Recent Thoughts on Digital Media

Jordan Rohan

Clearmeadow Partners

Presentation to the DPA Conference

October 28, 2008

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What Have I Been Up To?

- Started **Clearmeadow Partners**, a digital media advisory firm
  - Firm's mission: to help companies of all sizes accelerate growth in digital revenue
  - Profitable companies with defensible market positions
  - Advisory services, capital raising, and business development services
- Want to chat? jrohan@clearmeadow.com

THE WALL STREET JOURNAL ONLINE

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 technologies were a strong No. 2 in the market and 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.

Advertising & Publishing

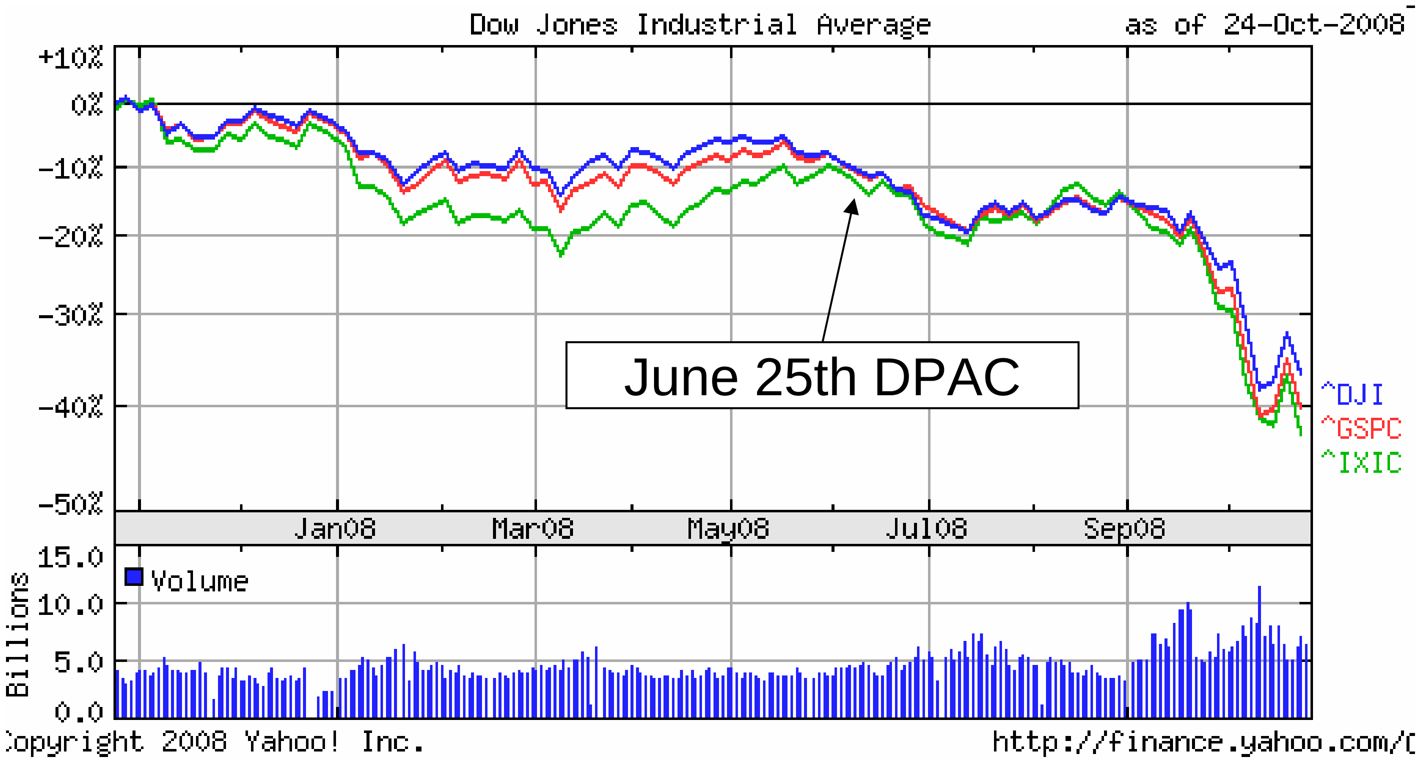
TOP ANALYST/Firm
Jordan Rohan
RBC Capital Markets

NOTABLE PICKS
BUY aQuantive
SELL ValueClick

Agenda

- Review of Macro Trends
- Slow Decline of Portals
- Publisher Perspective: Ceding control of content is unfortunate but necessary
- The New Rules of an Uncertain Market
  - Recession is bigger than you are
  - Fundamentals are no match for forced selling
  - The bottom will happen when you stop looking for it
- Tips for Survival

U.S. Market Averages Down ~40% in last 12 months….down 33% since June DPAC



A rally of 66% required to get back to even!

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Since the last DPAC in June…….
Public Markets Have Re-Valued Internet

	25-Jun	27-Oct	Difference	% Change
Google	$176,320	$104,320	($72,000)	-40.8%
Ebay	$37,284	$19,238	($18,046)	-48.4%
Amazon	$34,458	$21,233	($13,225)	-38.4%
Yahoo!	$30,998	$16,204	($14,795)	-47.7%

The "High-Growth" Internet has not been spared

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Review of Macro Trends:
Economic Recession…..

