

Morgan Stanley

The State of the Internet, Part 3

The World's Information is Getting Organized + Monetized

web 2.0 – 11/8/06

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Market Value of Top 5 Global Internet Market Leaders = 46% Higher than 3/00 Market Peak Thanks to Google

Google + Yahoo! + eBay + Yahoo! Japan + Amazon.com

- \$ 2B = market value – pre-2000 IPO
- \$178B = market value – Nasdaq peak – 3/10/00
- \$ 32B = market value – Nasdaq trough – 10/9/02
- \$259B = market value – 11/7/06

Source: FactSet and Morgan Stanley Research.

It's Tough to Succeed

- In public markets, ~2% of technology companies have created ~100% of net wealth
- On average, 2 technology 'ten-baggers' (stocks that rise 1,000%) go public each year

Source: Morgan Stanley Technology IPO Yearbook.

Internet Highlights...

- **Users / Usage** — Yahoo! has base of 418MM+ unique monthly visitors (+19% Y/Y with 24% Y/Y page view growth, CQ3)
- **Customer Acquisition** — Google (500K - 1MM advertisers / vendors, and rising); 30%+ clicks (and rising) on sponsored links - effective targeting should continue to improve + drive rising monetization
- **Commerce / Payments** — PayPal (123MM accounts, +41% Y/Y, CQ3) + Shopping.com has 40MM+ products in 325+ categories

...Internet Highlights...

- **Advertising** — 8% of total US advertising online in 2006E growing to estimated 13%+ within 5 years - Google + Yahoo! = key drivers + beneficiaries
- **Significant targeting / conversion improvements** (related to technology improvements + data leverage) — could bolster annual global revenue per unique user of \$9 for Google (+42% Y/Y) and \$10 for Yahoo! (+29% Y/Y) 2-3x in next 5 years
- **Personalization** — Recommendation engines improve monetization – examples include Amazon.com + Yahoo! Music

...Internet Highlights...

- **Communications / Telephony** — Skype (136MM registered users, +20% Q/Q, CQ3 — may be fastest growing product in history). Based on CQ1 data, Skype traffic = ~7% of global international long distance minutes. Global mobile data services revenue (ex. messaging) has \$10 ARPU (and rising). If Skype were a carrier, global registered user level would rank it #3 behind China Mobile (274MM subscribers) and Vodafone (187MM). IM (instant messaging) + SMS / MMS showing strong growth
- **Video** — ~60% of Internet traffic may be P2P file sharing of unmonetized video — ramp in tagging (for search) + partnerships + monetization – note recent moves by likes of ABC / CBS / FOX / NBA / Sony / Warner / Universal / Google / Yahoo!. Challenges (especially related to copyright and infrastructure stress) are significant, but over time, consumer demand should rule and content creators should benefit

...Internet Highlights

- **Local** — Google 'Long Tail' + eBay Classifieds (19MM+ unique visitors, +140% Y/Y, CQ2) – traction emerging
- **Community / Social Media** — Likes of Wikipedia, MySpace, YouTube, Yahoo! Flickr + Yahoo! Answers have experienced extraordinary growth. CyWorld (Korea) + TenCent (China) monetizing. 57MM blogs – doubling every 7 months, per Technorati. 1B camera-enabled mobiles within 1 year – 'citizen journalism' in infancy
- **Mobile** — While 17% of global Internet users (32% in N. America) have residential broadband, 8% of global mobile phone subscribers use 3G. American Idol - 63MM votes (via mobiles + Internet) in final 4-hour round, China's Super Girl - 12MM votes (primarily mobiles) in final 3-hour round. Mobile data services (bolstered by 2.5G & ex. messaging) revenue ~\$20B, comparable to online advertising revenue — illustrates potential monetization opportunity for broadband Internet!

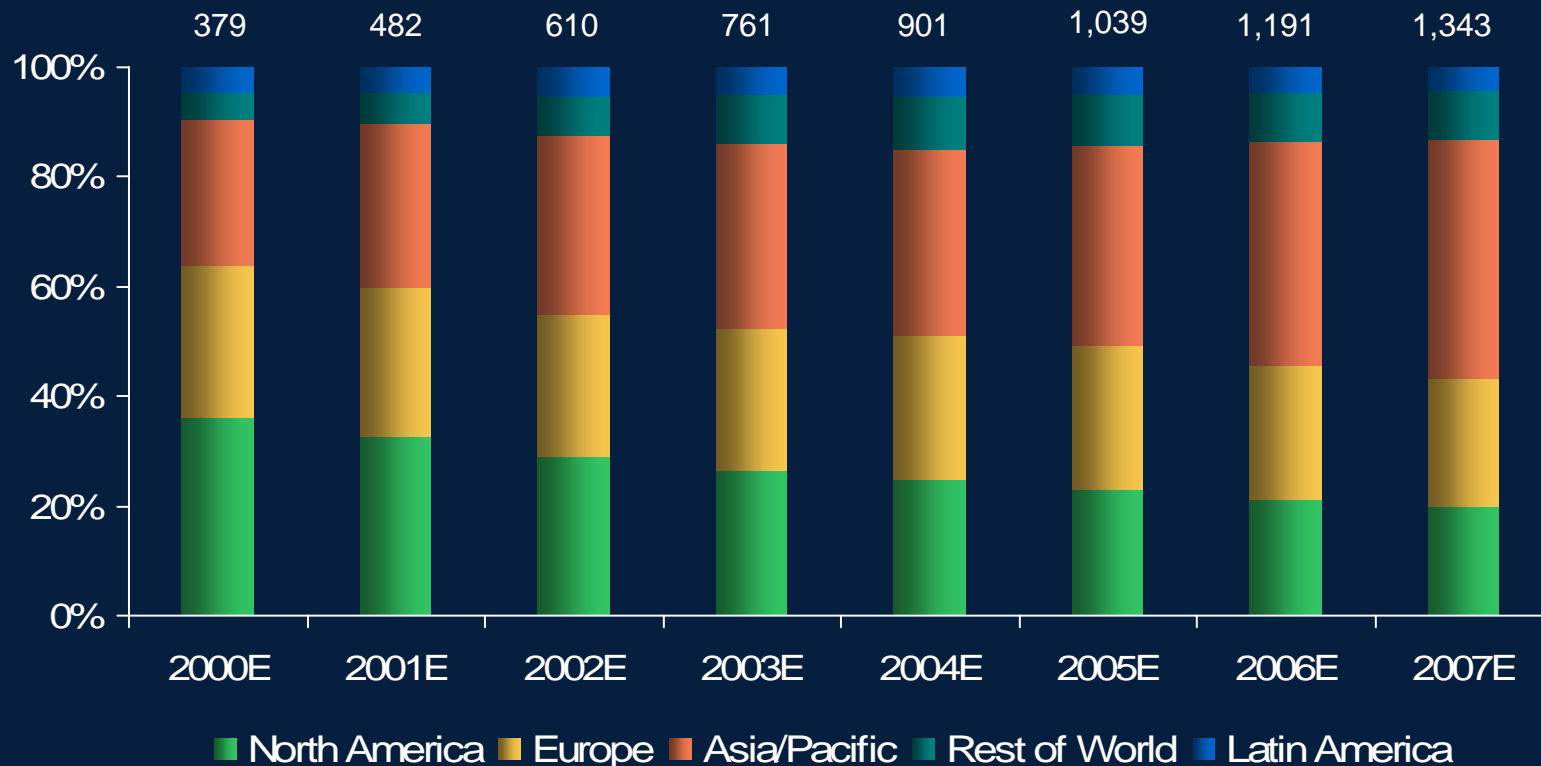
User-Generated Content (UGC) - Wikipedia + MySpace + YouTube Have Moved to Top of Internet User Pack

