



EXECUTIVE SUMMARY

Windows-based Shared Hosting: *Market Demands, Drivers, and Inhibitors*

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SUMMARY: As a result of the increased momentum around Windows-centric infrastructure solutions stemming from Microsoft [MSFT], its partners, and third parties, Tier 1 Research conducted a survey of mass market hosting providers to dive deeper into the market demands, drivers, and inhibitors of Windows-based shared hosting services. We conducted in-depth interviews with 22 hosting providers, ranging in size from under 10k customers to over 100k paying customers with active Websites. This report discusses the results of the study, as well as provides a recap of the key events in 1H03 relating to Microsoft as found in our Infrastructure Insider daily newsletter. Key highlights are as follows:

- **Windows versus Unix:** Learn about the current and future offerings available from the provider interviewed, broken out by operating system.
- **Installed base mix:** Of the providers offering both hosting platforms, the current installed split is 35% Windows and 65% Unix.
- **Drivers:** Learn what the hosting providers see to be the biggest drivers for Windows shared hosting as well as the mixed opinions about .NET.
- **Inhibitors:** Microsoft's licensing model, scalability, and security were the top reasons listed by Unix-only providers for not offering Windows hosting.
- **Market Trends:**
 - **Consumer versus commercial:** Learn when Windows or Unix based hosting is more prevalent and why.
 - **Scalability:** Unix-based shared hosting remains more scalable than Windows, but while this traditional metric is still meaningful, it becomes much less relevant to providers with clustered environments.
 - **Back-end systems:** all but one providers surveyed indicated they use their own, custom-developed back end platform for provisioning and delegated administration.
- **Growth:** New shared hosting customers are signing up for Windows-based packages with roughly the same frequency as Unix-based packages, and in general, providers offering both platforms are expecting better growth among Windows-based hosting throughout 2003. As such, we expect the overall mix to approach 40/60 Windows/Unix by early 2004.
- **Investment Perspective:** Given the relatively tiny portion of Microsoft's overall business attributable exclusively to the Web hosting community, we do not believe the conclusions are sufficient to impact overall stock performance. However, Microsoft's segment most directly impacted by these trends, Server Platforms, outperformed its key peers in 1Q03 relatively to 1Q02, and we expect continued strength in this segment.

Tier 1 Research

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Shared hosting, or volume hosting, has historically been a Unix-powered service (as opposed to Windows-powered). The reasons specific varied from provider to provider, but the key factors included:

- **Price** – Microsoft’s licensing model has been something that most start up hosting providers were look to avoid.
- **Scalability** – The number of Websites (or accounts) per server was significantly greater on Unix than Windows, enabling better economies of scale.
- **Security** – Given its position in the industry, Microsoft has often been the target of hackers, and some hosting providers preferred to avoid that risk entirely.

However, as Microsoft leveraged its brand and applications and tuned the company’s focus from operating systems and applications to all things Internet, more and more Windows-based shared hosting emerged in the market. This has been driven in large part by end users leveraging such applications as Frontpage, ASP, and SQL. In addition, Microsoft has been making a not-so-subtle push into enterprise infrastructure software through in-house development and acquisitions, and the company has bet heavily on its .NET Framework to be the future of Web services.

Tier 1 Research set out to determine as best as possible what the present demand is for Windows-based shared hosting, looking at the drivers, inhibitors, and market trends. In order to do this, we surveyed 22 companies that provide shared hosting and got qualitative and quantitative feedback regarding this topic. The results, along with our analysis and insights, are presented in this report. In addition, we reviewed the past six months of our Infrastructure Insider daily industry newsletter and have recapped the key Microsoft-related highlights in the recent past. Finally, we dove into Microsoft’s most recent form 10-Q, filed on 5/12/03, and discussed which segments are reaping the benefits of Microsoft’s moves in the infrastructure sector and why.

For those readers interested in daily coverage of this ever-changing market, Tier 1 Research makes the following information available in a real-time, web-based format through the password-protected sections of www.tier1research.com:

- **Customers:** A searchable database of over 8,000 web-based applications from over 4,000 enterprise customers. The listing shows the geographic location of the company headquarters and the hosting location as well as the provider of colocation, various managed services, and the web server powering the app.
- **Data Centers:** A searchable database of the 800+ outsourced Internet Data Centers with granular detail about each location from size and physical location to details on the environmentals, security, network providers, certifications, etc.
- **Company Statistics:** From headcount, revenue mix details, balance sheet information, to network statistics, this searchable database shows key operational and financial details for key companies in the sector by quarter dating back to the beginning of 2000.
- **Service Offerings:** A searchable database of the services provided by select companies in the sector, as well as details on the level of support provided on various technologies and applications.
- **SWOT Analysis:** A listing of the strengths, weaknesses, opportunities, and threats for dozens of the key companies in the industry.
- **Industry Address Book:** A listing of all key employees at a firm participating in the sector meant to be used as a centralized business development address book

