desilva+phillips MEDIA INVESTMENT BANKERS

2006 Online Advertising Roundtable

Big creative ideas and new technology… Siphoning off traditional budgets… Maximizing digital marketing leverage… Is an online ad marketplace in the offing?

desilva+phillips MEDIA INVESTMENT BANKERS
475 Park Avenue South • New York, NY 10016
(212) 686-9700 • mediabankers.com

2006 Online Advertising Roundtable

April 2006
Edited by Ken Sonenclar
Managing Director, Digital Media & Technology Group
sonenclar@mediabankers.com

Panel Moderator
Jay MacDonald
Partner, Digital Media & Technology Group
DeSilva + Phillips

Panelists
David Rosenblatt
CEO
DoubleClick, Inc.
New York, NY

Christopher Saridakis
CEO
PointRoll, Inc.
Philadelphia, PA

James A. Warner
Executive Vice President
Avenue A|Razorfish
New York, NY

On the cover, clockwise from upper left: Christopher Saridakis, James A. Warner, and David Rosenblatt.

DeSilva + Phillips, founded in 1996, is an investment bank specializing in the media and digital media industries. We provide M&A services and private placements of debt and equity to the magazine, Internet, newspaper, book publishing, trade shows & events, information, educational, and marketing-services industries. In the online world, we work closely with firms specializing in search marketing, advertising, lead generation, rich data, business intelligence, vertical search, web publishing, email services, and rich media. Contact us at (212) 686-9700. Or on the web at mediabankers.com.

About the Panelists' Companies…

Avenue A|Razorfish

Avenue A|Razorfish is the largest interactive ad agency, providing a range of services, from designing and building websites to managing online marketing programs, including search, banners, and other forms of media, such as email programs. Clients include Verizon, Capital One, JPMorganChase, Disney, Apple, and many others. The company is the largest buyer of online media and search media. It spent $418 million on behalf of clients in those two categories last year. Avenue A|Razorfish is part of aQuantive, a larger public holding company with a market cap now of nearly $2 billion. Two other large business units within aQuantive are Atlas, a technology company that competes with DoubleClick, and DRIVE Performance Media, a media offering sold to advertisers on a performance basis that uses a number of proprietary targeting and analytical tools.

* * * *

DoubleClick

DoubleClick was founded in 1996. The company was sold in April 2005 to private-equity investor Hellman and Friedman, which has a long pedigree in the media business, having owned Young & Rubicam and, most recently, Digitas. Since that deal closed, the company and its staff of 800 have focused exclusively on online advertising. A leader in every market segment where it participates, DoubleClick now has two businesses: the ad management business and also Performics, a search and affiliate media management company. DoubleClick is now positioned to invest aggressively.

* * * *

PointRoll

PointRoll, a wholly owned subsidiary of Gannett Co., Inc., powers some of the most creative, engaging, and consumer-friendly ad campaigns on the Internet. Founded in 2000, the company aims to enable advertisers, agencies, and online publishers to measurably increase conversion opportunity, brand awareness, creative expression, and message content without disrupting the user's online experience. With a goal of dramatically enhancing the impact of any Internet ad campaign, PointRoll's proprietary technology platform delivers a suite of rich media products including: FatBoy® expanding ads, Tomboy™ universal 100K+, TowelBoy® snap-back units, BadBoy™ floating ads, and PaperBoy Local Delivery™. PointRoll's rich media experts support every campaign with full service, including creative consultation and development, Q/A testing, and trafficking. PointRoll works with more than 500 advertisers and its technology is accepted by thousands of online publishers including Yahoo!, MSN and AOL.

The discussion below is an edited summary of the "Online Advertising: How High is Up?" panel held at the DeSilva + Phillips 2006 Media Dealmakers Summit on February 6, 2006, in New York.

Jay MacDonald: It's obvious that online advertising continues to grow at a significant rate. Broadband penetration is one of the key drivers, passing the 60-percent penetration mark. More people are spending more time on more sites. Various market forecasts all point to sharp growth. Market research firm Outsell suggests that the total online marketing spend will rise 19 percent this year and through 2008. That's eight times faster than projected growth for TV and radio and six times faster than for print. Search and rich media will propel the online spend to 5.7 percent of the total ad spend in 2006, which is 27 percent greater than in 2005. Search ad spending alone will grow 26 percent in 2006. Video advertising will grow from $225 million to $1.5 billion from last year to this. Interestingly, companies spend 33 percent of their ad dollars on their own websites, which is double what is spent on search. Lead generation, using free content such as white papers, will grow 19 percent, driven by high conversion rates and users opting in. Blogs and wireless ad spend, though small – less than two percent of the online budget – are poised to grow 43 percent and 19 percent, respectively.

