The INSIGHT Group
Software Company Services and Solutions Study – 2007 Update

Study Objective - Provide Senior Software Executives an in depth understanding of the trends, findings and strategic role Services play in their business.

Agenda

- Objectives
- Methodology
  - *Financial Analysis fiscal years 2002 – 2006*
  - *Follow-up interviews with 15 software companies*
- Findings
- Conclusions
- Initiatives for Long-term Success:
  - *Professional Services*
  - *License Growth*
  - *Maintenance and Support*

Study Objectives

- Provide Senior Software Executives an in depth understanding of the trends, findings and strategic role Services play in their business.

- Validate Services Best Practices in the Software Industry.

- Verify the value for software firms to develop, launch, and grow new value-add services, and _"manage services as a very profitable business"_.

Methodology

- Original study
  - Analyzed public data of 100 software enterprises … a joint research effort with Arizona State University
  - Analyzed a sub-set of 48 companies that reported complete revenue information by business segment
  - In depth interviews performed by INSIGHT Group partners with senior services executive of 15 major software firms to understand the importance and business impact of services

- Updated study with 2005 & 2006 Financial Data
  - Analyzed public data on the 68 remaining software companies
  - Analyzed a sub-set of 33 of 48 companies that reported complete revenue information by business segment for … Professional Services, Maintenance & Support (M & S), and Product/License business segments

- Combined the financial analysis with input from the executive interviews and recent INSIGHT client engagements

Financial Analysis

Companies Analyzed - Detailed Services Reporting

- **Advent Software**
- **Agile Software**
- **American Software**
- **Aspect Communications**
- **BEA**
- **BMC Software**
- **Business Objects**
- **Cadence Design**
- **Checkfree Corporation**
- **Cognos**
- **Computer Associates Int'l**
- **Convera**
- **CSG Systems**
- **E.Piphany**
- **Falconstor**
- **FileNet**

- **Hyperion**
- **I2**
- **IDX Systems**
- **Informatica**
- **Intentia**
- **Interwoven**
- **JDA Software Group**
- **Kronos**
- **Manugistics**
- **Matrix One**
- **McAfee, Inc.**
- **Mentor Graphics**
- **Mercury Interactive**
- **MRO Software**
- **Novell**
- **Open Text**

- **Opnet Technologies**
- **Openwave Systems**
- **Oracle**
- **Parametric Technology**
- **Pegasystems**
- **Peregrine Systems**
- **QAD**
- **Synopsys**
- **S1 Corporation**
- **SAP America**
- **SeeBeyond Technology**
- **Serena Software**
- **SS&C Communications**
- **Transaction Systems**
- **webMethods**
- **Wind River**

Companies in red have been acquired or gone private and no longer operate as a reporting entity.

Key Trends ... Overview

- The study included financial data from 2002 through 2006. Over this timeframe 33% of the companies reported declining software license revenues.

- Services is the predominant revenue stream (60%) and is growing at a compound growth rate of 9.9%.

- Maintenance and Support shows growth in 88% of the companies with a compound growth rate of 12% and gross margins averaging 79%.

- Revenue growth and profitability are major challenges and are driving a significant shift in the software industry
  - Software firms seek to grow revenue and expand product offerings and services to existing customers through mergers & acquisitions…to address growth, global reach and skills & capabilities *(reality: either grow, or be acquired !)*
  - 38% of top 100 companies were acquired or merged between 2002 to 2006 !
  - Software firms are pursuing services to fill gaps in product cycles.

Key Trends ... Overview (cont'd)

- In 2006 the 33 companies that provided financial segment data represented $51.2 Billion in total revenues. Up from $35.5 Billion in 2002 (8.8%CAGR)

- Services revenue grew faster than product revenue in 73% of the companies studies (In 33% of those companies, product revenue actually decreased)

- The companies experiencing positive growth in <u>Professional Services</u> revenue also grew all other revenues <u>significantly more</u> than the companies experiencing negative growth in Professional Services Revenue

Services / License Revenue Comparisons

Companies Where:	'02 – '06
Services revenues grew while license revenues declined	8 of 33 24%
Services revenues grew more than license revenues	14 of 33 42%
License revenues declined more than services revenues	2 of 33 6%
License revenues grew while services revenues declined	4 of 33 12%
License revenues declined less than services revenues	0 of 33 0%
License revenues grew more than services revenues	5 of 33 15%