- Trio of macro issues:
  1. Liquidity: Corporate debt spreads reflect unwillingness to lend
  2. DE-flation: Real estate revaluation
  3. De-leveraging
- Global Central Bank actions:
  1. Will it help?
  2. When will it help?

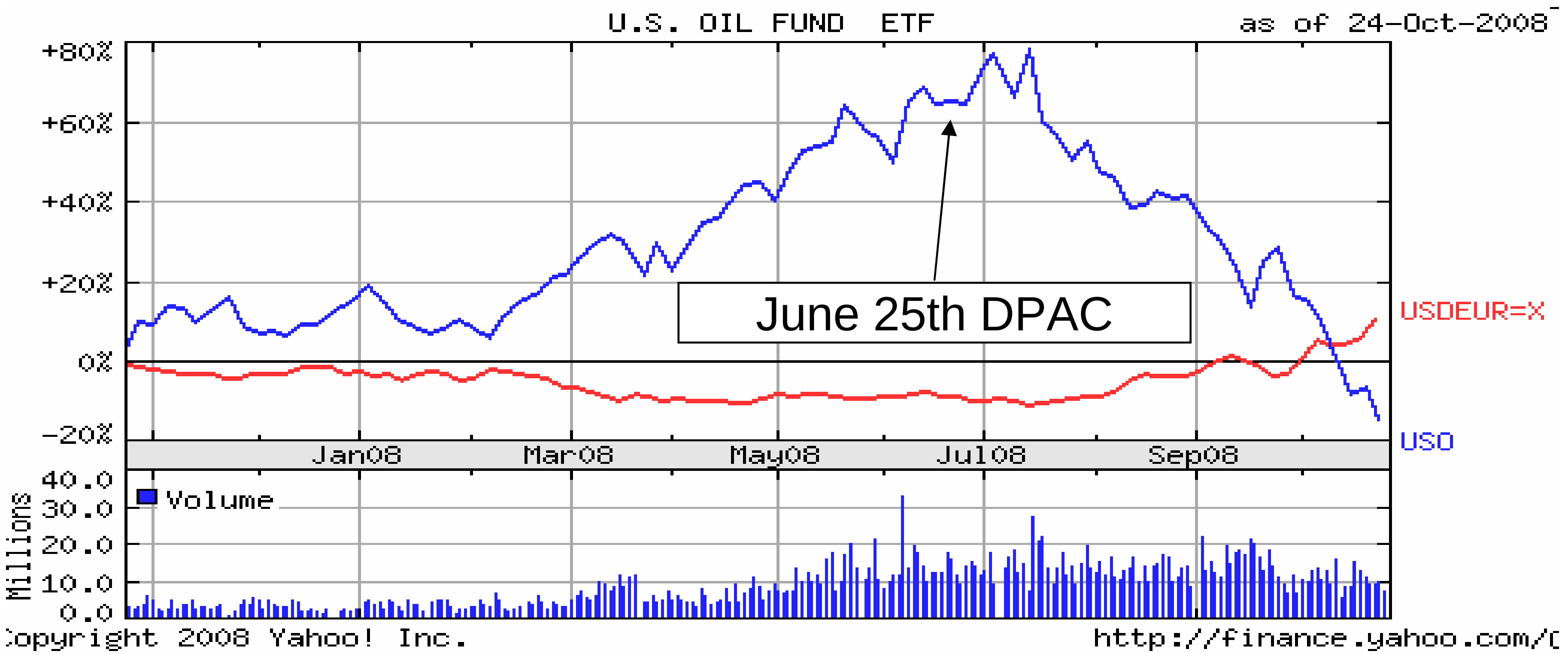
Review of Macro Trends:

There are some positives…...

- Inflation is no longer a concern….it's *deflation* now
- Central Banks liquidity injections have yet to be felt
- Libor has eased *slightly*
- Corporate balance sheets (excluding financials) are generally healthy
- U.S. corporations do not have a glut of inventories
- U.S. new homes sales unexpectedly rose slightly (2.7%) in Sept vs. August – Dept of Commerce

Positives: Strong dollar, falling energy

- Three month trends show startling reversal of dollar/euro valuation as investors seek safe haven in uncertain times
- Global recession leads to supply glut in oil, reduced demand for ethanol (corn) and basic materials
- Gas prices down $0.53 in last 2 weeks to $2.78/gal nationally