US Online Ad Spending, by Format, 2004-2010 (millions)

	2004	2005	2006	2007	2008	2009	2010
Paid search	$3,850	$5,129	$6,474	$7,533	$8,760	$10,073	$11,258
Rich media	$963	$1,251	$1,794	$2,418	$3,176	$4,208	$5,273
Classified	$1,733	$2,252	$2,730	$3,255	$3,833	$4,463	$4,988
Display ads	$1,829	$2,377	$2,886	$3,348	$3,723	$4,335	$4,418
Sponsorships	$770	$626	$624	$744	$986	$1,148	$1,425
Referrals	$193	$626	$780	$930	$986	$765	$570
E-Mail	$96	$125	$156	$186	$219	$255	$285
Slotting fees	$193	$125	$156	$186	$219	$255	$285
Total	**$9,626**	**$12,510**	**$15,600**	**$18,600**	**$21,900**	**$25,500**	**$28,500**

Note: eMarketer benchmarks its US online ad spending projections against the Interactive Advertising Bureau (IAB) - PricewaterhouseCoopers (PwC) data, for which the last full year measured was 2005
Source: eMarketer, March 2006

Q: On this panel we have PointRoll, a five-year-old entrepreneurial company that was recently sold to an old media company, Gannett; DoubleClick, a 10-year old company that went public and is now private; and a third company, Avenue A|Razorfish that is part of a public holding company. Chris, what's it like working for an old media company?

Chris Saridakis: That's a tough one. One of the challenges when we were acquired by Gannett was the issue of whether they would let us remain independent, be as innovative as we have been, and continue the entrepreneurial spirit that PointRoll started with. Aside from the price of the deal, there were terms, and "independence" became a key term. Gannett has been a great partner of ours. We are a wholly owned subsidiary and we operate independent of other Gannett properties. We are more empowered to do a lot more because we now have the backing of a multi-billion-dollar company. So we don't criss-cross our properties. They know the publishing space incredibly well and have relationships with advertisers across the Fortune 500, so we take advantage of that, but most importantly they leave us alone, which is how Gannett works with most of its acquisitions.

Q. David, how is life as a privately held company? And how are you better able to serve your customers since going private?

David Rosenblatt: Our reaction to going private is that it was the best day of our lives since going public. In this environment, with Sarbanes-Oxley, going private has allowed us to do things, both qualitatively and quantitatively, that we never could have done as a public company. Since closing the sale in July, we've separated all the online advertising assets into a separate business so we now have everyone focused on that. Moreover, we've substantially increased investment in the business, with plans now to hire 200 people on the base of 650 this year, all completely focused on the growth areas. This would have been impossible if we were public. It's just too difficult to explain to Wall Street that we're changing both the direction and the investment profile of the business, even though it will ultimately result in better products and services for our customers because we've got more people spending more money serving their needs.

Q. For all three: As more advertising dollars move to the web, people have more choices of where to spend it. What is the importance of technology both for your companies and from the perspective of the advertising community?

James Warner: Technology is everything. It is fueling the change in customer behavior, which is driving this sea change in the media/information/entertainment industry. It is driving mobility, personalization, fast-and-quick access to information, and it's all digital. Within our company, which has a strong heritage in technology, we have around 300 technologists; it's a point of differentiation between us and a traditional agency. Traditional agencies have historically been driven by big creative ideas. Digital media is increasingly becoming about big ideas, but it's a lot of little ideas and executing very well on a daily basis on those little ideas and those little parts of the campaign that are all driven by the technology. On an aQuantive level, it's been a real advantage for us because we've been able to use the close relationships we have with our clients who are facing marketing problems and opportunities and develop solutions for them that are unique, using our facility with technology. As we've developed individual solutions solving individual problems, the person developing it becomes a rock star in our organization and everyone looks to find a way of taking that same innovation and applying it to the challenges that they face. And ultimately it becomes a product and helps us to launch new businesses. Atlas, which is the technology business we started, was launched outside from the ribs of Avenue A|Razorfish, as was DRIVEpm. So being so focused on technology has been a big advantage for us and we'll continue to invest in technology.

David Rosenblatt: In this media, unlike every other media, technology is not a "nice to have," it's a "must have." And I'll give you a couple of examples. One of our areas of focus is the technology that is used to manage search campaigns. We launched a client last November that buys 700,000 key words. That just exceeds the ability of any one person to manage, let alone optimize. Similarly, in conventional display advertising, we're now delivering roughly seven billion ads each day. And again, that's a number that's impossible even for an individual client to manage on their own without some sort to optimization technology. We're in the process of bringing to market a set of algorithms that's designed to drive up response rates to advertising. In beta this model is producing a 35 percent lift in click rates. That's inconceivable in any other media. And finally in rich media you've got a proliferation of ad formats – this year mostly around video – that allows for data capture and a manipulation of content that is impossible in traditional media.

