IT SPENDING OUTLOOK

CRN Channel Research Report, April 2006

BY JOHN ROBERTS, *CRN*
APRIL 27, 2006

1. SOLUTION PROVIDER NEAR-TERM SALES FORECAST

Solution providers' overall near-term sales expectations rebounded in March following a steep decline in February. The overall sales expectations index came in at 94 in March (April 2004=100) compared to 87 in February. For comparison, the March 2005 index figure was 100.

The increase in sales expectations for the second quarter of this year was concentrated in software and security. Software saw a solid rebound in sales expectations, particularly in categories such as storage management software, voice over IP, supply chain management, application integration tools, CRM and accounting software. The increases in security sales expectations were broad based, including areas such as firewalls, anti-spam, intrusion detection and (especially) VPNs.

In contrast, hardware sales expectations declined slightly. Gains in areas such as PC severs and storage hardware (which reached its highest sales expectations level in a year) were offset by declines in subcategories such as networking hardware, imaging/image management and notebook PCs.

Networking sales expectations declined more sharply last month, led by networking software and wireless LANs.

Trends in overall sales expectations in the first three months of 2006 have followed the same pattern as that in 2005. After reaching high levels in January of both years, sales expectations dropped off in February, only to rebound in March.

Significantly, however, the level of near-term sales expectations has been running about seven percent lower so far this year compared to the same period last year. This could be an indication that solution providers are less optimistic about the overall growth of sales revenue this year compared to last year.

Solution providers' near-term sales expectations for the government market fell sharply in March (see Chart 3), mainly due to a near-doubling (from 5% to 9%) of the number of solution providers that expect their sales in this market to decline by more than 10 percent. It should be noted, however, that many solution providers remain optimistic about sales growth; 50 percent of those surveyed last month, for example, expect sales in the second quarter to increase by at least six percent. In addition, the February sales expectation figure was one of the highest in the past year, helping exaggerate the extent of the drop in sales expectations in March.

CHART 1

VAR SALES EXPECTATIONS INDEX

(BENCHMARK: APRIL 2004=100)

	Mar. '06	Feb. '06	Mar. '05
Overall	94	87	100
Hardware	92	93	96
Software	94	83	103
Networking	81	93	85
Security	96	91	91

CHART 2

HISTORICAL VAR SALES EXPECTATIONS INDEX

(BENCHMARK: APRIL 2004=100)

April 2004	100
May	105
June	92
July	103
Aug.	91
Sept.	99

Oct.	105
Nov.	93
Dec.	129
January 2005	116
Feb.	94
March	100
April	85
May	77
June	79
July	83
August	83
Sept.	75
Oct.	84
Nov.	89
Dec.	94
January 2006	105
Feb.	87
Mar.	94

CHART 3

VAR SALES EXPECTATIONS* BY MARKET SEGMENT

(BENCHMARK: APRIL 2004=100)

	Mar. '06	Feb. '06	Mar. '05
Large firms	75	86	65
Midsize companies	107	96	103
Small businesses	113	110	93
Government	58	93	101

*FOR THE THREE MONTHS FOLLOWING THE DATE SHOWN

BASE: 193 responding solution providers in March 2006
SOURCE: *CRN* Monthly Solution Provider Survey

----

2. LARGE COMPANY TECHNOLOGY SPENDING PLANS

Large company spending plans for the second quarter of this year remain strong, though slightly less optimistic compared to the first quarter, according to data from the March *CRN* Business Spending Survey.

Last month, 64 percent of the 125 large-company IT executives surveyed said they expected their company's technology budgets to increase over the next 12 months. This was down slightly from 70 percent in December, the last time these companies were surveyed. The 70-percent figure, however, was the highest recorded for large firms (those with at least 1,000 employees) in over a year.

In addition, nearly half of the companies that plan to boost IT budgets say they are "extremely committed" to doing so. At this level of commitment, planned spending increases are already being instituted. Another 36 percent of firms say they are "strongly committed" to carrying out planned budget increases, indicating these increases are very likely to be carried out in the near future.