Rank	Property	Total Global Unique Visitors (MM)	
		9/06	Y/Y Growth
1	Microsoft	505	5%
2	Yahoo!	481	8
3	Google	467	11
4	eBay	237	4
5	Time Warner	218	20
6	Wikipedia	155	110
7	Amazon	134	9
8	Fox	118	303
9	Ask	113	(0)
10	Adobe	95	5
11	Apple	95	38
12	Lycos	91	(3)
13	CNET	84	(10)
14	YouTube	81	2,662
15	Viacom	66	--

Source: comScore Media Metrix Global Data.

of Users – ROW Continues to Rise in Relevance N. America @ 36% of Users in 2000E; 20% in 2007E

Geographic Distribution of Internet Users (MM)



Note: ROW denotes rest of the world.
Source: Morgan Stanley Research.

China / India / Russia = Will Likely Continue to Make Impressive TMT Gains

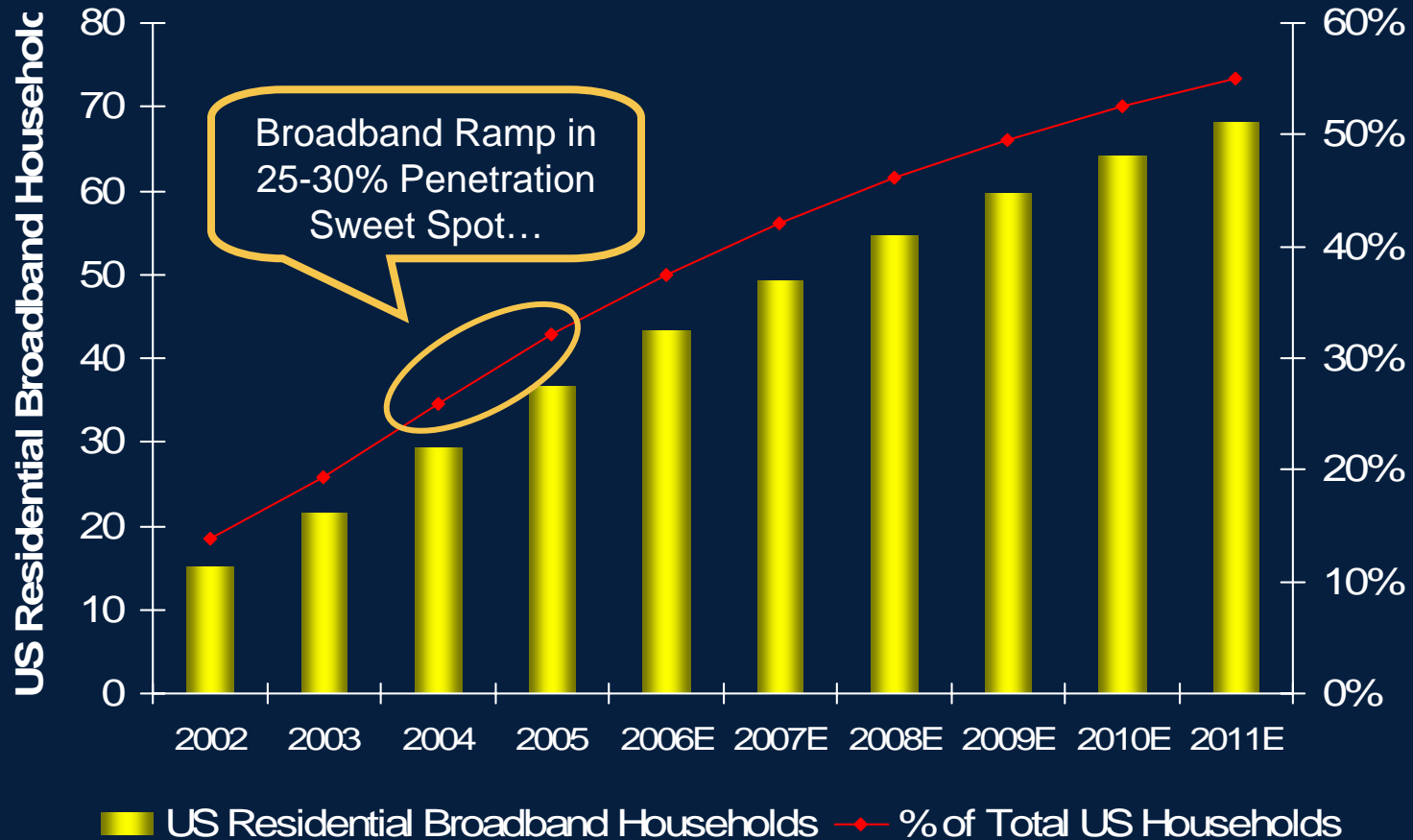
2004			2010E		
Rank	Country	Relative Weighting	Rank	Country	Relative Weighting
1	USA	9.0	1	China	8.7
2	China	8.2	2	USA	7.7
3	Japan	6.5	3	India	7.0
4	Germany	5.7	4	Japan	5.9
5	United Kingdom	5.5	5	Germany	5.3
6	India	5.3	6	United Kingdom	5.2
7	France	5.2	7	Russia	5.2
8	Italy	5.2	8	France	5.1
9	South Korea	5.1	9	Brazil	5.1
10	Canada	5.1	10	South Korea	5.0

From our database on market sizing of global TMT (Technology, Media & Telecommunications) products and services. We measure market sizes and growth rates for core TMT metrics: nominal GDP per capita (current USD); telephone lines; cable subscribers; installed PCs; mobile phones in use; Internet users and credit/debit cards in use. For each economy, we calculate past / present / potential global market weightings across seven TMT metrics - we call this our relative weighting and we use it to measure / rank a country's propensity for TMT products and services. We do this for the 50 most important economies based on purchasing power/economic strength, as measured in terms of population size, land mass and GDP per capita. We standardized each country's position in the global market in each category and adjusted the values to reflect a positive scale. The relative ratings and ranks were determined by calculating an average of z-scores across categories. For example, in the United States, standardized and adjusted values of 6.4 in GDP per capita, 8.4 in telephone lines, 11.3 in installed PCs, 7.6 in mobile subscribers, 8.9 in cable subscribers, 10.7 in Internet users, and 9.6 in credit/debit cards produces a relative weighting of 9.0. 2010E relative weightings derived by assuming 2003-2004 growth CAGR for each category to 2010, and ensuring category penetrations were not exceeded.

Source: Morgan Stanley Research.

