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North America

Industry

Enterprise Technology

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Industry Overview

June 22, 2005

Morgan Stanley CIO Survey: Slowing IT Budget Growth

GICS SECTOR INFORMATION TECHNOLOGY

US Strategist Weight	13.9%
S&P 500 Weight	15.1%

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- 2005 IT spending growth slips**
 Our May, 2005 CIO Survey forecasts 4.6% cash IT budget growth this year, down from 5.1% in March. IT budget revisions are now almost as likely to be down as up, as CIOs become more guarded in their outlook for the US economy.
- Most parts of tech stack to sustain decelerating spending growth**
 2005 cash spending on hardware expected to slow to 2.6%, down from 3.2% forecasted in March, 2005, growth in software spending to slip to 3.5% from 3.8%, while IT personnel gains could fall to 3.6% from 4.4%. Bucking the trend are network equipment, up 30 basis points to 3.4%, and outsourced services, which could grow 2.8%, up from 2.4% estimated in March, 2005.
- Largest increases and declines in CIO spending priorities**
 Optical transport and business process outsourcing posted the strongest gain, while the largest declines were registered by gigabit Ethernet, printers, consulting and systems integration, portal software, application server software, infrastructure outsourcing, and Layer-3 switching.
- Companion IT services report points to flat 2005 demand and pricing**
 CIOs are turning more cautious on IT services spending and pricing. Consulting and systems integration show the strongest demand within the context of flat IT services spending. For CIOs, price is the most important IT services vendor selection criteria. We see continued earnings risk for the consulting firms given operating margin pressure driven by 3% forecasted wage inflation yet only 1% billing rate increases.



The logo features the letters 'CIO' in a stylized blue font with a circular graphic behind the 'O', and the word 'Survey' in a larger, grey, sans-serif font below it.

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Morgan Stanley CIO Survey: Slowing IT Budget Growth

This report contains the latest results of our ongoing CIO Survey Series, which we have published in its current form since the beginning of 1999. The survey is conducted by telephone and uses a respondent base of 300 IT executives, of which 225 participate in the survey for each round of interviews.

This report contains results from our latest round of surveys, conducted from May 9 to May 20, 2005. All responses were collected in strict confidence and were used only in combination with all others in the survey sample. The survey yields a total of 225 responses from IT executives of the Fortune 1000. We present the results of the survey in the exhibits on the following pages.

Our survey focuses on enterprise technology spending by the Fortune 1000. The Morgan Stanley Technology Research Team believes that small-and-medium businesses (SMBs) and consumers are driving higher IT demand growth than enterprises. Rebecca Runkle, Morgan Stanley's hardware analyst notes that global PC unit shipment end-market demand is derived as follows: 35% from consumers, 25% from enterprises, 25% from SMBs, 8% from the education market and 6% from government. Mary Meeker, Morgan Stanley's Internet and PC Application Software analyst, estimates that Microsoft derives 35% of its end-market revenue from consumers, 35% from enterprises and 30% from SMBs.

Exhibit 1

Respondents — By Industry

Industry	% of Respondents
Financial Services	20%
Consumer Discretionary	12%
Information Technology	11%
Industrials	8%
Telecommunication Services	8%
Health Care	8%
Consulting / Services	8%
Consumer Staples	6%
Materials	3%
Manufacturing	2%
Public Sector	2%
Utilities	2%
Energy	2%
Other	8%

Source: Morgan Stanley CIO Survey, May 2005.