Chris Saridakis: There's no question that technology, operationally, is critical to PointRoll and any company in the online space. To grow as fast as we have grown – we now handle over 500 active campaigns every month – while pulling down the margins we do, technology is critical. Most important, being able to apply technology to the creative environment in the rich media world is a necessity. To be able to take people who are used to using crayons and different kinds of pallets and give them the tools to apply their creativity and their ideas for the advertiser online – that's where we excel and where we spend most of our time developing our technology.

Q. Do the advertisers ascribe a value to the technology or is it commodity from their perspective?

Chris Saridakis: I don't think they ascribe a value to it. From our perspective they see it as inherent; part of how you get the job done. I don't want a media planner or a creative person to get too tied up in learning about technology. As long as we deliver the product and we can get the message across to their client, we're doing our job and the end user can be assured that smart people are building and managing the technology back-end.

James Warner: I think that clients place a real value on it. They're looking for competitive advantages in their vertical space. Whether they're using technology to drive better response rates in search or banner media; using it to provide an experience through an ad unit or website, they're looking for technology to differentiate themselves from their competitors.

David Rosenblatt: We work on some level with every interactive agency in the market, aside from Avenue A. They all feel they need tools and data warehouses and the like, primarily to compete with the Avenue A's of the world.

Q. PointRoll's new "PaperBoy" product, which was launched last fall, reportedly reaches 69 percent of the total Internet audience and it incorporates market-specific content as well as dynamic information such as store pricing, store locator and coupon pricing information. Is this a complement to newspapers and direct-ad mailers such as Advo Inc., or a serious threat?

Chris Saridakis: It is an evolution of where pre-print or circulation dollars are heading. More and more people are spending a lot more time online; and not just within a browser, but across the board. A product like PaperBoy, which plays to the consumer-controlled environment, can tap into budget dollars that were going to traditional newspapers, and move them online. PaperBoy was launched at the end of October 2005, on Halloween, with 14 campaigns for eight of the top retailers and we're already doubling that. The interaction rates – the time that people are spending time with the ads – are significant. Fifteen percent of the people seeing the ad are interacting with it. And that interaction is lasting 30-40 seconds with an ad unit on a site that they really did not even intend to look at.

Q. How active are your companies in the global online advertising space? What are the major growth areas?

James Warner: We took our first steps overseas at the end of last year with the acquisition of DNA, an interactive agency in London. We have plans to expand either through organic growth or acquisition in other markets in Western Europe and Asia. Atlas, our sister company, has a broader international footprint already.

David Rosenblatt: If the online market mimics the off line market, then 50 percent of the business should be outside the United States. We're focused on it. We do about 15 percent of our business today outside the United States, and we'd like that number to go up.

Q. Can each of you discuss Google and how you are reacting to its growth beyond search, such as into rich media where it has begun testing a product?

Chris Saridakis: Google is an innovative company. As for Google getting into rich media, it emboldens us. I can't speak to how their test in rich media has gone, but it certainly validates everything we at PointRoll are doing. Brand managers are going to be spending a lot more money on interactive display ads that combine with a keyword. So it's exciting.

Q. Some see Google's recent acquisition of dMarc as their ticket into the radio advertising market. Others see it as giving them a full-

fledged ad-serving platform across many media types.

David Rosenblatt: It doesn't give Google that general platform. The reason some are saying that is because the founders of dMarc had previously founded AdForce, an ad serving company.

Q. In the future, do you see advertisers looking to work with one or two providers, or with a broader array of specialists?

James Warner: One man's ceiling is another man's floor. We see ourselves as a full-service provider within the digital space while another firm, Ogilvy & Mather, for instance, may see us as a specialist. It's our vision that in order to get the maximum leverage out of the digital channel, you need to have a common data platform, which allows you to measure the interaction between your marketing communications and your customers or prospects at every stage in the funnel. If you don't have a common data platform then you will make less than optimal decisions, whether it's a branding campaign or a campaign driving response. So the digital experience, which now begins with a search term or a display ad and runs all the way through to the confirmation page – all of that is digital media and you need one platform and one data and analytics solution to be able to analyze and optimize it.

Q. Can you discuss what you see with Pay Per Call technology?

James Warner: We are testing it now for one client with a large call center. We're optimistic, but we also see potential channel conflict in the industry between the large search engines such as Google and Yahoo, which are trying to drive clicks, not calls. Until they figure out how to monetize pay per call, it will be a continuing challenge.

Q. Advertising started with buy-side systems and sell-side systems. How will those systems continue to develop?

David Rosenblatt: We are the only technology player in the market with both a buy-side platform and a sell-side platform. And we very much see those sides converging over time into the creation of a marketplace. When that happens, how and to what percent of inventory on the Internet it applies – because it won't apply to everything – is yet to be worked out. But advertising assets on the web are pretty well suited to the creation of a marketplace, not just search but also display. There are few companies, large and small, dancing around that space right now.