Red indicates countries moving out of the top 10 TMT countries; green indicates countries moving into the top 10. GDP figures from IMF, shown in constant USD

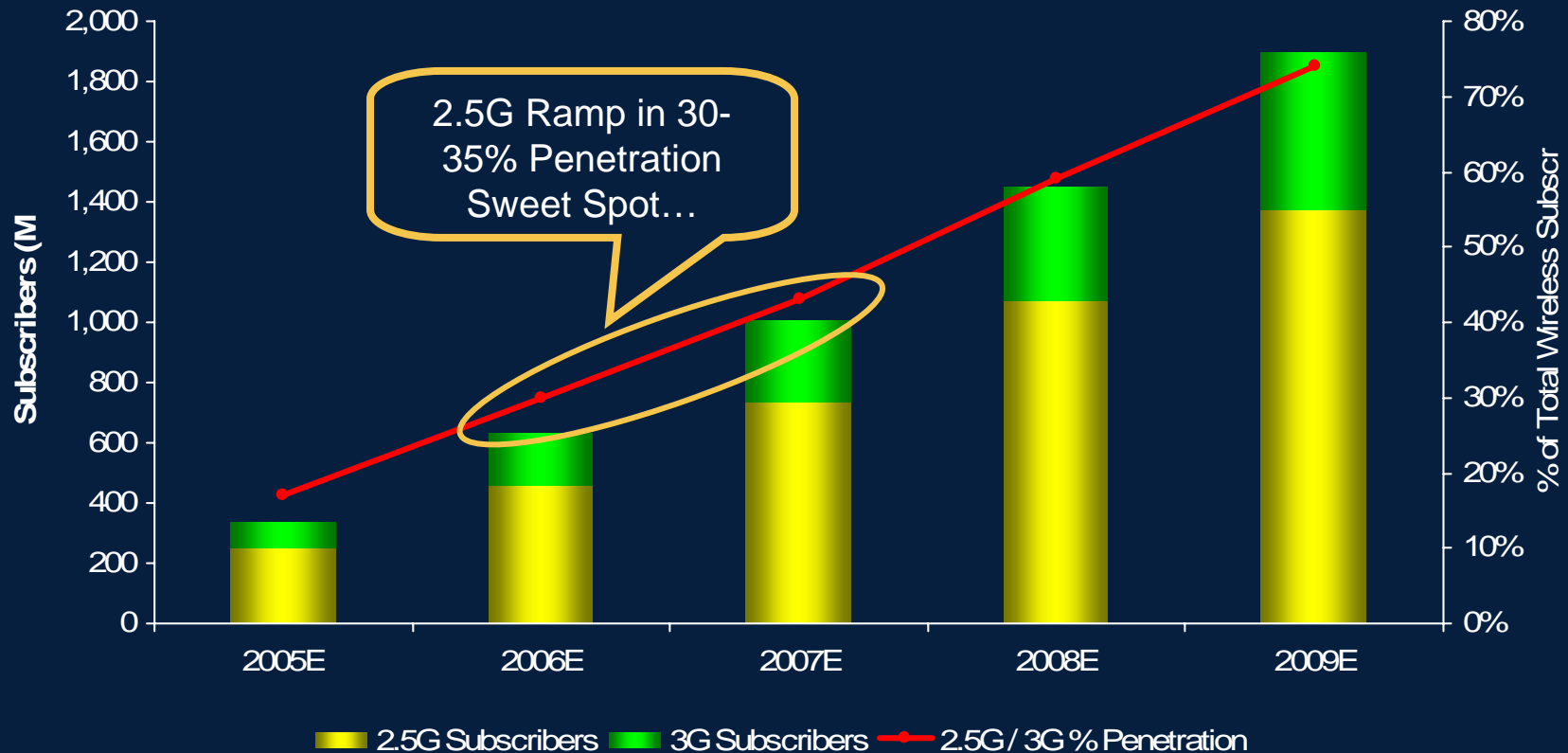
Broadband (“Always On”) – In Adoption Sweet Spot (25-50% Penetration)



Source: Morgan Stanley Research.

Mobile – Entering Adoption Sweet Spot – Key to Differentiate 2.5 vs. 3G

Global 2.5G / 3G Penetration



Note: 2.5G can be compared to 'narrowband' Internet access, while 3G can be compared to 'broadband / lite' Internet access.

Source: Morgan Stanley Telecom Research Scott Coleman, John Marchetti.

Global Internet Thesis

10-15% user growth

20-30% usage growth

30%+ monetization growth

Online Text / Music / Video – Paths to Monetization

TEXT



MUSIC / VIDEO



U.S. Internet Advertising – Search Has Been Growth Engine (Largely Related to Text) – Video Next?

(US\$ in MM, except where noted)

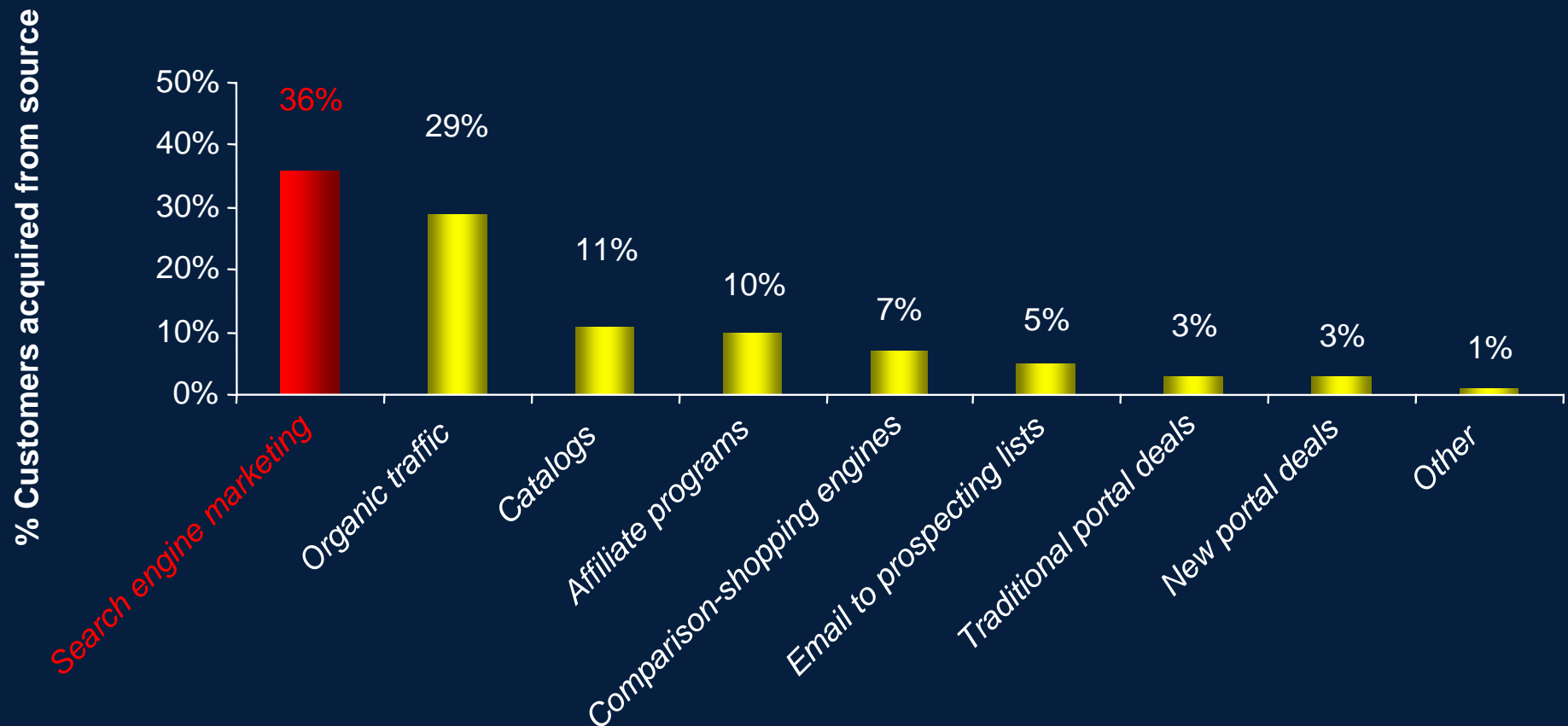
	2001E	2006E	CAGR '01E-06E
Search Advertising	\$285	\$6,681	88%
<i>% of Total</i>	4%	42%	
Display and Sponsorship	\$4,423	\$4,108	(1)
<i>% of Total</i>	62%	26%	
Rich Media	\$357	\$1,123	26
<i>% of Total</i>	5%	7%	
Classifieds	\$1,141	\$2,587	18
<i>% of Total</i>	16%	16%	
E-mail and Other	\$927	\$1,498	10
<i>% of Total</i>	13%	9%	
Total U.S. Internet Spending	\$7,134	\$15,998	18
U.S. Internet Users (MM)	141	205	8
U.S. Internet Households (MM)	51	73	8
U.S. Internet Spending per Internet Household	\$140	\$218	9

