



Market Roundup

September 7, 2001

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Microsoft's Great Escape

By Jim Balderston

The Justice Department announced this week that it was essentially dropping the case against Microsoft. The Antitrust Division announced that it will not seek to break up the company nor will it pursue any further action related to the "tying" or bundling complaint that charged Microsoft had illegally tied its Web browser to the Windows operating system. The Justice Department's actions leave in place the District Court of Appeals requirement that Microsoft give computer manufacturers greater leeway in altering boot-up sequences on PCs, and prevents the company from engaging in coercive behavior towards these vendors. The Justice Department made no comment on the upcoming release of Windows XP, the company's next operating system release due out in early October.

We have maintained from the beginning that there was a significant political element to this prosecution, and that the trial itself seemed irregular at best, and biased and predetermined at worst (regardless of Microsoft's incompetent bungling of its defense). The Court of Appeals upheld Thomas Penfield Jackson's findings, but sent the case back to another judge for remedy. Now the Justice Department says it is ready to enter settlement talks directly, without further prosecution. While some will attribute this change in tone to a more business-friendly Bush administration, we would argue that it simply underscores the political facets of the case more boldly than we were ever able to. That being said, Microsoft is not completely off the hook. The company will have to hammer out settlement terms that will contain some level of continued Justice Department scrutiny, and the company still has 18 state attorneys general mulling anti-trust actions. While Microsoft critics are sure to decry the Justice Department's decision, there is some potentially very good news for the sagging computer industry. If Windows XP does go out the door on schedule, it will be available on new computers for the Christmas shelves. XP has significantly higher hardware requirements than Windows 98 or 2000, and will in essence require PC upgrades for anyone running a box that is more than 18 months old. While we don't believe that XP is going to turn around the slumping PC market alone, it could provide an up tick of good news as the year ends and we move into 2002.

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Microsoft/HP Announce Enterprising PDA Solutions

By Charles King

Microsoft announced that its new PDA OS, Pocket PC 2002, will be commercially available starting October 4, 2001. The new software includes enhancements such as a new interface, Microsoft Media player and options that streamline interoperability with Palm devices. The OS also features capabilities aimed specifically at enterprise business users, including a Terminal Services application that allows users to access their Windows operating system-based server, support of strong passwords and the ability to connect to corporate information via a virtual private network (VPN). In addition, the new OS supports a range of wireless connectivity options from local area networks (802.11b) and personal area networks (Bluetooth) to wide area networks (via CDPD and GSM, or through two-body solutions). In a related announcement, Hewlett-Packard announced the October 4, 2001 release of the Jornada 565 and 568, color screen PDAs powered by Pocket PC 2002 Premium Edition, which includes a range of Microsoft productivity applications. The devices have a built-in CompactFlash Type 1 extended slot, allowing users to add memory cards and optional accessories such as wireless network solutions and the HP Pocket Camera.

PDAs have long been a bit schizoid, split unevenly between the narrow capabilities of the wildly popular Palm (along with its relation, Handspring) and Pocket PC-powered devices such as HP's Jornada and Compaq's iPaq whose more powerful capabilities sported premium price tags. While calling this split a simple delineation between toys and tools might make Palm advocates squeak a bit, the overwhelming presence of Microsoft products on and under the desktop offers an inherent advantage to any device that can successfully integrate with Windows apps. Until recently, PDAs were the poor cousins of desktops and laptops, but a growing interest in meaningful ubiquitous connectivity by business users has the potential of offering Pocket PC devices a leg up against less robust handhelds. Notice that we used the word "meaningful" in that last sentence, because business users need their PDAs to perform as more than battery-operated address books and calendars.

Which brings us to Pocket PC 2002, an OS whose myriad bells and whistles suggest Microsoft is finally taking handheld computing seriously. Most interesting to us are the Terminal Services application and VPN support, which offer PDAs new levels of enterprise network access. Additionally, the support of a variety of wireless protocols suggest scenarios where PDAs could be used for everything from network access for tech support staff to wireless order submission by mobile sales personnel. Given the added capabilities the new OS offers Pocket PC devices, we expect Palm and Handspring are likely to suffer continuing difficulties and market share erosion. While HP's new Jornadas may be the initial PDAs to sport the new OS, we doubt being first to market will offer the company any appreciable advantage. To our way of thinking, Compaq's capable iPaq has long been the leader of the Pocket PC parade, with devices from HP and others following some distance back. The announced acquisition of Compaq offers HP a distinct, happy advantage in the PDA market, especially given the new opportunities driven by Pocket PC 2002.