Tier 1 Research designed an in-depth survey and spent between 30-60 minutes on a phone interview with executives from each of the companies listed in Exhibit 1 below. Each conversation was taped with the participants’ knowledge, and the results were transcribed into a working document and then transferred into Excel for data analysis.

Exhibit 1: Companies participating in Window shared hosting survey

Company	Public/Private	Retail size (000s)	OS offered
About	Private		
Affinity	Private		
AIT	Private		
Alabanza	Private		
C I Host	Private		
CrystalTech	Private		
Datapipe	Private		
DellHost	DELL		
EarthLink	ELNK		
ExpertHost	Private		
Homestead	Private		
Hostopia	Private		
Hostway	Private		
Interland	INLD		
Lycos	TRLY		
ModWest	Private		
Onmis	Private		
Pair	Private		
Superb	Private		
Verio	NTT		
Web.com	Private		
XO	XOCM.OB		

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Source: Tier 1 Research

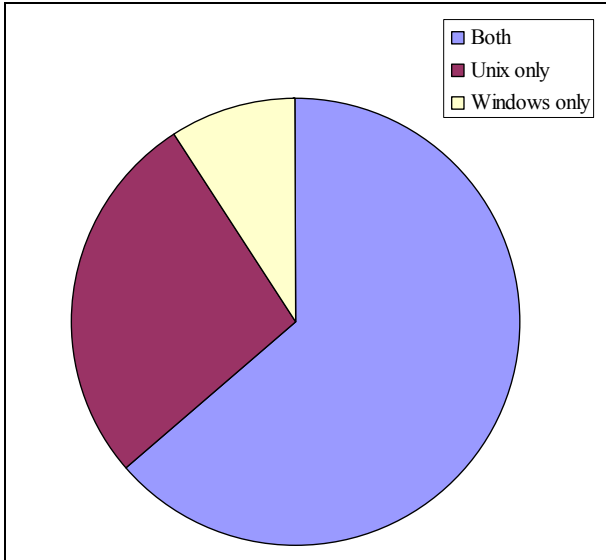
As promised to each of our participants, no further company-specific data will be revealed in our results, but we felt it was important to let our readers know the caliber of companies and industry leadership that is represented in this study.

The “Retail size” column in Exhibit 1 refers to the total number of paying, active Websites that the company currently manages. We made every effort to speak to companies of all sizes, those with less than 10k customers to those well above 100k customers, and this is just one of the ways we slice and dice the results in the data presented below.

One final point worth stressing is that when we use the term Unix, we are referring to all flavors of Unix, as well as Linux.

We begin by reviewing the key characteristics of the companies that were surveyed, as found in Exhibits 2 & 3. When looking at this data, it is important to realize that there's a difference between Windows hosting done on a Windows server and hosting that enables Windows applications (regardless of the underlying operating system). A few of the providers that we spoke with were quick to point this out, although for the purposes of Exhibit 2, this represents hosting done on a Windows server.

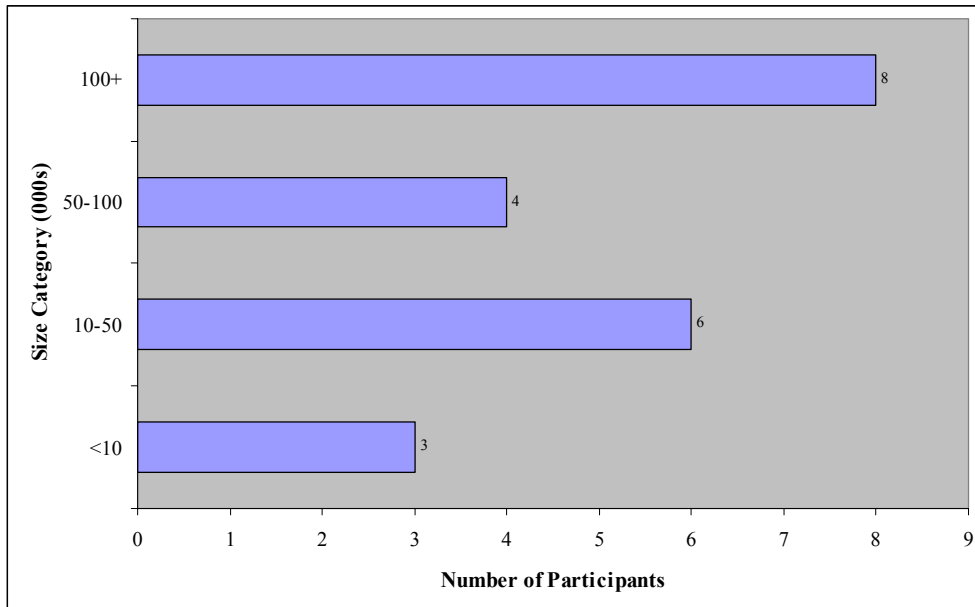
Exhibit 2: OS Platform Offered by Survey Participants