Source: Internet Advertising Bureau and Morgan Stanley Research estimates.

67% of Global Internet Users Use Search

Search = Top Customer Acquisition Tool for Online Retailers

% of New Online Customers for Online Retailers / Marketing Spend Mix (2005)



Note: 8% of global Internet traffic was derived from search while 67% of global Internet users used search in 1H2006, per comScore.

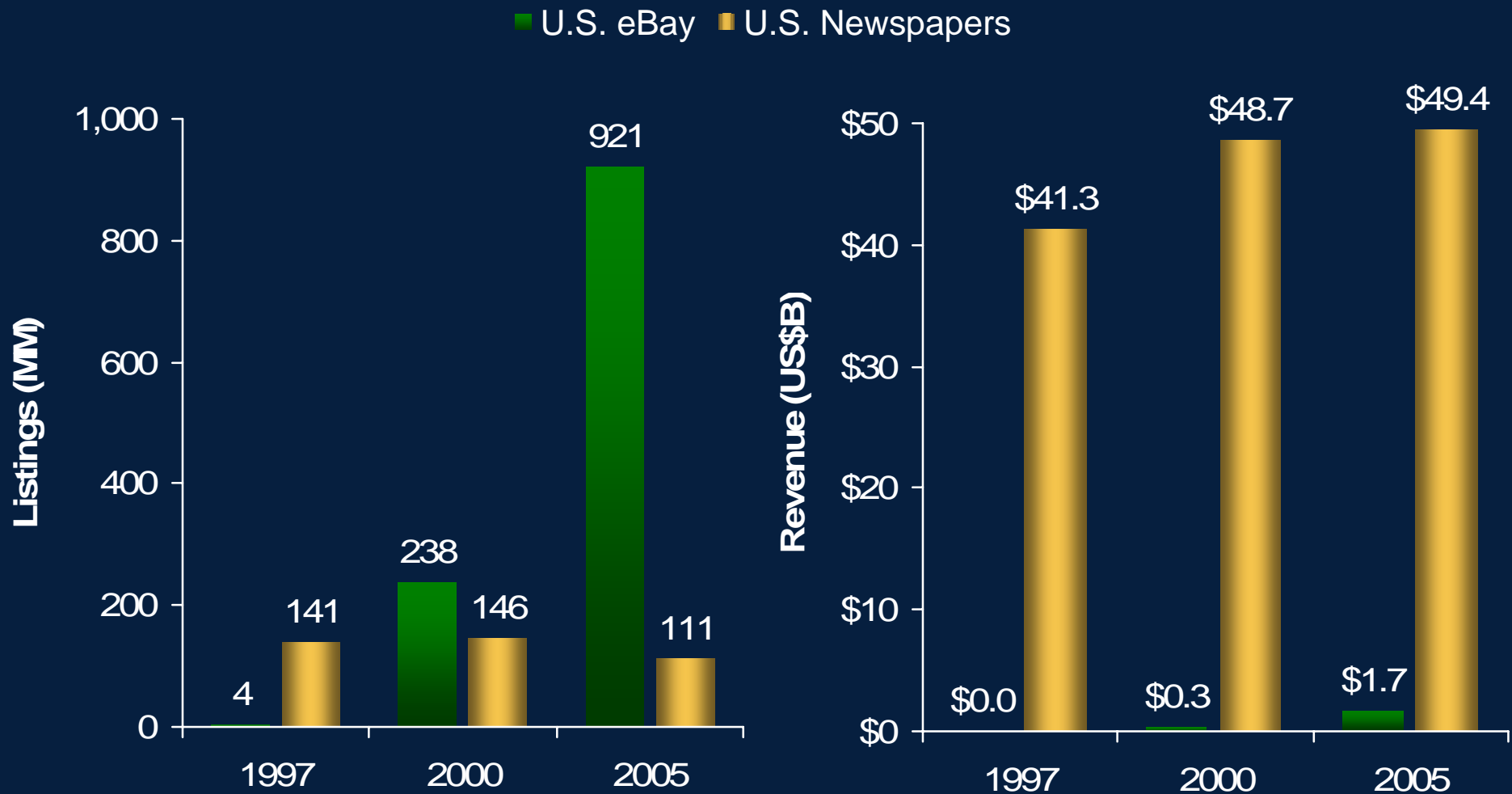
Source: The State of Retailing Online 2006, Forrester Research.

Internet Ad Spend = Movin' on Up - \$217 Per Home vs. \$980 for Newspapers?

Medium	2005 Advertising Spending (\$B)	Households (MM)	Ad Spending / Household (\$)
Promotions	\$106	99	\$1,071
Newspapers	49	50	980
Classifieds	17	55	309
Direct Telephone	97	99	980
Direct Mail	57	99	576
Broadcast TV	45	99	455
Radio	20	60	333
Cable TV	19	70	271
Internet / Online	13 ↑	60 ↑	217 ↑
Yellow Pages	16	99	162
Outdoor	6	99	61
Total	\$428	834	\$5,106
Average	43	83	511

Morgan Stanley Research, PricewaterhouseCoopers, IAB, Jupiter Research, McCann-Erickson, RAB; Newspapers include Classifieds. Promotions (\$106B) include: incentives (\$28B), promotional products (\$23B), point-of-purchase (\$18B), specialty printing (\$8B), coupons (\$7B), premiums (\$7B), promotional licensing (\$6B), promotional fulfillment (\$5B), product sampling (\$2B), and in-store marketing (\$2B). Households may use multiple advertising mediums.

Over 9 Years, Ratio of eBay US Listings to Newspaper Classifieds
 Moved from 1:35 to 9:1 –
 But Related Newspaper Revenue Still Outpaces eBay 25:1!?

