

Software Spending May Soften

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Our 2005 outlook for software remains cautious. In our view the sector continues to be faced with a cyclical transition fueled by evolving technology platforms and shifting customer buying patterns that may result in new business models and increasing consolidation.

Consequently, we estimate that software may continue to lag the broader technology sector over the next 12 months. We would recommend focusing on names with market leading positions and defensible installed bases, such as Hyperion, Salesforce.com, Tibco, Opware, and Interwoven.

We anticipate only a marginal pick up in software spending for 2005 as vendors continue to transition their underlying technology platforms and business models.

While this shift may ultimately fuel broader demand, the near-term risk of customer deferrals remains high, especially ahead of significant new releases.

Results from individual interviews and informal surveys indicate improving spending intentions, with priorities centered on business intelligence, security, systems management, on-demand, and knowledge management.

While spending towards new projects likely picks up in 2005, they still take a back seat to maintenance, support, and enhancement of existing projects.

With recent new highs being set into year-end we would look to lighten up software exposure in the first half of 2005.

Although 2005 growth expectations are reasonable, valuation multiples appear to reflect these expectations and upside may be more challenging to achieve.