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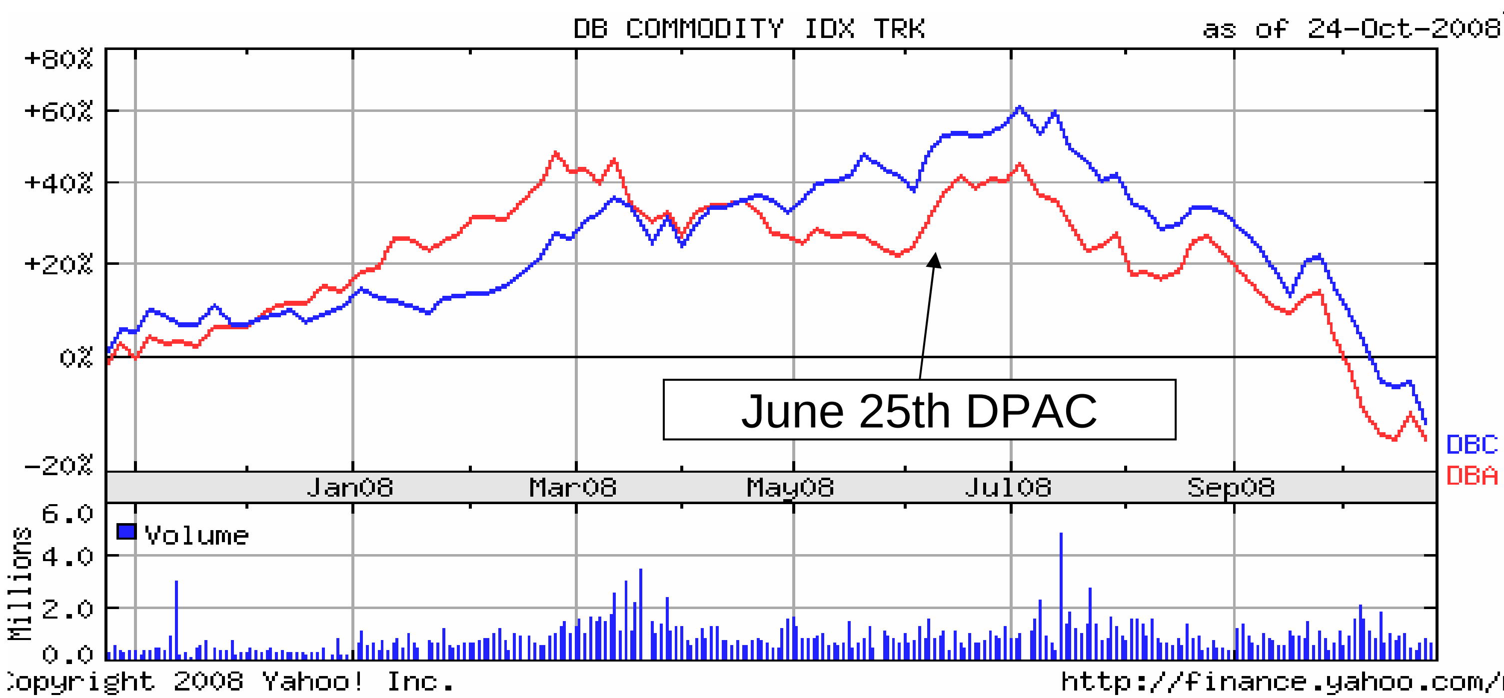
Positives: Food and energy prices lower

- Global slowdown, reduced speculation results in lower agriculture and base metals
- Commodities down 45% since DPAC in June



Review of Macro Trends:
The Bad News…..

- Banks still not lending enough
- Home prices have not stabilized
- Industrial production slowing
- Retail sales softening
- Unemployment rate will continue to rise
- Capital markets under severe selling pressures
  - Nothing is safe: Gold and Utilities have fallen as well, which is unusual in low interest rate environment

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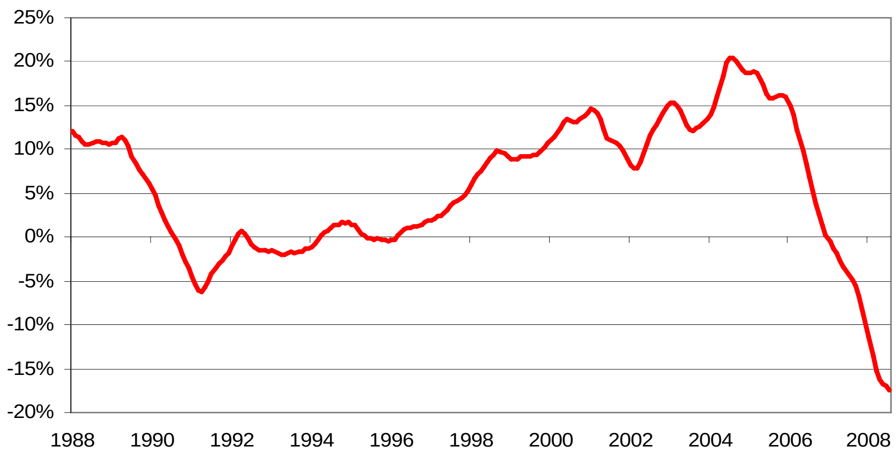
Negatives: Real Estate Revaluation
It may take a few more years

