



The Economy and its impact on the media universe

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Clearmeadow Partners

Presentation to the DPA Conference

June 25, 2008



Agenda

- What have I been up to?
- Big Media/Advertising: The Search for Catalyst Companies
- 2008 Key Developments including Yahoo Implosion
- Discussing Google: Growth in 2½ quadrants
- Stock recommendations

What have I been up to?

- Started **Clearmeadow Partners**, a digital media advisory firm
 - Partners include Mike Kelly, former president of AOL Media Networks, and Richard Chang, VC extraordinaire
 - Firm's mission: to help companies of all sizes accelerate growth in digital revenue
 - Advisory services, capital raising, and business development services
- Want to chat?
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May 19, 2008

BEST ON THE STREET

Advertising & Publishing

May 19, 2008

As consolidation swept through the online-advertising business last year, many of the top advertising and publishing analysts found success with companies that were acquisition targets.

No. 1 in the sector, Jordan Rohan, formerly of RBC Capital Markets in New York, a unit of Canada's RBC Financial Group, reached the top with a buy rating on aQuantive Inc., a digital-advertising firm that was snapped up by Microsoft Corp. for \$6 billion last year. His buy on aQuantive from February to May generated a return of 145%.

Microsoft's interest in aQuantive didn't surprise Mr. Rohan because Microsoft had made a failed attempt to acquire DoubleClick, an online-ad technology company that Google Inc. ended up purchasing for \$3.1 billion. Thinking aQuantive's digital-advertising

Advertising & Publishing	
	TOP ANALYST/Firm Jordan Rohan RBC Capital Markets
	NOTABLE PICKS BUY aQuantive SELL ValueClick

there were no other viable options, Mr. Rohan switched a hold rating to a buy. He went back to hold after Microsoft announced its plan to snap up aQuantive in May.



Key Developments in 2008

- The media recession cometh
 - Trio of macro issues: Liquidity, Inflation, Real estate revaluation
 - Federal reserve handcuffed by stagflation; time to raise rates?
 - Good news, bad news – mostly bad news for US consumer
- Catalyst Companies: Things we like
- Google stock outlook: be patient
 - new equilibrium due to lower growth US market
- Yahoo: “Oops... now what?”
 - exodus continues as company slowly shrivels
- Facebook goes mainstream
 - Business model needs refinement
- So everyone has an ad network? What does that really mean?



Pessimistic Views from 30,000 feet

- Havas Chairman Bollore:
 - "I believe the crisis will happen," he said at a press conference at the Cannes Lions ad convention. "I don't believe there is any reason the global (ad) market will remain as high as it is." Source: WSJ 6/19/08
- George Soros, legendary financier:
 - "Whether we are in a recession now is questionable; that we shall slip into a recession in the course of 2008 I consider a certainty."
 - "The problem for the U.S. is that a rising [Chinese currency] will cause prices at Wal-Mart to rise. A little inflation in a recessionary environment might be a good thing, but the Federal Reserve has to be concerned about the stability of the currency." Source: Soros, The Credit Crisis of 2008 and What it Means



Why so downbeat, guys?





Macro forces in play

- We are not in recession, yet, largely because unemployment remains low
- That said, there are three important macro forces in play
 - **Liquidity crisis:**
 - Halfway home: \$350-\$500 billion marked down
 - Very bad for profits of major banks, brokerages
 - Federal reserve now lending up to \$400 billion against risky securities, delaying final mark-down
 - **Inflation:**
 - Feeling modest impact but no resolution in sight
 - Lesser of three evils
 - **Real estate revaluation:**
 - Just rounding first base in some areas
 - Dynamics very different from town to town



Stagflation on the horizon?

- Dow Chemical, yesterday, raised prices 25%, after raising 25% two weeks (2nd time in three weeks), while reducing output.
 - Management says company is struggling with higher fuel costs and sluggish growth
- UPS issues profit warning on Monday, citing “anemic” US economy and “unprecedented increase” in fuel costs. Fedex warns last week. Together the two shippers send 22m packages a day.

Weak dollar, high materials costs abound

- Fed rate cuts have ushered in new era of weak dollar
 - Weak dollar alone doesn't make oil go from \$60 to \$137 per barrel
- Demand from BRIC for food, materials outstrips increases in supply
 - steel, fertilizer, heavy machinery, chicken & dairy, wind, water, rice...