Exhibit 2

Respondents — By Company Revenues

Revenues	% of Respondents
Under \$1 Billion	6%
\$1 – 5 Billion	37%
\$6 – 10 Billion	21%
\$11 – 20 Billion	19%
\$21 – 30 Billion	8%
Greater than \$30 Billion	9%
Unable to Comment	1%

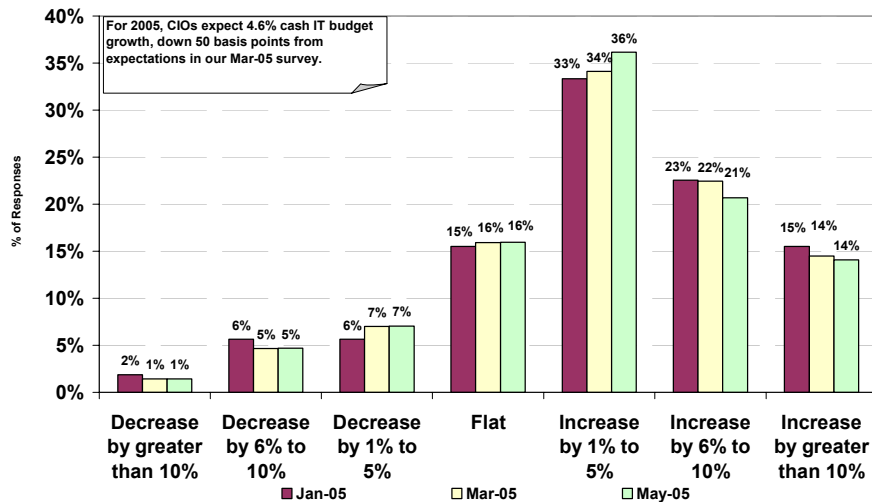
Source: Morgan Stanley CIO Survey, May 2005.

Slight Downtick for 2005 IT Budgets, With Greater Likelihood of Revisions

Exhibit 3

For 2005, Forecasted Cash IT Budget Growth of 4.6%, Down 50 basis points Versus Mar-05 Expectations.

By what percentage will the cash outlays portion of your IT Budget change for 2005 vs. 2004?

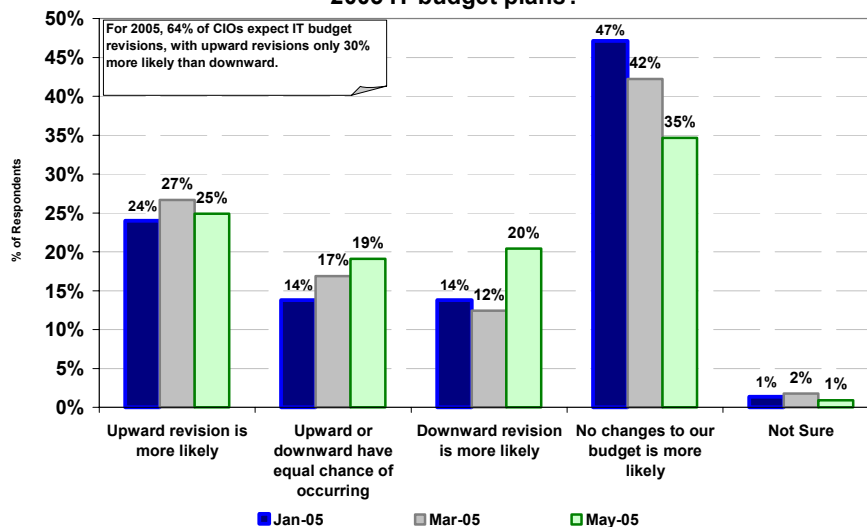


Source: Morgan Stanley CIO Survey, May 2005.

Exhibit 4

2005 Budget Revisions Almost as Likely to be Down as Up, a Negative Change from March, 2005

What are your expectations regarding potential revisions to 2005 IT budget plans?