Services Revenue Driving Growth
73%

Product Revenue Driving Growth
27%

Services Revenue Growth Can Offset License Revenue Decline

- Revenues from Licenses declined in 33% of the companies reporting full financial data
- 24% of these companies saw an increase in services revenues in the same timeframe
- Of these, the increase in services revenue was high enough to drive an increase in total revenues for 21%
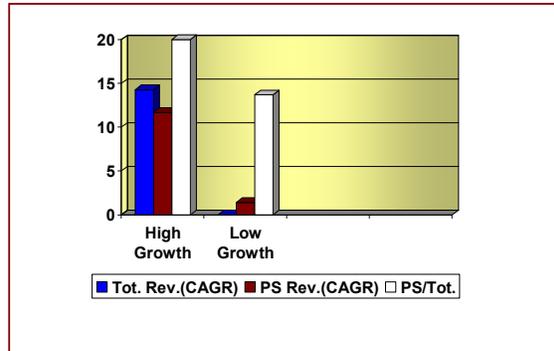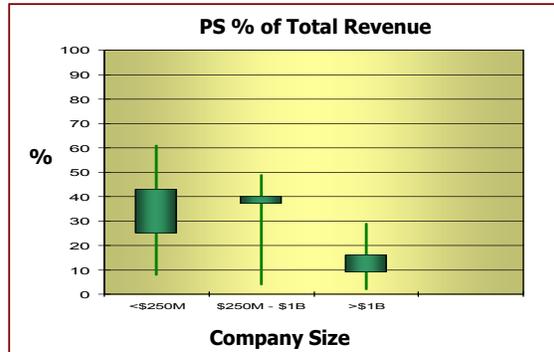
Revenue Growth '02 - '06

% of Companies

33% 24% 21%

■ Lic. Rev. Down ■ Svcs Rev Up ■ Total Rev Up

PS % of Total Revenue
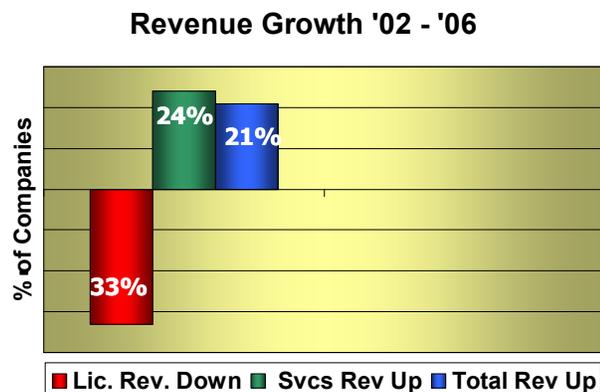
- What is the right amount of Professional Services?????
  - Average of 33 companies =20%
  - Median of the 33 companies = 16%
  - Fastest growing companies = 20%
  - Slowest growing companies = 14%
- Larger companies tend to have a smaller percentage of revenues come from Professional Services.
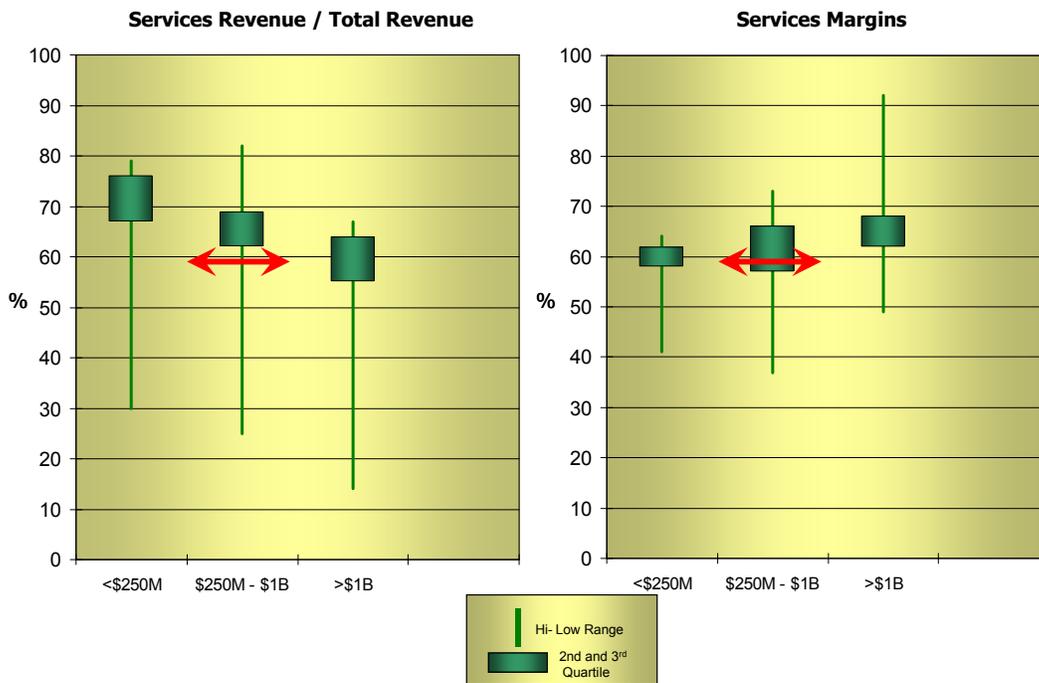- Larger companies are growing at a faster rate:

