CRN research

IT SPENDING OUTLOOK

CRN Channel Business Research Report, January 2006

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1. SOLUTION PROVIDER NEAR-TERM SALES FORECAST

Solution providers' overall near-term sales expectations closed out 2005 with a modest gain, which marked the third straight monthly increase from hurricane-induced lows, according to exclusive *CRN* research data.

The overall sales expectations index came in at 94 in December (with April 2004=100) compared to 89 in November. (See Charts 1 and 2.)

The increase in sales expectations in December was led by two categories that lagged in the recent past, security and networking. (See Chart 1.) Networking hardware and software sales expectations, which had reached their lowest point in more than a year, rebounded sharply. Security sales expectations perked up to their highest level since June, led by VPNs and intrusion detection.<<Possibly incorrect. Awaiting feedback from John.>>

Software sales expectations showed a more modest gain in December compared to networking and security. As was the case in November, however, the growth in sales expectations was broad-based, in categories such as data warehousing, supply chain management, Web site design and development, Linux, and business-class communications.

Hardware sales expectations, which had seen strong growth in October and November, leveled off in December but remained at their highest level since March. Categories such as desktops, notebooks

and peripherals all saw increases in sales expectations last month, with notebook segment revisiting a yearly high that was first touched in January 2005.

The increase in sales expectations in December covered all major market segments as well, particularly large corporations and the government. (See Chart 3.) These expectations are likely to be realized, at least in the corporate segment, according to data from the December *CRN* Business Spending Survey (see Section 2, "Large-company Technology Spending Plans").

That channel sales expectations should increase at the end of the year is not totally unexpected. Past *CRN* research data, for example, has shown that for a significant percentage of businesses, the start of a new yearly technology spending cycle coincides with the start of the new calendar year, and solution providers are likely to anticipate higher sales as the new spending cycle gets started.

What *is* interesting is that the increase in overall sales expectations in December 2005 was considerably muted compared to the unbridled exuberance shown by solution providers in December 2004, when sales expectations hit an all-time high.

But this optimism lasted only a few months, as the data in Chart 2 shows, with expectations tailing off sharply by May 2005. A more reserved outlook for sales expectations currently could mean less dramatic swings in expectations as 2006 wears on.

CHART 1
VAR SPENDING EXPECTATIONS INDEX
(BENCHMARK: APRIL 2004=100)

	Dec. '05	Nov. '05	Dec. '04
Overall	94	89	129
Networking	96	70	105
Software	93	89	132
Hardware	92	92	121
Security	90	76	124

CHART 2
HISTORICAL VAR SPENDING 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

CHART 3
VAR SALES EXPECTATIONS* BY MARKET SEGMENT
(BENCHMARK: APRIL 2004=100)

	Dec. '05	Nov. '05	Dec. '04
Large enterprises	92	69	83
Midsize companies	94	92	112
Small businesses	99	85	110
Government	94	56	113

*IN THE THREE MONTHS FOLLOWING DATE SHOWN

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2. LARGE-COMPANY TECHNOLOGY SPENDING PLANS

Enterprise-sized companies (those with at least 1,000 employees) continued to grow more positive about their near-term spending plans, according to data from the December *CRN* Business Spending Survey.

Seventy percent of the 125 large-company IT executives surveyed last month said they expected their company's technology budgets to increase over the next 12 months. (See Chart 4.) This was the highest percentage recorded in more than a year, and was up from 59 percent in September, the last time enterprise companies were surveyed.

An uptick in spending plans in December is not unusual; *CRN* research data reveals the same pattern occurred in both December 2003 and December 2004. For many companies, the start of the calendar year also marks the start of a new yearly IT spending cycle, and the data reveals that this cycle was indeed a key factor behind the more positive trend in spending expectations in the December survey.

But a closer look at the data reveals that the priority businesses placed on technology spending was higher in December 2005 compared to the previous year in many Internet-related and hardware/software categories. (See Chart 7.) Services-related categories, such as managed services, Web services, and business-class communications services (voice and data) are also on an upward trend.