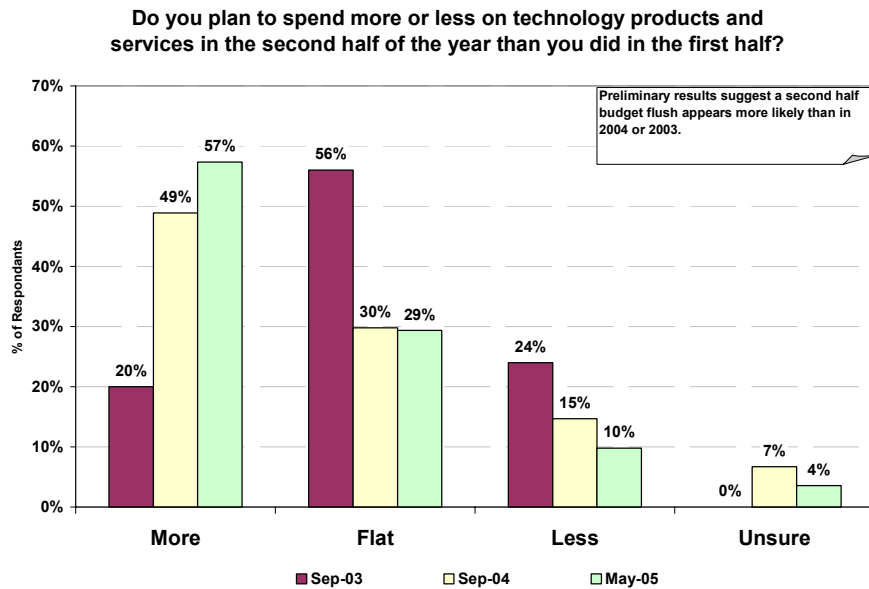


Source: Morgan Stanley CIO Survey, May 2005.

Higher Second Half Spending Possible, With Firming Pricing Trends

Exhibit 5

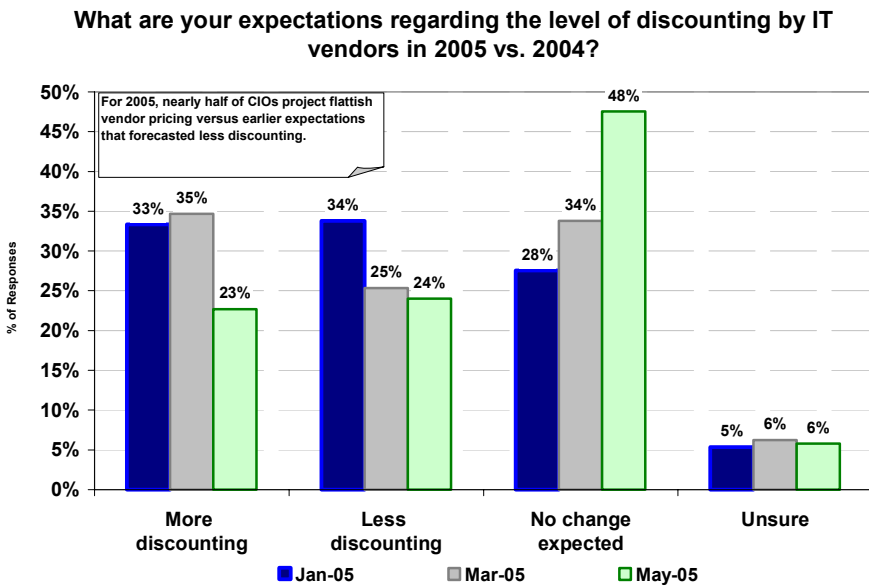
Second Half Spending Increase Appears More Likely than in 2004 and 2003



Source: Morgan Stanley CIO Survey, May 2005.

