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Software

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Software Faces New Reality

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- New numbers from the Bureau of Economic Analysis show that business software spending decreased 0.4% last quarter -- the first decrease since the current categories were constituted in 1989.
- We believe that, as a result of software's increasingly large share of capital spending, software company revenues will be more susceptible to general economic malaise than they have been to date.
- Higher volatility will likely reduce the valuations of companies that cannot quickly adjust their spending to respond to changing economic conditions.

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Software's performance over the 49 quarters tracked in the survey contrasts starkly with that of business hardware, which contracted in 15 of those same quarters -- almost one of every four. Software has been supported by large backlogs of requests and IT departments that are fairly immune to cutbacks. The software industry also lacked the upside that hardware enjoyed as a result of customer resource constraints and technical limitations.

Increased consultant use precipitated the first-quarter decline. Consultancies have made IT departments more nimble when it comes time for cutbacks. At the same time, software spending has more than doubled -- from 10% of equipment and software spending to 24% -- making it a fatter target for spending cuts.

Business-to-business mania created a backlog of maintenance work that IT professionals are currently working through. We expect this to be worked through quickly and fuel a rebound in software spending this year. This does not mean that spending will grow immediately, but it does suggest that software companies will once again have the ability to accurately forecast their sales. Demand for supply-chain improvement, collaboration, improved customer relations, and new Internet enabled processes will fuel the industry's rebound.

For graphs showing sequential growth rates and percentage of fixed investment for hardware and software over time, please visit our full note at http://www.epoch.com/research_center/pov/pov_details_sw_note010430.html.

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