Large companies trimmed actual IT spending in December and January, as was the case with small businesses. Average per-firm spending levels began to move higher in February (up 19 percent on average compared to January).

Given the fact that seven times as many large companies expect to increase IT budgets over the next 12 months compared to those that expect budgets to decline, CRN sees this upward trend in per-firm spending continuing in the second quarter of this year.

Solution providers are likely to find solid sales opportunities in Internet-related categories such as security, Web services, application/database development and wireless networking.

In addition, large firms appear to be paying increased attention to security and online payment systems, as the level of spending priority for these two categories are higher now than they were a year ago.

Hardware and software categories offering strong opportunities for the channel include networking, desktops and PC servers. The level of spending priority for PC servers is higher now than it was last year.

CHART 4

LARGE COMPANY TECHNOLOGY BUDGET OUTLOOK

Q: Do you expect you company's IT budget to increase, decrease or stay the same over the next 12 months?

(PERCENTAGE OF LARGE COMPANIES CITING EACH CHOICE)

	Mar. '06	Change from Dec. '05
Increase	64%	-6 percentage pts.
Decrease	9%	0 percentage pts.
Stay the same	27%	+6 percentage pts.

BASE: 125 large company IT executives polled in March 2006

CHART 5

LARGE COMPANY TECHNOLOGY BUDGET GROWTH

Q: How much does your company plan to increase (or decrease) IT spending over the next 12 months?

(PERCENTAGE OF LARGE COMPANIES CITING EACH CHOICE)

A. Of the 64% of businesses planning to INCREASE spending

Increase more than 20%	35%
Increase 16% to 20%	23%
Increase 11% to 15%	16%
Increase 6% to 10%	16%
Increase 1% to 5%	10%
Total	100%

B. Of the 9% of businesses planning to DECREASE spending

Decrease more than 20%	37%
Decrease 16% to 20%	9%
Decrease 11% to 15%	18%
Decrease 6% to 10%	27%
Decrease 1% to 5%	9%
Total	100%

CHART 6

LARGE COMPANIES' COMMITMENT TO TECHNOLOGY BUDGET CHANGES

Q: How committed is your company to making planned changes in IT spending?

(PERCENTAGE OF LARGE COMPANIES CITING EACH CHOICE*)

A. Of businesses planning to INCREASE spending

Extremely committed	48%
Strongly committed	36%
Moderately committed	11%
Slightly committed	5%
Total	100%

B. Of businesses planning to DECREASE spending

Extremely committed	27%
Strongly committed	37%
Moderately committed	18%
Slightly committed	18%
Total	100%

*NOTE: "EXTREMELY COMMITTED": SPENDING CHANGES ALREADY BEING INSTITUTED. "STRONGLY COMMITTED": SPENDING CHANGES VERY LIKELY TO BE IMPLEMENTED SOON. "MODERATELY COMMITTED": SPENDING CHANGES UNDER ACTIVE CONSIDERATION. "SLIGHTLY COMMITTED": SPENDING CHANGES UNDER DISCUSSION BUT NOT LIKELY TO BE INSTITUTED ANYTIME SOON.

BASE: 81 large companies planning to increase spending, 11 large companies planning to decrease spending, polled in March 2006
SOURCE: *CRN* Business Spending Survey

----

3. HOT GROWTH CATEGORIES

Solution providers shook up the top 10 list of categories where they have the highest sales expectations, with four new categories joining the list in March. Voice over IP rejoined the list (in second place) after a one-month hiatus, along with anti-spam, PC servers and storage software. These categories replaced firewalls, desktop PCs, remote access and networking hardware.

Managed services, one of the hottest technologies in the market today, topped the list, replacing anti-virus, which dropped to a tie for third. Intrusion detection was another fast-mover, jumping from eighth place in February to a tie for third place in March. Many solution providers may be missing out on these burgeoning sales opportunities, however, since neither of these categories appears on the top 10 list of technologies that VARs plan to recommend to their business clients over the next three months.

