that sets them apart. Conversely, the bottom 25% of those surveyed received a proportionately larger base pay raise, probably because only about half of CFOs receive variable pay.

| Overall Compensation—CFO* | Median | Top 25% | Bottom 25% | Raise |
|---|---|---|---|---|
| Base Pay—current | $143,000 | $160,000 | $110,000 | 6% |
| Base Pay—last year | $135,000 | $151,154 | $100,375 | |
| Variable Pay—current | $20,000 | $38,679 | 0 | 33% |
| Variable Pay—last year | $15,000 | $30,000 | $1,000 | |
| Total Pay—current | $160,000 | $188,000 | $126,000 | 8% |
| Total Pay—last year | $148,500 | $180,000 | $107,577 | |

* Number of respondents = 94 for “current,” 85 for “last year.”

| CFO Pay by Company Size* | Base Pay | Variable | Total | Raise |
|---|---|---|---|---|
| Under $1 million—current | n/m | n/m | n/m | |
| Under $1 million—last year | n/m | n/m | n/m | |
| $1-$5 million—current | $125,000 | $20,000 | $135,000 | 4% |
| $1-$5 million—last year | $120,000 | $10,000 | $130,000 | |
| $5-$10 million—current | $135,000 | $8,000 | $145,000 | 7% |
| $5-$10 million—last year | $126,000 | $6,500 | $138,500 | |
| $10-$99 million—current | $152,000 | $27,500 | $179,848 | 3% |
| $10-$99 million—last year | $147,500 | $20,071 | $167,367 | |
| $100+ million—current | n/m | n/m | n/m | n/m |
| $100+ million—last year | n/m | n/m | n/m | |

* Number of respondents = 3 for Under $1 million, 27 for $1-$5 million, 23 for $5-$10 million, 36 for $10-$99 million, and 5 for $100+ million. Values are medians. n/m = Sample size too small for accurate comparisons.

| CFO Pay by Development Stage* | Base Pay | Variable | Total | Raise |
|---|---|---|---|---|
| No significant customer revenue—current | n/m | n/m | n/m | n/m |
| No significant customer revenue—last year | n/m | n/m | n/m | |
| Privately owned, privately funded—current | $126,000 | $15,000 | $135,000 | 5% |
| Privately owned, privately funded—last year | $120,000 | $13,000 | $132,800 | |
| Privately owned, venture funded—current | $150,000 | $25,000 | $175,000 | 7% |
| Privately owned, venture funded—last year | $140,000 | $17,500 | $150,000 | |
| Public—current | $220,000 | $60,000 | $280,000 | 7% |
| Public—last year | $205,000 | $50,000 | $263,000 | |

* Number of respondents = 2 for No significant customer revenue, 57 for Privately owned, privately funded, 20 for Privately owned, venture funded, and 15 for Public. Values are medians. n/m = Sample size too small for accurate comparisons.

14% to 30%, depending on the size of the sale. Like agents, our resellers participate in the revenue stream. However, unlike agents, resellers provide first level support to their customers.

**How do you handle customer access and data issues? One of the points that worry SaaS resellers is that the software company knows who their clients are and how they use the software. Many resellers have traditionally held this information close to the vest.**

They're protected on a contractual basis. We put it in writing that we will only access a reseller's customer data at their request. We don't need to know the reseller's customer.

**"Resellers demand high levels of service from SaaS providers. 99.9% uptime is critical. We provide support escalation within 30 minutes and resolution within 48 hours."**

*—Siamak Farah*
*InfoStreet*

**How do you handle the recurring billing?**

We built our own billing system. Every reseller and direct customer has a plan and terms and billing schedules can vary widely; our system had to have a great deal of flexibility. We can bill monthly, quarterly, yearly, even daily. The system bills the reseller and and they pay us. If they don't pay their bills, the service is turned off, though of course we work with the reseller to avoid this situation. One point about the SaaS model is that if a reseller goes out of business, it does allow you to stay in touch with the customer and avoid disrupting their business. We had a situation like this occur and the customer came to us because they wanted to keep using the system.

**How much of your revenue is derived from your channel?**

Roughly around 35% to 45%. Broken down more precisely, 25% of overall revenue comes from OEMs, 5% from resellers, and 5% agents.With OEMs, our deals are usually with firms over $100m; private label customers vary in size but tend to be over $1m; resellers can vary widely as well and agent sales are normally with firms under $1m.

**Have your resellers or customers asked about being SAS 70 compliant? *(Editor's note: Softletter will be publishing a future article on SAS 70 compliance.)***

We haven't received a lot of push from our channel about it. To date, only a couple of banks inquired about SAS 70, but they ended up putting the product behind their own firewalls. I do see it as a growing trend. But it's not cheap; count on spending $100k to be SAS 70 certified. We'll be looking at it next year.

**"In cases of conflict between our internal salesforce and our resellers, the resellers win."**

*—Siamak Farah*
*InfoStreet*

**What are your future channel plans?**

We believe our channel will undergo explosive growth over the next two years. We forecast that channel sales will eventually account for 60% of our total revenue.

