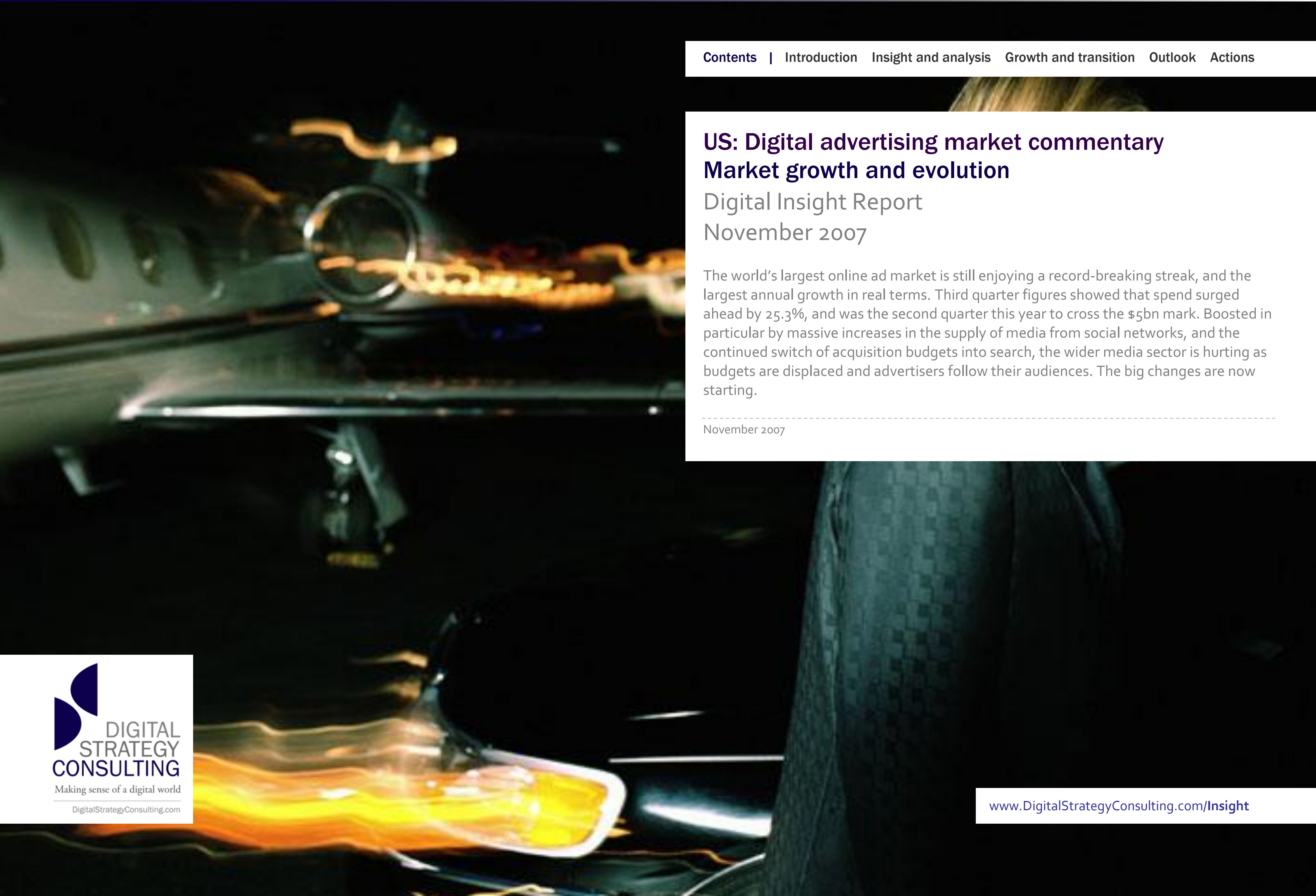


US: Digital advertising market commentary
Market growth and evolution

Digital Insight Report
November 2007

The world's largest online ad market is still enjoying a record-breaking streak, and the largest annual growth in real terms. Third quarter figures showed that spend surged ahead by 25.3%, and was the second quarter this year to cross the $5bn mark. Boosted in particular by massive increases in the supply of media from social networks, and the continued switch of acquisition budgets into search, the wider media sector is hurting as budgets are displaced and advertisers follow their audiences. The big changes are now starting.