Notebook PCs and anti-spyware remained on the top 10 list in March, though both dropped several positions compared to the previous month. Notebooks fell from a tie for second place to a tie for sixth position, while anti-spyware went from a tie for second to tenth.

But in contrast to managed services and intrusion detection, notebook PCs and anti-spyware also appear on the top 10 list of products that solution providers plan to recommend to their business clients in the second quarter of this year (see section 5 below). Look for these two categories, along with PC servers and wireless LANs, to be among the leaders in sales growth over the near term.

CHART 7

IT CATEGORIES WITH HIGHEST SALES EXPECTATIONS

(PERCENTAGE OF VARS EXPECTING SALES GROWTH OF 6% OR MORE IN THE SECOND QUARTER OF 2006)

Managed services	64%
Voice over IP	63%
Anti-virus	62%
Intrusion detection	62%

Anti-spam	61%
Wireless LANs	60%
Storage software	60%
PC servers	60%
Notebook PCs	60%
Anti-spyware	59%

BASE: 193 responding solution providers in March 2006
SOURCE: *CRN* Monthly Solution Provider Survey

----

4. BEST-SELLING BRANDS

A sharp jump in the percentage of solution providers citing IBM as their best-selling Unix server vendor highlights the results from the March Solution Provider survey.

Last month, 36 percent of solution providers cited IBM as their best-selling vendor in this category, more than double the figure in February. The increase came at the expense of the vendor's competitors, especially custom systems, which saw its best-selling percentage fall to its lowest level since *CRN* began collecting data many years ago.

Interestingly, Hewlett-Packard saw a similarly large jump in its best-selling percentage in the Unix server category in February. The vendor gave back some of this gain in March, but still managed to hold onto most of the increase.

Future data will determine if the small and midsize company Unix server market is consolidating around IBM, Sun and HP, leaving custom systems out in the cold.

Custom systems lost ground in the desktop and PC server markets as well, breaking a recent upward trend. Unlike in many past instances, the losses cannot be attributed to component availability, as the data show component shortages eased significantly in March compared to February in all major categories.

Coupled with a decline in the percentage of solution providers building white boxes, the fact that branded desktops, notebooks and servers appear on the top 10 list of products that VARs plan to recommend to their customers over the next three months seems to show that solution providers are favoring branded systems when it comes to PC hardware sales. It is too early to tell, however, if this is the start of a longer-term trend.

Acer stalled in its recent upward streak in the percentage of solution providers citing its notebooks as best selling. Nonetheless, the vendor's presence in the small- and midsize-company notebook market has increased over the past year.

In the first quarter of 2006, an average of 5.1 percent of VARs cited Acer notebooks as their best selling, compared to 4.3 percent in the first quarter of 2005. The numbers may look small, but this represents a 19 percent increase in Acer's best-selling percentage.

Dell's position in the PC hardware market stabilized in March, following declines in January and February. The vendor saw slight gains in the percentage of solution providers citing its desktops and PC servers as their best selling and a more substantial gain in the notebook market.

Despite weakness in Unix servers, Hewlett-Packard's overall performance in March was positive. Solid gains were recorded in the desktop and PC server markets, while the vendor's notebook percentage increased slightly.

However, HP still lags significantly behind Dell in both the desktop and notebook PC markets, though the vendor enjoys a substantial edge over Dell in the PC server arena.

For the second straight month, Lenovo saw a slight increase in the percentage of solution providers citing its desktop and notebook PCs as their best selling. However, Lenovo has once again fallen behind custom systems in the notebook market, though it remains ahead of rival Toshiba.