  WDP1
  - *<$250M = 4.7% CAGR*
  - *$250M - $1B = 5.7%CAGR*
  - *> $!B = 8.4% CAGR*

Slide 11

WDP1   Suspect the growth of larger companies is driven by acquisitions
William D. Puso, 1/21/2008

Services Revenue / Total Revenue

Services Margins

Hi- Low Range

2nd and 3rd Quartile

Observations

- Services are a significant contributor to software company revenues and profits representing:
  - *60% of revenues*
  - *50% of profits*
- Services are the fastest growing segment of most software companies' businesses.
- No substantial difference between application and infrastructure companies
- Software companies with a focus on growing their professional services grow all services faster than those companies without a growing professional services business.
- Successful services businesses buffer the ups and downs of product cycles.
- Services gross margins are not as high as product margins but focus on these businesses is essential for growth.

Software Executive Interviews

Methodology

- Interviewed top executives of fifteen software companies.
- Asked a series of Eleven questions focusing on:
  - *Business Challenges*
  - *Actions planned to address challenges*
  - *Current business performance*
  - *Channel management*
  - *Services business management*
- Consolidated findings from interviews to complement Financial Analysis findings.

Companies Interviewed

- **Advent Software**
- **AppNet Solutions**
- **BEA Systems**
- **BMC Software**
- **Cognos/IBM**
- **EMC**
- **Dassault Systemes, America**
- **IMS Health**

- **Mentor Graphics**
- **Microsoft**
- **Novell**
- **Peregrine Systems**
- **SAP**
- **Symantec**
- **Veritas / Symantec**
- **Vignette**

Survey Results

- Most Significant Business Challenges?
  - *Revenue and profit growth*
    - ✓ License revenue declining
    - ✓ Primarily focusing on growing product revenue
  - *Solutions focus*
    - ✓ Deliver solutions faster and more effectively
    - ✓ Improve solutions selling capabilities
    - ✓ Transform company from product to solution company
    - ✓ Consulting services drive license sales
  - *Business partners*
    - ✓ Support to deliver quality services – trained and certified
    - ✓ Improved selling capabilities
    - ✓ Develop effective channel strategy
- Actions to address challenges?
  - *Revenue and profit growth*
    - ✓ Acquisitions
    - ✓ Focus on growing services
    - ✓ Business reorganization with support and services industry sector management
  - *Solutions Focus*
    - ✓ Focus on "evidence-based" consulting services
    - ✓ More thought leaders
    - ✓ Utilize SI partners to sell software solutions

Survey Results (cont'd)

- Actions to address challenges?
  - *Business partners*
    - ✓ Hired channel management executive
    - ✓ Focus on better channel support – training
- Is company focused on fee-based services?
  - *Strategic driver*
    - ✓ Services growing at 20%+
    - ✓ Positive offset to economic decline
    - ✓ Increasing importance to highest priority
  - *Primarily to drive license sales*
    - ✓ Used as a differentiator but usually given away
    - ✓ Number one goal is support product sales
  - *Customer satisfaction*
    - ✓ Majority of business is repeat business – services are a key contributor to customer satisfaction
    - ✓ High correlation between customer satisfaction and service people involvement
    - ✓ Services involved in every project has major positive impact on customer satisfaction.

Survey Results (cont'd)

- Top three services and revenue contribution
  - *Maintenance & Support – 60% to 65%*
  - *Consulting – 20% to 25%*
  - *Education / Training – 5% to 10%*
- Which services are viewed as most important to future success, why?
  - *Management consulting*
    - ✓ Facilitates product growth
    - ✓ High value to customer
    - ✓ Largest revenue source
  - *Maintenance & Support*
    - ✓ Revenue impact
    - ✓ Profit impact
    - ✓ Customer loyalty
- Direct sales and business partners selling software and services….coverage strategy….effectiveness?
    - ✓ Broad array of business partner strategies
    - ✓ Mostly geographic coverage, two with industry segment focus
    - ✓ Some use of services sales reps but most in support of product sales reps
    - ✓ Account executive programs
    - ✓ Consulting services sales reps for selected opportunities

