

# Server Virtualization

COMPANIES: CSCO, CTXS, MSFT, VMW



## vSphere Fuels Rising Optimism

VMware business is stabilizing during 3Q09, driven by vSphere upgrades, and sales are expected to accelerate through year-end, resulting in single-digit yy growth for the full year.

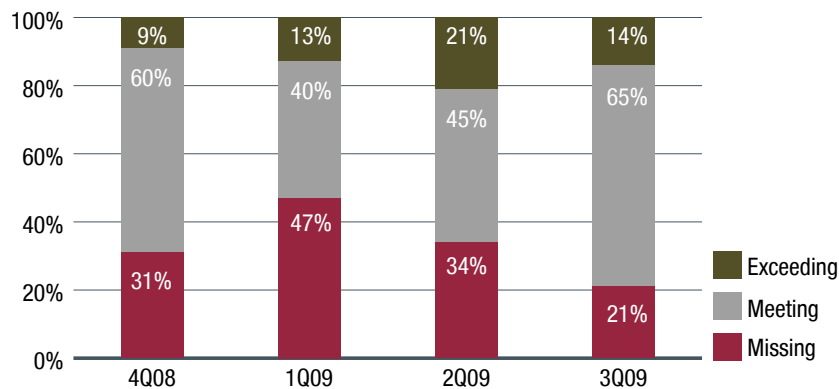
- OTR Global's read on VMW is positive, an improvement from mixed in the June report
- Sources' 3Q09 VMware sales flat yy, similar to 2Q09 results; sources' 2009 sales expected to grow 2%-5% yy
- More sources met or exceeded goals than in the previous 3 reports; subjective optimism based on pent-up demand, full pipelines, customer upgrades
- vSphere upgrades, including increased management capabilities, and economic rebound cited as factors in improved business tone
- Area to Watch: Sources note increasing interest in desktop virtualization; December release of VMware View expected to increase desktop virtualization demand during next 6 months

### EXECUTIVE SUMMARY

Sources' 3Q09 **VMware Inc.** sales are meeting or exceeding most sources' expectations, reflecting improved economic activity and better forecasting ability, with 2009 sales expected to grow mid-single digits yy. Acceptance of vSphere 4, full pipelines and general economic recovery are fueling year-end optimism. As customers move beyond the initial server consolidation phase of virtualization, vSphere's management tools, including fault tolerance and power management, help make the business case more compelling. VMware's lock on the server virtualization market remains unchallenged, and sources said once VMware View is released in December, marketing efforts could help the company gain share in the still-nascent desktop space.

### KEY DATA

#### More Sources Meeting to Exceeding VMW Sales Forecasts in 3Q09



Source: OTR Global LLC

### SOURCES & BACKGROUND

47 resellers, integrators and distributors of server virtualization products

**UNITED STATES** 23 sources representing more than \$28 million in 2008 VMware sales; **EUROPE** 15 sources (6 in France, 5 in Germany and 4 in the United Kingdom) representing more than \$121 million in 2008 VMware sales; **ASIA** 9 sources (6 in India and 3 in Japan) representing more than \$57 million in 2008 VMware sales

**REPEAT SOURCES** 27 (16 in the United States, 4 in Europe and 7 in Asia) from OTR Global's June report, plus 11 from other reports

**INTERVIEWS** Late August through mid-September

**AVERAGES** Straight; global average weighted according to VMware's geographic distribution of sales at the end of 2Q09 (U.S. 52%, International 49%)

"If you are selling virtualization, you own the customer because virtualization combines hardware, storage, server silos and the network."

U.S. reseller

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## Business Stabilizing, Confidence Growing

With the overall IT spending picture showing signs of improvement during 2H09, sources said they were becoming busier and more confident about the remainder of 2009. Sources' VMware sales were flat on average during 3Q09 yy. "We're flat, which is consistent with last year, and we had a great year last year," a U.S. source said. (Two-thirds of repeat sources' 3Q09 yy growth results were in line with or better than their results in the June report.) More than three-fourths of sources said their VMware business during the quarter met or exceeded their goals, higher than in the past three reports

"We see the market improving slowly, though we know it will not happen immediately," an Indian source said. Another source said, "We now have a dedicated virtual tech rep and are increasing our technical implementations."