- 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

US HOUSE PRICES
% yearly change in single family homes



Source: Case-Schiller Index

→ SLOW & STEADY IMPACT ON AD SPEND

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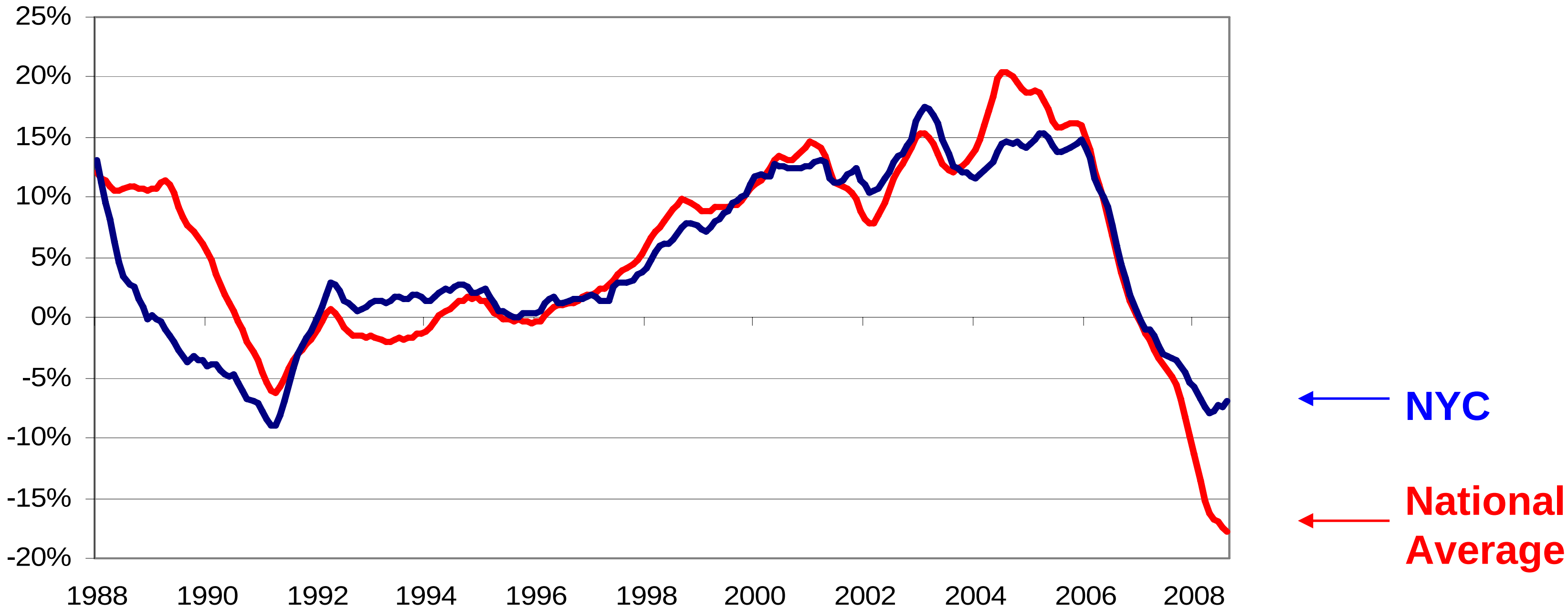
Negatives: Real Estate Revaluation

…New York City is not immune either….

- Case-Schiller reporting NYC down 6.9% y/y vs. National Average of down 17.7% in Month of August

US HOUSE PRICES

% yearly change in single family homes



Source: Case-Schiller Index

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Negatives: Corporate Debt Spreads Remain Massively Wide

	Spreads		
U.S. Corporate Indexes	**1 YR Ago**	**25-Jun**	**27-Oct**
U.S. Corporate	143.0	303.0	570.0
Double-A-rated (AA)	118.0	258.0	450.0
Triple-B-rated (Baa)	171.0	356.0	650.0
High Yield			
High Yield Constrained	432.0	846.0	1,631.0

