Interactive Local Media Advisory

The Rapidly Evolving Internet TV Landscape

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Summary: In November, we released a White Paper titled "From Reach to Targeting: The Transformation of TV in the Internet Age," in which we explored the state of Internet television and its development, growing demand and advertising models. Since then, there has been a daily flow of announcements and product launches from companies across the online video space, including television networks, Hollywood content producers, Internet portals and start-up service providers. The activity in the space deserves a second look — an addendum to the aforementioned White Paper that represents a new area of coverage for The Kelsey Group. This new focus will also be reflected at our upcoming conference, Drilling Down on Local: Targeting the On-Demand Marketplace, which will take place March 26-28 in San Jose, California (visit www.kelseygroup.com/dd2006/ for more information). As we begin to tackle this dynamic market sector, please let us know how we are doing and how we can better analyze its many facets and address your particular interests within the space.

Every January at the International Consumer Electronics Show in Las Vegas, a requisite parade of new gadgets are showcased and drooled over for four days. This year, the "geekery" running wild in the conference and exhibit halls had an added dimension that could be felt throughout the show — and that literally stole the stage.

The keynote address of Microsoft's Bill Gates, usually the main event, was upstaged by the speeches of Yahoo!'s Terry Semel and Google's Larry Page. Each addressed a packed house at the Las Vegas Hilton Theater, where a line snaked out the door, down the hall and past endless rows of slot machines.

For the first time at CES, Internet companies, not hardware and software vendors, dominated the headlines. Their announcements centered on video and content, rather than gadgets and gizmos. And instead of technophiles and execs, a star-studded cast was called upon to dazzle the keynote audiences.

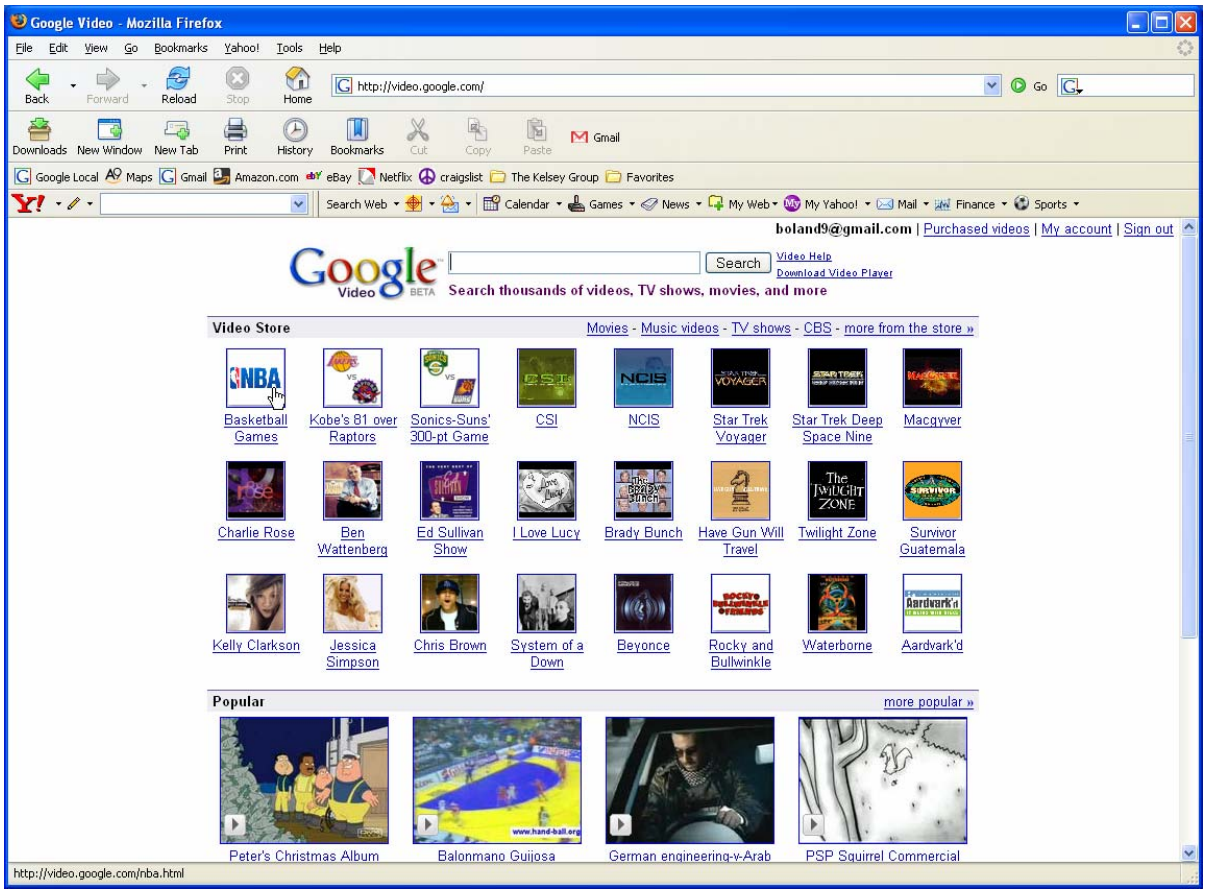
The tech world's new courtship with Hollywood was personified by the appearances of such celebrities as Tom Cruise and Ellen DeGeneres, who both joined Semel during his keynote address, and Robin Williams, who appeared on stage with Page.