The improvement reflects both increasing business activity and the ability to forecast revenue better, and sources said it has become easier to adjust their targets to achievable numbers. Sources who answered in both reports showed a sharp improvement in their ability to meet goals, with more than three-fourths meeting or exceeding in September compared with slightly more than one-half in June. Most sources said deal sizes during 3Q09 either remained the same or increased qq, consistent with commentary that business levels are increasing and budget constraints are easing.

Many sources said their pipelines were full and they expect 4Q09 to be extremely busy with both new customer installations and existing upgrades and additions. Overall, sources expect 2009 VMware business to increase an average 2%–5% yy. The midpoint of sources' forecasts of approximately 3% yy FY2009 growth would translate to 4Q09 growth in the high single digits, if 3Q09 comes in approximately flat yy as expected.

"We may grow around 15%, which is a good result [compared] with other IT segments. Virtualization is still a strategic investment for companies for which the ROI is very important," a French source said.

There was minimal variation among the three regions, as U.S. sources' 3Q09 yy sales were flat, while European sources' sales were flat–up 4% and Asian sales were flat–down 5% on average yy. One French source said, "The summer has been calm in terms of the closing of projects, but we have entered several conversations with customers, which will probably sign something this autumn." A source in India said, "We are meeting expectations; 2Q09 is when things started improving. So we are looking at the markets improving and IT budgets on the rise. Keeping this in mind, we expect Q3 to be good and Q4 to be even better." Another Indian source said, "We have witnessed about 30% growth and have a good pipeline across the industry verticals. While there has been an overall market dip across the product lines, VMware is no exception during the year. But of late, more customers are adopting virtualization from a TCO point of view, which has contributed to the growth curve."

Two U.S. sources' yy VMware sales more than doubled during 3Q09, as both said their companies' service capabilities and commitment to VMware helped build a surge of activity and that VMware is directing more business through partners who can support customers with integration and services to help clear the learning curve hurdle. One, a source who sells to the U.S. federal government, said, "There has been huge growth for us this year compared to last, simply because we are strongly focused on this and I am selling it to every customer we have. VMware is hiring in the federal space and there is a greater alignment with partners. If you are selling virtualization, you own the customer because virtualization combines hardware, storage, server silos and the network."

The other source whose business more than doubled said his company has identified virtualization as a driver for sales well beyond the VMware license sales and has invested in staffing and training

"We are meeting expectations; 2Q09 is when things started improving. So we are looking at the markets improving and IT budgets on the rise. Keeping this in mind, we expect Q3 to be good and Q4 to be even better."

*Source in India*

### REGIONS FAIRLY CONSISTENT

### OUTLIERS FOCUS EFFORTS

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around that specialty. “The piece that’s more interesting to us is the 2x in drag. So if it’s \$3 million to \$4 million in specific virtualization stuff, it will be another \$6 million to \$10 million on the hardware and other products,” he said.

## vSphere Tools Help Build Traction

Sources said the economy was not the only factor weighing on VMware’s sales; other negative factors include a steep learning curve for customers, lack of support from some software vendors, and the complexity and scale of projects that move beyond simple server consolidation and encompass the entire IT architecture. Now, however, the release of vSphere 4.0 appears to be providing the additional tools, and the lessening of economic pressures has begun to shake resources loose so that customers and partners can resolve some of those issues.

More than one-half of sources anticipate vSphere sales acceleration by the end of 2009, compared with one-third in the June report. “The biggest deal is that what VMware has done is create an entire ecosystem. They started with basically one product, and now you have so many add-ons, additional tools, third-party products; the whole thing has just really taken off like crazy. Their management tools and the add-on stuff are phenomenal. Their chargeback and Orchestrator modules are amazing,” a U.S. source said. A German source said the new features have finally pushed one of his customers to launch a long-delayed project. “What we’re seeing is a strong trend for automation — how I would manage my virtual servers, and the green argument and energy efficiency. That’s a trick that’s working,” he said. The customer in question “has been wanting to virtualize for the last two years; one or two months ago it got going, and they’ll save [a lot per] year.”