Q. Can anyone comment on the monstrous earnout on dMarc?

David Rosenblatt: Earnouts don't mean that much. If dMarc turns into a $20 billion asset, will it be worth Google having paid an extra $900 million? Yes. What is the probability of that happening? Nobody knows. To me the question is more, what do you get for the first hundred million. By definition, whatever Google winds up paying for beyond the initial hundred million they will get value for. But how much valuable intellectual property did Google get for a $100 million is the more fundamental question.

Q. What are the biggest drivers in the open marketplace for ads?

David Rosenblatt: There's a definitional issue. What is the market? What kind of inventory is monetizable through a market? We already know search inventory is. The question is whether it works for display advertising, and if so what types of display? It's a safe bet that the very highly branded type of inventory is probably not going to work. What people forget when they talk about Google is that, at the end of the day, most advertising is aimed at making people think of a product that wouldn't otherwise think of. This is something you can't accomplish through search, for the most part. That kind of awareness-building is heavily dependent on context and content. I don't think that's really amenable to a market. The direct-response stuff that is the basis, for instance, of lead-generation, does work pretty well for a market. The obstacles are partly behavioral: getting people to think differently about how they sell and how they buy. They're partly technical because it's harder to do this for display advertising than it is for search. Display ads are just more complicated and more variable.

James Warner: A marketplace for direct-response display advertising is already available through performance networks like Advertising.com, DRIVEpm, Google's AdSense, ValueClick and others. It has a long way to go, but the roots of that are in place today.

Chris Saridakis: The biggest barrier from a rich-media standpoint is getting down to a standardization of what is a rich-media ad. And as far as Google getting into a rich-media environment, imagine this over 300,000 publishers that AdSense cuts across. So the real competition is the publisher who is not only selling inventory, but contributing inventory to Google's AdSense. So when you think of rich media and expanding ads or images floating across, that could conflict with the other market or advertiser. The marketplace as it relates to rich media is a little more of a challenge.

Q. Google just paid $1 billion for five percent of AOL. There's a rumor in the marketplace now that Microsoft is looking to buy Yahoo. Any reactions?

James Warner: I haven't heard that rumor. It's a good one. Culturally I think it would be very hard to pull off. There's a real sense of mission within Yahoo and I don't see them heading in a direction that would enable them to consolidate with MSN.

David Rosenblatt: The rumor arises from Microsoft's not having gotten the AOL deal done. So are they willing to spend $70 billion to have an answer to Google in search? From what we've heard and seen they've built a pretty good monetization product for search. They feel like it's a solvable problem and they don't feel like they need to spend that kind of money on it. That would be my sense and inclination if I were they.

Q. What do you see for U.S. publishers that are experiencing an increase in international traffic to their sites? How should they deal with their interactive agencies if they don't have much foreign presence?

James Warner: We are currently managing campaigns for several clients even though we don't have a footprint that covers the globe. We do that through partnerships with agencies in key markets. Certain large publisher and portals have footprints that we can buy from centrally. Some local verticals or local portals in local markets may require local buying expertise. For a publisher trying to access a particular foreign market, I would recommend either aggregating international users and marketing to those global advertisers, or finding a way to create a special niche if you have content or an audience that's really unique.

Q. Can you comment on the role of behavioral targeting?

James Warner: With some limits, we're big fans of behavior targeting. Our company, DRIVEpm, uses behavioral-targeting techniques among other variables to target ads to consumers. The challenges have been around scale – finding behavioral segments that are large enough, that are worth paying a premium for, because you have to pay a premium to reach them. Our experience has been mixed. We've had some campaigns that are extraordinarily successful because we have identified a large enough niche. A good example would be re-marketing to our clients' best customers. We can determine on our site whether someone has shopped and purchased on a client's site before. Re-messaging to that audience segment is extraordinarily valuable. There's a very high conversion rate, with a much lower cost per acquisition than the general market. It is difficult, though, to aggregate a large number of customers because typically less than five percent of the Internet population are customers of our clients' sites. So you have to find other segments that have that kind of performance and yield a large enough scale.

Q. Some have suggested that the value of an ad on a website is four times greater to a "known" visitor – a visitor identifiable by demographics, not necessarily by name – than to a completely unknown visitor. Do you believe that is true?

David Rosenblatt: There's no way response rates are four times higher if you know someone's name. The better rule of thumb in direct marketing is that transactional behavior is the best predictor of future transactional behavior. For that you don't need to know the person's identity.

James Warner: The real lift comes from *not* showing an ad to someone you determine is not a good prospect for you. There's a very high delta between the response rate from someone you know is a customer and showing them an ad versus someone who you think is not a good customer and suppressing the ad. That's where there's great leverage.