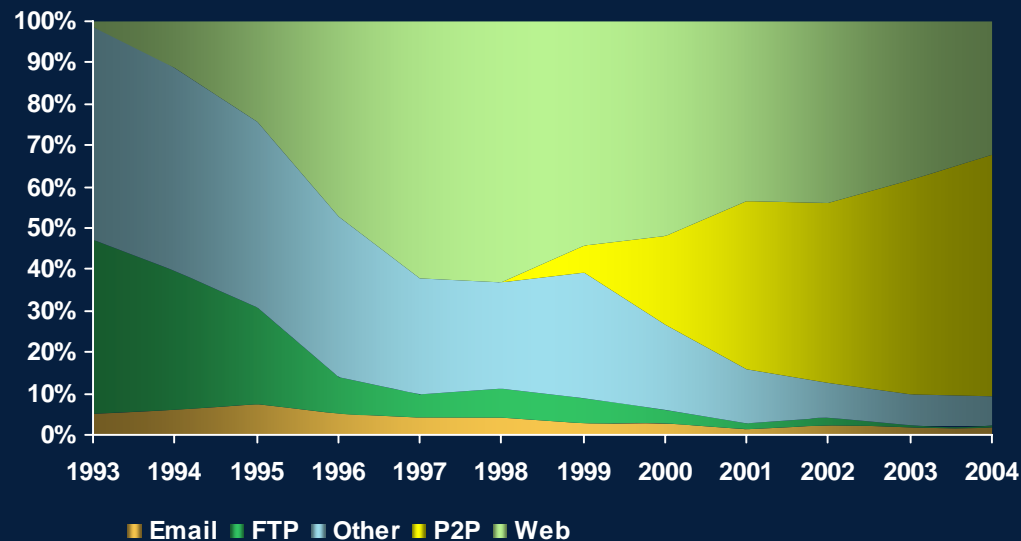


*Note: eBay (One Website) vs. All U.S. Newspapers (1,468 Dailies) Annual Classified Ads (MM).
 U.S. Newspaper market size excludes online revenue. U.S. eBay revenue shown excludes classifieds revenue such as Craigslist.
 Source: Newspaper Association of America, eBay, Morgan Stanley Research.*

Rapid P2P Growth (Mostly Video) is Stressing Internet + Is Undermonetized

- Peer-to-Peer (P2P) traffic was 60% (and rising) of Internet traffic in 2004, with BitTorrent accounting for 30% of traffic, per CacheLogic
- “P2P affects Quality of Service (QoS) for ALL subscribers” (1)

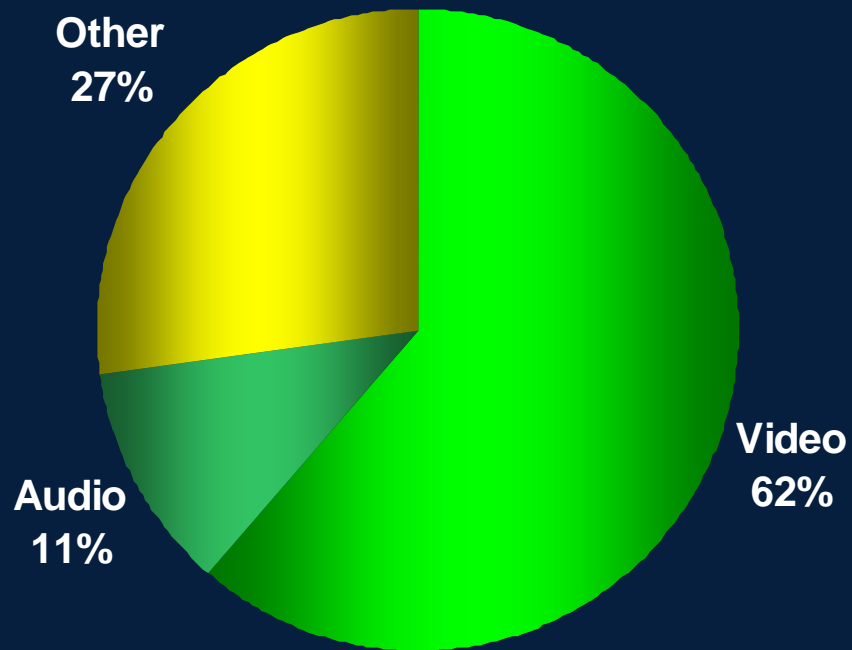
Internet Protocol Trends (1)



(1) Source: CacheLogic “P2P in 2005,” (9/05).

Video Dominates P2P

File Format Mix on 4 Major P2P Networks (1)



- Video is P2P bandwidth hog

(1) Source: CacheLogic "P2P in 2005," (9/05). Mix of file formats by volume of traffic generated over 4 main P2P networks: BitTorrent, eDonkey, FastTrack, and Gnutella. Weighted by volume of traffic on each network.

Online Video Momentum – Building and Building...

1. 10/05 – Disney / ABC and Apple to offer episodes of popular shows like *Lost* and *Desperate Housewives* available ad-free via iTunes for \$1.99 apiece
2. 10/05 – 1MM+ videos, priced at \$1.99 each, downloaded from Apple's iTunes site in less than 20 days
3. 11/05 – Comcast / CBS and DirectTV / NBC to offer on-demand TV shows for \$0.99
4. 11/05 – Cisco to acquire Scientific Atlanta for \$7B to prepare for demands of online video; expecting network traffic increases of 4-6x annually, instead of 2x gains seen in US and Europe, driven by video consumption requirements
5. 11/05 – Time Warner to stream episodes for free (supported by 2-minute blocks of 15-30-second commercials) in Jan 2006. Initial run limited to 30 series (*Wonder Woman*, *Growing Pains*, *Kung Fu...*) but TWX plans to expand to 100+ series and 300+ episodes per month
6. 11/05 – *NBC Nightly News* to air its entire broadcast on the Internet -- *NBC Nightly News Netcast with Brian Williams* will be available for free beginning at 10PM EST
7. 12/05 – NBA to digitize 60+ years of footage and post on NBA.com, beginning in 2006, with a searchable database that will include players involved and exact locations on court
8. 12/05 – CBS will offer NCAA basketball March Madness games for free in 2006, on streaming ad-supported basis
9. 12/05 – CBS offers free streaming video of 2 comedy programs *Two and a Half Men* and *How I Met Your Mother* on Yahoo! during the week of 12/27
10. 12/05 – AOL / Google to collaborate to showcase AOL's premium video service within Google Video

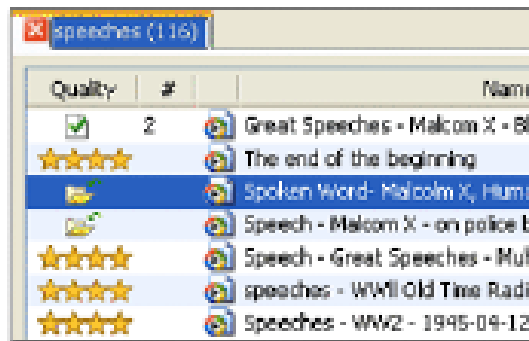
...Online Video Momentum – Building and Building

11. 1/06 – Google to offer for-pay video over Internet from likes of CBS and NBA
12. 1/06 – DirectTV / FOX to offer on-demand TV shows for \$0.99 and pre-air shows for \$2.99
13. 3/06 – Cingular to offer on-demand video service for 3G mobile phones for \$20 a month
14. 4/06 – Disney to offer many TV shows for free anytime on the web
15. 5/06 – Italy to get mobile TV in time for World Cup. Service offered by Mediaset and Europa TV
16. 6/06 – Yahoo Video hosts video uploads and allows users to search videos on other sites
17. 7/06 – A&E's History Channel UK makes appearance on audio / video search engine Blinkx
18. 7/06 – Amazon to open online movie store
19. 7/06 – Warner Bros. Entertainment to sell studio shows on iTunes
20. 8/06 – AOL opens video portal
21. 8/06 – Google and Viacom sign video distribution deal
22. 9/06 – Amazon launches Amazon Unbox, offering downloadable movies and TV shows
23. 9/06 – Apple to offer downloadable movies from Miramax and Walt Disney via iTunes at prices of \$9.99 - \$14.99
24. 10/06 – Microsoft to use Blinkx technology to power the video search on its MSN Internet sites and Live.com
25. 10/06 – CBS and YouTube strike strategic content and advertising partnership
26. 10/06 – Google to acquire YouTube for \$1.65B in stock
27. 10/06 – AOL and Brightcove launch distribution service for selling digital video downloads

Online Video – It's Getting Tagged / Findable / Easy to Search!