OIL

US\$/Euro

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<http://finance.yahoo.com/>

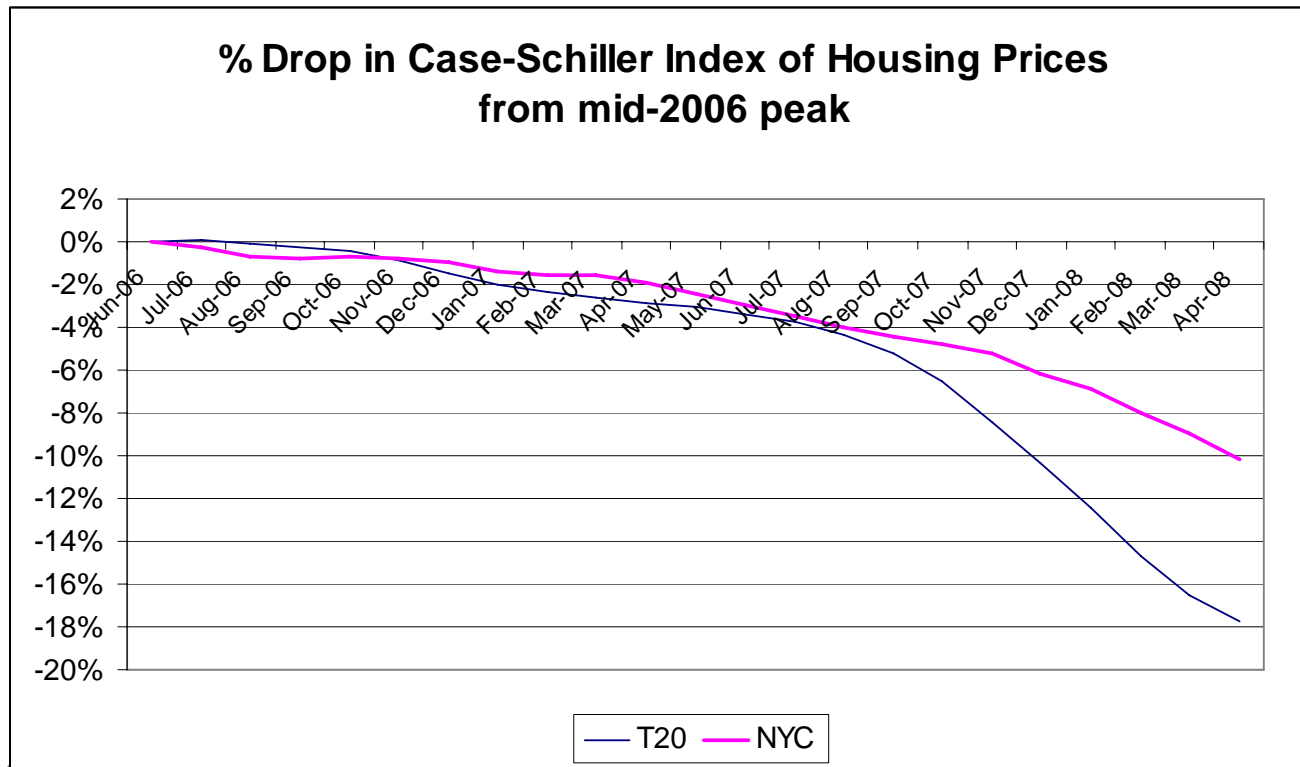
Good news: Inflation relatively contained

- Some cost inflation impacting online businesses:
 - Shipping costs higher
 - Lower margins for “free-shipping” merchants
 - Cost of imports up
 - Consumer electronics and branded fashion showing much higher costs
 - Costs of consumer travel increasing
 - Substitution occurring
- Consumer buying power reduced by expensive food and gas
 - Happening at gentler pace than indicated by consumer confidence
 - 70% of corporate direct costs are **labor**, not materials



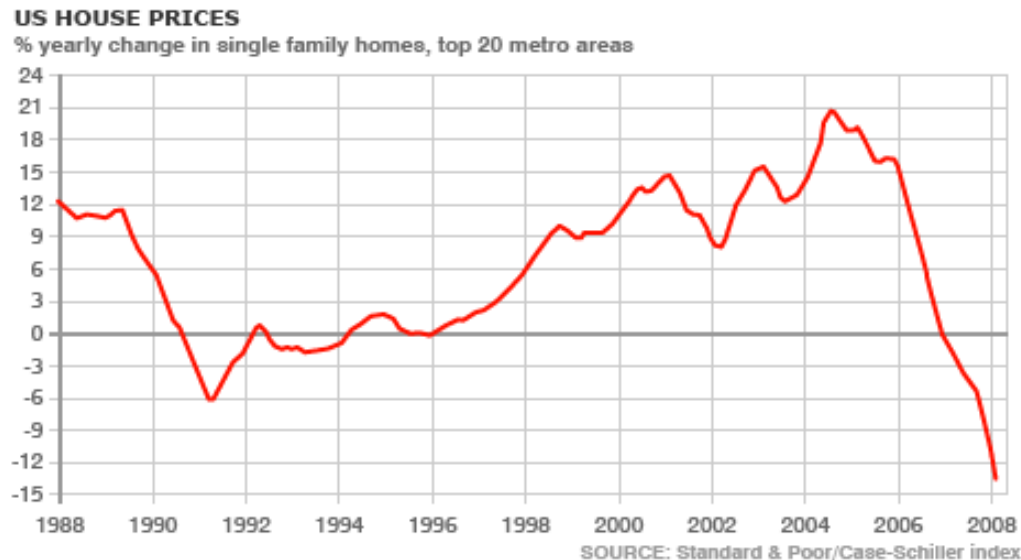
Everybody's favorite topic... real estate prices