- Business Partners sell and deliver services and solutions…….conflicts……impact on customer satisfaction?
  - *Seven companies used business partners to sell services and solutions*
  - *Others used business partners for skills augmentation*
  - *Most were used as subcontractors*
    - ✓ Easier to manage
    - ✓ fewer customer satisfaction issues
  - *Business partner issues:*
    - ✓ Pricing can reduce margins
    - ✓ Customer satisfaction when implementation/design services don't perform to requirements
    - ✓ Driving deals beyond their capabilities
  - *More effective use of business partners*
    - ✓ Certification of skills
    - ✓ Well defined business partner strategy
- Acquisition of services firms….. Integration challenges…..resut in improved capabilities and offerings?
  - *Eight companies had made acquisitions to:*
    - ✓ Improve reach and geographic coverage
    - ✓ Fill solutions portfolios
    - ✓ Acquire skills and capabilities for targeted markets
  - *Challenges included:*
    - ✓ Morale
    - ✓ Integration – lack of common processes
    - ✓ Attrition

Survey Results (cont'd)

- How do you gather input on customer "wants and needs"…….. Does it give you the information you need?
  - *Sources mentioned:*
    - ✓ Annual Customer Satisfaction Surveys
    - ✓ Customer advisory boards
    - ✓ Sales rep feedback
    - ✓ End of engagement surveys
  - *Assessment of effectiveness*
    - ✓ Two of 14 good
    - ✓ Others fair to poor
- What systems are used to manage the services business (forecasting, T&E, Utilization…..)
  - *Various systems used to manage specific pieces*
    - ✓ Peoplesoft – HR
    - ✓ Siebel – CRM
    - ✓ Oracle – Services
  - *Homegrown systems*
  - *Spreadsheets*

Services Business Management

Client's View of Key Services Elements Implementations	% Yes
Services Business Strategy & Plan	100
Documented customer engagement / services deal making process	57
Dedicated services P & L financial model in place	71
Track gross profit for services	86
Break out maintenance and professional support services	64
Clearly defined market and delivery charters for the services business	36
Dedicated services marketing function	21
Robust customer services wants and needs assessment process	29
Share assets, infrastructure, and skills between product & services business	79
Clear understanding of your competitors services capabilities	36
Customer satisfaction / loyalty programs in place	86
An aligned compensation model between sales and service	57

Observations

- Interview feedback consistent with financial analysis
- Establishing an effective customer solution and/or value added services focus is seen by most as critical to success…it is key to:
  - Increasing revenue growth
  - Offsetting revenue growth in periods of economic decline
  - Driving incremental product revenue
- Additionally, executives believed value-added services contributed to:
  - Developing long term customer relationships
  - Differentiating offerings/solutions versus competition
- Management of the Business Partner channel is universally viewed as an on-going significant focus
  - *Alignment…conflict*
  - *Customer satisfaction*
  - *Account control*
  - *Skills/capabilities…certification*

Observations (cont'd)

- An effective / aligned software and services coverage model was identified in only 1/3rd of the companies interviewed … another 1/3rd indicated a need to get aligned … the balance would continue to only have a product focus

- Only 20% of the companies had comprehensive /formal plans to assess customers' solutions / services wants & needs

- Less than 20% of the accounts surveyed had aligned services business processes in place and automated

- For all, acquisition integration is a cultural challenge

2007 Software Study

Conclusions

A Successful Professional Services Business	→	**Increased License Sales**	→	**Increased Revenue and Profit from Maintenance and Support**

A Successful Professional Services Business

•Builds a "Trusted Partner" relationship with the client
• Relationship can lead to repeat / additional business
• Well defined Business Partner strategies expand coverage and capabilities
• Lower margins but:
 • Additional profit $
 • Improves ROCA

Increased License Sales

• Accounts for 39% of revenues
• Gross margins in excess of 85%
• Provides the base for M&S Services

Increased Revenue and Profit from Maintenance and Support

• Accounts for 38% of revenues
• Gross margins average 78% 60%
• Needs focus to optimize delivery
• Requires aggressive sales approach
• Important to be able to demonstrate value

Conclusions

- This progression is evident in the most successful companies

A Successful Professional Services Business	→	**Increased License Sales**	→	**Increased Revenue and Profit from Maintenance and Support**

- Challenging undertaking but the rewards are worth the effort

- The INSIGHT Group has a roadmap of key initiatives for succeeding in each area minimizes the risk. Please contact us for additional information on the study and roadmap.

  Mike Byrnes   mbyrnes@insight-group.com
  Ed Petrozelli petro@insight-group.com