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Equities

## Reps and Warranties: Vital to the Deal

*Miro Parizek, Corum Group*

In virtually every M&A related transaction, the seller makes contractual representations and warranties. Reps and warranties are basically assertions of fact and form the foundation for a purchase agreement. They are vital because they give an acquirer confidence that they are actually buying what they believe they are buying. A buyer wants to secure the value of assets and clarify the liabilities of the target company, and this is achieved via the reps and warranties. The representations and warranties section of an agreement is not intended to protect an acquirer against overpaying for a company, but is instead intended to certify that all of the means of creating value are indeed in existence, under the company's control, and there are no lurking liabilities.

Reps and warranties relate to financial statements, accounts receivable, taxes, employee benefits, intellectual property, etc. and assure buers that:

- The company's financial statements are true and correct and have been prepared in accordance with generally accepted accounting procedures.
- The company has no liabilities other than those reflected in its latest balance sheet and those occurred in the ordinary course of business since the date of the last balance sheet.
- The company owns all of the assets it purports to own, without liens or encumbrances except those disclosed.
- The company's intellectual property and products don't infringe the rights of others
- The company is in compliance with all laws in connection with its operations and that there are no notices of violation.

The seller makes these representations and warranties in good faith, and the buyer relies upon these statements to close the transaction. Representations and warranties made by the seller, but which prove false, potentially subject the seller to liability for breach of contract, negligent misrepresentation, damages and perhaps even rescission of the agreement.

More time is often spent negotiating reps and warranties than is dedicated to the price and structure of a transaction. Proper preparation will help mitigate the time and effort spent on this part of your sales agreement.

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| Company/Description | Acquired by | Price/Terms | Revenues | Multiple |
|---|---|---|---|---|
| **Subimo** | WebMD (WBMD) | $60,000,000 | $8,200,000 | **7.32** |
| • *Online tools* | | *Terms: Cash and stock* | | |
| **Stellent** | Oracle (ORCL) | $440,000,000 | $130,750,000 | **3.37** |
| • *Web content management* | | *Terms: Cash* | | |
| **Per-Se Technologies (PSTI)** | McKesson Corp | $1,800,000,000 | $541,170,000 | **3.33** |
| • *Healthcare software* | | *Terms: Cash* | | |
| **Protx** | Sage Group (SGGEF.PK) | $38,000,000 | $3,600,000 | **10.56** |
| • *Online payment services for SMEs* | | *Terms: Cash* | | |

CORUM
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CardFile

## Specialized and Online Backup

- **Carbonite (www.carbonite.com):** Inexpensive online backup system; $5 for 40G. Offers free trial.
- **GOExchange** (www.lucid8.com): Not really a backup program, but a specialized utility that examines, compacts, and cleans up Exchange databases (the company also offers DigiVault, a continuous backup system that provides real time protection of Exchange backup). Microsoft does offer command utilities that clean up Exchange, but they're tricky to use and can wipe out data even if used correctly. We decided to mention this product after a recent anguished conversation with an IT friend of ours who lost two years of Exchange data (and eventually his job).
- **HandyBackup** (www.handybackup.com): Nice utility that allows you to plug in FTP backup capabilities into Outlook, ICQ, your registry, and other specialized files. FTP backup can be a very cost effective alternative to paid online services.
- **Mozy** (www.mozy.com): Fairly inexpensive online backup system with nice interface. Has a "free" service that offers 2G of backup; fairly useless. 60G will cost $9.95 a year.

**CITISTREET CIO BARRY STRASNICK ON HIS LINUX "BALANCE SHEET LIABILITY":** "Like many IT executives, I took great offense to Ballmer's comments. If Microsoft really thinks there is some code in Linux that violates their patents, they should publish those lines of codes immediately instead of just posturing in the press. [Fear, uncertainty and doubt] may have worked for IBM in the 1970s (some of us are old enough to have been around then), but not today. There were some applications I had been thinking about moving to a Microsoft platform, but this has now totally alienated me from Microsoft." (Quoted in Computerworld, 11/21/2006)

**ADOBE CEO BRUCE CHIZEN ON HIS LOVE FOR GOOGLE:** "Oh, I love Google. Google is a big threat for Microsoft and distracts it from the rest of us. [Google] is simultaneously our heat shield and an important partner." (Quoted in InformationWeek, 11/21/2006)

**PROGRAMMER MOISHE LETTVIN ON THE WINDOWS VISTA DESIGN PROCESS:** "But here's how the design process worked: approximately every 4 weeks, at our weekly meeting, our PM would say, "the shell team disagrees with how this looks/feels/works" and/or "the kernel team has decided to include/not include some functionality which lets us/prevents us from doing this particular thing". And then in our weekly meeting we'd spent approximately 90 minutes discussing how our feature -- er, menu -- should look based on this "new" information. Then at our next weekly meeting we'd spend another 90 minutes arguing about the design, then at the next weekly meeting we'd do the same, and at the next weekly meeting we'd agree on something... just in time to get some other missing piece of information from the shell or kernel team, and start the whole process again." Quote on http://www.drizzle.com/~lettvin/2006/11/windows-shutdown-crapfest.html, 11/24/2006

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