- Real estate prices have fallen 18% on average, from the mid-2006 peak, with some markets like NYC down ~10%



Bad news: real estate revaluation may take a few more years

- Revaluation matters more for investors, speculators than those who own-and-occupy homes
- Most severe in areas with greatest speculation including FL, CA
 - Even within those states, some areas not seeing major revaluation
 - Neighborhood-by-neighborhood analysis required
- In areas of less impact, headlines worse than reality
 - Secondary impact: Headlines impacting consumer confidence and spending levels, which are impacting confidence of would-be borrowers



→ SLOW &
STEADY
IMPACT ON
AD SPEND,
most yet to
be seen



The consumer is wilting

- The Conference Board said Tuesday that its Consumer Confidence Index dropped to 50.4 from a revised 58.1 in May. The reading was the lowest since February 1992, when it was 47.3.



Why it matters for
marketers and media
companies



Auto Industry Ad Spend: Outlook mixed, at best

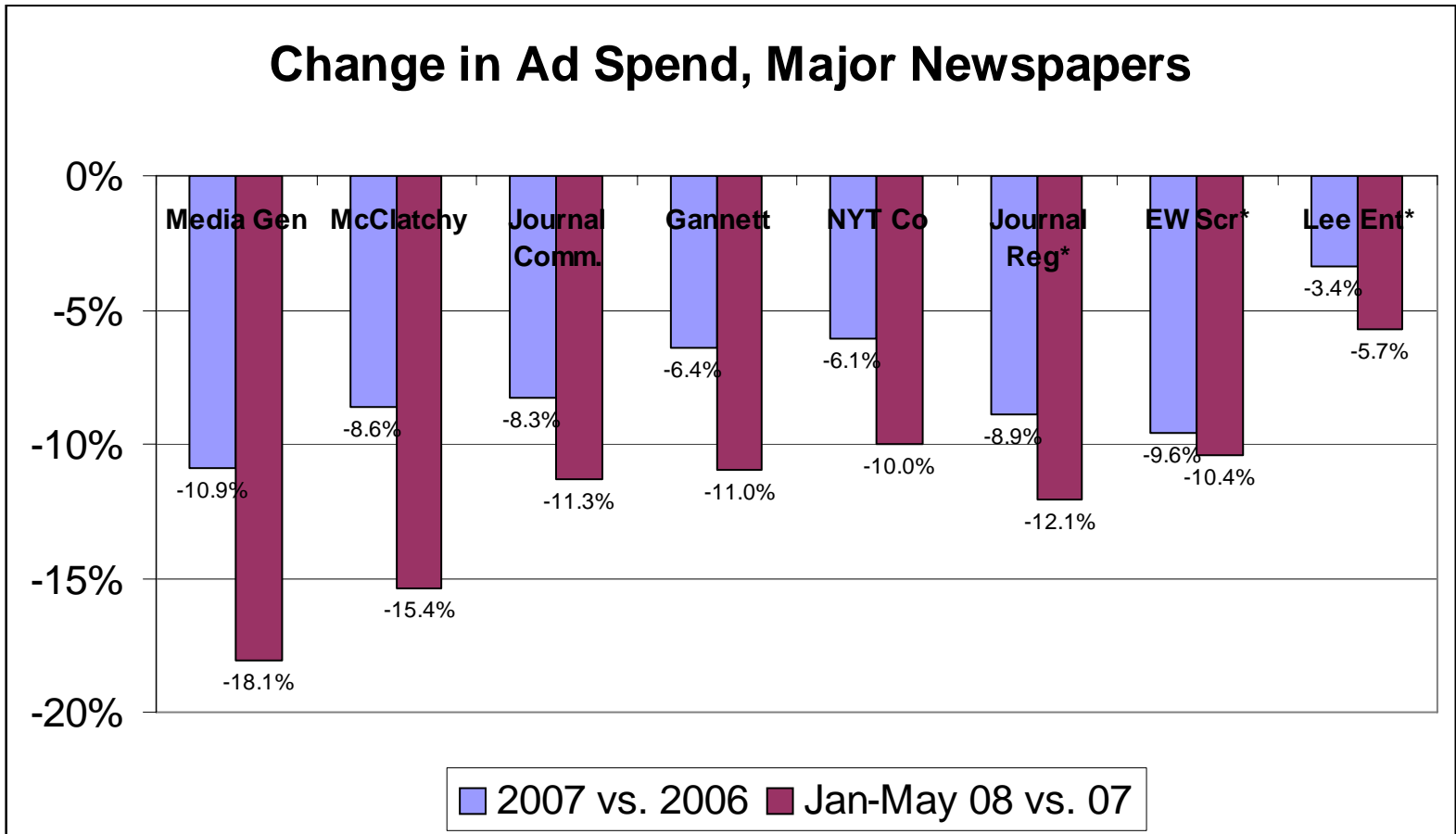
- From Adweek, 6/13/08:
 - “Spending dropped 12 percent to slightly more than \$2 billion, per Nielsen, while TNS says the drop was just a tad more, 13 percent to about \$3.2 billion.
 - Ford and Chrysler had the sharpest spending drops. Chrysler was down 47 percent, per Nielsen, and 42 percent, according to TNS, while Ford was down about 30 percent, according to both ad trackers.
 - The Nielsen figures don't include online spending, while the TNS Internet data covers display ads, but not search.
- According to a report issued this week by [eMarketer](#), online ad spending by the auto companies will increase this year almost 22 percent to \$3 billion. The research firm predicts that \$5.6 billion in car spending will shift to the Web by 2012 as more consumers spend time online researching vehicle purchases.