The New Video Paradigms

During his presentation, Page, Google's cofounder and president, unveiled a new video player and store that enable users to purchase and view content from CBS, the NBA and other providers. Google plans to partner with additional television networks as well as movie studios to expand the store's content and will accept material from independent publishers to fill out the long tail of its video offerings.

In all its content arrangements, Google will split revenues roughly 70/30 in the producers' favor and allow them to set their own pricing. This will not only offer users more choice, control and interactivity than television, but will also give content producers a more direct relationship with viewers.

Video Store Part of Google's New Offerings



Source: Google (2006)

Meanwhile, Yahoo! Chief Executive Officer Semel focused on the seamless convergence of content across devices and platforms. Through a new product called Yahoo! Go, users can access personalized content on any device connected to the Internet. Instead of storing data separately on individual devices, all the user's content resides on Yahoo! servers. This means changes to data or personalization features on, say, a cellphone are also reflected on the user's PC, television and any other connected device. The service is available on certain Nokia Series 60 handsets and will be downloadable to other Nokia models, as well as some Motorola phones, at an undisclosed point in the future.

Semel also explored the advertising possibilities of providing a place for users to keep all their personalized content that can be accessed from anywhere. This includes, news, instant messages, e-mail and, more notably, self-published content — photos, music, video — for which Yahoo! and independent content publishers can share revenues.

"Almost everything on Yahoo! is content. About 80 percent of the content people have heard of, but then there's that [long] tail," Semel said. "People can elect to have us add an advertisement to [their content] and effectively go into business as a publisher." This

can potentially “hook” users with Yahoo! products that are cemented in the interfaces of myriad devices, and the content organization lets the company learn more about users by having all their data in one place. Combine the behavioral targeting this data would allow with the geotargeting capabilities of mobile devices, and one can see where Yahoo! might want to go with this.

Yahoo! Go Links User Content Across Devices

Source: Yahoo! (2006)

A Disruptive Influence

These announcements from Google and Yahoo! have the potential to be very disruptive to the television industry, namely cable and satellite providers. The lack of scarcity online, compared with the more finite world of cable TV channels, will make it easier and cheaper for content creators to produce and distribute their material. By knocking down the walls around content distribution, eliminating scarcity and reducing cost, Google is giving producers a more direct pipeline to consumers. Consumers, as a result, will have more choice regarding what they watch and how they watch it.

