

BNP Paribas – PE Autumn Series

Online's Disruptive Effect on Established Media Businesses

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Foreword

As a purely media-focused strategy consulting company, Ocean Strategy has worked with more than 100 clients across all sectors of media, many of whom are industry leaders.

Together with our clients, we have experienced and actively shaped the increasing shift from traditional to new media – first the change in media usage, and then the move from traditional to new media advertising revenue, which typically follows media usage with a small time lag.

Without doubt, 'classic' content online media such as news or entertainment websites will continue to grow and attract bigger parts of the advertising spend at the expense of traditional media, and thus continue to change revenue streams in media companies.

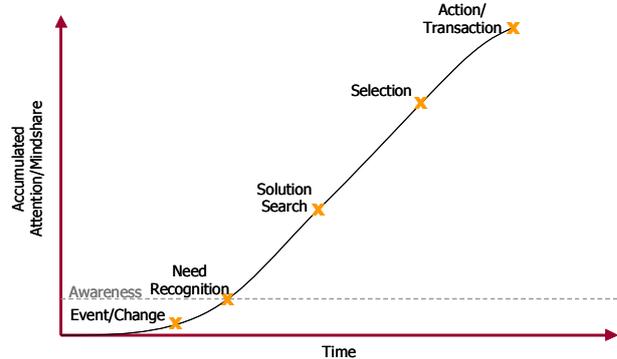
However, online media businesses have the potential of causing a much more disruptive and 'game changing' effect on the overall use of media. By actively changing the purchasing process, these companies are creating the possibility of new revenue streams while in some cases eliminating the need for certain forms of advertising altogether. We strongly believe that the biggest disruptive effect comes from **transaction-focused online media businesses**, which have the potential to truly reshape the traditional purchasing process.

While we already see a few successful examples of transaction-focused digital media companies, some of which we will present in this report, we expect many more to emerge over the coming years.

This report aims to explain the disruptive effects that come from online businesses focused on the transaction phase and, based on our analysis, to give examples of interesting investment targets for private equity investors.

- **Solution search:** Possibly with a time lag, the consumer looks for solutions to satisfy the need through information search.
- **Selection:** The information gathered enables a selection between the potential alternatives that have been identified. This involves both product/service and supplier.
- **Action/Transaction:** A purchase or action takes place that solves the need.

Chart 1: Consumer Behaviour and Steps in a Purchase Transaction



Advertising in the purchasing process

Advertising is used across all phases of the purchasing process from the initial creation of a need through to the transaction itself. However, the way customers can be influenced differs in each phase, and with it the type of media used.

In the UK, traditional media advertising (TV, print, direct mail, outdoor, directories, radio, cinema) still accounted for 81% of revenue in 2008 (see Chart 2 below). New media (online display, classifieds and search) has, however, seen impressive growth (CAGR 03-08: 48%).

1. The Purchasing process – the key to understand advertising

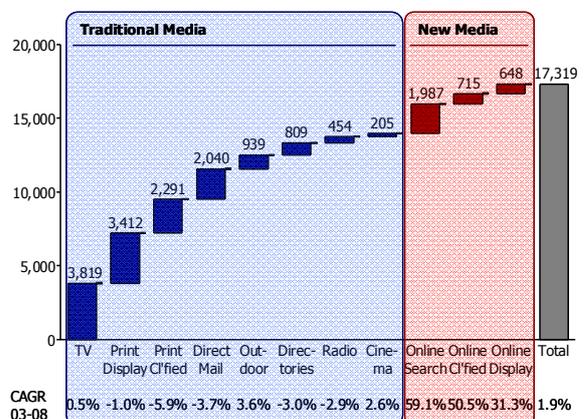
The purchasing process

Any advertising is made to affect the consumers' or business buyers' selection of goods or services and suppliers. In understanding the purchasing process and how advertising works in this process, we can create interesting insight regarding both traditional and new media.

Any purchasing process (both B2C and B2B) follows certain steps (see Chart 1):

- **Need recognition:** An event or change causes the consumer to recognise a need.

Chart 2: Advertising by media type in the UK (2008, £MM)



To better understand the shifts from traditional to new media advertising, a comparison of 'Push' vs. 'Pull' advertising is necessary.

- **Push advertising:** Information is pushed towards the consumer – communication is generally non-interactive; typically found in early stages of the purchasing process (works best for creating new needs or building brands); media used are TV, radio, print display, cinema, outdoor and online display
- **Pull advertising:** Information is pulled by the consumer – communication is generally interactive; typically found in later stages of the purchasing process (works mainly for fulfilling existing needs by providing the consumer with the required information); media used are print classifieds, directories, online classifieds and online search

By plotting the different advertising media into the purchasing process framework (see Chart 3 below), we can show the fundamental shift that is happening within pull advertising: There is a major shift from **traditional media pull advertising** (print classifieds, directories and partly direct mail) to **new media pull advertising** (online classifieds and online search).