Telecom, Retail Ad Spend Soft

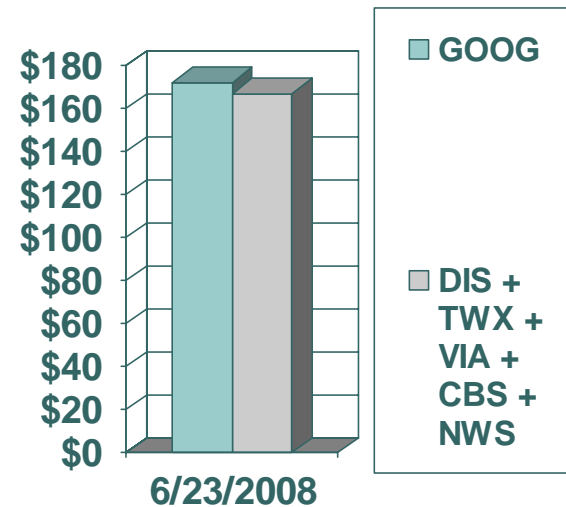
- Online display ads grew 8.5% in 1Q07, half of prior year's 1Q comp
- Telecom advertising ... was "very weak" in first quarter. So was retail, particularly local advertisers that divide their online budgets between display and search.
- "The difficulties the retail market is going through, with all the cutbacks in consumer spending and all the uncertainty about the general economy resulted in cutting back in many sectors," said Swallen.
- Newspaper ads -5.2%; radio -4.5%
- Television +1.7%. Outdoor +2.5%, Magazine +0.8%
- Financial services industry overall ad spend was flat for the period.

Newspapers Hit the Hardest



Quandary for Big Media

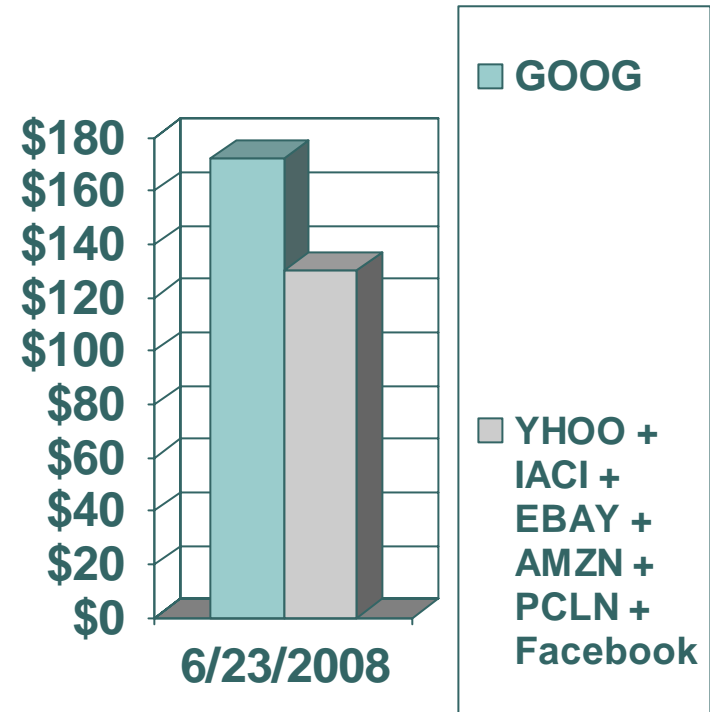
- Google (\$172bn) worth more than DIS+TWX+VIA+CBS+ NWS ... COMBINED!
- Problems:
 - Aggregate share of media for Disney/ABC/ESPN and all other affiliated properties
 - TELEVISION: ~17
 - ONLINE: <2
 - International revenue mix less than 20% vs. 51% and growing for Google



1. Time Warner excludes Time Warner Cable

Quandary for Other Internet Companies

- Google (\$172bn) worth more than YHOO+IACI+EBAY+AMZN+ PCLN + Facebook ... COMBINED!
- Problems:
 - “Destination” model of Internet content being disrupted by Google
 - Social Media not very profitable for most
 - Growth of US Internet user population has decelerated to <5%





A Need for Catalyst Companies™

- Catalyst companies:
 - Companies with digital DNA that, in combination with larger media companies, could start to narrow the gap in market share, market cap
 - Acquisition of these companies may extend careers of media execs long enough to figure out how to compete with Google
 - Represent optionality and potential for reacceleration of revenue growth
 - Can operate independently; may be integrated into larger framework



Things we like:

- Widget-ized contextual content and advertising (two-in-a-box)
- Super-local lead generation platforms
- Innovative i-Phone apps
- High-margin ecommerce companies with buying power
- Successful reseller of carbon emission credits for consumers
- Commercial application for Twitter

The Landscape

Company

CBS
YHOO
DIS
TWX
NWS
MSFT
WPPGY

Growth 03/04

5%
76%
14%
7%
15%
15%
5%

Growth 06/07

-2%
12%
5%
6%
13%
14%
5%

S2BY!