Source: Wall Street Journal

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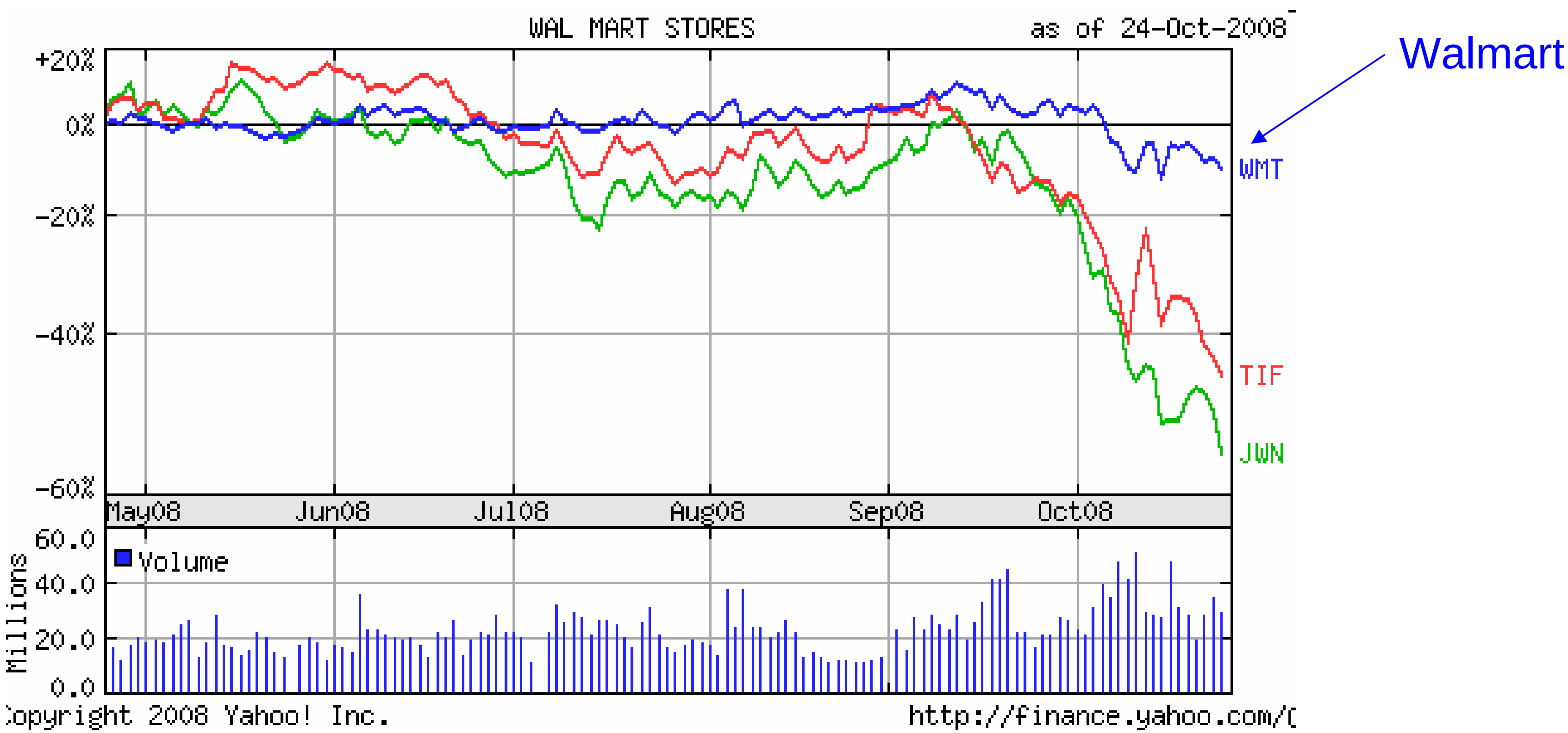
Negatives: Consumer tightening

Preferring Walmart over Tiffany and Nordstrom



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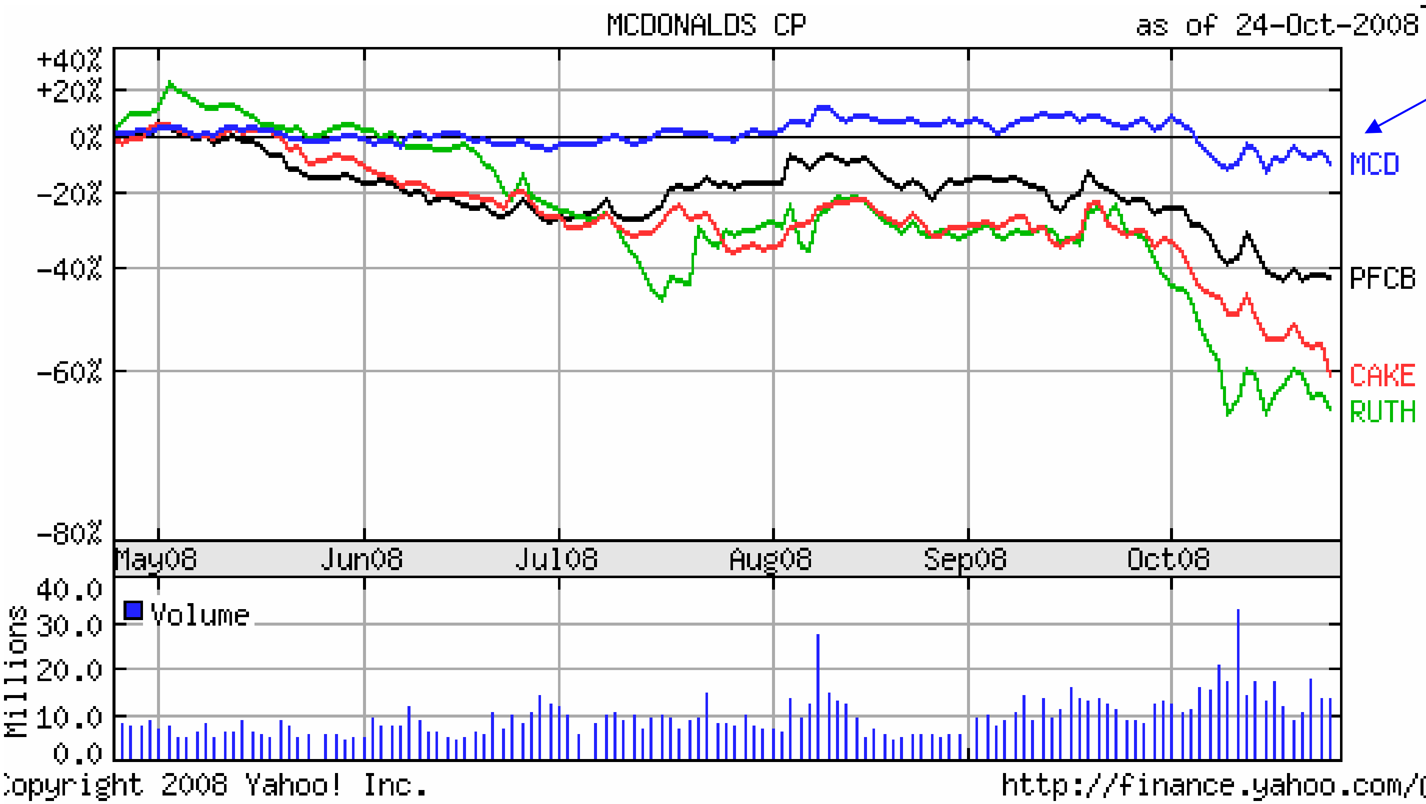
Negatives: Cutting back on casual dining