LimeWire 4.10

The Fastest P2P File Sharing Program on the Planet



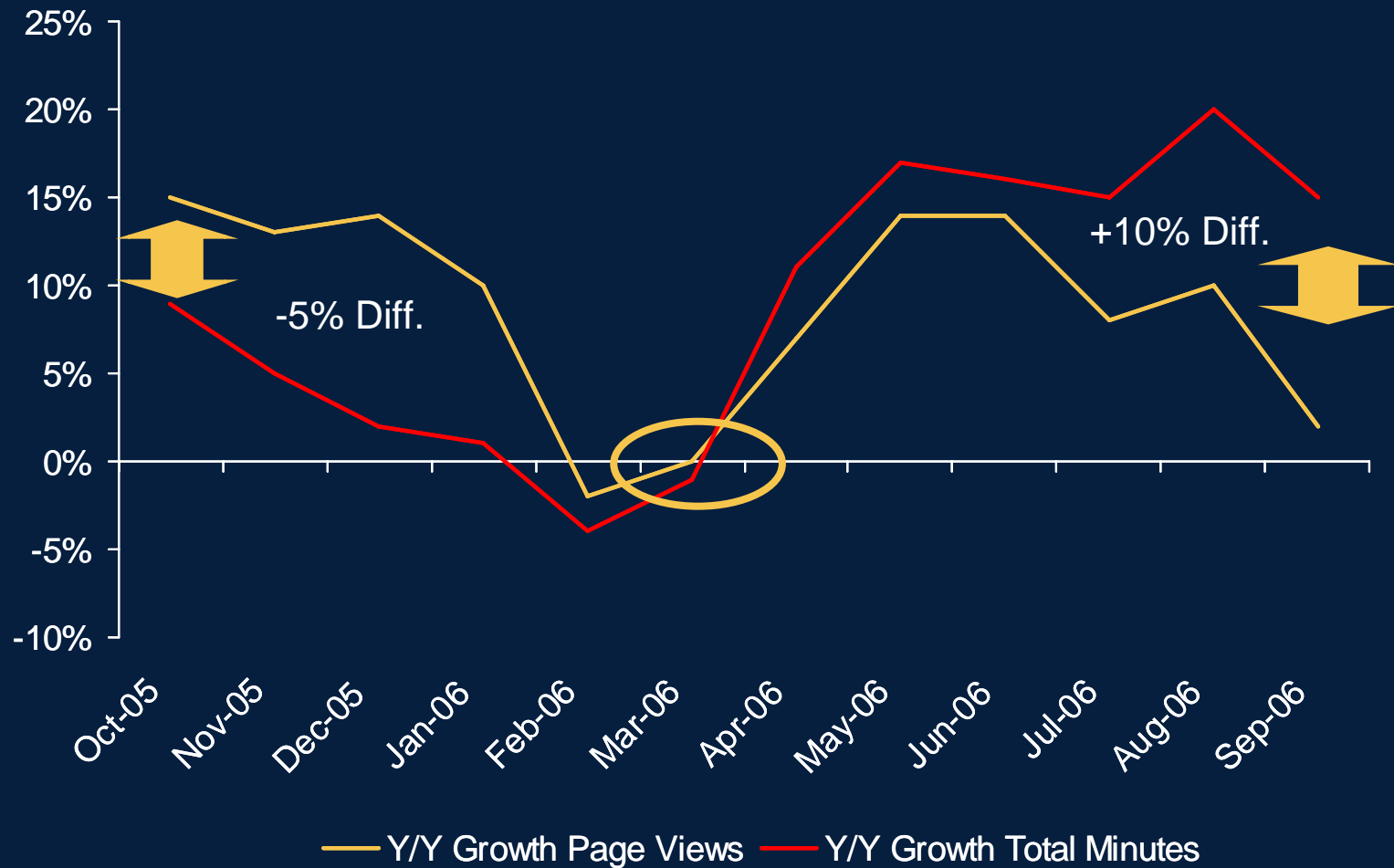
- + Guaranteed clean install with no bundled software
- + Windows- and Mac-compatible
- + Firewall-to-firewall transfers
- + Cleaner, updated interface with new icons
- + Proxy support

[Get It Now](#)

You also get:

- Ease of use - just install, run, and search
- Ability to search by artist, title, genre, or other metainformation
- Elegant multiple search tabbed interface
- "Swarm" downloads from multiple hosts help you get files faster
- iTunes integration for Mac and Windows users
- Unique "ultrapeer" technology reduces bandwidth requirements for most users
- Integrated chat
- Directly connect to a computer
- Browse host feature—even works through firewalls
- Added Bitzi metadata lookup
- International versions: Now available in many new languages

Minutes Growth Outstripping Page View Growth – Video Usage?



Source: comScore Media Metrix Global Data.

Power of the Door...

Sometimes you know what you are looking for and sometimes you don't - editing / organizing can help...

Selectively placed on Yahoo!'s front page / door

THE 9 is a daily broadcast on Yahoo! TV, showcasing **9** daily selections from **millions** of Web content files

The screenshot shows the Yahoo! TV interface for 'THE 9'. At the top, it says 'YAHOO! TV' with 'Sign In' and 'New User? Sign Up' links. Below that, it says 'THE 9 BETA' and 'Refreshed Daily By PEPSI'. The date is 'September 2006' and the day is 'Fri 8'. The main content is a video player showing a woman (Maria Sansone) with a large '1' overlaid on the screen. To the right of the video is a list of 9 items, each with a number and a link to the content. The items are: 9. Pass the NFL Game Pass, Please; 8. Lohan was Robbed!; 7. When Cockroach Attacks; 6. The Color Purple; 5. Zipline-A-Dee-Doo-Dah; 4. Art You Kidding?; 3. Affleck's Back!; 2. Sleep Soundly; 1. Hey Kids! It's Baby Goats! At the bottom right of the list is a 'SHARE THIS PAGE' button.