Catalyst Companies

Last.FM, C|NET
Yahoo, RM, BL, Delici.o.us
Club Penguin, Rivals, HSSports
AOL, Tacoda, 3rd Screen, Bebo, Quigo
MySpace
Yahoo? (NO), AQNT,
TFSM, Outrider

So how is that impacting Google stock?

- Google shares have found **new equilibrium** between peak (\$700+) and trough (\$420)
- Equilibrium P/E ratio of around 24x on '09 EPS of \$24, down from 34x multiple on \$26 EPS
- New equilibrium seems fair... shares should find support at \$500 mid summer. Be patient.



Google's Growth Quadrants

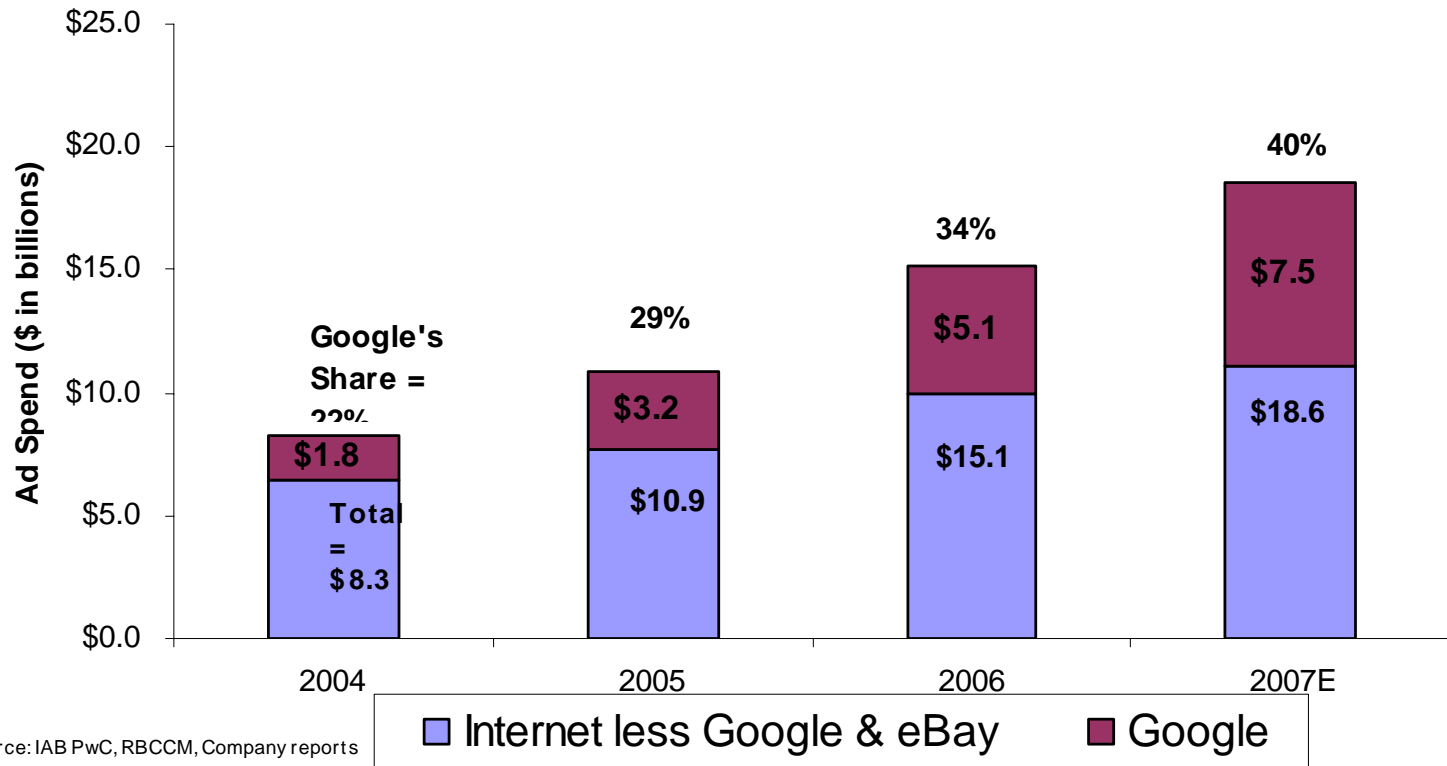
- Google's US national sales team is missing internal forecasts
- Google's Online Sales and Operations are making up for it
- International remains v. strong
 - ROW faster than UK