Preferring McDonalds over Cheesecake Factory, PF Chang's and Ruth Chris



McDonald's

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The Rules of an Uncertain Market

- **The financial markets will do their best to cause the maximum pain to the greatest number of people**
- The economic cycle (recession) is bigger than you are
- Fundamentals are no match for forced selling
  - Stocks still go down despite good fundamentals
    - They go down more when there are bad fundamentals
- The bottom will happen when you stop asking

Will Digital Continue to Outperform?

- Reasons cited for digital to outperform:
  - Efficient spend
  - Measured results
  - Ability to target
  - Free space
  - Budgeting process: ability to back out

- Key risks to digital outperformance thesis:
  - Cyclical forces stronger than secular shift at end of cycle
    - Traditional media has been cut, digital could be next
  - Digital now large enough to be cut back
    - Now approaching 10% of total advertising in U.S.
  - Easy to cut budgets, simply increase ROI hurdles

On the (Slow) Decline of Portals…

… and the implications for the Internet ecosystem

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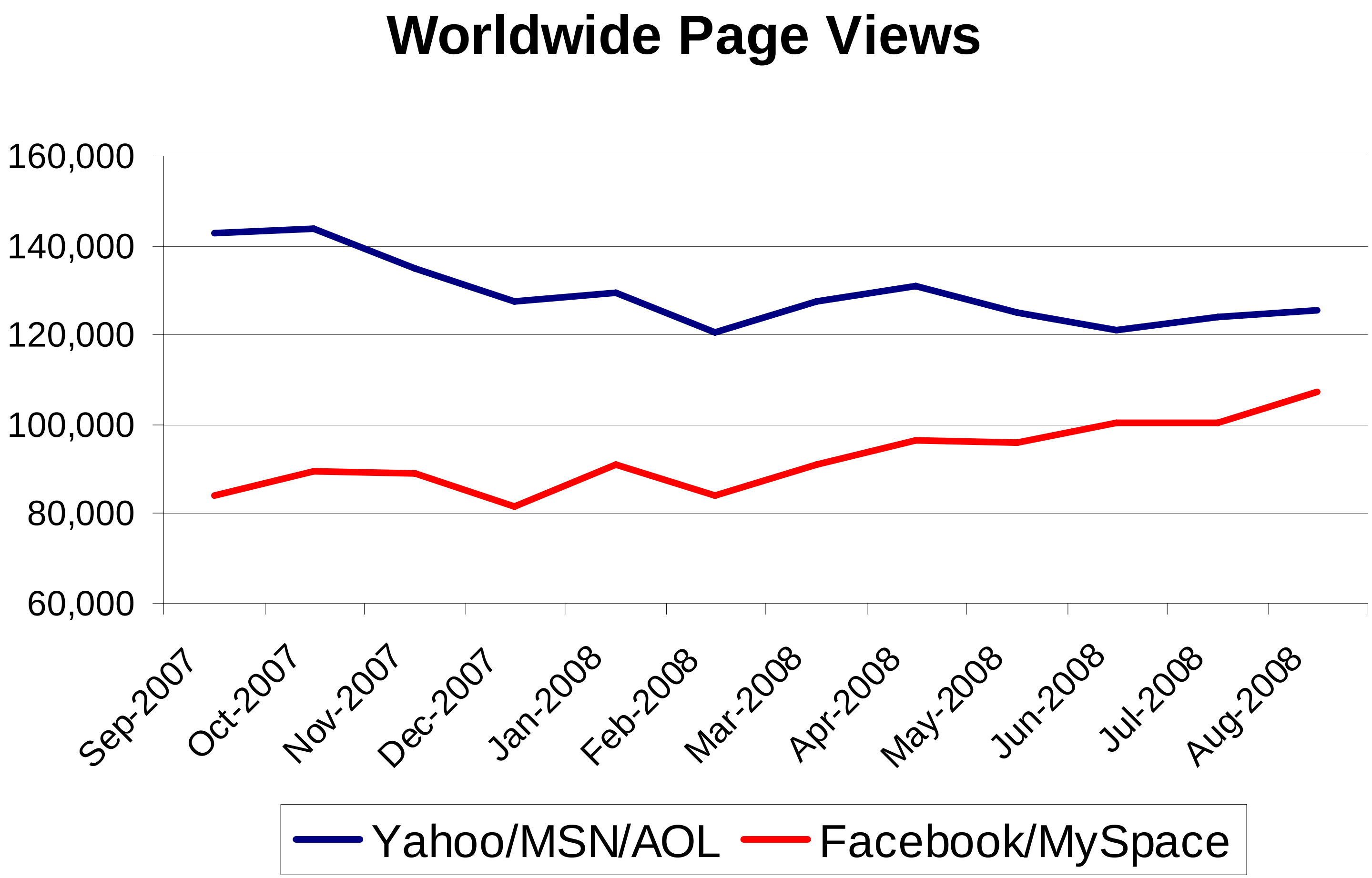
Social Media Continues to Grow