A source in India said, “vSphere seems to be attending to almost everything that data center and large business guys are asking for. It’s a very feature-rich product. From what I’ve seen and heard about it, vSphere will adhere to each and every need of the customer — be it security, scalability, storage — everything.”

Though smaller bundles have helped ease some of the pricing pains associated with server virtualization, vSphere itself is not an attractive option for many smaller customers. One source in India said, “Last quarter there was a lot of hype surrounding vSphere. Turns out it’s a little too complicated for SMBs to handle. For the big-spending customers, it’s useful. They are the ones who are able to fully utilize the functions and features. I feel vSphere is easily accepted by customers with large setups who can afford the complex and expensive licensing model. For SMBs, it’s just a painful product.”

As in previous reports, VMware holds a solid lead in the server virtualization space, despite the continual commoditization of hypervisor technology. More than two-thirds of sources now and in the June report reported no share shifts and said VMware is maintaining a dominant position. A U.S. source said, “Once people make these large investments, they are not really going to change to another vendor even though some other options are lower-cost alternatives. These people spent a lot up front, so moving and changing is rare.”

Similarly, as in previous reports, sources reported little change in pricing qq. Some sources reported more bundled deals as incentives to take on larger projects, but very little discounting.

## Desktop: Still on Horizon, But Closer

Sources expect desktop virtualization to finally begin to drive revenue during the next six months, spurred by VMware’s release targeted in early December of VMware View, the next generation of

“Their management tools and the add-on stuff are phenomenal. Their chargeback and Orchestrator modules are amazing.”

*U.S. source*

**VSPHERE LESS SUITABLE FOR SMB MARKET**

**COMPETITION STILL DISTANT**

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VMware's VDI (virtual desktop infrastructure). The new release is expected to include offline desktop functions and client virtualization, as well as advanced cloning features.

Seventeen sources in the United States and Europe cited desktop as a potential driver of new sales, and a few said desktop would help fuel an increase in deal sizes and overall VMware sales growth. One U.S. source said, "The next uptick in VMware sales is desktop sales." A U.S. source who noted no change in current deal sizes said, "Once we start doing larger projects that include desktop, things will change and you should see deal size begin to grow." Another U.S. source said, "The revised VMware desktop offering is finally going to be more of an enterprise offering and will allow for operations and management to be pulled out of local operations and put in the data center, which is what needs to be done in order for desktop to have any shot of being worthwhile."

Comments from channel sources are consistent with comments from attendees at VMworld in early September. One source whose colleagues attended the show said VMware has launched an intense sales effort aimed at establishing new business in the desktop market. "The takeaway was, 'You have to do desktop, you have to do it now, and you have to do it with [VMware],' " he said. However, the source also was cautiously optimistic. "Desktop is not the right fit for everything and not necessarily cheaper than what people are doing now," he said. "But it simplifies desktop management, and there are people making an effort at it."

Although VMware is pushing its capability in desktop, sources still consider **Citrix Systems Inc.** the leader within the market. A handful of sources said Citrix's XenServer had actually lost ground in the server virtualization market, but overall few changes took place. One U.S. source said, "When you talk about better options, VMware is it for servers, but you have to admit that in the desktop space, Citrix has the better solution, especially when you use that on top of a VMware hypervisor. I see a hybrid solution for desktop developing." Most sources said the dual-hypervisor solution was at least somewhat likely, with customers choosing best-of-breed or less-expensive products for their lower-priority uses.

