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Market Roundup

May 30, 2003

Reversing the Spin Cycle: Novell Challenges SCO's UNIX Claims

By Charles King

The controversy over SCO's UNIX intellectual property claims, which formed the basis of its threats against Linux vendors and customers, escalated this week. Novell, who originally "sold" UNIX to The Santa Cruz Operation in 1995, challenged SCO's assertions of UNIX ownership, pointing out that the agreement between the two companies did not transfer UNIX copyrights and patents to SCO. In a letter, Novell CEO Jack Messman refuted SCO's ownership interest claims and said that over the past few months SCO has repeatedly asked Novell to transfer UNIX copyrights to SCO, a request Novell has rejected. Messman reiterated Novell's support of Linux and open source efforts, and warned SCO of the potential legal liabilities it faces if its allegations are groundless. To clarify matters, Messman demanded that SCO promptly and specifically state its infringement allegations against Linux users or recant them. In a formal response, SCO stated that the company owns the contract rights to the UNIX operating system and has the contractual right to prevent improper donations of UNIX code, methods, or concepts into Linux by any UNIX vendor. SCO also said that its lawsuit against IBM does not involve patents or copyrights, but instead specifically alleges breach of contract (presumably the contract for UNIX that is the basis for the AIX operating system, but it could also concern the contract between these companies that was the foundation of the long defunct Monterrey initiative). In an interview, SCO CEO Dan McBride claimed that the company had never requested a transfer of copyrights from Novell since it believed it already purchased those rights. Further, he suggested that unless more companies start licensing SCO's property, the company might sue Linus Torvalds, who is credited with inventing the Linux OS, for patent infringement.

While it may appear that SCO has fallen deep into a rabbit hole, arriving in a UNIX/XINU Wonderland where down is up and up is down, we believe a simpler explanation might clarify things. First, it should be remembered that much of the credence given to SCO's claims over the past few weeks was granted due to the perception (fueled by the company's statements) that SCO is the legal owner of UNIX patents and copyrights. Indeed, the inflammatory letters SCO sent to 1,500 global Linux users two weeks ago claimed that "Linux infringes on our UNIX intellectual property (IP) and other rights." Since IP as a legal term applies only to trade secrets, patents, and copyrights, it is clear why the letters upset Linux customers, vendors and developers, and why Novell's revelations have sparked additional outrage, as if any were needed, against SCO in the open source community. As the presumed owner of UNIX, SCO controlled the media spin cycle on this matter, but they have become a disgraced bystander in light of Jack Messman's scathing letter.

It is interesting to note that SCO's formal response to Novell takes a long step away from the company's earlier IP assertions and tries to redefine the IBM suit as a simple contract dispute. This is a smart move, seeing that SCO has effectively been hoist on its own rhetorical petard (and perhaps contracts). But given that, what are we to make of SCO CEO Dan McBride's curious statements about believing that the company had acquired UNIX copyrights as part of its 1995 deal, and his combative comments regarding Linus Torvalds? The first issue is easy enough to parse. By suggesting that a simple misunderstanding clouded the UNIX ownership issue, SCO is

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attempting to inoculate itself against potential claims that the company misrepresented itself while negotiating UNIX licenses. SCO's explanation could also serve as a defense against Linux users and developers who, as Novell suggested, might assert that SCO's claims caused them material damage. It is not a bad strategy, so long as people buy it. For now, we believe McBride's threats against Linus Torvalds should be tossed into the waste can along with other examples of empty executive bravado. One hoary old business school maxim asserts that a good offense is the best defense. Given the events of the past few days, SCO would do better to learn that acting smart is better than acting, and being, offensive.

Price Cuts for Microsoft?

By Jim Balderston

Microsoft announced this week that it was cutting the prices of Office XP Standard and Office XP Professional by approximately 15%. It also said it would cut retail prices on stand-alone applications such as Word 2002, Excel 2002, PowerPoint 2002, and Access 2002 by approximately 30%. These price reductions will take effect on May 28 in North America and worldwide after that. The company also announced that it would augment the Software Assurance program it launched last year with training, support, and deployment and management tools. It also said it would re-instate employee home-use rights of Office products. These new rules will come into effect in September. In other news, Microsoft lost a bid to continue to provide software to the city of Munich, Germany, which instead decided to purchase a Linux-based system. Microsoft CEO Steve Ballmer was unable to convince the Munich government to keep 14,000 computers on the Windows platform, which instead went to SuSE and IBM. SuSE's bid for the contract was reportedly $3 million higher than Microsoft's.