Purchase the full report at <https://shop.tier1research.com> to see the exact percentage splits published.

Source: Tier 1 Research

Exhibit 3: Size of Participants' Customer Base (in 000s)



There was a nice distribution of customer bases among the survey participants, as the perspectives of providers of all sizes matters.

Source: Tier 1 Research

As noted in the introduction, in addition to the survey results, we felt it important to provide our readers with a recap of the news and events surrounding Microsoft's role in the Internet infrastructure sector in recent months. This commentary and analysis is taken from Tier 1 Research's Infrastructure Insider daily industry newsletter, and the below pages are designed to outline the depth and breadth of the strategic moves Microsoft is taking, as well as the role that Microsoft's partners are playing in the proliferation of Windows-centric solutions.

6/3/03 -- Microsoft announces \$2bn+ in spending for Windows Server System

In a move that both creates and responds to demand for its infrastructure products, Microsoft's [MSFT] SVP for the Windows Server System division (Paul Flessner) said that R&D spend for its family of server software will exceed \$1.7bn next fiscal year. From a product perspective, the investment centers on integrated and interoperable (as long as its Microsoft-friendly!) software infrastructure. The areas of focus include the following: 1) application infrastructure and data management capabilities through Microsoft SQL Server; 2) e-business and integration capabilities through Microsoft BizTalk Server, Microsoft Content Management Server, Microsoft Commerce Server and Microsoft Host Integration Server products; 3) operations infrastructure capabilities including firewall security and caching capabilities through Microsoft Internet Security and Acceleration Server; 4) management capabilities through Microsoft Operations Manager, Microsoft Application Center and Microsoft Systems Management Server; 5) networked storage capabilities through Microsoft Windows Storage Server; and 6) information worker capabilities including messaging, collaboration and real-time communications capabilities with Microsoft Exchange Server, Microsoft Office SharePoint, Portal Server, Microsoft Project Server and Microsoft Office Real-Time Communications Server. Just as IBM said it is investing \$1bn in making the entire company's solution sets supportive of on-demand, this is Microsoft's stab at positioning its big spend next year on the next big thing.

Recognizing that infrastructure professionals and its 775k+ Windows Server System partners worldwide require more than software, as noted in the beginning, Microsoft is allocating the equivalent of roughly a fourth of the Windows Server System R&D budget to support, guidance, training, education, and community building. This will include investments into the following programs: 1) TechNet -- a community-oriented Web site that acts as a central resource with technical briefings, special offers, forums, and an e-newsletter; and 2) MSDN Online -- the Microsoft developer Web site used by millions of software developers worldwide, and needless to say the Windows Server System areas will get beefed up. Quoted in the release was Brad Sherrell, assistant VP of IT at Pacific Life, which currently uses Windows Server System and the Visual Studio? .NET 2003 development system.

5/29/03 -- ServerBeach and CrystalTech announce plans for Windows Server 2003

After a couple of months of battle testing the reported improvements in such areas as security, reliability, availability, scalability, and IIS6.0 integration, we are starting to witness the roll out of hosting and migration offerings, for both dedicated and shared hosting, centered around Microsoft's [MSFT] Windows Server 2003 (see our 3/28/03 commentary below). Specifically, in separate announcements, we saw two mass market hosting providers make such moves. **First**, ServerBeach, a privately held provider of dedicated hosting, unveiled hosting plans on Microsoft Windows Server 2003 and Microsoft Windows Server 2003, Web Edition. ServerBeach is continuing to offer Windows Server 2000 and will give customers their choice of platform, with the price point on both starting at \$119/month.