This shift within pull advertising can be explained in more detail by looking at the three fundamental compromises, which the consumer faces in the selection and transaction phase:

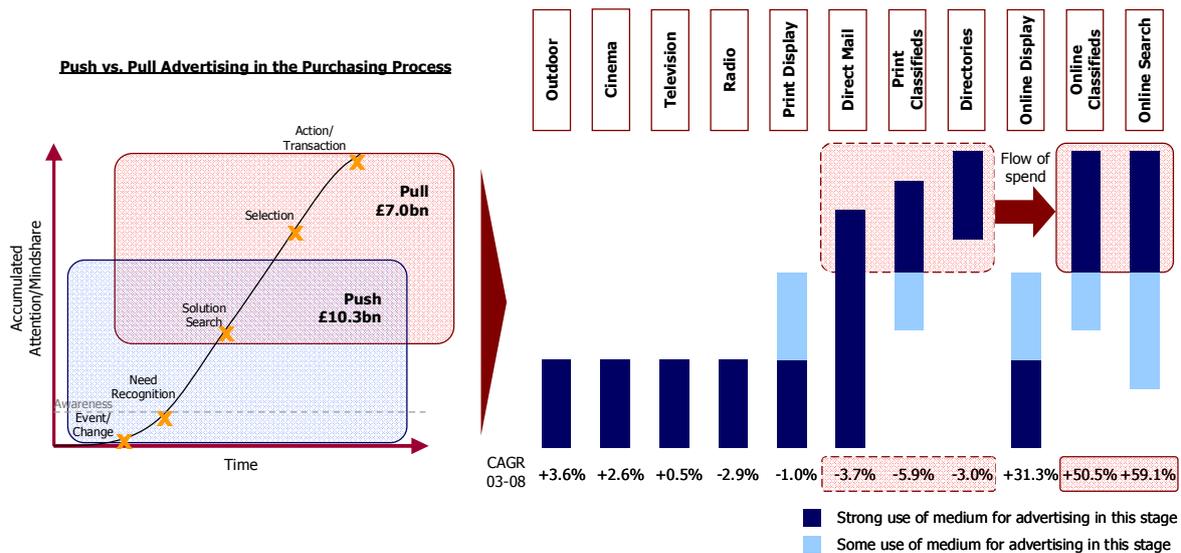
- Complex/time consuming product/service information gathering process (flexibility/efficiency)
- Lack of information on suppliers and product/service availability (availability)
- Transaction time consuming and process inconvenient (accessibility)

Through recent technological developments, but also through the rise of rich information sites and one-stop-shops on the internet, online search and online classifieds are particularly suited to break all three of these compromises. Not only do they enable online transactions in a matter of clicks, but they also link them directly to the selection phase, making the purchasing process a lot more efficient and flexible.

We therefore believe that **pull advertising / advertising in the later stages of the purchasing process** – where the consumer is actively looking to satisfy a need – **is undergoing a revolution , thereby changing the entire purchasing process.**

Clearly, the effect is strongest for the purchases of goods and services, where a significant amount of the attention/mindshare is spent on selection and transaction. This is the case for large acquisitions (e.g. electrical equipment, cars etc.) or acquisitions that are recurrent (e.g. insurances etc).

Chart 3: The Role of Media in the Purchasing Process



We want to note that the picture in push advertising is more stable. Growth rates for online display have been lagging behind those for online search and classifieds, and some traditional media (outdoor, cinema and TV) have seen increasing advertising spend over the last five years. We believe that traditional media will continue to remain strong in push advertising, where the fundamental goal is reach, which is best achieved through multichannel strategies involving, but not limited to, online display. Therefore, the purchasing process for FMCG goods and the effect on traditional advertising is likely to be largely unchanged.

2. The disruptive effect of online – where and why it impacts

The internet has sparked a number of new opportunities for advertising across the purchasing process. The first wave of online business models was basically a copy of existing offline models (i.e. focus on display, directories and classifieds). However, the increasing utilisation of search, technological advancements and social developments have inspired new business models.