CHART 8

BEST-SELLING HARDWARE BRANDS

PERCENTAGE OF VARS CITING EACH AS TOP-SELLING UNIT, IN MONTH LISTED

DESKTOPS	Mar. '06	Feb. '06	Mar. '05
Dell	37%	36%	31%
HP	29	20	25
Custom systems	24	31	26
Lenovo	4	3	8

NOTEBOOKS	Mar. '06	Feb. '06	Mar. '05
Dell	32%	28%	24%
HP	23	22	21
Custom systems	12	9	14
Lenovo	11	10	18
Toshiba	9	9	8

PC SERVERS	Mar. '06	Feb. '06	Mar. '05
HP	33	30	32
Dell	26	25	21
Custom systems	18	25	25
IBM	14	12	13

UNIX-BASED SERVERS	Mar. '06	Feb. '06	Mar. '05
IBM	36	16	17
HP	29	37	20
Sun Microsystems	21	24	18
Custom systems	5	10	24

BASE: 193 responding solution providers in March 2006
SOURCE: *CRN* Monthly Solution Provider Survey

----

5. SOLUTION PROVIDER RECOMMENDATIONS TO BUSINESS CUSTOMERS

The list of the top 10 products and technologies that solution providers plan to sell or recommend to their small and midsize business clients over the next three months showed little change in March compared to February. Branded servers were added to the list, replacing networking software. The list remains dominated by three basic technology areas---security, networking and PC hardware.

The top four categories on the list were unchanged in March compared to February. There were some shifts in position, however. For example, networking hardware moved from a tie for third place to first place, and wireless LANs dropped from first place to fourth.

Networking hardware is an interesting case; while it tops the recommendations list, it does not appear on the top 10 list of categories where solution providers have the highest sales growth expectations for the second quarter. While VARs may not have strong near-term sales expectations for networking hardware, they are certainly looking to pump up sales growth further down the road.

Branded systems have also shown upward movement, with branded servers new to the list in March and branded desktops jumping from a tie for eighth place in February to fifth place last month.

Is a new PC replacement cycle in the works? If so, this development would contradict doom-and-gloom predictions in the news that the delayed Vista release is going to delay PC replacement until after the new year. But this data seems to indicate that solution providers think such a refresh is due, and data from *CRN*'s Business Spending Survey seems to confirm this view because PC hardware is among the top hardware/software spending priorities for companies of all sizes.

CRN analysis also shows that there is a strong correlation between categories appearing on the top 10 sales growth expectations list and those appearing on the top 10 sales recommendations list. The data for March is no exception; solution providers are fully expecting many of the categories on the top 10 recommendations list to pay off in top-line sales growth in the second quarter of this year.

Six of the categories on the top 10 sales expectations list, including anti-virus, anti-spam, wireless LANs, PC servers, notebook PCs and anti-spyware, also appear on the top 10 list of categories that solution providers plan to recommend to their business clients.

CHART 9

TOP PRODUCTS/TECHNOLOGIES VARS PLAN TO SELL/RECOMMEND TO BUSINESS CUSTOMERS*

(PERCENTAGE OF VARS CITING EACH)

Networking hardware	52%
Anti-virus	51%
Firewalls	47%
Wireless LANs	46%
Branded desktops	43%
Branded notebooks	42%
Storage hardware	42%
Branded servers	39%
Anti-spyware	39%
Anti-spam	39%

*IN THE SECOND QUARTER OF 2006

New To the List in March:
Branded servers

Dropping Off the List in March:
Networking software

BASE: 193 responding solution providers in March 2006
SOURCE: *CRN* Monthly Solution Provider Survey

EDITOR'S NOTE

JOHN ROBERTS is CRN's director of research. He can be contacted via e-mail at jorobert@cmp.com.

Each month, CRN randomly surveys readers on a range of topics, such as near-term sales expectations, best-selling technologies, business customer segments and custom systems. Several hundred responses are received from solution providers monthly.

Please note that *CRN* is going to a quarterly, instead of monthly, format for the Research Report. The next Report, highlighting the IT spending outlook for the third quarter of this year, will be published in July.