Some sources said **Microsoft Corp.** has the potential to take desktop sales from VMware by making licensing prohibitively expensive. A U.S. source said, "VDI and the desktop side of things are significantly increasing — that is due to the maturity of VDI itself, and also the upcoming release of Windows 7 [scheduled for October]." Another said, "Adoption has been slow on the desktop side, but we see 2010 as being the year for desktop. Vista was and is a horrible OS. Because of that, customers put off purchasing a new OS for a long time. Customers have to make the move now, and a lot are going to use that upgrade path as the time for VDI."

Most sources said they market virtualization along with other products, making strategic partnerships important. "Everybody wants to be VMware's best friend," one said. Sources cited the joint marketing effort with **Cisco Systems Inc.** as one to keep an eye on for future product launches and strategic positioning. A large U.S. source said, "Cisco is the big one, and I see that as a snowball rolling down the hill — and we are right now only at the top. What Cisco is and trying to do is cool, no doubt. Cisco is a force to be reckoned with, and VMware fits right in to their plan."

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This report was researched and written by **Jennifer Stong** and **Suzanna Kerridge**, with additional reporting by **John Hedrick**, **Nancy Piccin**, **Ulli Wilser**, **Juliette Courouble**, **Joel Bassett**, **Sarang Sonawane** and **Geetha Nandikotkur** for OTR Global LLC.

"Once we start doing larger projects that include desktop, things will change and you should see deal size begin to grow."

*U.S. source*

## CITRIX OR MICROSOFT THE SPOILER?

## STRENGTHENING TIES

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## UNITED STATES

“When you have someone who has VMware or chooses to go with them, they are basically going to be there forever; no way is anyone ripping this stuff out.”

“vSphere will accelerate upgrades because of its cloud computing capabilities and power.”

“There are less enterprise-size deals and more medium deals.”

“vSphere’s features are good enough to push through upgrades, but it has not hit home for us just yet. But we also do not expect any pushback from customers when the time comes, and a lot of that is because of what people want and need their virtualization to do.”

“Microsoft is hot on VMware’s heels, but Microsoft Migration is not as good as VMotion because you have to shut down the servers.”

“With Orchestrator, you can have vCenter do the scripting and everything. It’s a great tool because without it, you have to power down virtual machines by hand and then bring them back up; with this, in about three keystrokes it does it all. I am also excited about the App Speed stuff; it figures out which apps are talking and monitors traffic for bottlenecks, and does in-depth analysis.”

“VDI is finally beginning to become a bigger influence. This is relevant to server virtualization because you do need to have a robust front and back end to be able to deploy VDI.”

“VMware has basically everything under the sun for virtualization readily available. The word is that their desktop offering, once revised, will be even better, further ingraining them in total virtualization.”

“Citrix is so far ahead of the game in application virtualization and delivery; they have a chance to stay there, and then backing into the data center. VMware is the opposite, sneaking into application. They are both doing well. I don’t know how Microsoft is going to fit in because they are so far behind.”

“New features — especially fault tolerance — are attractive; and SMB is a wide-open market.”

“If you sell on the high availability, fault tolerance, disaster recovery, app delivery — on that message, vSphere has a lot to offer.”

“Deals are there, sitting and waiting to be signed and started. I will say that in the past couple of weeks I have finally seen a slight uptick begin, which makes me hopeful for the end of the year.”

“Sales overall are better than we thought they would be. We are also really doing well on the PS side and are booked out by one and a half months, so I either have to hire more guys or up my fee for the work. We also see a lot of server refreshes coming due, which means sales will go up yet again.”

“You do your mission-critical stuff on VMware because it is that much better and trusted. You then can do your tier-2 and even some desktop stuff on [Microsoft’s] Hyper-V.”

## EUROPE

“We’re slowly getting the first signs with customers responding to cost pressure and talking about consolidation, but they are still standing on the brakes because liquidity is the prime issue.”

“The VMware story just seems more plausible than some of the others that are being sold. It seems to have a more solid story on why it will save you money, return on investment, the business imperatives for doing it. It is an altogether more compelling argument.”

“A lot of customers have thought about their projects and the budgets they could liberate for them, but not many deals have been signed.”

“The three main boosts for server virtualization are: the importance of green IT, the need to secure infrastructures, and the aim to virtualize desktop, which is the newest point, but not the least.”