While Microsoft spun the changes to Office pricing and the added goodies to the Software Assurance (SA) program as proactive positives, we can not help but think that there is a little more backtracking here than the company would want to admit. The SA program brought howls of protests from Microsoft's enterprise customers, and could have inspired some to take a hard look at Linux alternatives and make purchasing decisions similar to the city of Munich.

What we find interesting here is not only that Linux continues to gain traction, but it does so at Microsoft's expense. Clearly Redmond is feeling some competitive pressure here, and that ironically could be a good thing for Microsoft. While the Munich decision was certainly not great news for Microsoft, perhaps a small sliver of silver lining might be found in the fact that the cries of "monopolists" begin to lose their shrillness when a real alternative begins making its way into the market. To date, Microsoft has been able to overcome Windows alternatives, largely because those alternatives themselves were significantly flawed and because end users recognized them as little more than proprietary means for other companies to assume competitive market positions. For a while Java seemed one possible heir-apparent, but Sun's failure to release the code to the open market – a la Linux – made that effort one that seems almost quaint in retrospect. Linux remains a real threat as millions of Linux developers, fueled by both growing financial opportunities and intense anti-Microsoft zeal, continue to offer viable alternatives to the Microsoft solutions. We expect that the growing availability of such alternatives is at least partly responsible for Redmond's decision to sweeten its SA program. In taking a final look at the Munich deal, we can not help but note that IBM – as a result of its full-throated support for Linux – seems to be gaining increasing financial momentum from that decision. Could the events in Munich portend future, serious erosion of Microsoft's dominance in the desktop OS marketplace? Stay tuned.

Entry-Level POWER4+: IBM Introduces the eServer p615

By Charles King

IBM has introduced the eServer p615, a new low-end POWER processor-based system that the company indicates offers 110% more performance at one-third lower cost than its predecessor. IBM described the new system as an affordable one- and two-way entry-level option for SMBs and an ideal solution for enterprise departmental or divisional applications. Available in rack-mounted or desk-side versions, the eServer p615 comes with IBM's POWER4+ processor, can support over 1TB of internal storage and up to 16GB of memory, and includes six PCI-X I/O slots. The eServer p615 supports AIX 5L and Linux, and IBM's Cluster Systems Management (CSM) tools.

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Additionally, the new server offers full remote management capabilities via wireless devices such as PDAs. Planned availability for the IBM eServer p615 is May 28, 2003, with a starting price of $5,745 for a one-way Express Configuration.

Entry-level servers are a decidedly unsexy segment of the hardware market, especially in the 64-bit space where high-end performance, capacity, and scalability tend to inspire headlines and vendor prestige. At the same time, though, vendors depend on their entry-level products as important drivers of overall sales, and as affordable solutions that perform important, if underappreciated, proselytizing duties among new and continuing customers. A vendor's willingness to populate its low-end offerings with high-end features serves as proof of product dedication and longevity, which are important concerns for enterprises that have made sizeable investments in specific platforms. On the other hand, entry-level customers want value and performance, and offer enormous potential for future sales to vendors who satisfy their requirements. We believe that the new IBM eServer p615 provides a good example of how best to play the entry-level game. Not only does the new system deliver a definite step up in performance over its predecessor (the p610), but it does so at a lower price, along with greater scalability and flexibility. Overall, the p615 appears to be capable of delivering the goods for the SMB and enterprise clients IBM is targeting.

But the p615 fulfills another, equally important strategic role for IBM beyond driving sales and revenue. The p615 completes the POWER4+ migration across IBM's entire pSeries product line, an important step in the company's continuing efforts to validate and promote the POWER platform. The fact is that the 64-bit server market is currently a serious battleground. Traditional market leader Sun Microsystems has been hit particularly hard by the economic downturn, while HP (whose market share benefited hugely from its Compaq acquisition) is in the midst of a long and complex 64-bit migration to Intel's Itanium platform. How well Sun will respond to a market dramatically different from the one the company thrived in during the 1990s is uncertain. How loyal HP customers (including myriad Alpha and Tandem users) will remain during the transition to Itanium is far from clear. Though competitors like to disparage POWER as stodgy and out of date, IBM continues to show that the platform has loads of headroom. Additionally, the company has laid out a credible POWER development roadmap that stretches well into the future. While raw performance may be good for headlines, businesses of every size seem to understand that product and vendor dependability are equally or even more important to keeping their day-to-day IT operations up and running. The new eServer p615 suggests that IBM is paying as much attention to its entry-level solutions as it is its high-end servers. This message is likely to resonate with a wide range of current and potential customers.

