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Piper Jaffray & Co.

Reason for Report:
Industry Overview

| Related Companies: | Share Price: |
|--------------------|--------------|
| AKAM | 57.31 |
| AMZN | 41.26 |
| AAPL | 89.20 |
| AQNT | 27.80 |
| CNET | 9.24 |
| DRIV | 57.65 |
| EBAY | 33.50 |
| EXPE | 22.35 |
| FMCN | 83.43 |
| FTD | 20.31 |
| GOOG | 475.86 |
| GSIC | 20.10 |
| GYI | 56.06 |
| HRAY | 6.22 |
| IACI | 40.26 |
| INSP | 23.15 |
| JUPM | 10.07 |
| LOOK | 4.60 |
| BIDU | 107.01 |
| MCHX | 13.80 |
| MOVE | 6.46 |
| NFLX | 23.39 |
| NILE | 39.19 |
| NTES | 21.18 |
| OMTR | 14.94 |
| OSTK | 18.64 |
| PCLN | 54.16 |
| RNWK | 8.54 |
| SINA | 35.89 |
| SOHU | 24.24 |
| SOLD | 5.81 |
| TFSM | 10.00 |
| UNTD | 13.66 |
| VCLK | 26.47 |
| WSSI | 13.82 |
| YHOO | 31.65 |
| MNST | 54.00 |
| MSFT | 29.35 |

Technology

The User Revolution: The New Advertising Ecosystem

KEY POINTS: Today we published a comprehensive report entitled "**The User Revolution: The New Advertising Ecosystem and The Rise of the Internet as a Mass Medium.**" In our 400+ page report, we have identified several key findings. **We expect global online advertising revenue to reach \$81.1 billion by 2011**, representing a 21% CAGR (2006-2011).

- **The User Revolution.** The advertising world is going through a revolution, one that we call the "User Revolution" as it is happening primarily with the consumers, who are taking control of content consumption and branding. We believe this trend will cause a significant rise in prominence of the Internet as a major content consumption and marketing medium.
- **"Communitainment."** The Internet has increasingly become a principal medium for *community, communication, and entertainment*—three areas that have collided together and are impacting each other's growth—generating a new type of activity that we call *communitainment*.
- **The Internet Is Mainstream.** The Internet has become a mainstream media outlet that now rivals traditional media for reach and advertising dollars.
- **Media Fragmentation.** The proliferation of online and offline media outlets has resulted in shrinking television audiences and an increasingly fragmented media landscape.
- **The Golden Search.** We believe search continues to gain ground, driven by the rise of search as the New Portal, the increasing use of search in branding campaigns, and the local search opportunity.
- We believe **Google's** wide variety of non-search-related products creates a virtuous cycle of brand affinity that drives incremental search volume.
- **Video Ads Could Drive The Next Wave.** We believe Internet video ads could become a game changer for large brand advertisers, who are used to the 15- or 30-second TV commercial.
- **Internet Usage Patterns Are Changing.** Portals maintain the highest reach, but the fastest growing category of destinations is communitainment sites such as MySpace and Facebook.
- **Ad networks** are experiencing increased demand due to increasing Internet fragmentation, desire for more targeted inventory, increasing usage of networks for branding, and increased site visibility.
- **Agencies** are rapidly evolving into more sophisticated, technology-savvy entities that combine best of breed offerings.
- **Watch These Companies.** We expect companies such as Google (and YouTube), Yahoo!, Disney, News Corp., Time Warner, Microsoft, InterActive, Facebook, Craigslist, Brightcove, Yelp, SINA Corp., Baidu, aQuantive, ValueClick, 24/7 Media, Netflix, Wikipedia, MobiTV, Digg, and Hakia to be the most important players to watch.
- **Conference Call.** We will be hosting a conference call on Tuesday, February 27 to discuss the main findings from our report. **Please contact your Piper Jaffray Account Executive for a copy of the full "User Revolution" industry report and for information about the conference call.**

See the following pages for the executive summary and a picture of the new media world order.

RISKS

Risks include a slowdown in advertising spending, migration to eCommerce, or failure to monetize users, which could result in significant valuation declines.