The level of spending priority for Internet-related categories such as voice over IP, wireless, Web services, application integration, CRM and online payment systems hit their highest levels in the past 18 months, with VoIP and wireless showing particularly strong increases in spending priorities compared to September.

The results were similar for most hardware/software categories, including networking hardware, networking software and PC servers. Notebooks and peripherals were two categories that showed particularly strong increases in Q4 '05. Indeed, the spending priority

level for notebooks is nearing parity with desktops, which is a marked difference from a year ago when desktops were prioritized significantly above notebooks.

Will this rosy outlook for channel sales to the enterprise segment continue beyond the first quarter of this year? One positive sign comes from data showing that the opening of a new yearly IT spending cycle was not the only reason behind the more positive spending outlook. Factors such as general economic conditions and technology budgets also played a role, and the economy is expected to continue growing solidly this year. As businesses expand operations and upgrade existing technology systems, their spending plans are growing.

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)

	Dec. '05	Change from Sep. '05
Increase	70%	+11 percentage pts.
Decrease	9%	+1 percentage pt.
Stay the same	21%	-12 percentage pts.

BASE: 125 large-company IT executives polled in December 2005
SOURCE: *CRN* Business Spending Survey

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. Businesses planning to INCREASE spending

Increase more than 20%	48%
Increase 16% to 20%	20%
Increase 11% to 15%	17%

Increase 6% to 10%	12%
Increase 1% to 5%	3%

B. Businesses planning to DECREASE spending

Decrease more than 20%	55%
Decrease 16% to 20%	18%
Decrease 11% to 15%	9%
Decrease 6% to 10%	9%
Decrease 1% to 5%	9%

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. Businesses planning to INCREASE spending

Extremely committed	59%
Strongly committed	25%
Moderately committed	10%
Slightly committed	6%

B. Businesses planning to DECREASE spending

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

*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: 87 large companies planning to increase spending, 11 large companies planning to decrease spending, polled in December 2005
SOURCE: *CRN* Business Spending Survey

CHART 7
LARGE-COMPANY SPENDING PRIORITY CHANGES
Q: Using a scale from 1 to 5 where 5 means "High Priority" and 1 means "Low Priority, please rate the level of priority for spending by your company in the following categories over the next three months.
(MEAN RATING)

	Dec. '05	Sept. '05	June '05	Mar. '05	Dec. '04	Sept. '04
Internet-Related						
Security	4.08	4.04	4.08	3.97	4.04	3.63
Web services	3.86	3.85	3.77	3.84	3.72	3.49
Wireless	3.86	3.61	3.7	3.67	3.49	3.5
Business-class communications services	3.82	3.56	†	†	†	†
Application/database development	3.81	3.6	3.75	3.76	3.81	3.42
Intranet development	3.79	3.64	3.72	3.83	3.73	3.56
Managed services	3.7	3.41	†	†	†	†
Access to legacy systems (EAI)	3.7	3.51	3.44	3.57	3.43	3.35
Supply chain management	3.67	3.56	3.6	3.65	3.49	3.49
Application hosting	3.64	3.51	3.45	3.77	3.4	3.33
Online payment systems	3.62	3.52	3.59	3.42	3.4	3.27
VoIP	3.58	3.32	3.27	3.49	3.37	3.37
CRM	3.47	3.31	3.41	3.5	3.39	3.14

Hardware/Software	Dec. '05	Sept. '05	June '05	Mar. '05	Dec. '04	Sept. '04
Networking hardware	4.02	3.79	3.69	3.86	3.84	3.52
Desktop PCs	3.91	3.73	3.73	3.77	3.81	3.58
Notebook PCs	3.9	3.47	3.47	3.57	3.44	3.41
Networking software	3.88	3.8	3.72	3.78	3.79	3.57
PC servers	3.86	3.66	3.62	3.61	3.63	3.54
Storage management software	3.86	3.51	†	†	†	†
Storage hardware	3.83	3.61	†	†	†	†
Peripherals	3.76	3.32	3.55	3.54	3.47	3.32

7

Unix-based servers	3.72	3.39	3.5	3.56	3.44	3.16
Storage	†	†	3.3	3.81	3.79	3.51

† Data not collected.