The “how” is where Yahoo! Go comes in, because it will allow users to watch Internet-delivered video on a TV set in “lean back mode” in addition to watching it on a PC in “lean forward mode.” We expect product developments throughout the tech and media worlds in coming months to strongly emphasize bridging this gap between the living room and the home office.

There will also be more choice involved in how to pay for content. Semel made it clear that Yahoo! will rely on ad support, while Google’s video store, in the manner of Apple’s wildly successful iTunes music store, will charge for content. The models could eventually converge, however, and put more choice into users’ hands.

“We may be able to give users much more choice around that,” said Bradley Horowitz, Yahoo!’s director of media and desktop search, when we spoke to him in the fall. “I could subsidize things with ads, and this could be branded advertising where Nike or Coke would be quite willing to put a 15-second bumper in front of your personal video to help build brand awareness for their product. But I also might want to be a premium user, and I’m willing to pay US$4.95 a month to not have to endure that 30-second ad.

This is all in the spirit of speculation, but I think you'll have pay-per-view, I think you'll have subscription, I think you'll have premium service, and I think you'll have ad-supported models. It's too soon to say what is going to work, so we are going to be very playful and exploratory."

It will come down to a question of user preferences, so a great deal of experimentation indeed will be necessary. According to research released this month by Points North Group and Horowitz Associates (no relation to Yahoo!'s Horowitz), consumers prefer free on-demand video content with commercials over the alternative $1.99 charge, which is the approximate fee for video from the iTunes and Google stores, by a margin of more than 3-to-1 (62 percent vs. 17 percent; 21 percent were undecided).

Regardless of the monetization strategies determined over time, the initial moves into this space are significant and representative of these companies' revenue stream projections for the next decade. As Google and Yahoo! continue to grow, they must diversify their revenue streams to stave off the effects of maturity in the markets they lead. The expectation set by Google's stock price in particular compels the company to find new sources of value in its base of technology.

The moves into publishing video content represent the right direction for both companies to leverage existing strengths in a new growth industry. When combined with the targeted ad networks Google and Yahoo! have already built, video distribution initiatives will become powerful mediums for content and ad delivery that will be relevant on national and local levels. This will be predicated on long-tail content where the value of targeting can make up for the lack of reach. This will come with its own set of challenges. How users navigate the long tail and find what they are looking for is one. Most likely to overcome such a challenge would be Google and Yahoo! — the very companies that revolutionized online search.

Other Notable Video Developments

The video announcements at CES didn't stop with Google and Yahoo!. The traditional leaders of the conference also had some things to say and products to unveil in the video arena.

Gates pulled back the curtain on Urge, MTV Networks' new digital video and music service, and focused on Microsoft Live's online content and the newest version of Windows Media Center, which will have greater video downloading capabilities as well as interactivity with TV sets and high-definition monitors. He also showcased the red-hot Xbox 360 for its connectivity and its high-definition DVD capability, which Microsoft and others are championing as the new standard in HD DVDs.

Intel Corp. staked its claim in the video and content arena as well. Paul Otellini, Intel's president and CEO, announced deals with more than 60 movie and television companies. He also unveiled the company's Viiv platform for video delivery, which is based on Intel's new Core Duo processor family.

The video and content emphasis at CES is indicative of the activity, buzz and product development going on throughout the tech world. A number of notable announcements, partnerships and product rollouts have occurred since we released our IPTV White Paper in November. These can be divided into two categories: customer facing sites (or video stores such as Google's) and advertiser and publisher facing services.

Customer Facing Sites

America Online and Truveo

The week after CES, America Online joined its chief competitors in the portal world by announcing that it will acquire newly launched video search engine Truveo. Through the

move, AOL hopes to bolster its market share and traffic growth in the video search space, where it trails Yahoo! and Google, according to data released from Hitwise in December. The acquisition will build upon AOL's position in the video search space, which was born in November 2003 with the purchase of Singingfish, continued with its launch of AOL Video Search in June of last year and culminated in its landmark online video coverage of the Live 8 concert in July.