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Executive Summary

Birth of a New Era In Advertising. We are living through pivotal times in the advertising world, which is marked by the end of one era—the golden age of advertising that began after the end of World War II—and the beginning of a new era. This new era can also be termed a golden age, but not necessarily for the advertiser. It is the golden era for consumers, and it is already impacting advertising far more profoundly than any other development over the last 50 years. These changes are driven by what we call the User Revolution. Like many major social trends, the changes will not happen overnight, and we expect the User Revolution, which has just begun, to last several years before the new regime is fully established and the old statues have all been toppled.

Five-Year Growth Estimates For Internet Advertising: Over 20% CAGR. For the Internet sector, the new era is a welcome change as the Internet's most important characteristics, flexibility and user control, are also the hallmarks of the User Revolution. (In fact, the Web been a major instigator of this user uprising.) As such, we believe the Internet will assume a premium position in the new regime of media consumption. This is in part why we believe our new estimates for global online ad spending may prove overly conservative. We estimate a 20% CAGR over the next five years, far outpacing all other major sectors of media and advertising. We believe global online ad spending, now around \$32 billion (in 2006), will exceed \$80 billion by 2011. We note that every year for the past three years, we have had to increase our estimates based on the faster growth rates in the online ad sector than we had originally predicted.

The Revolution Is About Control. The uprising by the users is over control—control of the **type of content** users want, control of the **place and time** content is delivered, control of the **advertisements** that the users are willing to take, and control of the **brands** they want to create. Unlike most revolutions, where the masses revolt because of major hardship and grievances, the User Revolution was largely driven by the proliferation of media options, the emergence of the Internet, and the growing sophistication of consumers.

The Picture Of The Media World In The New Regime

In the new era, we expect the following:

(1) search will assume an even more central role; (2) the distinction between traditional and new media will disappear; (3) consumers will use an increasing and large number of Websites, TV channels, and other sources; (4) consumers will design their own content and programming, and companies that enable and encourage this will prosper; (5) social networking sites will continue to grow and potentially become the new portals; (6) users will select most products and services they buy based heavily on reviews and ratings (by other users and experts), changing the impact of traditional ways of advertising; (7) video will be the killer app of the Web, supplementing or taking over most other types of content; (8) simplicity, speed, intuitiveness, and usefulness will be the key attributes of the successful media channels; and (9) multi-tasking and multi-channel use will be the norm.

MEDIA WORLD ORDER

| Media Trends | Pre Revolution | Post Revolution |
|------------------------------|--|---|
| 1. Online vs. Offline Media | Separate, competitive | Integrated into one medium |
| 2. Media Sources | Few, large content providers | Multiple sources, vertically focused |
| 3. Content Control | Centralized—controlled by the publishers | Fragmented—controlled by the users |
| 4. Internet Content | Text-based | Video-based |
| 5. Main Navigation Method | Portals | Search |
| 6. Consumer Decision Process | Basic, largely influenced by advertising | Sophisticated, driven by reviews and rating |
| 7. Competitive Advantage | Exclusive content | Simplicity, speed, interconnectivity |
| 8. Media Consumption Pattern | Focused single channel use | Multi-channel, distributed attention |
| 9. Social Networking | Limited to few early adopters/teenagers | Mainstream/routine activity |

Source: Piper Jaffray & Co.

In this new media reality, companies will need to own or partner with many channels to be omnipresent with the users, forcing media companies to cooperate much more on standards, realizing that the user is king.

The Drivers Of The User Revolution

We have identified six major trends in the media world and the Internet that define the User Revolution. These are as follows:

- **The Emergence of Communitainment** – the combination of communication with entertainment and community
- **The Increasing Popularity of Usites** – Websites with predominantly user generated content will flourish
- **Mainstreaming of the Internet** – the Web is now a routine media channel for most demographic groups
- **Evolution of User-Generated Brands** – users are taking control of both the promotion and definition of brands
- **Declining Usage of Traditional Media** – consumers are spending less time on TV and newspapers in particular; simultaneous media usage makes traditional media less effective for the advertiser
- **Fragmentation of Content Consumption** – consumers are using an increasing number of channels both offline and online in order to get content from their "best-of-the breed" source; larger networks are losing out

Communitainment and Usites are the most serious threat to the traditional method of content consumption (online or offline) and are the hallmark of this User Revolution. For example, how does a site like Yelp merge merchant reviews and social networking to become an online phenomenon, growing from 200,000 unique visitors in February 2006 to more than 800,000 in December 2006? Similarly, where are young people getting the time to spend one to three hours a day on MySpace? On what other activities and media sources are they cutting back? Finally, why is this type of activity—combining entertainment with communication with a group of like-minded friends—so popular and does it indicate the next stage in media usage, which is going from the shared experience of the early days of network TV to the more individualized preferences of cable TV and Tivo, and finally to the shared experience of fully connected virtual networks. The new regime has people "Googling," "YouTubing," "Yelping," "MySpacing," and, of course IMing/chatting, while at the same time they are sharing their favorite songs, movies, stores, and destinations with each other. Communitainment is the major achievement of the User Revolution, and it could replace other activities unless media companies acknowledge this trend and opportunistically embrace it.