November 2007

DIGITAL STRATEGY CONSULTING
Making sense of a digital world
DigitalStrategyConsulting.com

Analyst's profile:
Danny Meadows-Klue

Danny has been a researcher and commentator in the digital networked industries since 1995. He managed the UK's first online newspaper and has helped run web businesses ranging from mass market portals and consumer magazines, to online stores, search and email services. He is the co-founder of the UK and European IABs, was their president for four years and has been lecturing on digital marketing for more than a decade.

"We're still in the early stages of the transition to the digital networked society. The massive growth in online advertising may have fuelled web media, but the same migration of audiences and advertising is now hurting the classic channels deeply. In this decade of incredible social and technological transition, the major changes are yet to come. Firms who plan to survive transition need to become adept at reading the landscape, and adapt quickly based on what they learn."

Introduction

Big changes for world's largest online ad market

Every year we provide our commentary on the growth of the online advertising market in the US, the related restructuring in the media industry, and the key trends in this segment of the digital networked economy.

This short Digital Insight Report explores the nature of channel shift and some of the implications for classic media businesses, advertising agencies and marketers trying to navigate the digital economy. Deciding where to place media spend is becoming more challenging with each new channel, rather than less. The US market remains unassailably the largest in raw online marketing spend, but some of the models for media planning and measurement in Europe are now pulling ahead.

With the professionally produced content sector founded on the advertising model, the continued leap in web ad spend has much wider implications for the future growth and diversity in online media and entertainment. The US market benefits from the concentration of home-grown talent at Google, Yahoo, eBay, Amazon, MSN and the digital megabrands, combined with economies of scale of being in the largest online audience market.

Since 2000, we have been talking about the digital networked society and the implications for firms as their sectors make the transition. Digital Insight Reports explore patterns within these changes and provide some of the navigation to successfully make the transition.

Speed read

US online adspend has crossed a record $5bn a quarter for the second time at $5.2bn

The first nine months of 2007 totalled $15.2bn, nearly 26% up from the same period in 2006

The world's largest online ad market still enjoying largest annual growth on real terms

Growth rate still over 25%

Digital Strategy's forecast for the full year is remains at $22.5bn

The growth in online is offset by dramatic changes in the market share of other channels as budgets are drained from classic media to fuel digital marketing

Search engine advertising continues to dominate, but all online formats are growing, with new waves of brand advertising entering the industry

Insight and analysis

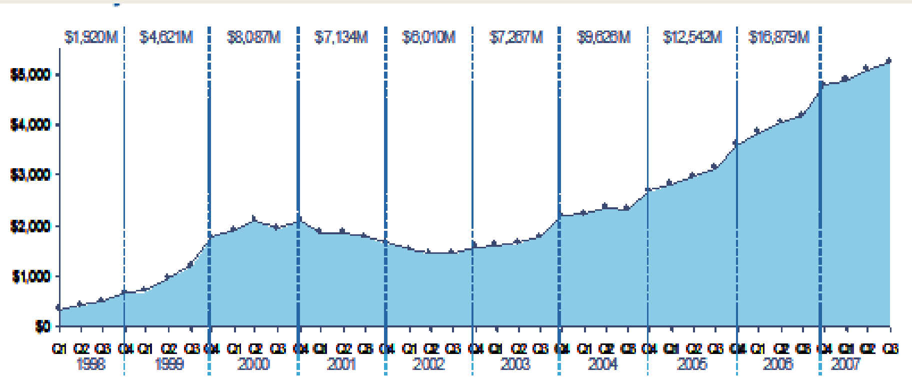
Net breaks $5bn for second quarter running

The latest numbers for the US from PricewaterhouseCoopers (PwC) and the IAB confirm that the world's largest online ad market is still enjoying the largest annual growth in real terms. Spend surged ahead by 25.3%, crossing the $5bn mark for the second quarter in this year.