“It’s still VMware first, Citrix second. Microsoft remains difficult. We’re also one of the largest Microsoft partners, and the customers they are adding are not precisely the biggest fish in the pond.”

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“There is still a lot of marketplace out there. The classic competition is Citrix and Microsoft, but I’m not sensing much information, so I’m not too concerned right now. Citrix is very present in Germany but less so in the rest of Europe. There you find Microsoft more often. But for the future, I expect a greater threat from Microsoft.”

“I checked the numbers yesterday and don’t see growth — slightly down on licenses — but overall, services are not down and it should be flat. Many customers are optimizing their installed environments rather than buying new licenses.”

“The climate is quite positive for virtualization because of important demand from customers who are looking for such solutions to rationalize their infrastructures and to protect the heart of their business: data. Virtualization is a very trendy aspect, not totally broken by the economical context as some other segments are. We are still in a discovery phase, which implicates important growth.”

“VMware is very well positioned in this market and is a sure investment for companies that are looking for a fast ROI. People are willing to pay the price it needs to have high-level solutions and to be sure of their performance.”

## ASIA

“Overall IT spending is not robust because of the recession, but VMware is still the most popular virtualization solution.”

“vSphere won’t be an automatic upgrade in this cost-saving environment. ... The earliest I think we’ll see movement is in 1Q10 in the new fiscal year.”

“The quarter has been favorable to VMware business, and we observed a 25% growth in business. The so-called economic slowdown seems to be over and more so in the ASEAN region. The customers are opening up to spend on various technologies, with virtualization being one. The service providers sector has started spending; we have done about 12 deals during the quarter.”

“HP has been gaining ground from an OEM standpoint. VMware is still leading with higher acceptability and newer features. In the client computing space, Citrix is emerging as a strong player.”

“VMware has not been so aggressive in its discounting. It is evolving various modules or packages for varied category of customers with a revised pricing — be it midmarket or enterprise customers. It gets aggressive on ELAs with the concept of configure based on the order value, but ELAs are not many.”

“We see virtualization adoption increasing at a fast pace. At least 20% of all new servers sold go directly into virtualized environments. Virtualization software sales are flat year to year due to customers going slow on migration and new projects. We expect virtualization software sales to pick up by year-end.”

“The change that we see now is VMware [used to] pass on the discounts to the end user, but now, it passes on to the partners as value-adds. For value-adds, VMware is recommending partners to avail free training instead of asking for more discounts, which would otherwise have been expensive. From a bundling perspective, the acceleration kits are helping us a lot.”

“It’s quite likely that customers will move toward dual-hypervisor approach. I think sooner or later it won’t be a market for hypervisors at all. It will for features that are available on hypervisors. Microsoft is already giving the hypervisor free. VMware is known for its stability in production environment and low downtime. Microsoft has a long way to go before they can prove their stability to the large guys. So in the near future, I see customers using VMware in high-risk critical applications and Microsoft at lower end.”

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## 1a. Has your 3Q09 VMware business increased, decreased or remained the same to date yy?

	U.S.	EUROPE	ASIA	TOTAL
Up more than 100%:	2*	-	-	2
Up 41%–50%:	2	-	-	2
Up 21%–25%:	1	-	-	1
Up 11%–15%:	-	1	-	1
Up 6%–10%:	1	1	3	5
Up 1%–5%:	1	2	3	6
Up:	2	-	-	2
Flat:	5	8	-	13
Down:	3	1	-	4
Down 1%–5%:	-	2	-	2
Down 11%–15%:	1	-	-	1
Down 26%–30%:	1	-	2	3
Down 41%–50%:	2	-	-	2
No response:	1	-	-	1
Not applicable:	1	-	1	2
<b>Average:</b>	<b>Flat</b>	<b>Flat-up 4%</b>	<b>Flat-down 5%</b>	<b>Flat</b>