AOL will integrate Truveo with its existing video search products and the extensive content assets available through its corporate siblings at Time Warner. The integration is set to take place within the next few months. In the meantime, AOL continues to form external content partnerships such as those it already has with Reuters, MTV and iFilm.

AOL Advances in Video With Truveo Deal

Source: Truveo (2006)

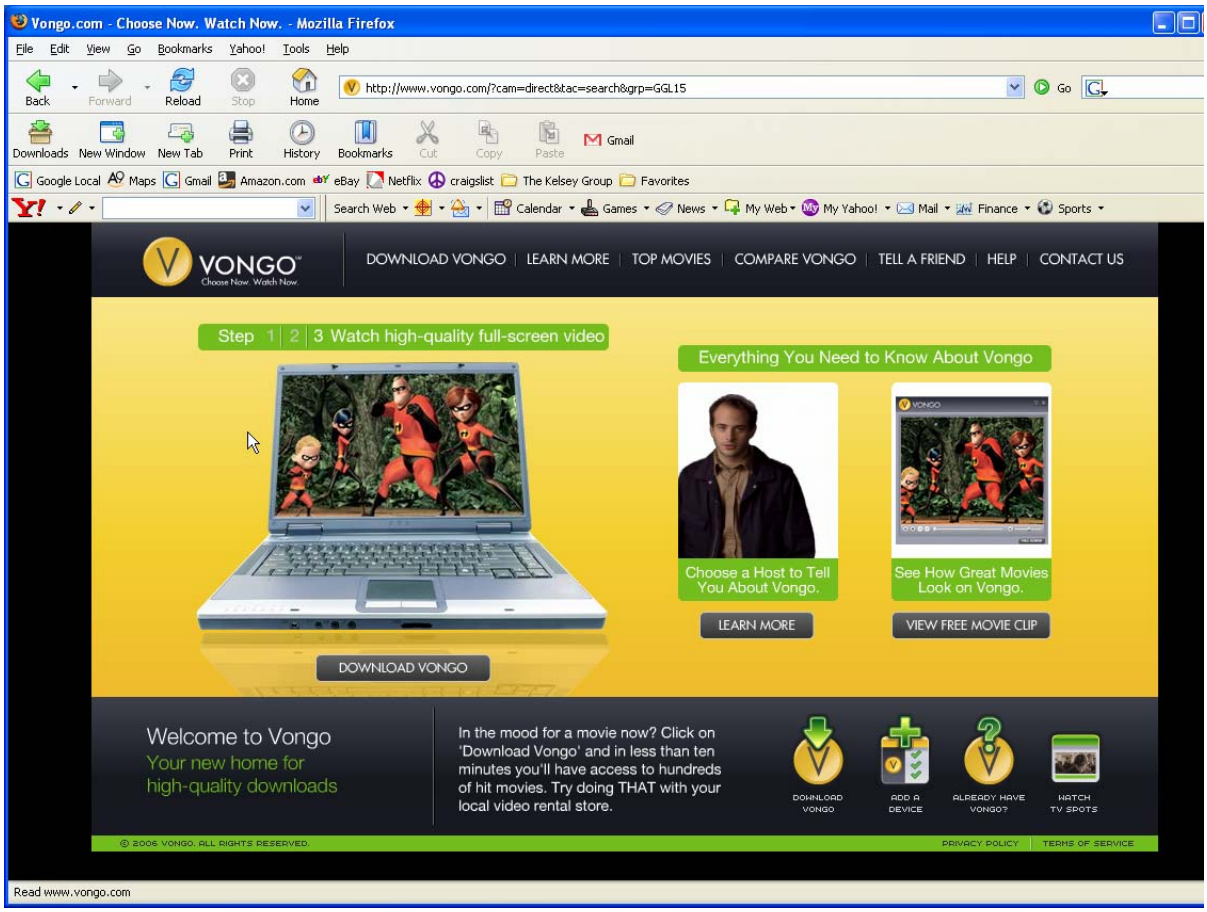
Truveo boasts better search ability for video content, which will be an important point of distinction for online video services as they become increasingly inundated with long-tail content. The company likes to refer to its proprietary search technology as "visual crawling." Instead of searching the metadata given to some video files by their creators or the closed-caption transcripts available for other content (both represent industry standards for video search and are widely agreed to need improvement), Truveo "visually" examines additional dimensions of context surrounding video, such as the data adjacent to video files on the Web sites where they reside.