US Internet advertising revenues for the first nine months of 2007 totalled $15.2 billion, setting yet another new record, an almost 26 % increase on the same period in of 2006. Spend was $5.2bn in the third quarter of 2007.

US IAB President Randall Rothenberg noted that "the continued robust growth of the industry indicates that marketers increasingly understand and appreciate the benefits of interactive advertising," adding that "Marketers large and small have come to accept digital media as the fulcrum of any marketing strategy."

The growth was propelled not just by search engines (which increased their share of online adspend to 41%) but also by the wider consumer advertising sector. Classifieds continued to swell, but they did lose share within online to the Rich Media and Video formats which now account for 8% of all online advertising.



Quarterly $ revenue growth comparisons — 2000-2007 year to date

2007 third-quarter revenues at $5.2bn recorded the highest quarterly revenue total since reporting began in 1996, and marked the second time in a row that quarterly revenues exceeded $5.0 billion.

Source: PricewaterhouseCoopers / Internet Advertising Bureau

Advertising Formats - Search and Display continue to lead formats

Search engine advertising continues to dominate the US market, indicating how search will rise to become the largest format is most countries over the next three years. Rich media advertising (which includes video) is now set for rapid growth as new models for the delivery of television content through the internet start to accelerate.

	FH 2006 ($ millions)	FH 2007 ($ millions)
Search	40% ($3,164)	41% ($4,097)
Classifieds	20% ($1,582)	17% ($1,699)
Referrals/Lead Generation	7% ($592)	8% ($799)
E-mail	2% ($158)	2% ($200)
Display Related:	31% ($2,413)	32%($3,198)
– Rich Media (Includes Video)	6% ($475)	8%($799)
– Ad Banners / Display Ads	21% ($1,622)	21%($2,099)
– Sponsorships	4% ($316)	3% ($300)
– Slotting Fees	<1% (<1$)	<1% (<$1)

Source: IAB US, PricewaterhouseCoopers 2007

Industry Concentration - Concentration of revenues by top companies remained consistent

The market remains highly concentrated, with 70% of all advertising dollars traded through the hands of just ten sales points. This pattern has been consistent since the mid nineties, however the sales points themselves include advertising networks who represent large numbers of sites.

	FH 2006	FH 2007
Top 10	71%	70%
Top 25	84%	82%
Top 50	94%	91%

Source: IAB US, PricewaterhouseCoopers 2007

Pricing Models - Performance deals now leading pricing models, followed closely by CPM deals

The trading models in online marketing continue to be more diverse than those of any other media. The CPM (cost per thousand exposures) model has been eclipsed for the first time by performance based marketing (pricing on a per click or per action basis), as search engine advertising influences the wider banner culture to spread the idea of shared risk. This is likely to have a wider effect on how television and print media are traded.

	FH 2006 ($ millions)	FH 2007 ($ millions)
CPM	48% ($3,797)	45%($4,497)
Performance Deals	47% ($3,717)	50%($4,997)
Hybrid	5% ($395)	5% ($499)

Source: IAB US, PricewaterhouseCoopers 2007

Growth and transition

Topline growth hides turmoil

Overall the US ad market is faring well, but as in the UK this disguises the dramatic churn and channel switching between media that has made it the most turbulent and unpleasant of times for many media owners. The US press classified sector continues to suffer the agonising pain of the CraigsList free-to-air model, the rise of the Google pay-per-click leads generation model has cut deep, and eBay has replaced the garage sale market.