….while portals decline…



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Social Media is fantastic consumer application
…but only marginally profitable…

Portals	**CPM**
Yahoo	$7.36
MSN	$9.03
AOL	$13.61
Social Networks	
Facebook	$0.63
MySpace	$1.34

Source: Clearmeadow, RBC, Comscore

All else equal, if a consumer spends an hour daily on Facebook instead of AOL, the Internet ecosystem would miss out on over $600 of annual revenue

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Publishers: Bringing Content to Social Media

- Syndication
- Widget-ization
- Partnerships
- Behavioral targeting and audience re-targeting

Unfortunately, all of these approaches require publisher to cede control of monetization, context, and inventory availability

So what to do about Content Fragmentation?

- The best defense is a good offense
  - Vertical ad networks make sense as long as there are very tight controls on publisher quality
  - Yield differentials should be massive
    - Plenty to share with partners
    - MTV and Martha Stewart recently started vertical ad networks, using existing sales forces and leveraging media brands to command higher pricing

- Competitors in the print or television world can be partners in digital

- We don't need more ad networks, we just need to apply the best media sales forces to high quality third party inventory
  - "You can distribute some of our content if we can sell ads on some of your page views"

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Yahoo: Decline Accelerating

Quarterly results: weak, as predicted

Search surprisingly strong, display weaker than understood

- 10% workforce reduction unfortunately insufficient

Savings of $400mm offsets loss of 8% of company ad revenues

Yahoo! shares imply only $8 billion for US portal and $17 billion total

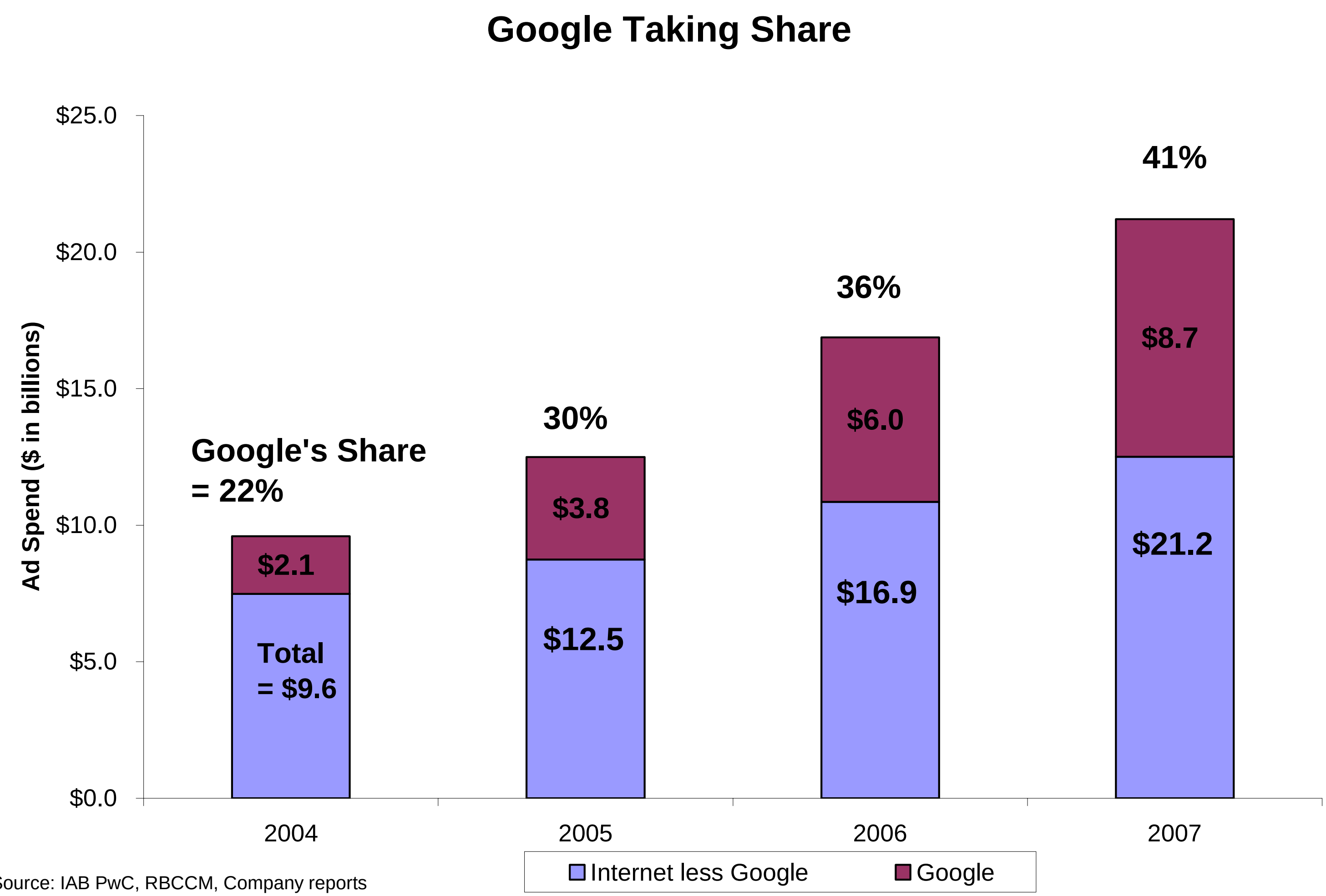
Microsoft offered $45 billion for whole company!