In addition, AOL will get further distribution of its video through its recent deal with Google. Among other things, the two companies will collaborate in “video search and showcasing AOL's premium video service within Google Video.” How this will play out isn’t clear, but it is another step forward for AOL in the video space and makes it a company to watch closely.

Vongo

The Starz Entertainment Group this month launched Vongo, an online video service that will charge users US$9.99 per month to view thousands of movies, some just out of theaters. The movies are available for download on Windows-based PCs and are viewable on TVs and some portable devices. The content is imbedded with DRM software that causes movie files to remove themselves from hard drives after a certain term, and new content is added each week. The subscription also gives users a live stream of the Starz movie channel and the ability to order pay-per-view titles and events for $3.95 each. Currently Vongo is the only site with this combination of features and the content aggregation capabilities of a premium movie channel.

Vongo Features A-Grade Movie Downloads



Source: Vongo (2006)

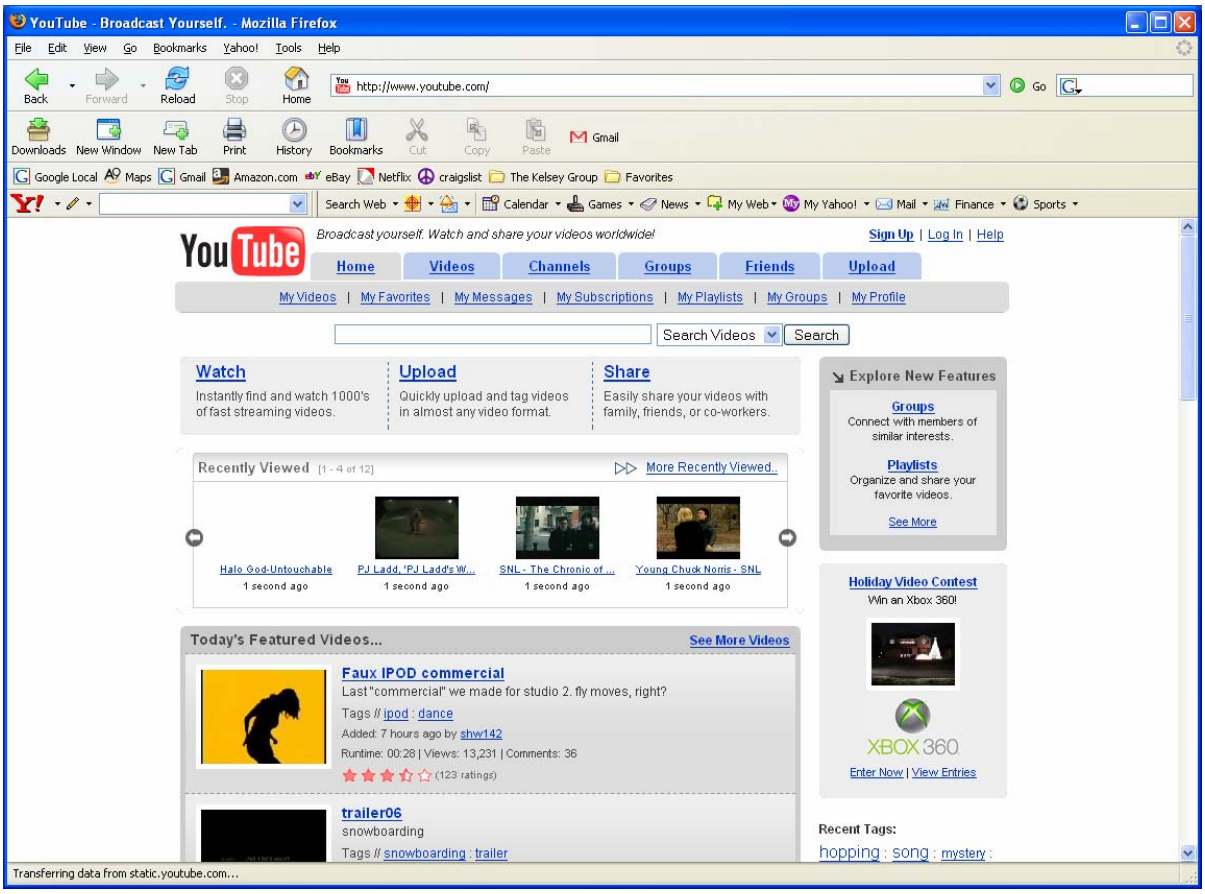
YouTube

YouTube is a free video-sharing service that recently crept up on the online video marketplace and represents an interesting model. We like to think of it as the Flickr of

video. Users can upload video and search YouTube's library of user-generated content. And, as with Flickr, they can tag and add editorial layers of content.

YouTube's strategy of employing users, rather than software, to tag content is similar to what Yahoo!, which acquired Flickr last March, has done across its network. Indeed, this type of "folksonomy" could be powerful in the video arena, as it has proved to be with photos on Flickr, and could render technologies such as Truveo obsolete (or at least reduce them to overkill).

YouTube Allows Users to Tag Video Content



Source: YouTube (2006)

Given the volume of long-tail content available on the Web, the challenge is indexing it. "It turns out that people are really good at this problem, and there are 6 billion of us on this planet. If you can create the right system and incentives to allow people to do that heavy lifting for you, you've got the problem nailed," Yahoo!'s Horowitz said. "That is very much where we are headed in Yahoo! Search — specifically to begin to create the systems that allow people to make a big difference [in] what is going on in search results and in peoples' ability to discover, browse and navigate content. So you will see us over time apply the same concepts that are manifest in Flickr in all of our properties, and none is more exciting or relevant [than] video."