Base: 125 large-company IT executives polled quarterly
Source: *CRN* Business Spending Survey

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3. HOT GROWTH CATEGORIES

The technologies that solution providers expect to be the hottest sellers this quarter changed dramatically again this month, with Web services, VoIP and managed services now topping the list. (See Chart 8.) The appearance of Web services and business-class communications services in the top 10, in addition to the sustained high status of managed services, demonstrates the increasing importance of services to channel revenue and profits.

This is the second month in a row in which the list of the top 10 categories where solution providers have the highest near-term sales expectations showed a significant degree of turnover. Six categories were new to the list in December, coming on the heels of a five-category turnover in November. This degree of turnover is unprecedented in the 16-month history of *CRN*'s Monthly Research Report.

The six new categories included networking hardware, networking software, intrusion detection, business-class communications services, imaging/image management and Web services (which vaulted into first place on the list). The categories dropping off the list included anti-spam, anti-virus, storage hardware, firewalls, Web site design/development, and remote access.

Solution providers' efforts to boost networking hardware and software sales (see Section 5) appear to be paying off, as both of these categories returned to the top 10 list in December.

Interestingly, only one security-related category (intrusion detection) is represented on the list for December, the fewest security categories since *CRN* began publishing the Research Report in June 2004. With anti-virus and firewalls topping the list of products that solution

providers plan to sell or recommend to their customers (as shown in Section 5), this may be a short-lived event.

But this trend may also be a reflection of the fact that the line is becoming clearer between stand-alone security solutions (such as anti-virus software or firewalls) and "all-in-one" security solutions that combine several business IT security needs into a single package, and that the latter is becoming more prominent in the marketplace.

CHART 8
IT CATEGORIES WITH HIGHEST SALES EXPECTATIONS
(PERCENTAGE OF VARS EXPECTING SALES GROWTH OF 6% OR MORE IN THE NEXT THREE MONTHS)

Web services	60%
Voice over IP	58%
Managed services	57%
Wireless LANs	57%
Intrusion detection	56%
Imaging/image mgt.	56%
Networking hardware	56%
Networking software	55%
Hosting	54%
Business-class communications services (voice and data)	54%

New To the List in December:
Networking hardware
Networking software
Intrusion detection
Business-class communications services
Imaging/image management
Web services

Dropping Off the List in December:
Anti-spam
Anti-virus

Storage hardware
Firewalls
Web site design/development
Remote access

BASE: 314 responding solution providers in December 2005
SOURCE: *CRN* Monthly Solution Provider Survey

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4. BEST-SELLING BRANDS

Dell turned in a stunningly strong performance in December. In a move never before seen in the 11 years that *CRN* has been collecting data, 45 percent of solution providers cited Dell as the manufacturer of their best-selling desktop PC, up an amazing 21 percentage points from November. (See Chart 9.) This is the highest monthly percentage ever recorded for a branded vendor in the desktop category. Dell also scored a 10 percentage point gain in its notebook figure, which rose to its highest level since March 2004. The vendor recorded a smaller, but still significant, increase in the PC server category as well.

The turnaround is all the more remarkable given *CRN* research data showing Dell losing ground in the small and midsize company desktop market for most of the past year. Given the size and suddenness of the turnaround, the December figure must be interpreted with caution. But Dell's gains in the PC hardware market coincided with significant losses by custom systems, which has been the vendor's nemesis throughout the past year.