How should the growth in demand for Windows shared hosting and Microsoft’s moves in the infrastructure sector be viewed from an investor’s perspective? To answer this question, we begin with a review of Microsoft’s form 10-Q for 1Q03, filed on 5/12/03. Exhibits 9-12 look at Microsoft’s key segments that we believe should be the focus of this investigation. Here are the definitions of these segments, as stated by Microsoft:

- **Client:** includes revenue from Windows XP Professional and Home, Windows 2000 Professional, Windows NT Workstation, Windows Me, Windows 98, Tablet PC, and operating system software for use in devices other than PCs (embedded systems).
- **Server Platforms:** consists of server software licenses and client access licenses (CALs) for Windows Server, SQL Server, Exchange Server, Systems Management Server, Windows Terminal Server, and Small Business Server. It also includes BackOffice/Core CALs, developer tools, training, certification, Microsoft Press, Premier product support services, and Microsoft consulting services
- **Business Solutions:** includes Microsoft Great Plains, Navision, and bCentral.

Based on these definitions, we believe the Server Platforms group stands to benefit the most from the Microsoft’s infrastructure moves, and we can see from the below data points, that of the three segments that are greater than \$1bn, the Server Platforms line is showing the strongest Y/Y growth for both revenue and operation income.

Exhibit 9: Microsoft 1Q03 revenue by segment (GAAP)

	1Q03 Revenue (\$M)	% Total	1Q02 Revenue (\$M)	% Total	Change
Client					
Server Platforms					
Information Worker	\$2,127	29.7%	\$2,128	29.4%	0.4%
Business Solutions	\$147	1.9%	\$75	1.0%	96.0%
MSN					
CE/Mobility					
Home and Entertainment					
Reconciling Amounts					
Consolidated	\$7,835	100%	\$7,245	100%	8.1%

See all the details in the full report, available at <https://shop.tier1research.com/>

Source: Microsoft 10-Q for 1Q03

Joshua H. Beil – Vice President, Research and Development

Mr. Beil joined Tier 1 Research in August of 2001 as the VP of Research and Development. He joined the firm from Exodus Communications, one of the leading web hosting providers, where he worked as the Senior Analyst in the Strategic Planning group. Prior to Exodus, Joshua worked at International Data Corporation (IDC) where he helped to create and maintain the Worldwide PC Tracker web product for the multi-national industry research firm. Mr. Beil holds a Certificate in E-Business from UCSC Extension, and he graduated with honors from the University of California at Santa Cruz with a major in Psychology. Joshua has been quoted in numerous publications including The Washington Post, CNET, Teledotcom, eWeek, WebHost Magazine, The Web Hosting Industry Review, Top Hosts, Host Buzz, and Linux World News. He can be reached at (831) 426-2658 or joshua@tier1research.com.



Andrew M. Schroeffer – President and Founder

Mr. Schroeffer founded Tier 1 Research in August of 2000 after four years on Wall Street. Most recently, Mr. Schroeffer was a Vice President and Senior Equity Analyst with Goldman Sachs covering the Internet Infrastructure Services sector. Prior to Goldman Sachs, Andrew was with U.S. Bancorp Piper Jaffray where he covered Communication Service Providers as a Vice President and Senior Equity Analyst. Mr. Schroeffer is an honors graduate of St. John's University having earned a BA in Economics and Accounting. Andrew has been quoted in numerous worldwide publications such as the Wall Street Journal, Red Herring, USA Today, Web Hosting Magazine, HostingTech, Business2.0, and Inter@ctiveWeek. Mr. Schroeffer has also been interviewed on such television programs as CNBC, CNNfn, the Nightly Business Report, and various ABC-affiliate shows. He can be reached at (763) 694-9992 or andy@tier1research.com.



Tier 1 Research – Company Description

Tier 1 Research is an independent research firm covering the IT and Telecom markets often referred to as the Internet infrastructure industry. Founded in September 2000, the business model combines financial and strategic analysis of both public and private companies to bring a holistic perspective that merges the best of Wall Street with industry research. Tier 1 Research works with institutional investors, venture capital firms, enterprise IT buyers, and industry vendors as an extension of their competitive analysis team. Services include the daily "Infrastructure Insider", quarterly trend and market sizing reports, financial models, online databases with deeper operational and statistical details, and consulting services. Partners include: PrimeSourcing Advisors and AFCOM (for the enterprise IT buyers) and BNY/Jaywalk and Talmage Capital (for the institutional investor). The company is based in Minneapolis and has offices in New York and Silicon Valley. The firm can be reached at (763) 694-9992 or on the Web at, www.tier1research.com.

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