According to Hitwise, YouTube has grown the most in market share over the past three months, compared with Yahoo! video search, Google video search (before the Google video store launch) and AOL's Singingfish (before the Truveo acquisition). YouTube claims its users are sharing 20,000 videos per day, and viewers are watching 10 million clips per day. It has attracted a young and powerful demographic, among which viral

marketing can spread like wildfire. This is reminiscent of the success of MySpace within the same demographic. Like MySpace, YouTube will become a hot acquisition target — especially for a company like Yahoo!, which could leverage it as a powerful tool (for all the reasons mentioned above) and monetize it through its existing ad network.

Another site, called Vimeo, has also joined this space with an interesting combination of video sharing (like YouTube), social networking (like MySpace) and video blogging, known as "vlogging."

Advertiser and Publisher Facing Services

Brightcove

In late November, Internet TV start-up Brightcove received $16.2 million in Series B funding from AOL, IAC/InterActiveCorp and Hearst Corp., among others. The service, yet to launch, was founded by Jeremy Allaire, former chief technology officer of Macromedia. Brightcove will offer large and small video producers a platform to distribute their content and generate ad or sales revenues — either on their own Web sites or those of affiliates or through other consumer facing Internet services. Part of the funding arrangement with AOL will give Brightcove customers the option to syndicate content directly to AOL.com and have it indexed and searchable in AOL's video library.

Spot Runner

The most recent entrant in the Internet video space represents a brand-new model that has intriguing possibilities for advertising and monetization of online video. Spot Runner, which launched earlier this month, is best-described as an Internet-based TV ad buying network that focuses on local.

Using a self-service platform, an SME can choose from a library of existing creative ads that Spot Runner has aggregated. The SME then selects geographic markets as well as desired scheduling and other metrics and — voila — ends up with a television ad for a flat fee that is far less expensive than what the business would pay to create its own spot for cable or local broadcasting distribution.