Exhibit 6

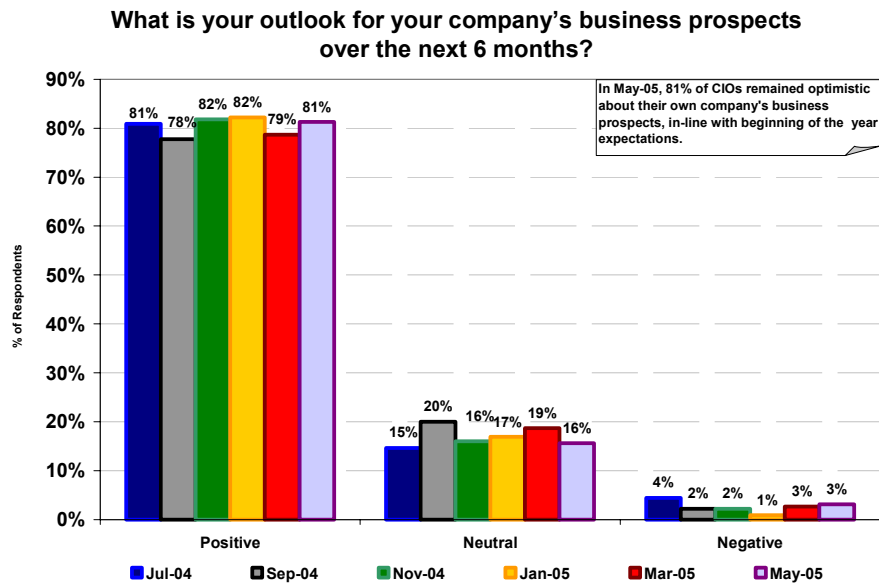
CIOs See Stabilization of Pricing Environment



Source: Morgan Stanley CIO Survey, May 2005.

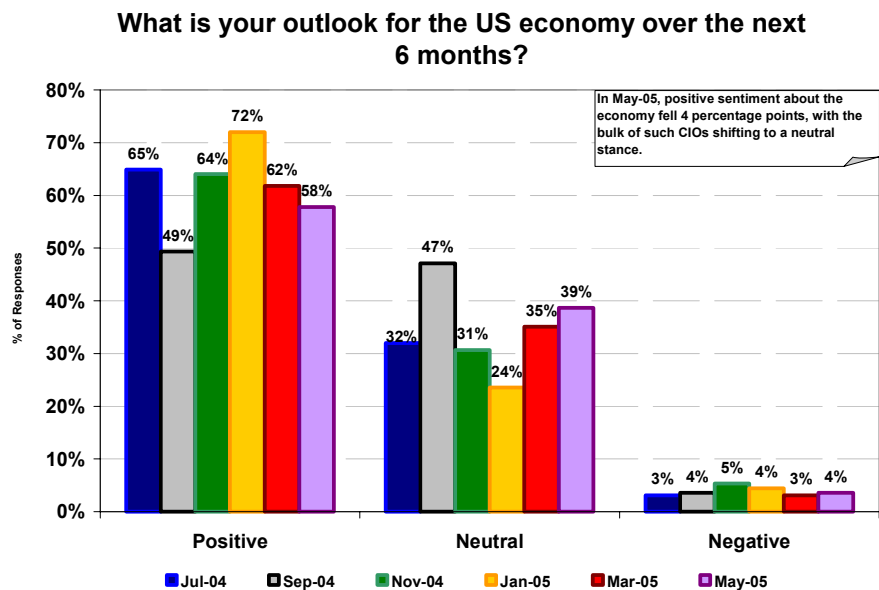
Confidence in Own Business Remains Strong, Economic Outlook Weakening

Exhibit 7
CIOs Continue to Have a Strong Positive Outlook for their Own Business



Source: Morgan Stanley CIO Survey, May 2005.

Exhibit 8
While CIOs Outlook for the U.S. Economy Continues to Soften



Source: Morgan Stanley CIO Survey, May 2005.

Executive Summary

2005 Enterprise IT Spending Growth Outlook Modestly

Contracts — Our May 2005 Survey of 225 Fortune 1000 CIOs (chief information officers) points to 2005 cash IT budget growth of 4.6%, a 50 basis point reduction from Jan-05 and Mar-05 Survey forecasts. Although CIOs remain positive on the outlook for their own businesses, their views on the economy and the direction of potential budget revisions softened. In contrast, vendor pricing trends appear to be stabilizing, and over half of CIOs signaled higher spending over the next six months compared to the first half of the year. Taken together, we see softening North America IT spending over the next 2-3 quarters.