\* Outlier sources excluded

## 1b. Have you exceeded, met or fallen below your 3Q09 VMware expectations?

Exceeded significantly:	1	1	-	2
Exceeded:	4	-	-	4
Met:	12	10	7	29
Fallen below:	2	4	1	7
Fallen below significantly:	2	-	-	2
No response:	1	-	1	2
Not applicable:	1	-	-	1

## 2. Do you expect your 2009 VMware business to increase, decrease or remain the same yy?

Up more than 100%:	2*	-	-	2
Up 41%–50%:	2*	-	-	2
Up 31%–40%:	1	-	-	1
Up 21%–25%:	-	-	1	1
Up 16%–20%:	-	-	1	1
Up 11%–15%:	-	4	-	4
Up 6%–10%:	-	1	3	4
Up 1%–5%:	1	1	2	4
Up:	4	-	-	4
Flat:	5	4	-	9
Down:	-	1	-	1
Down 11%–15%:	2	-	-	2
Down 31%–40%:	-	-	1	1
Don't know:	1	3	-	4
No response:	4	1	-	5
Not applicable:	1	-	1	2
<b>Average:</b>	<b>Flat-up 4%</b>	<b>Up 5%–10%</b>	<b>Up 3%–8%</b>	<b>Up 2%–5%</b>

\* Two outliers excluded from average

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### 3. Have the forces influencing sales of server virtualization products become more or less favorable to VMware during the past three months?

	U.S.	EUROPE	ASIA	TOTAL
Significantly favorable:	1	-	1	2
Moderately favorable:	3	3	4	10
Slightly favorable:	12	5	1	18
No change:	7	5	3	15
Less favorable:	-	1	-	1
Don't know:	-	1	-	1

### 4. Which vendors have gained and lost share? (Some sources gave more than one answer while others did not respond)

#### GAINED

VMware:	2	2	3	7
Microsoft:	1	1	-	2
Oracle/Sun:	1	-	-	1
Citrix:	-	1	-	1
Microsoft/Citrix alliance:	-	1	-	1
None:	16	9	5	30

#### LOST

Citrix:	1	2	1	4
Oracle/Sun:	1	-	-	1
VMware:	-	1	-	1
Microsoft:	-	-	1	1
None:	16	9	5	30

### 5. Is VMware more or less aggressive on pricing qq?

More aggressive:	4	-	-	4
No change:	16	11	8	35
Less aggressive:	1	1	1	3
Don't know:	-	1	-	1
No response:	2	2	-	4

### 6. When do you expect sales acceleration from vSphere?

3Q09:	4	2	-	6
4Q09:	5	3	5	13
2010:	5	-	-	5
1Q10:	1	-	1	2
2Q10:	3	-	-	3
2H09:	1	-	-	1
Don't know:	-	-	1	1
No response:	2	2	-	4
Not applicable:	2	8	2	12

### 7a. Did your average 3Q09 deal size for VMware increase, decrease or remain the same qq?

Increased:	6	1	2	9
Increased slightly:	3	2	-	5
No change:	9	6	7	22
Decreased slightly:	1	2	-	3
Decreased:	1	2	-	3
Don't know:	2	-	-	2
No response:	1	2	-	3

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## 7b. If your deal size is increasing, what is contributing to the change?

	U.S.	EUROPE	ASIA	TOTAL
Expanding environments:	1	-	2	3
Deals including desktop:	2	1	-	3
Bundled deals:	2	-	-	2
Funds being released:	1	1	-	2
Buying only what is needed:	1	-	-	1
Extending infrastructure:	1	-	-	1
Source-focused incentives:	1	-	-	1
Pent-up demand:	-	1	-	1
Not applicable:	14	12	7	33

## 8. Do you expect your customers to adopt a dual-hypervisor approach to virtualization during the next year?

Very likely:	3	1	2	6
Somewhat likely:	8	5	4	17
Not at all likely:	6	9	2	17
Don't know:	2	-	1	3
No response:	4	-	-	4

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John Hedrick has a long equity interest in Microsoft Corporation (MSFT) and International Business Machines Corp. (IBM).

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