This could be revolutionary in that it eliminates a huge barrier to SME video advertising. More importantly, it has enormous relevance in an Internet TV context, where better targeting is available and long-tail content will open up vast reaches of inventory for corresponding SME advertising. A challenge we foresee will be marketing the service to SMEs that have an aversion to TV advertising because of preconceived notions about costs and challenges. Spot Runner will be an attractive acquisition target for companies with an existing sales channel to SMEs and cross-platform sales strategies or those with self-provisioning channels in place.

Tremor Network

Also this month, Tremor Network announced it will introduce a video advertising network built on its recent acquisition of streaming video advertising company Dynadco. This will be similar to Brightcove, offering video publishers a platform for content creation and ad sales. Publishers can basically choose to sell their own ads or split revenues with Tremor to sell and serve up ads next to their content. The company has already reached deals with undisclosed news, sports and entertainment content producers. It will also share revenues with a network of Web sites that don't have video content and would like to add it to their sites — in effect expanding Tremor's ad inventory (and reach).

Meanwhile, Reuters and the Associated Press are working on similar video networks wherein member sites are offered a video player and news content. Affiliate MSN will handle the ad sales and share revenues with the hosting sites and the news networks.

This could be a model we see growing, to bring Web video to smaller sites and increase the available video ad inventory in these networks. It's very similar to Google's AdSense network of Web sites that share revenues with Google for placing contextualized text ads on their sites.

VideoEgg

Internet video start-up VideoEgg announced this month that it has received venture funding from August Capital to advance its VideoEgg Publisher. The platform simplifies the process of self publishing video from any digital camcorder, Web cam, mobile phone or existing video file. The company will market this to the general video publishing marketplace, as well as anyone interested in adding video to classified ads, auction postings, real estate sites, and dating and social networking sites.

IPTV vs. Internet Television

It is important to distinguish between Internet television and Internet Protocol Television, or IPTV. Internet television is any video offering delivered over the public Internet — which would include virtually all the services outlined above. IPTV, on the other hand, is a closed system in which a service provider delivers a broadband signal to a set-top box connected to a television. With IPTV, there won't be as much free rein for companies or individuals to launch video channels and deliver content, simply because it will require a content or distribution partnership with the service provider that "owns" the network. That's as opposed to launching a video channel or self-published content through an existing video portal like Google or AOL on the public Internet.

Microsoft's IPTV Software User Interface

Source: Microsoft (2006)

The reality of IPTV is farther away. Telecom operators such as AT&T and Verizon are currently laying down new fiber and copper networks to handle the bandwidth-hungry video service packages they plan to deliver. AT&T is testing a limited service rollout in its hometown of San Antonio and has another test slated for San Ramon, California. The company has scheduled a more widespread deployment for midyear.

IPTV has the advantages of a direct transmission path to the user's set-top box and better compression technologies (via software from Microsoft, for example; see images above). The delivery of Internet TV, by comparison, has network limitations that only allow streaming of small or low-resolution files; larger files require long download times.

IPTV providers will combine the advantages of cable television (users will interface with their televisions and set-top boxes with a remote control, a setup they are comfortable with) and that of IP technologies. IPTV will have a switched video architecture, which means only one channel is called up at a time — similar to the way sites are brought up individually in a Web context. This compares with cable and satellite television architecture, in which all channels are delivered at once for users to flip through. The result is IPTV won't have any bandwidth limitations on the amount of channels available,

and bandwidth is freed up for other features, such as watching multiple programs (appealing for sports fans) and pulling in content in various interactive ways.

Washington Post tech columnist Leslie Walker put it eloquently in a Jan. 12 article on IPTV:

"Basically, IPTV allows multiple layers of video, pictures and text to be mixed with video feeds in ways viewers can control with their remotes. It's the old interactive TV vision — point your remote at an actress on screen and up comes her name, prior credits and perhaps a 'buy me' button for her blue sequined dress."