As in Europe, the pay for results classified engines such as Oodle will encroach further into the yields (if not the volumes) of US regional and local press, while disintermediation is effectively letting even small advertisers deal direct. As IP-based geotargeting grows, barriers that have prevented small business advertising from moving to the web will melt away, strengthening the traditional and mobile web platforms at the expense of press. The small business engines within eBay will rise in strength even further, placing Amazon and eBay in exactly the same space in the US domestic market.

"There's a tremendous violence in traditional media as it continues to get displaced by digital."

Sir Martin Sorrell
CEO WPP Group

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Digital Insight Reports
In times of huge economic, social and technical change, knowledge becomes a critical success factor. We created the Digital Insight Reports to bring you insights from a particular part of this fast changing industry. We read the patterns in the landscape and decode them for you to offer clear advice and an independent perspective. They cover key issues in the digital networked economy.

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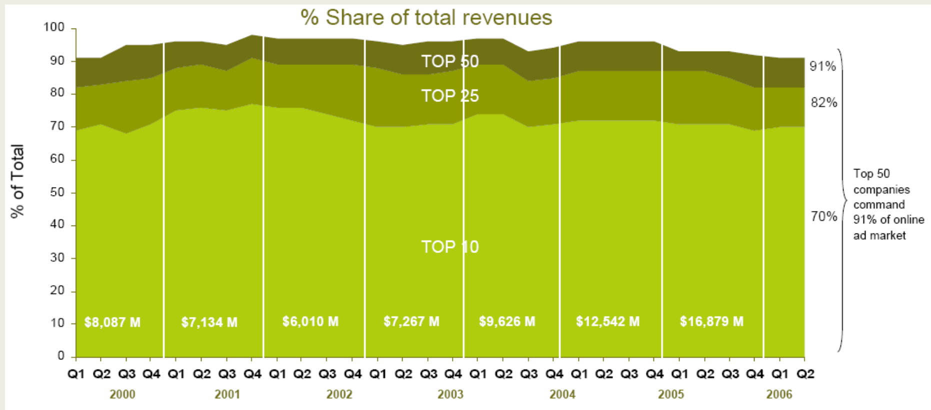
The nature of the inescapable Google effect is broadening. Whether the DoubleClick acquisition is approved by competition authorities or not, it's only natural that Google will expand in to the display advertising market and its reach will allow for the delivery of audiences with comparable or greater volumes than a TV network buy. This will encroach on a relatively untouched TV advertising sector, just as IP TV dollars start to shift. Television has been on increasingly shaky ground for ten years in the US; the challenges of media fragmentation were initially added to by media clutter (which is why so many Americans simply can't recall the adverts in the breaks they just watched), and then the Tivo generation learned how to retake control of their media – screening out commercial altogether.

Many consumer brands we spoke to are now talking frankly about switching campaign budgets to the web as TV's audience reach stumbles but, worse, perceived ad effectiveness falls even faster. Media fragmentation, marketing savvy audiences, and massive changes in consumer behaviour are all impacting faster in the US than most countries and it's all much faster than most classic media groups can hope to adapt. This paves the way for polarisation in both corporate profits and digital audiences. As Digital has been predicting since 2003, when the shake-out comes it will be larger and more brutal than most classic media (or their shareholders predict).



Industry revenue concentration remains high
Online advertising continues to remain concentrated with the ten leading ad-selling companies, which accounted for 70 percent of total revenues in the second quarter of 2007, down slightly from 71 percent reported for the second quarter of 2006.

Companies ranked 11th to 25th accounted for 12 percent of revenues for the second quarter of 2007, while companies ranked 26th to 50th accounted for 9 percent in the second quarter of 2007.

Source: PricewaterhouseCoopers / Internet Advertising Bureau

Outlook

Where next?

Digital Strategy's forecast for the full year is remains at $22.5bn, with the growth continuing, but at a gently softening rate. More brutal is the switch in non-advertising spend as investments in the web presence of firms, the relationships with web retailers and the role of email relationship management all continue to swell dramatically, albeit under the radar of the official figures because they remain untracked.