IT Companies Form Anti-Gray Market Alliance

By Clay Ryder

A group of IT companies announced on Wednesday that they have formed the Anti-Gray Market Alliance (AGMA) with the goal of assuring their customers' product satisfaction, educating the marketplace about the illegal or deceptive brokering or diversion of products, and addressing the unauthorized flow of

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products to the gray market. The group indicated that it would pursue a program to educate those in the distribution channel, share best practices, improve communications about and monitor levels of gray market activity. Founding members of the Alliance are: 3Com, Apple, Compaq Computer, Hewlett-Packard, Nortel Networks and Xerox Corporation. Membership in the group is open to all technology companies worldwide. AGMA is affiliated with Information Technology Association of America (ITAA); ITAA will provide management services to the group. The AGMA will be organized as a not-for-profit trade association.

Although it may be less apparent in North America than in other regions of the world, sales of gray market products are nothing new. Sometimes they manifest themselves as simply as a product bearing a different model number or older revision of a component, or the differences may be as significant as product manuals written in Thai, Polish or Cantonese and incompatible electrical connectors. At other times, currency fluctuations are a driving force in product diversion. If the Australian dollar fell dramatically against the USA dollar, a similar, if not identical, product could now be acquired at a substantial cost advantage. When dealing with a roll of film, this entails one level of risk, but with a PC, router, phone switch, server, etc., the level of risk escalates dramatically.

We believe that the driving force of the AGMA is much less about price arbitrage than customer satisfaction and brand preservation. A consumer with a gray market product would likely find that service and repair centers are not equipped to support the model in question, not to mention that the concept of warranty is null and void. The purchaser may have saved some cash up front, but will ultimately come to realize that you generally get what you pay for. But for the vendor, the potential customer dissatisfaction would reflect badly on their brand and market position. In a marketplace where IT suppliers of all stripes have witnessed their revenues evaporate; the timing of this brand protection initiative is not surprising. With every IT vendor searching for the magic balm that will resurrect sales, brand protection and customer retention is imperative. We believe the announcement of the AGMA is a reflection of just how tenuously many of its member firms view their future customer and revenue base.

Web Hosting: Field of Nightmares?

By Charles King

Citing a "need to transition leadership as the company maneuvers through challenging times," Exodus Communications announced the resignation of CEO Ellen M. Hancock and the appointment to that position of L. William Krause, a member of the company's board of directors and former Hewlett-Packard executive. In an unrelated event, Dell Computer announced that it has transferred the assets of its DellHost Web hosting service for small- to medium-sized businesses to Sprint for an undisclosed sum. The service will retain the DellHost name and Sprint will operate the site with Dell hardware.

The periodic disasters that have occurred during Exodus's ongoing circular voyage down the toilet are so common that they hardly qualify as news, but combined with Dell's hasty exit from playing host to SMB Web sites, it gives us a chance to consider the challenges faced by hosted services. Over the past year, though most public attention has been focused on the dramatic failures of numerous dotcoms, especially those in the ecommerce sector, Internet-based service companies such as Web hosts and independent DSL providers endured similar carnage for a different set of reasons. Along with paltry sales and slow growth in the number of Web-savvy consumers, ecommerce vendors suffered from the failed promises of Internet advertising promoters and had difficulty creating and managing recognizable brands. But problems on the Web-based service side were largely due to the need to build out pricey, service-supporting infrastructure that saddled Web hosts and independent DSL providers in particular with

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enormous debt loads. As the NASDAQ and the U.S. economy hit the skids, Web service vendors began a rapid fade.