DoD Goes Deep

By Jim Balderston

Symantec announced this week that the Defense Information Systems Agency – the U.S. military's lead agency for communications and information technology -- has subscribed to Symantec's DeepSight Threat Management System and its DeepSight Alert Services to provide intelligence and early warnings about global cyber attacks and vulnerabilities. The three-year agreement will provide DISA with information and alerts based on data collated from Symantec's 19,000 DeepSight sensors arrayed over the Internet and in 180 countries. The service tracks vulnerabilities of some 13,000 versions of 3,200 products looking for specific activities that could make those products vulnerable. DISA will receive the same intelligence and warnings that other customers in the private sector receive from Symantec. No terms of the deal were announced.

Symantec officials said they hope that this deal will open doors to other government agencies – like the Department of Homeland Security – since this service is not classified for any military intents or purposes. Clearly such a service is valuable, whether it is to a government agency or to private sector owners of substantial infrastructure assets in the global telecommunications market. Being able to turn an early warning of possible threats into a viable defensive response is as important to the information age as keeping the shipping lanes open was to nations just a few generations ago.

Having said that, we have to wonder where exactly the DeepSight offerings stand in the DoD's lines of defense? Is this on the front line, an early warning system that gives other lines of defense the time and information to

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prepare? Or is this the core of the DoD's cyber defense parapets? While the issues here are substantial, the answers are amorphous in the extreme. The U.S. military possesses information that could be immensely more valuable to those that might wish this country harm than do most corporations. In other words, since the stakes are so much higher, the DoD needs to have a lot more in place than simply the DeepSight warning system if it is to provide real security to America's telecommunications and IT infrastructure. After all, since cyber alert technology and information is available to the public market, one could assume that the DeepSight system could also serve much like a police scanner might to a common bank robber. Given that, we hope that DoD recognizes that it must maintain a multilayered, state of the art IT defense perimeter, one that in nearly every case will be more than private sector enterprises will ever have to erect. We do not expect the DoD to make the particulars of its defense shield public, but while we believe the DeepSight service could provide information necessary for enhancing DISA preparedness we hope it is part of an outer ring warning system and not a core component that has been procured far too late in the game.

PeopleSoft Improves Its Balance Sheet for Better Times

By Myles Suer

At the PeopleSoft shareholders' meeting this week, management claimed that the company is taking market share away from competitors (Oracle, SAP, and Siebel) and that its profits for 2002 were at record levels. At the same time PeopleSoft announced a decline in revenues of 5% but said it cut operating expenses by 10%. Looking forward, the company believes the IT environment will continue to be difficult, and expects continuing longer evaluation cycles, a need for better ROI justifications, and higher authorization approval levels. The company announced that the strategy required to navigate through this environment involves gaining market share from competitors, broadening the PeopleSoft application suite, expanding globally and stabilizing the company's finances wherever possible. While the company does not plan to introduce any new architectural offerings in the near term, it believes that future upgrades (from PeopleSoft V7 to V8) and cross sell from a broadened suite will propel future growth. Company representatives also claimed successes linked to the company's Real Time Enterprise product positioning.

It should be clear that PeopleSoft is not the Dell Computer of enterprise software. While Dell's continuing market and revenue growth is derived from the company keeping all engines running efficiently, PeopleSoft is using a shrink-to-grow tactic, similar to the one used by HP, to keep income alive at the expense of all else. Meanwhile, their future for the next year or so will be driven by Global 2000 companies' uncertain appetite for capital spending. The company is positioning itself for what it hopes will be better days, using its size and financial stability to compete with smaller rivals. It is unclear to us whether PeopleSoft's pure Internet Architecture or Real Time Enterprise approach will be as much of a competitive weapon as the company thinks. If the market remains tough, we believe that PeopleSoft will find adding and updating software while continuing to cut expenses increasingly challenging. We also think that PeopleSoft's lack of strategic vision is a long-term issue for the company. Real Time Enterprise may indicate a direction the larger industry is heading, but it is certainly inadequate for defining the company's purpose or value proposition. To move ahead successfully, PeopleSoft needs to define for itself, its stockholders, its employees, and its customers who the company is, what the company does and why it all matters.

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