Who else could "save" Yahoo?

- Yahoo! still has a solid core franchise. When the cycle turns, the company will be able to combine with traditional media company.
  - One could reasonably expect Yahoo's display ad business to be down 10-15% in 2009
- Valuation now invites new potential owners
  - Potential buyers below $20 (Disney, Comcast, News Corp., GE)
- Conclusion: Down, but not down for the count

Predictions for 2009

Google continues to gain share…



Source: IAB PwC, RBCCM, Company reports

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Consolidation Will Return

- Key hurdle is corporate liquidity
- Most likely to be acquired: MNST, YHOO, VCLK, parts of the IACI group of companies
- Valuations support action now

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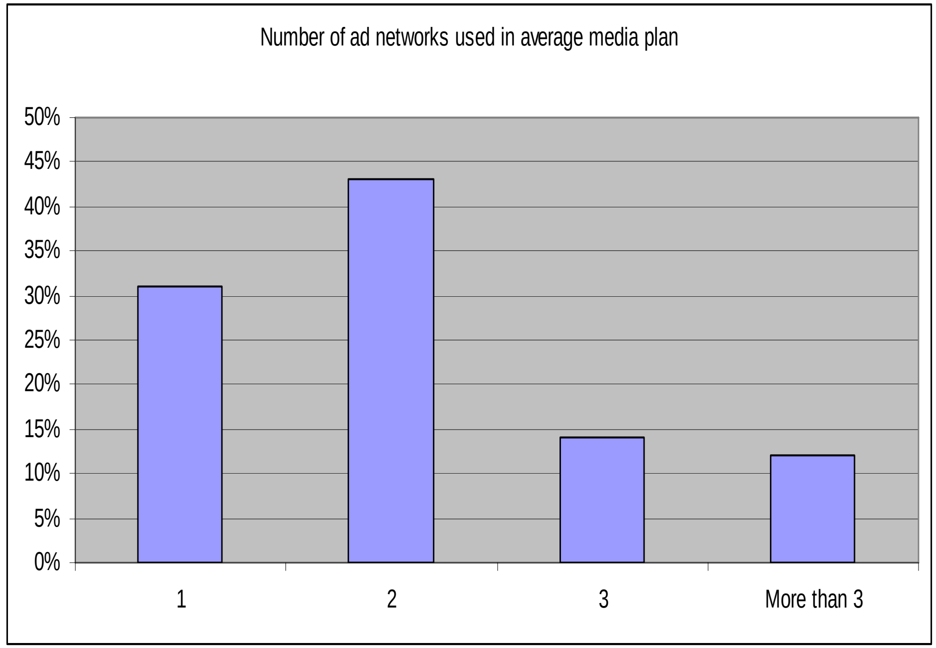
Ad networks… enough already

- 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 TFSM 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

…Marketers & Agencies are Increasingly Selective Towards Ad Networks….

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



Source: Collective Media 2008 Survey

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Impact of Ad Networks: Over-Supply

Key Finds from Bain/IAB Digital Pricing Research

- Increased use of networks – representing 30% of sold inventory, up from just 5% in 2006
- Average CPM's on networks of $0.60-$1.10 vs. $10-$20 in direct sold
- Publisher challenges in managing price and yield
  - Lack of measurement data
  - Lack of resources to optimize CPMs and yield
  - Lack of data on network volumes and pricing

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