The explosive growth of social media is being effectively monetised as media owners harness both behavioural and contextual ad technologies to trigger a step-change in the profitability of consumer generated content. Google's opening up of YouTube to carry display advertising is just the start of a much deeper trend for the commercialisation of social media, and for those content owners who choose not to let ads build into their pages there will readily be an 'ad free' opt out payment. Unlike the choice given to internet users for surfing with ads switched off, many content owners will readily shell out a few hundred dollars for the privilege, inviting parts of 'the long tail' into the heart of the new massive networks.

> "In the US, 2008 will be the year when TV advertising starts to move to the web"

What's particularly interesting is the way search is holding its own, dominating all other formats and becoming a US media channel in its own right. As Google spills onto the mobile handset in the US in 2008, another wave of search advertising supply will open up. At Digital, we're still bullish about the market and see no sign of slowdown in the switch to search from classic customer acquisition channels, or the switch to online in business to business marketing.

In the US, 2008 will be the year when TV advertising starts to move to the web, fuelled by an opening up in the avenues for television content to, legally, reach US audiences. Smarter rights agreements and technical advances in the architecture for IPTV delivered content will see the US start to catch up with where some of the European markets already have reached. The big difference will be the massive economy of scale that this instantly creates to advertisers, changing the nature of the television landscape within a surprisingly short period of time.

For mobile advertising we still see 2009 as the year the industry reaches its tipping point, although wider mobile marketing (sms and mobile related digital outdoor advertising) will continue to enjoy a massive wave of growth across the second half of 2007 and all of 2008.

Digital Insight Report - UK: Digital advertising market commentary

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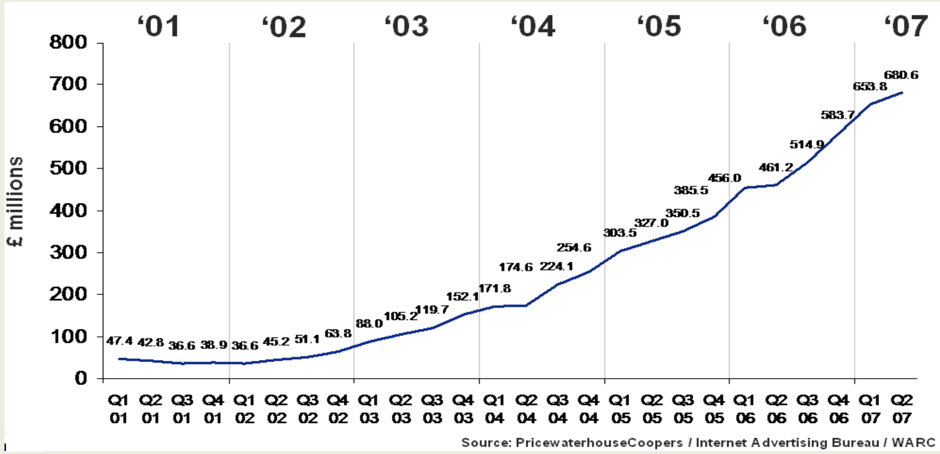
Biggest leap yet

The latest figures confirm the rapid switch to online marketing is continuing in spite of the sector's existing size, challenging any suggestions that the market has matured and is slowing down. In Europe's lead media market, the internet's share of all advertising swelled to almost 15% in the first half of 2007, with further record-setting leaps in real growth. Boosted in particular by massive increases in the supply of media from social networks, and the continued switch of acquisition budgets into search engines, the wider media sector is starting to feel the real impact of the digital networked economy as the models that underpin many print and broadcast players get called into question.

As Digital's team had forecast, online ad spend growth held steady at above 40% year-on-year, giving the largest quarterly rises, and triggering further concerns across the TV and magazine industries about the profitability of classic media.