Underlying Indicators Suggest Continued Growth, But Increasing Potential for Downward Revisions:

1. In May 2005, the Up-to-Down Budget Ratio remained at a record 5.4, matching Jan-05 and Mar-05 levels, surpassing the previous high of 4.4 posted in Nov-04.
2. However, 20% of CIOs expect negative budget revisions, up from just 12% in Mar-05. In May-05 upward budget revisions were only 30% more likely than downward changes, whereas they were twice as likely in Mar-05.
3. Over the next six months, 57% of CIOs expect to spend more on technology products than during the first half of the year, suggesting a greater likelihood for a second half budget flush than in 2003 and 2004.
4. 2005 vendor pricing continues to stabilize as nearly 12% of CIOs shifted expectations from more vendor discounting toward flat pricing. For example, in May-05, only 23% of CIOs expect more vendor discounting down from 35% in Mar-05.
5. Over the next six months, 79% of CIOs are optimistic about their own company's business prospects, slightly less than the 82% in January 2005.
6. Our May 2005 survey demonstrated a downtick in the outlook for the economy. For the next six months, 58% of CIOs offered a positive outlook for the US economy, down from 62% in Mar-05 and 72% in Jan-05.

Exhibit 9

Up-to-Down Budget Ratio History

Survey Period	Up-to-Down Budget Ratio	Year-over-Year Growth Period
Feb-04	2.74	2004 vs. 2003
Jun-04	2.77	2004 vs. 2003
Jul-04	2.66	2004 vs. 2003
Sept-04	2.46	2004 vs. 2003
Nov-04	2.39	2004 vs. 2003
Jul-04	3.38	2005 vs. 2004
Sep-04	3.78	2005 vs. 2004
Nov-04	4.41	2005 vs. 2004
Jan-05	5.43	2005 vs. 2004
Mar-05	5.43	2005 vs. 2004
May-05	5.39	2005 vs. 2004

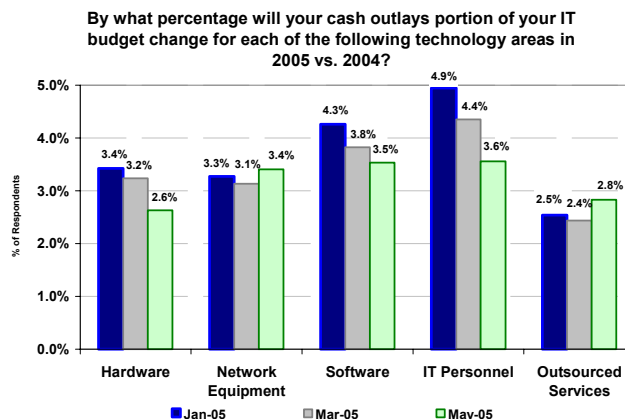
Source: Morgan Stanley CIO Survey, May 2005.

Weakened outlook for IT Personnel, Hardware and Software spending, while Outsourcing demand rebounds

— For 2005, CIOs project approximately 3.5% year-over-year growth each in spending for IT personnel and software down from 4% increases in May-05. In contrast, CIOs have slightly increased spending expectations for outsourcing and network equipment, to 2.8% and 3.4% from 2.4% and 3.1% in May-05, respectively.

Exhibit 10

IT Budget Growth By Major Category



Source: Morgan Stanley CIO Survey, May 2005.

Most Significant Changes in Spending Priorities for 2005

— Since our March, 2005 survey, improvements in CIO spending priorities were marginal and registered by: Database (up 3), Optical Transport (up 3) and business process outsourcing (up 3). In contrast, Gigabit Ethernet demonstrated a sharp move down nine places to 21st. Smaller priority decreases were posted by: Printers (down 5), Portal Software (down 4), Consulting & Systems Integration (down 4) and Layer-3 Switching (down 4).