The vast number of existing online media businesses can be grouped into five different business models:

- 1. **Display advertising:** Classic ad space selling (regardless of content type)
- 2. **Listing sites:** Classifieds, online directories, often specialised by industry vertical

- 3. **Lead-based sites:** Often marketplaces, where potential buyers can show interest, leads are sold to suppliers
- 4. **Rich information sites:**
 - a. Subscription-based: Usually B2B databases for product and market information
 - b. Referral-based: Information about products or services to help in search
- 5. **Transaction and price comparison sites:** Act as broker or partner of the transaction – could include price details or other important information and links to suppliers

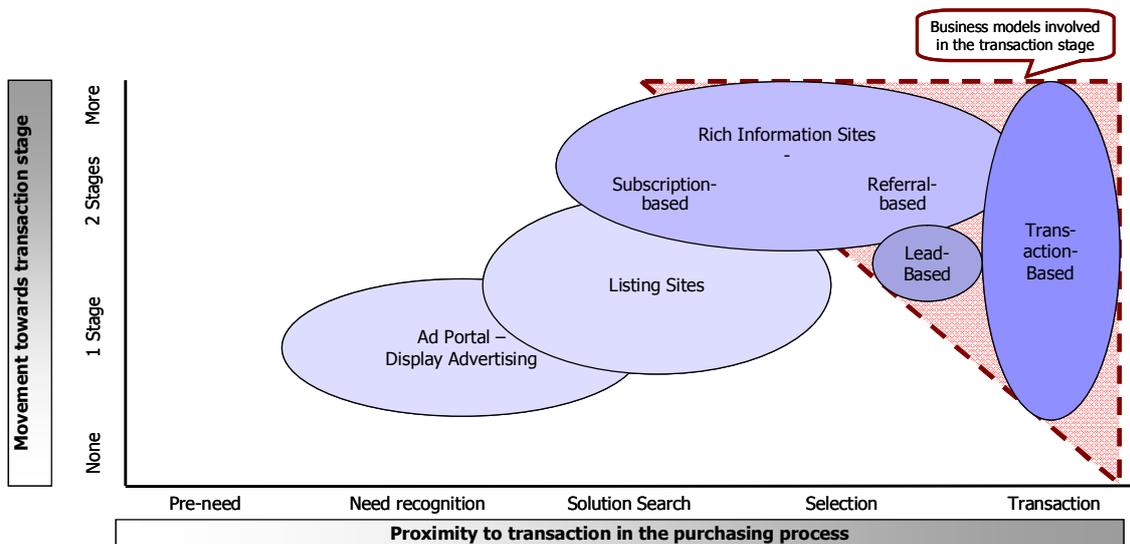
It is important to note that all five models are **online media business models which act in the purchasing process and can affect advertising** – pure online retailers and other non purchasing process related online businesses are not part of this analysis.

3. Moving purchasers to the transaction – online models in the 'sweet spot'

The five models can be mapped based on their proximity to the transaction stage (how close to a transaction does the customer leave the site, x-axis), and the number of stages the customer goes through on the site (y-axis), as illustrated in Chart 4 below.

Combining this map with our previous analysis suggests that the models in the transaction stage could do particularly well, as they are where money is changing hands.

Chart 4: Online Business Models Mapped on the Purchasing Process



These models include:

- Purely transaction-based models, including price comparison sites
- Lead-based sites
- Rich information sites with a referral-based model

This analysis is strongly supported by our empirical research based on industry rankings, e.g GP Bullhound's Media Momentum 2009, which ranks the fastest growing digital media companies in Europe. Around 75% of online media companies involved in the purchasing process had built their success based on a pure transaction model, with the remainder being rich information sites (referral- and subscription-based).

Only a small number of pure online media groups are currently quoted (see Chart 5 below). Two of these are focusing on display and classified advertising, while Moneysupermarket.com Group is the only one based on a transaction model. In addition, a number of online sites have been launched or acquired by traditional media groups. Of these, the vast majority in the consumer space employ pure display or classified advertising strategies, while a number of sites in the B2B

domain use subscription-based business models. Transaction-based models are still quite rare.

This difference between the prevailing business models of the established online businesses and those of the fastest growing ones gives a clear indication that we have only seen the first wave of the online revolution.

Conclusion

Online transaction businesses are operating in an immature industry with only a few companies having a value making them interesting as targets for mid-market Private Equity. This, however, is likely to change in the very short term. Therefore, both to support an initial assessment of 'what is coming' and to guide the attractiveness of a concrete opportunity, we will encourage investors to have this simple framework included in the initial evaluation of an online company's business model.

Extending to the traditional evaluation process, an evaluation of a transaction site should take the following into account: Size of the transaction market the site is targeting, severity of compromises undertaken off-line and solved with the online model, the competition (online and offline) as well as how far the model moves the buyer to the transaction point.

Chart 5: Pure Online Media Companies Listed on UK Stock Exchanges

Business	Moneysupermarket.com Group PLC	Rambler Media Group Ltd	Rightmove PLC
Description	Online price comparison sites	Portfolio of Russian search & price comparison sites	Online property website
Model	Transaction-based	Display Advertising; Listing Site	Listing Site
Revenue (2008)	£178.8m	£76.0m	£74.0m
Profit (2008)	-£59.0m	£2.3m	£25.5m
Market Capitalization	£407.6m	£29.2m	£660.6m
P/E	n/a	16.2	24.2

4. Hot Players and 'Watchlist'

We have identified a selection of top-class, high-growth companies featuring innovative business models in the transaction stage (see Chart 6). In addition, our framework suggests a further ten

start-ups show great potential to grow into highly successful businesses (see Chart 7). Though still in the early stages of their lifecycle, they definitely merit a closer look.