This scenario is not especially original. In the years following the Civil War, speculative investment in the railroad industry drove stock prices to stratospheric heights and led to huge capital outlays for building-out financially unsustainable railroad infrastructures. Sure, the era inspired its fair share of Robber Barons, but it also produced scores of dead companies and hosts of disillusioned stockholders who went broke when the market ran off the tracks. Though today's bust harbors eerie similarities to that earlier debacle, does it mean that Web hosting is dead? Hardly, but it is becoming more the purview of conservative, infrastructure-heavy telecom companies than specialists who are enduring some tough, elemental business lessons. Before a company steps into an unfamiliar quagmire, like Dell, it should have a sensible exit plan. If an organization decides to embrace the "If we build it, they will come" business model, it had better have an effective strategy for getting fans through the gates and attractive debt financing until the stadium is paid off. Otherwise, like Exodus's owners, employees and investors, it will be left with little more than a weed-choked field of broken dreams.

Red Hat Releases Embedded Linux Developer Suite

By Charles King

Red Hat announced the Red Hat Embedded Linux Developer Suite, a packaged offering that combines new versions of its embedded Linux platform, development tools, runtime technologies and support services into a single offering. The Red Hat Embedded Linux Developer Suite includes Red Hat Embedded Linux based on the open source Red Hat Linux operating system. The product offers developers capabilities for different device requirements targeting MIPS, SuperH, X86, PowerPC and ARM/StrongARM/XScale architectures. The product will be available for sale in October. Pricing was not included in the announcement.

Red Hat's developer suite comes as something of an also-ran, considering the recent raft of major embedded system announcements from companies including Intel, Compaq, Monta Vista and Microsoft. But the sheer density of these events suggests that the embedded system market, which caters to a wide range of computerized consumer and industry products including digital watches, calculators, cellular phones, microwave ovens and manufacturing equipment, has finally caught the eye of mainline technology companies. Why this is happening is easy enough to discern. With the PC industry in a nosedive, hardware and software vendors are actively exploring new markets for their products. While embedded systems devices do not typically offer the scale of returns offered by the PC market, they make up the difference in sales volume.

The embedded systems industry has traditionally been the purview of a wide variety of proprietary systems vendors, but companies like Monta Vista Software have long advocated utilizing open source options, such as its Hard Hat Linux product, for embedded system devices. In fact, the company is working with Intel to develop Linux options for the new StrongARM processor. Microsoft's long running interest in consumer products makes it a natural player in this space, especially given the embedded capabilities of Windows XP. So where does this leave Red Hat? Beating the bushes for embedded systems product developers and hoping to cash in, we expect. Given the ongoing failure of Linux to make a significant dent in the U.S. desktop market, Red Hat needs to explore every possible option just to survive, let alone thrive.

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Not Quite Invisible Yet — Half of U.S. Households Have Computers

By Jim Balderston

The Census Bureau announced this week that 54 million households, or just over half of all U.S. homes, have at least one computer and that 41.5% of U.S. households have Internet access. The report also noted that 65% of children between the ages of 3 and 17 had used a computer at home, and nearly one-fifth of the same age group use email or other Internet-related applications at home. Meanwhile, schools-based computer use and Internet connectivity continue to rise, allowing nearly 90% of all school-aged children to access the Internet either at home or at school. The increase in home computers is fivefold since 1984, when collection of such data began. Home Internet connectivity has more than doubled over the past three years, going from 18% in 1997 to its present level of 42% of households. Internet and computer usage household penetration rates were directly proportional to household incomes, the study also showed.

The Census Bureau created quite a news day for itself, with nearly every major news outlet offering a story on the topic. That this is news, we believe, still indicates that the so-called Internet “revolution” is still in an early stage. We have long argued that the Internet will truly be “revolutionary” when it becomes all but invisible. Or to put it another way, when Internet usage rates are no longer the topic of new stories, something truly notable will be going on: The revolution will not be televised. But the Census Department’s numbers tell an interesting story, and indicate that the ubiquity of Internet-based computing is not going to take as long as that of some of its technological brethren. With a majority of children being exposed in either school or home, we are but a fraction of a generation away from seeing this ubiquity become a reality. And that reality, when it comes, will be both invisible and revolutionary. Telephones and automobiles, not to mention television, have made huge impacts on our lives. Yet today, most of us can’t identify those impacts – on either a meta or micro level – because they have always been with us. Yet just as automobiles have changed the way we build cities, and television how we see the world, the Internet will have profound impacts that we can barely imagine. One thing we know for sure, however, as long as Census data on the topic remains a hot news item, we aren’t there yet.

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