Custom systems lost ground in all major markets in December, particularly desktop PCs and RISC servers. This follows losses in November as well, and is another indication that component shortages are seriously affecting the custom systems market. As discussed in the Custom Systems Report on *CRN*'s Market Intelligence Web site, component shortages remained high in December in key areas such as microprocessors and memory. Moreover, shortage problems are becoming more widespread, continuing to increase in areas such as video graphics cards and network interface cards. Custom system builders have been reporting Intel motherboard shortages to *CRN* for quite some time, and now AMD has confirmed reports that it's running

short of supply, possibly explained by strong indications Dell has pre-ordered a large amount of AMD product. (See "VARs: An AMD-Dell Deal Would Hurt Channel Margins" by Kristen Kenedy in *CRN*'s January 12 news at CRN.com.)

Compared to custom systems, branded vendors such as Hewlett-Packard and IBM were far less negatively affected by Dell's surge this month.

Hewlett-Packard saw a decline in the percentage of solution providers citing its desktops as best-selling, but realized gains in notebooks, PC servers and Unix-based servers. IBM turned in another solid performance in December (for the fourth time in the past five months), as the percentage of solution providers citing IBM servers as best selling increased modestly.

Lenovo was a different story, however. The vendor saw a sharp drop in its notebook percentage, and its already minuscule desktop percentage also fell slightly.

CHART 9
BEST-SELLING HARDWARE BRANDS
PERCENTAGE OF VARS CITING EACH AS TOP-SELLING UNIT, IN MONTH LISTED

DESKTOPS	Dec. '05	Nov. '05	Dec. '04
Dell	45%	24%	26%
White box	23	33	39
HP	17	24	23
Lenovo	4	5	6

NOTEBOOKS	Dec. '05	Nov. '05	Dec. '04
Dell	35%	25%	23%
HP	24	20	25
Lenovo	8	12	15
Toshiba	7	8	10
White box	6	13	12

PC SERVERS	Dec. '05	Nov. '05	Dec. '04
Dell	28%	20%	22%
HP	27	25	26
White box	22	29	34
IBM	15	14	11

UNIX-BASED SERVERS	Dec. '05	Nov. '05	Dec. '04
IBM	24%	21%	19%
HP	22	20	16
White box	16	26	32
Sun Microsystems	15	13	13

BASE: 314 responding solution providers in December 2005
SOURCE: *CRN* Monthly Solution Provider Survey

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5. SOLUTION PROVIDER RECOMMENDATIONS TO BUSINESS CUSTOMERS

Security and networking products are what solution providers will be touting most to customers in the near term. They head 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 next three months, a list that showed only minor changes in December compared to November. (See Chart 10.) Branded desktops and databases were added to the list, replacing branded servers and anti-spam.

Networking hardware and networking software remain on the top 10 list, as solution providers continue their efforts to boost sales in these two categories. These efforts may finally be starting to pay off, as the data in Sections 1 through 3 reveals. It should be noted that despite the growing importance of new, cutting-edge technologies to the channel business model, "basic" categories, such as networking, are still the foundation for revenue and profits among many solution providers.

Firewalls and anti-virus held the top two places on the list, but how long this trend will continue is an open question. As mentioned in Section 3, the distinction between stand-alone and "all-in-one" security solutions is becoming clearer, and with price and functionality high on the minds of business executives, the market for combined security solutions could see stronger growth than stand-alone sales as 2006 progresses.

CHART 10
TOP PRODUCTS/TECHNOLOGIES VARS PLAN TO SELL/RECOMMEND TO BUSINESS CUSTOMERS*
(PERCENTAGE OF VARS CITING EACH)

Firewalls	44%
Anti-virus	44%
Network hardware	43%
Wireless LANs	39%
Storage hardware	36%
Branded desktops	34%
Branded notebooks	34%
Network software	33%
Databases	33%
Peripherals	33%

*OVER NEXT 90 DAYS

New To the List in December:
Branded desktops
Databases

Dropping Off the List in December:
Branded servers
Anti-spam

BASE: 314 responding solution providers in December 2005
SOURCE: *CRN* Monthly Solution Provider Survey

13

EDITOR'S NOTE

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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.