	LOW	HIGH
HIGH	US Online Sales & Ops 24% of total 35% Growth	Int'l Emerging Markets 36% of total 40%+ Growth
LOW	US Direct Sales 25% of total ~10% Growth	Int'l Early Markets (UK) 15% of total <20% Growth

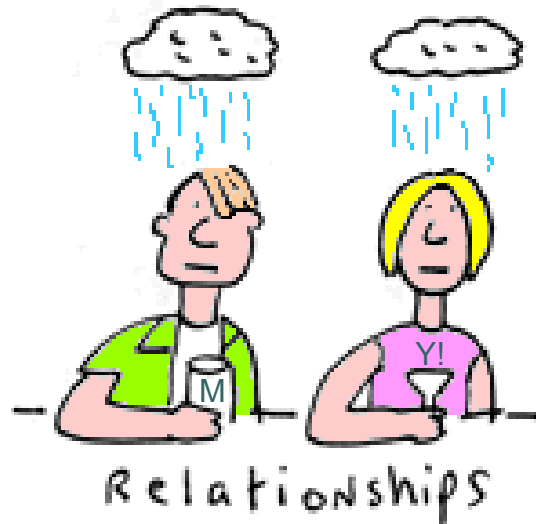
Decelerating in part bc of slow-growth economy

Google Now Over 40% of US Internet Ad Spend

Google Taking Share



Discussing the Microsoft Yahoo courtship

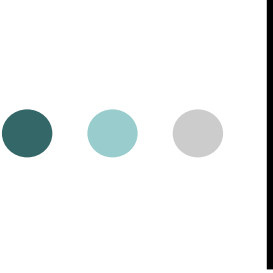




Yahoo: Oops!

- ? Yahoo mgmt treated 62% premium like bad diagnosis from doctor
- ? Jerry Yang in a tough spot now
 - Legal liability if Microsoft goes away forever
- ? Icahn to the rescue... not
 - Patience may not be there
 - In MSFT's interest to feign indifference now

CONCLUSION: YAHOO SLOWLY SHRIVELING, WITH MASS EXODUS FOLLOWING BUSTED MSFT DEAL



What now? (for Yahoo)

- If Yahoo is allowed to outsource search monetization to Google or Microsoft, it will lose ability to improve long tail monetization
 - Very tough position for advertisers, even tougher for publishers
- Reality check: In my opinion, Microsoft will not be able to realize \$47 billion of value out of Yahoo
 - If Microsoft buys Yahoo search business, and not the rest of the company, the rest of Yahoo is not likely to be acquired (ever)
- Other potential buyers below \$20 (Disney, Comcast, News Corp., ATT)

...I have a neutral view toward YHOO shares now...

Would be a buyer if senior management transition happens



Predictions for 2008





Break-up is good for IACI

- As currently structured, IACI doesn't resonate with many investors
 - Growth investors like search and media, and dislike HSN
 - Value investors like free cash flow of HSN and don't like implied valuation of rest of business
 - Nobody really likes outlook for Lending Tree
- With Malone/Diller battle behind us, the break-up of IACI should drive shares to \$30
 - Key catalyst is separation of HSN from rest of company

Sum of parts for IACI

Chart 6: IACI sum of parts analysis

	2009E					
	Revenues	% Total	EBITDA	Est. Margin	EBITDA Multiple	EV
Retail (\$mn)	\$ 3,255	45.7%	\$ 295	9.1%	8.5 x	\$ 2,510
U.S. Retail (HSN, Cornerstone)	3,255	45.7%	295	9.1%	8.5 x	2,510
Services (\$mn)	\$ 1,697	24.8%	\$ 351	20.7%	9.7 x	\$ 3,394
Ticketing (Ticketmaster)	1,219	17.8%	298	24.4%	8.0 x	2,382
Lending (LendingTree)	293	4.3%	20	7.0%	15.0 x	305
Real Estate	63	0.9%	(7)	-11.2%	nm	189
Home Services	122	1.8%	40	32.6%	13.0 x	517
Media & Advertising (\$mn)	\$ 1,114	16.3%	\$ 172	15.4%	12.0 x	\$ 2,062
Membership & Subscriptions (\$mn)	\$ 1,042	15.2%	\$ 300	28.8%	8.5 x	\$ 2,541
Vacations (Interval)	446	6.5%	185	41.5%	8.5 x	1,574
Personals (Match.com)	397	5.8%	94	23.5%	9.0 x	842
Discounts	198	2.9%	21	10.5%	6.0 x	125
Eliminations						
Other (TVTS, Emerging, Corporate)	\$ 16	0.2%	\$ (113)	nm	10.0 x	\$ (1,126)
IAC Total	\$ 7,123		\$ 1,005	14.1%	9.3 x	\$ 9,381
			Plus Net Cash ('08 Target)			\$ 1,500
			Shop Channel & Europe Equity			\$ 700
			Equity Value			\$11,581
			Shares Outstanding			305
			Per Share Value			\$38