The differences between IPTV and the Internet TV offerings of AOL, Google, Yahoo! and others will become more and more negligible as technologies are developed to integrate users' PCs and televisions, and as broadband speeds increase into homes.

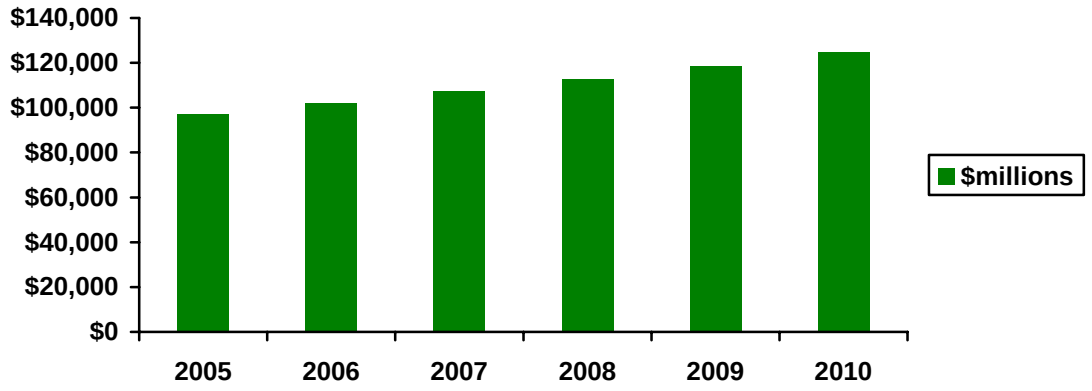
Ad Models: The Bottom Line

From an advertising perspective, Internet TV players are perhaps in a better position than IPTV providers, because of the models already in place on the Web for paid search and advertising. The self-provisioning models of some paid search companies could have applicability to the large and fragmented base of advertisers that will be interested in Web-delivered video. And performance-based advertising could be integral to these models, meaning Google AdWords and Yahoo! Search Marketing could have a leg up on reaching local advertisers.

IPTV providers, on the other hand, will have to form relationships to bring in advertising to fill the broad reaches of ad inventory that will open up with their expanded content capacity. They will also want to take advantage of IPTV's local targeting abilities by selling to a fragmented base of local and SME advertisers. A cable television ad sales model will not scale to this level. But luckily the leaders in the IPTV space — AT&T, BellSouth and Verizon — all have directory publishing assets to bring this advertising base into the picture. How or if they will do this isn't clear and could require some innovation (technologies like Spot Runner, for example), but the opportunity is there, based on demand, inventory and existing sales channels.

Regardless of sales channel, we can look forward to video distribution having relevance to local advertising. Whatever business model wins out in the video space of the next decade will be able to claim an increasing share of the local advertising market, estimated by The Kelsey Group to reach nearly $125 billion by 2010 (see chart below).

The Kelsey Group Local Advertising Market Projection



Source: The Kelsey Group Preliminary Forecast (2006)

A great deal still needs to happen: User adoption must reach critical mass, and business models have to develop and prove sustainability. An important question therefore is: When will the industry reach a point where clear-cut revenue models can be discerned? Also, when will standards be established for creating local sales channels, ad targeting and performance metrics?

We believe these factors will coalesce in the next three to five years. During this time, we will see a great deal of experimentation, innovation and business activity, as companies on the consumer and advertiser facing sides attempt to establish industry standards and, more importantly, be first to reach market with them. Media companies interested in this space should think in these terms and take risks, as is necessary in any fledgling technology field.

There will indeed be a great deal of experimentation in the online video space over the next five years. The product launches and business activity outlined above (and continuing "as we speak") are more than anything emblematic of a positioning for the future and testing of the waters.

As Steve Wadsworth, president of the Walt Disney Internet Group, opined during a panel discussion at the National Association of Television Program Executives' recent annual conference, "Let's get out in the market early and see what the consumer wants."