Chart 6: Hot Players in the Transaction Stage

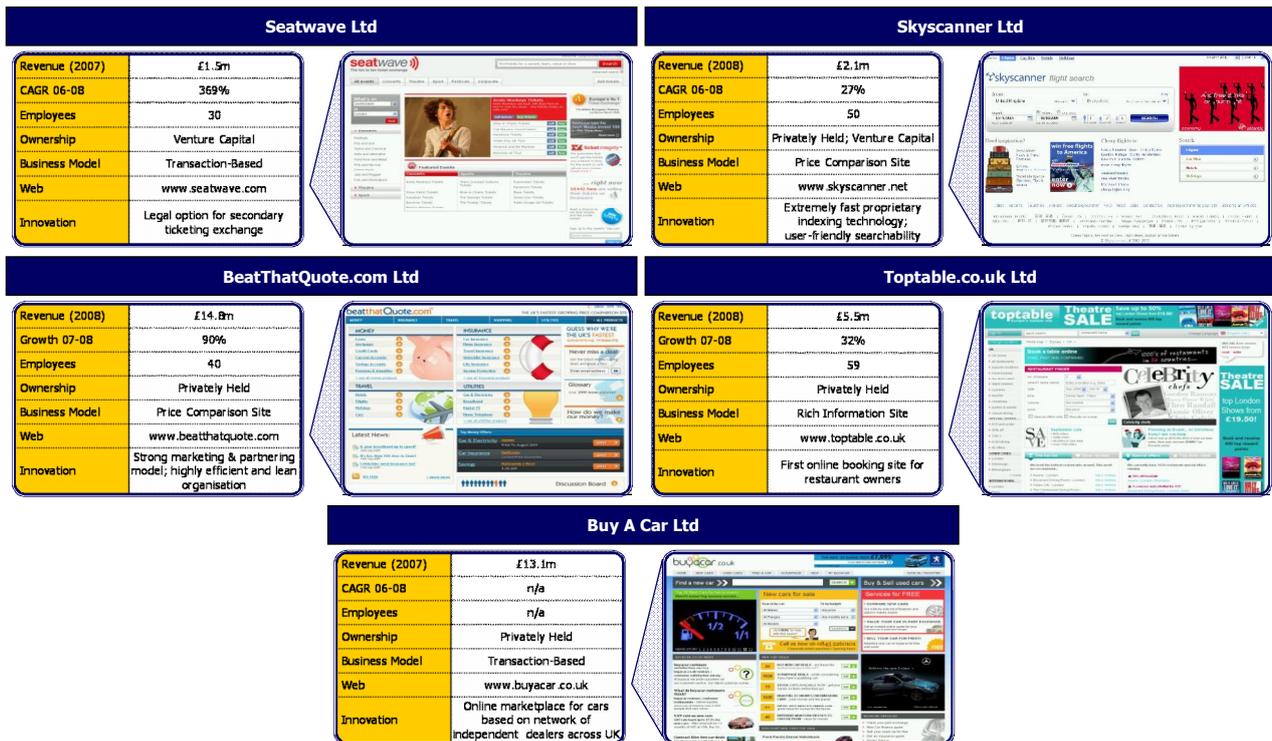


Chart 7: Companies to Watch

Company	Website	Description
Crowdstorm Ltd	www.crowdstorm.co.uk	Social shopping site that lets you buy products based on advice from peers and by tracking where your peers have bought the product
By Design (UK) Ltd	www.mydeco.com	Design a 3D room with actual furniture and household products and buy them directly from the retailer through the site
Demotix Ltd	www.demotix.com	Users can upload photos or videos, which demotix markets to mainstream media, passing 50% of proceeds on to user
Pixsta Ltd	www.pixsta.com	Visual search engine based on similarities between images; technology is already used in fashion shopping sites like www.empora.com or www.net-a-porter.com
Shazam Entertainment Ltd	www.shazam.com	Application for mobiles that tells you title and artist of any song that's playing in the background and lets you buy it online
Aroxo Ltd	www.aroxo.co.uk	Online B2C marketplace for quote-based purchases, whose business model is based on leads generation and selling
Viagogo Ltd	www.viagogo.co.uk	Online secondary ticket exchange; main competitor of Seatwave
Osoyou Ltd	www.osoyou.com	Social shopping site for women, focusing on fashion; provides peer-to-peer advice and forums
LeadPoint Inc	www.leadpoint.co.uk	First B2B exchange online for leads with websites for the US and UK; US-based company
Etsy Inc	www.etsy.com	Online marketplace for handcrafted items, prohibits selling mass articles; US-based company