Exhibit 11

Technology Spending Priorities Over the Next Twelve Months

Question: Over the next twelve months, how do you expect your spending to change for each of the following technology priorities relative to your current spending levels?

Technology	May-05		Mar-05		Jan-05		Nov-04
	Ranking	Δ in Rank	Ranking	Δ in Rank	Ranking	Δ in Rank	Ranking
Security (Network Equipment)	1	Up 1	2	---	2	---	2
Security (Software)	2	Down 1	1	---	1	---	1
Wireless LAN (access points & routers)	3	N/A	N/A	---	N/A	---	N/A
Storage Hardware	4	---	4	---	4	Up 3	7
VoIP	5	Up 1	6	---	6	Up 2	8
Storage Area Networks (SANs)	6	Down 1	5	---	5	Up 4	9
Storage Software	7	Up 1	8	---	8	Down 4	4
Application Integration Software	8	Up 2	10	Up 1	11	---	11
Document Management Software	9	---	9	Up 1	10	Up 3	13
Business Intelligence Software	10	Up 1	11	Up 2	13	Up 3	16
Portal Software	11	Down 4	7	---	7	Up 1	6
Database	12	Up 3	15	Down 3	12	---	12
Windows 2000/2003 Upgrade - Server	13	---	13	Down 4	9	Up 1	10
Wireless LAN (clients)	14	N/A	N/A	---	N/A	---	N/A
Notebook PCs	15	Up 2	17	Down 2	15	Down 1	14
CRM - Customer Relationship Mgmt	16	---	16	---	16	Down 13	3
LAN Telephony	17	Up 1	18	Down 1	17	Up 2	19
Application Server Software	18	Down 4	14	Up 4	18	Down 3	15
Windows Servers	19	Up 1	20	Up 1	21	Up 4	25
Intel Servers	20	Down 1	19	Up 1	20	Up 3	23
Gigabit Ethernet	21	Down 9	12	Up 2	14	Up 7	21
Windows 2000/XP Upgrade - Desktop	22	---	22	---	22	---	22
Linux Servers	23	---	23	---	23	Up 3	26
IT Education and Training	24	Down 3	21	Down 2	19	Up 1	20
Desktop PCs	25	Down 1	24	---	24	Up 4	28
New Custom Development	26	---	26	Up 2	28	Down 10	18
ERP - Enterprise Resource Planning	27	Up 1	28	Down 2	26	Down 9	17
Routing	28	Down 1	27	Down 2	25	Up 2	27
Consulting & Systems Integration	29	Down 4	25	Up 4	29	---	29
SCM - Supply Chain Management	30	Up 1	31	Down 1	30	Up 1	31
Microsoft Office Upgrade	31	Down 2	29	Down 2	27	Down 3	24
Application Outsourcing	32	Up 1	33	Up 2	35	---	35
E-commerce Software	33	Down 1	32	Down 1	31	Up 2	33
Layer-3 Switching	34	Down 4	30	Up 2	32	Down 2	30
Offshore Services	35	---	35	Up 1	36	---	36
Procurement and SRM Software	36	---	36	Down 2	34	Down 2	32
Layer-2 Switching	37	Down 3	34	Down 1	33	Up 1	34
CAD/CAM & EDA Software	38	Up 1	39	Up 3	42	Down 1	41
Optical Transport	39	Up 3	42	Down 4	38	---	38
Business Process Outsourcing	40	Up 3	43	---	43	---	43
Copiers	41	Down 3	38	Up 1	39	Up 1	40
Printers	42	Down 5	37	Up 3	40	Down 1	39
Unix Servers	42	Down 1	41	Down 4	37	---	37
Infrastructure Outsourcing	44	Down 4	40	Up 1	41	Up 1	42
Mainframe Hardware	45	Down 1	44	---	44	---	44
Mainframe Software	46	Down 1	45	---	45	---	45

Source: Morgan Stanley CIO Survey, May 2005.

Enterprise Technology – June 22, 2005

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