Exclusive sponsorship by Pepsi

THE 9 features the 9 "best, weirdest, and funniest videos, photos, and stories" on the Web

"The best Video Blog"
"One of the 50 coolest websites of 2006" – TIME Magazine (8/06)

Vlog host:
Maria Sansone

Morgan Stanley

...Power of the Door

UGC + User Participation + Social Networking + Monetization

Watch video clips from previous "THE 9"s

THE 9 Archives

Week of August 28 - September 1

Monday August 28th
9. The Emmys and the Dundies
8. Get on the Stick!
7. Break My Heart, Ruin My Music
[More >>](#)

Tuesday August 29th
9. J. Simp's Public Laryngitis
8. Make Every Day Mascot Monday!
7. I Have a Frequently Asked Question
[More >>](#)

Wednesday August 30th
9. 7-Year-Old Uses His Head
8. About Face Drawing
7. Dial Up the Pay Phone Project
[More >>](#)

Thursday August 31st
9. Grooving in the Galaxy
8. Outlandish TV
7. J. Simp Exclusive!
[More >>](#)

Friday September 1st
9. VMAAAAA!!!!!!
8. The Circle of Life
7. Eight-Legged Dogs
[More >>](#)


THE 9 Poll


Today's Show: September 8th
Let us know your favorite story from today's episode of THE 9.

- 9. Pass the NFL Game Pass, Please
- 8. Lohan Loses It!
- 7. When Cockroach Attacks
- 6. The Color Purple
- 5. Zipline-A-Dee-Doo-Dah
- 4. Art You Kidding?
- 3. Affleck's Back!
- 2. Sleep Soundly
- 1. Hey Kids! It's Baby Goats!


VOTE

Get More

 **Meet Maria Sansone**
Everything you want to know about Maria on Yahoo! 360
[More >>](#)

NINE ALERTS
Get an alert when there's a new 9 

Pepsi 10th



What did we miss?


Know of something that belongs in THE 9 but don't see it here? Let us know and come back daily to see if your link has made the cut as the Pepsi 10th.

Your name Your email address

The URL*

What it is (30 word max)*

*Required



Interactive - Online voting + user participation

Utilizes Yahoo! 360 as social networking tool

Video – Key Question

In 3 years, what % of content used on Web will be...

- Amateur
- Professional
- Semi-professional
- Combinations (mashups) of above?

Monetizing Video – Keywords + Adjacent Sponsorships – Do Users Really Want 30 Second Pre-Rolls?

Tags

[pets](#)

[dog](#)



[nike](#)

[tiger](#)



Branding + Interactivity – Think About “Enter Sweepstakes” –
Free Month of Puppy Chow... 18 Holes with Tiger...

Compelling Audio Search Technology Exists



The screenshot displays the 'video now' search interface. At the top left is the 'video now' logo. Below it, a search bar contains the text 'Aquarium' and a 'GO' button. To the right of the search bar is a 'help' icon. Below the search bar are three radio buttons for filtering results: 'latest', 'last 7 days' (which is selected), and 'last 30 days'. At the bottom left of the interface, it says 'POWERED BY NEXIDIA'. On the right side, there are two tabs: 'LATEST VIDEO' and 'MOST POPULAR'. Below these tabs is a list of search results:

- Police are eager to get a man off the streets who they say has been **terrorizing women** at a **Gwinnett County park**
- Authorities on the scene of a southwest Atlanta **apartment fire** discover a body
- Douglasville investigators collect more evidence in the **murder of a 71 year old woman**

Source: Nexidia.

Monetizing Audio – Apple iPods + iTunes = \$16B, up from \$141MM 3 Years Ago

	CQ2:03E	CQ3:06E
Cumulative iPod Units Sold	972K	68MM
Cumulative iPod Revenue	\$136MM	\$14B
Cumulative iTunes Songs / Videos Downloaded	6MM	1.7B
Cumulative iTunes Songs / Videos Revenue	\$5MM	\$1.8B

Source: Apple Computer and Morgan Stanley Research estimates.

Using Google as Benchmark for U.S. Internet Sites, Inventory Monetization Should Still Have Significant Upside

	Unique Users (000s)	Total Pages Viewed (MM)	Total Minutes (MM)	CQ2E Annualized US Ad Rev. per User
Total Internet	173,428	462,186	310,466	\$31.44
<i>Y/Y Growth</i>	<i>2%</i>	<i>2%</i>	<i>15%</i>	<i>--</i>
Google	107,365	10,264	5,232	\$12.28*
<i>Y/Y Growth</i>	<i>23%</i>	<i>62%</i>	<i>80%</i>	<i>--</i>
Yahoo!	129,724	39,878	42,715	\$8.65*
<i>Y/Y Growth</i>	<i>5%</i>	<i>-9%</i>	<i>25%</i>	<i>--</i>
Microsoft	119,376	18,721	22,125	\$3.25
<i>Y/Y Growth</i>	<i>4%</i>	<i>-14%</i>	<i>0%</i>	<i>--</i>
Time Warner	120,276	18,000	36,106	\$1.62
<i>Y/Y Growth</i>	<i>1%</i>	<i>-43%</i>	<i>-6%</i>	<i>--</i>
MySpace	55,849	34,988	11,503	\$1.32
<i>Y/Y Growth</i>	<i>158%</i>	<i>263%</i>	<i>634%</i>	<i>--</i>
eBay	78,991	10,972	6,480	\$0.33
<i>Y/Y Growth</i>	<i>13%</i>	<i>1%</i>	<i>-7%</i>	<i>--</i>
YouTube	20,759	1,326	1,047	<\$1.00*
<i>Y/Y Growth</i>	<i>--</i>	<i>--</i>	<i>--</i>	<i>--</i>

* Denotes net revenue estimates.

Source: comScore Media Metrix (9/06) and Morgan Stanley Research estimates.

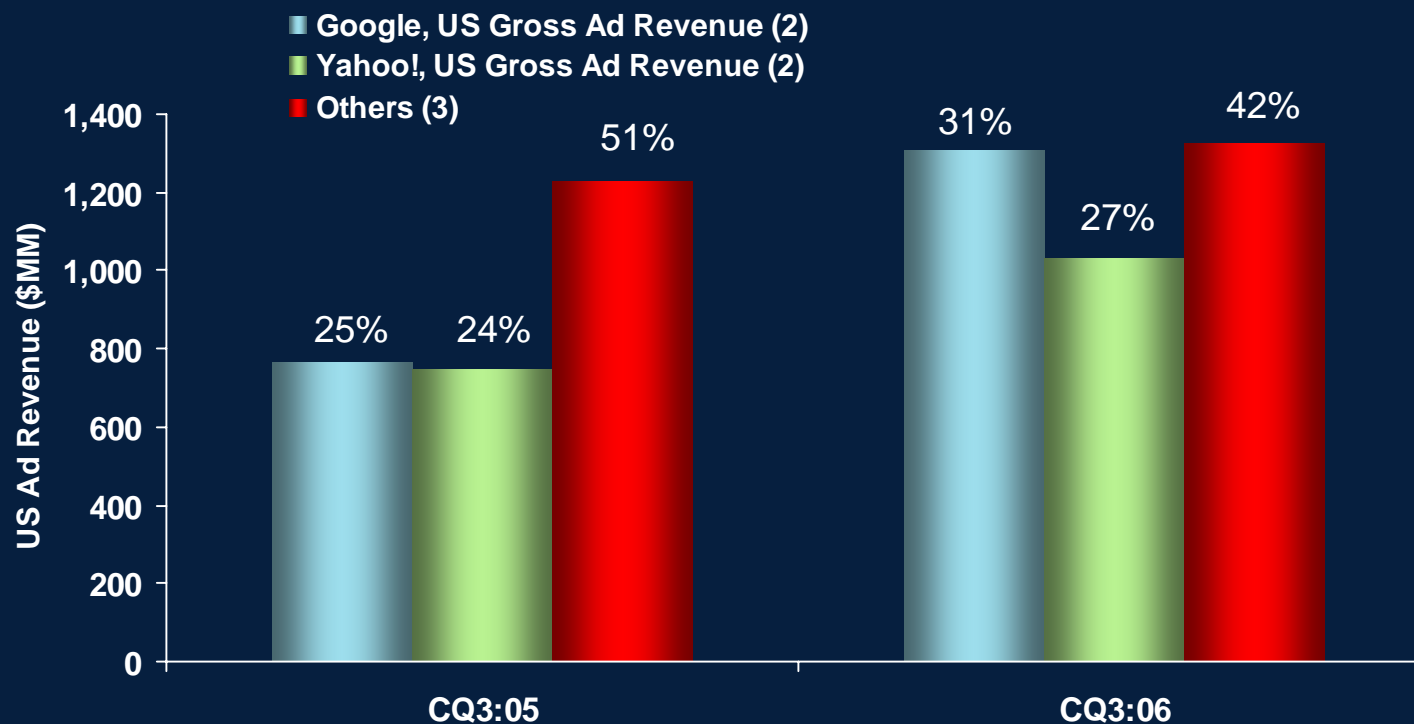
Only 13% of Top 15 Online Retailers are Internet Pure-Plays – What About Media?