Traditional Media. The growth and popularity of communitainment is in direct contrast to the declining value of traditional media, as reflected in the decreasing use of TV, newspapers, and other sources. In our 2006 Online Media Survey, 40% of the respondents said they watch less TV than they did two years ago, while less than 18% said they watched more.

Search and Google Dominate the Internet. While consumers are spending far less time and attention on TV and newspapers, they are busy searching, or more accurately, Googling, as Google's share of search continues to rise, and we expect this trend to continue for some time. We believe Google can eventually achieve 70%-80% market share both in the United States and worldwide. Search itself has become the new portal model, as many users now rely on search to navigate the Web and find answers to their questions. Searching is no longer just used to find information or to buy a product; search is the way people navigate the Internet.

We believe Google is the most important company to watch over the next 10 years in the Internet, as the User Revolution fully unfolds. The combination of Google's strong market share and brand in search and the company's aggressive innovative strategy on new products aligns Google more than any other company with the new User-based media.

What Are Media Companies to Do? The upshot of the above trends, which we discuss in detail in this report, is that both advertisers and publishers need to change their strategies, and in some cases, their business models.

Publishers need to realize that their competition is no longer the other publishers, but a range of what we would call content and services destinations. Many of these, such as Flickr, Yelp, or YouTube, are not considered publishers in the traditional sense yet they pull consumer attention away from the traditional publishers. Thus, both traditional media channels and Internet sites have to adapt to user control and content, as well as to consumers' desire to go to smaller, more specialized content sources. This requires new thinking for many companies, and it gives an advantage to the so-called "Web 2.0" firms, such as Google, which are inherently much more user-focused.

The Web's Darwinism. Successful online destinations (we prefer to use destinations rather than the word "publisher" as we believe the latter does not accurately describe the networks on the Web today) will need to embrace users and transition their business models away from providing content and services in return for advertising to a business model that is focused on creating cohesive communities of users that generate ideas, content, and, most importantly, brands. The next task of these destinations is to match the best advertisers with the user groups, allowing the content to get richer and more relevant for the users, and enabling the advertisers to engage their target group in their brand. Providing news or entertainment is now a commodity, and successful destinations need to go well beyond this, looking into the needs of the modern Internet users. The "portal," as we know it, is effectively dead. Users now do not need a single destination that provides every type of service or content with effective search tools; they can navigate to best-of-breed destinations and tools. The successful destinations of the next ten years will be agile and aggressive networks of smaller sites with specific applications that are highly tailored to user needs. With users becoming much more sophisticated, we have become more convinced that only the fittest will survive and Web Darwinism will play out over the next five years as the User Revolution fully unfolds.

Advertisers need to adapt to the new consumer demands and match their services closely with consumer needs. The old advertising adage that advertising is about "convincing consumers to buy what they don't know they need" has to change. Consumers largely know what they need, and they want messages that are targeted at those specific needs. They also want to associate the brand with their lifestyle, and in doing so, they will become evangelizers for that brand. Thus advertisers need to forge closer relationships with consumers – close enough to be part of the content they are consuming, not just a commercial interruption of the content. In the new regime, advertisers must not only follow customer cues, they must also join their networks as active participants with a genuine

interest in promoting consumers' interests. This is probably one of the most radical changes that the User Revolution will cause in the advertising world, but we believe the most successful businesses in the next 20 years will be those who are fully aligned with consumers' social ideals.

******Please contact your Piper Jaffray Account Executive for a copy of the full "User Revolution" industry report ******

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| | | | Count | Percent |
| BUY [OP] | 357 | 56.49 | 89 | 24.93 |
| HOLD [MP] | 246 | 38.92 | 20 | 8.13 |
| SELL [UP] | 29 | 4.59 | 2 | 6.90 |

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