IACI
worth
up to
\$38

Source: Merrill Lynch equity research

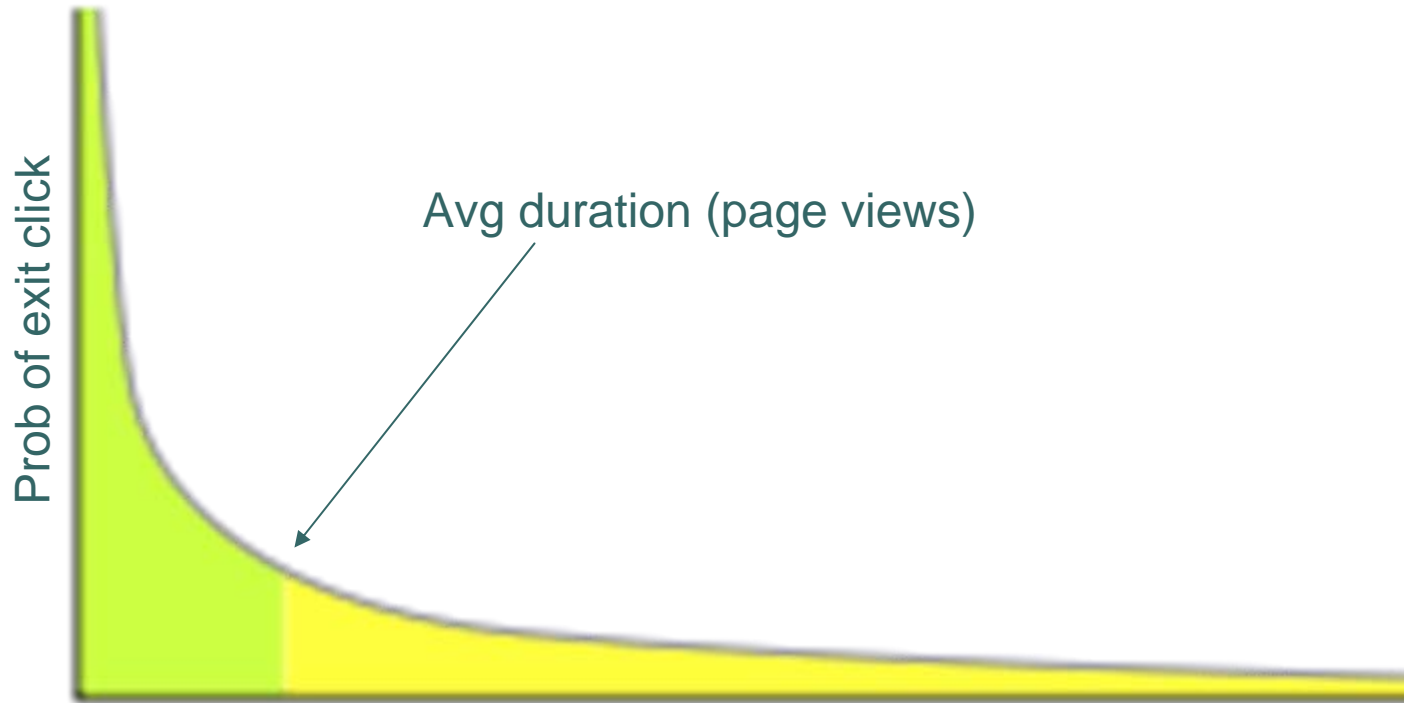


Facebook... much to say

- Social media business models at a crossroads
 - Response advertisers frustrated bc of low CTRs
 - Brand adv are hesitant to commit large % of budget (~10%)
 - Search monetization partners (GOOG) losing money on MySpace deal
- Necessary improvements to go beyond college and high school pop:
 - Multiple profile views for different types of friends
 - Company has announced this and not (yet) delivered
 - Necessary for adults who have different personas
 - Segmentation of inventory by sequence within each user session
 - First 5 impressions worth more than next 100, per session
 - More tools to reduce news feed and mini-feed clutter
 - Ex.) Ability to opt out of mini-feed from specific friends and overly communicative twitterers
- Not worth \$15 billion, but one could easily see \$6bn+ now
 - Worth more without significant cash flow

Predictions: Facebook stays independent long enough to go public, and ad networks eventually figure out how to segment Facebook inventory better

● ● ● | “Exit Clicks” on social media inventory:
basic exponential decay curve





Ad Networks, Ad Nauseum

- Ad networks are sprouting up everywhere
 - Consolidation makes sense strategically and financially
 - In 2007, there was \$2 billion of M+A and \$300mm+ of VC investment, not counting AQNT and TFMSM acquisitions
 - Net margins are generally low, in the 10-15% range, even for fully scaled ad networks
- The key differentiators include the degrees to which a network focuses on:
 - Targeting
 - Acquiring inventory directly or on a representation basis, and whether on an arbitrage or revenue-sharing basis
 - A particular media type or type of inventory
 - Selling on a CPA, CPC or CPM basis, whether via auction or negotiated
 - A network vs. an exchange