- First half of 2007: £1,334.3 million
- First half of 2006: £917.2 million

With the UK market acting as a key indicator for European online adspend behaviour, the latest results will boost stock prices for continental firms looking for models of their own country's digital economy a few years down the line. The research is particularly accurate because it relies on publisher revenue declarations (under non-disclosure agreements to PricewaterhouseCoopers) and not rate card or sector estimates. It is also one of the only markets in the world to include a revenue declaration from the largest single player - Google.



Online advertising growth since the dotcom boom: now nearly £700m in Q2

Source: PricewaterhouseCoopers / Internet Advertising Bureau / WARC

Actions

What should I do? Key takeouts

Advertisers: Question whether your strategic media mix reflects where your audiences place their attention. Question whether the integrated marketing models you run are designed for today or 2003. Invest in talent, training and retention of digital staff. Learn about the strategic models that can integrate your media and heavily invest in data analysts to learn exactly what works and how: put the science into marketing - create a culture of optimisation of the results.

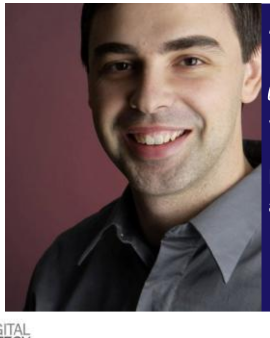
Media owners: If not already in place, invest fast in building a digital strategy that helps protect your brand franchise. Focus investment on building sustainable product rather than protecting short term ad revenue. Train teams at every level, and invest in talent.

Offline agencies: Find strong digital partners and build integrated plans to protect your client relationships and continue delivering value. It's too late for many to migrate to digital and hire the teams needed, so by focussing on partnerships there's a way of protecting client relationships.

Digital agencies: Invest in talent, training and staff retention. Build strategic models for media that can work across thousands of campaigns, and focus on analytics as a way of learning exactly what works and how: put the science into marketing and optimise the results.

Investors: Continue to follow audiences and product development rather than short term profits or revenues. Review portfolios against the Web 2.0 criteria and scrutinise evidence to look for sustainable success. Continue to anticipate the impact of disruptive technologies and shocks to the supply chain, and assume that the ad models of CPM and CPC will melt into smarter currencies in the medium term. Pay particular attention to markets that will be pressured by wiki and search models.

For information about developing resilient digital strategies, or training your team to thrive and succeed in the rapidly changing digital sector, just ask Digital's team.



"The ultimate search engine will understand everything in the world... and give you back something instantly. We have a long way to go before we're there."

Larry Page, Co-founder & President of Products at Google talking last year about the future of search engines and artificial intelligence.

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The Search Academy

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"Without harnessing search engines, your needle will never be found in the most giant of haystacks."

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A portfolio of Digital Training Academy courses to help marketers of all levels of digital experience get more from search engines and the tools they provide. Special courses designed to convert newcomers, boost the skills of experienced search marketing agencies, and everyone in between.

What is it about?

Showing your how to get more customers at a cheaper price, giving the models and techniques for successful search marketing.

Digital Training Academy programmes

Boosting the effectiveness and productivity of media owners, brands and their agencies.

"Learning is like rowing upstream: not to advance is to drop back."

Chinese proverb

Boosting your digital teams

Our programme of training for media owners, consumer brands, agencies and business service firms covers more than 40 different disciplines within digital marketing and publishing. We cover everything from improving the effectiveness of search marketing to writing smarter email campaigns, from harnessing social networks and blogging, to strengthening media sales teams.

How can we help you?

Simply ask Danny@DigitalStrategyConsulting.com or call + 44 (0) 20 7244 9661

Our strategy and training programmes

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- → Business plan analysis and risk assessment
- → Executive digital management coaching
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If you have any questions about our approach to training, or the detailed content of the course then please email or call the team.

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Making sense of a digital world

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