Rank	Company	2005 Online Global Sales (US\$MM)	2005 Online Global Sales as % of Total Sales
1	Amazon.com	\$8,490	100%
2	Office Depot	3,800	27
3	Staples	3,800	24
4	Dell	3,779 *	7
5	HP Home & Home Office	2,829 *	3
6	OfficeMax	2,567	28
7	Sears Holdings	2,160 *	4
8	CDW	1,769	28
9	SonyStyle.com	1,625 *	2
10	Newegg.com	1,300	100
11	Best Buy	1,267 *	4
12	Wal-Mart	1,050 *	0.3
13	J.C. Penney	1,039	6
14	QVC	1,017	16
15	Apple Computer	901 *	7

* Denotes 'Internet Retailer' estimate.
Source: Internet Retailer Report (2006).

Google + Yahoo! = ~58% of US Online Ad Revenue

US Online Ad Revenue Mix (1)



(1) Source: Ad revenue totals from IAB/PriceWaterhouseCoopers Interactive Advertising reports.

(2) Calculated as reported revenue multiplied by the reported percentage of US Ad Revenue.

(3) Calculated as the difference between total IAB US revenue and the sum of Google, Yahoo! gross revenue.

(4) Assuming that TAC of Google and Yahoo! was included in others total, this segment would have been up 20% Y/Y.

Google + Yahoo! Share Significant (~30%) Portion of Revenue with Partners + Affiliates – Trend Will Continue

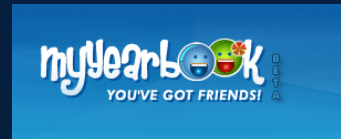
- Google generated \$2.7B in gross revenue in CQ3; it **PAID OUT** \$825MM to thousands of partners like AOL, Ask Jeeves, Blogger, EarthLink, and HowStuffWorks
- Yahoo! generated \$1.6B in gross revenue in CQ3; it **PAID OUT** an estimated \$459MM to thousands of partners like CNN, ESPN and *The Wall Street Journal*

Watch Where Global Younger Generation Goes

Ringtone Downloads, Connecting Mobiles to Net



Social Networking



Video



Web OS Programs



In-Game Advertising



Community / UGC / Personalization are Key...

Yahoo! Movie Reviews

The Critics:
B+
15 reviews

Yahoo! Users:
A-
15281 ratings

Tencent Instant Messaging (PC / Mobile)

Social Networking / Tagging

eBay Feedback Ratings

Seller information

[selling2u-half](#) (256 ★)

Feedback Score: 256
Positive Feedback: 96.0%
Member since Nov-15-01 in United States

Amazon Recommendation Engine

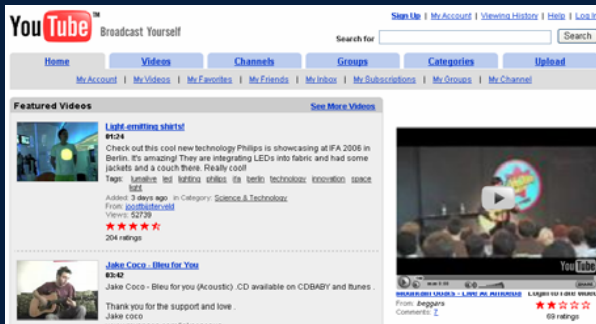
Customers who bought items like this also bought

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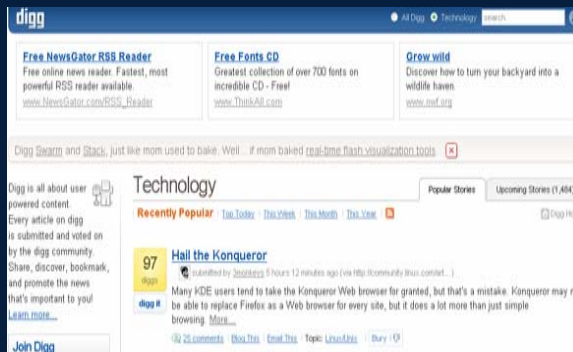
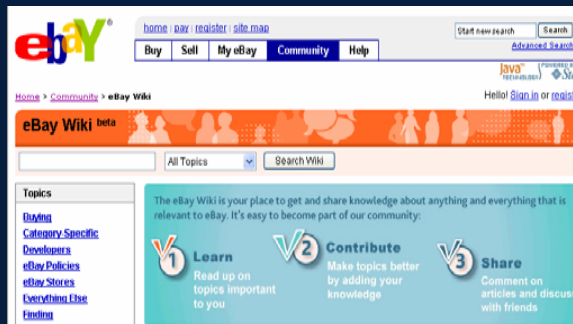
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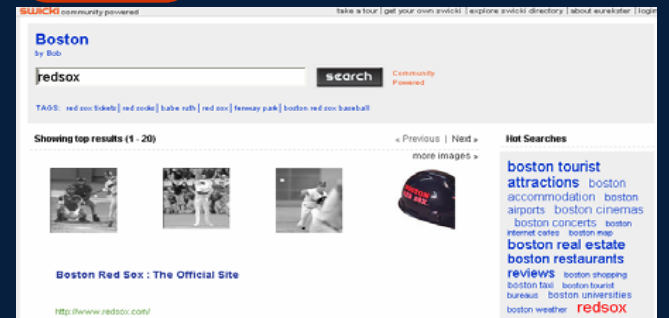
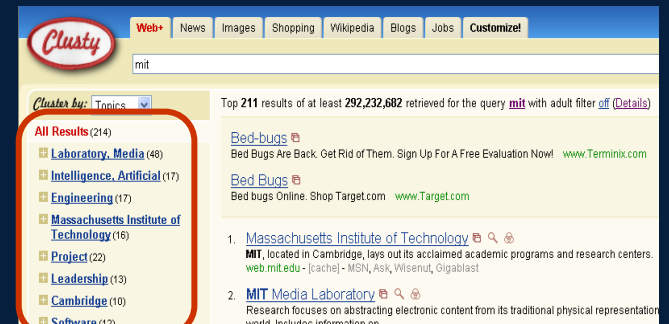
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Total	2,081		694		

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