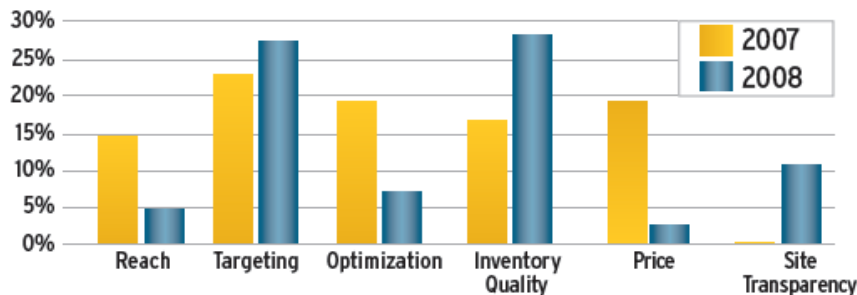
Recent 3rd Party Research Validates Findings

- Collective Media recently published its 2nd annual study on ad networks
 - Surveyed over 200 media buyers/ marketing execs
- Use of ad networks is growing
 - 95.5% of US agencies and advertisers plan to work with ad networks in '08, up from 81.5% in '07 (+17%)
 - Over 50% of respondents started using ad networks within last two years, in part because some decisions are made at junior level within agency
 - Global revenues on ad networks should exceed \$3b in 2008 with \$2b in US alone
 - There is some significant double counting wrt the IAB estimates of total \$26b US online ad revenues, however.

Inventory quality and targeting drive decisions for ad buyers

- To media buyers, the broad array of options is almost incomprehensible
 - ROI matters most but hard to measure for branding purposes
 - Beyond ROI, **inventory quality and targeting** are most important differentiators
 - Comscore “reach” is easily manufactured
 - not differentiator above a certain acceptable level
 - Customer service also important though not listed on this study
 - Transparency increasingly important
- For publishers, yield (net to publisher) is first and foremost
 - Differing views on blind vs. direct representation model
 - Control of ad selection, customer service, receipt of upfront commitments for inventory

What best differentiates one ad network from another?



Key Stats:

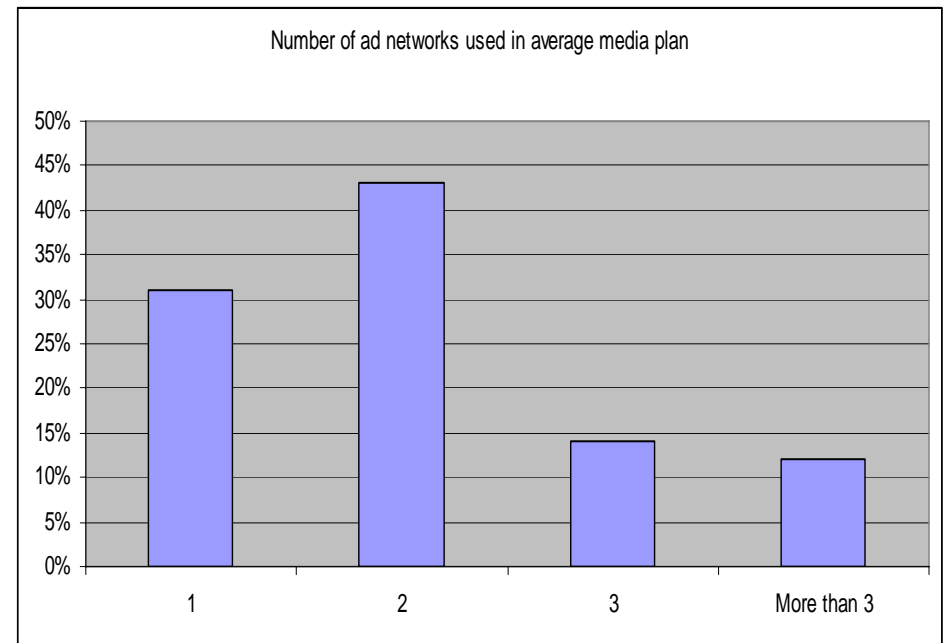
61.8% **increase** in inventory quality

64% **decrease** in reach

Source: Collective Media
2008 Ad Network Study

...marketers & agencies are increasingly selective

- 74% use 1 or 2 ad networks in avg media plan
- Two ad nets seems like the magic number (43%)
- Less than 15% use 3+ per plan



Source: Collective Media 2008 Survey



Today's Stock Recommendations

Global Consumerism: Tiffany's (TIF), Nike (NKE), LVMH (LVMHY)

Digital Growth Engines: Omniture (OMTR), Mercado Libre (MELI) below \$50

*Share gainers: GMarket (GMKT), MDC Partners (MDCA)***

Less of a mess: IACI (worth \$30+ if split and some parts sold)

Speculative Russian Internet Stock: Rambler Media (London AIM Exchange)

***Disclosure: As of June 25, 2008 I have a position in MDCA*



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