

Global / China Internet Trends

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Outline

- Attributes of Winning Companies
- Global Internet
- China Internet
- Your Questions

Attributes of Winning Companies

Attributes of Winning Companies...

1. Large market opportunities - it is better to have 10%, and rising, market share of a \$1 billion market than 100% of a \$100M market
2. Good technology/service that offers a significant value/service proposition to its customers
3. Simple, direct mission and strong culture
4. Missionary (not mercenary), passionate, maniacally-focused founder(s)
5. Technology magnets (never underestimate the power of great engineers)
6. Great management team / board of directors / committed partners
7. Ability to lead change and embrace chaos
8. Leading/sustainable market position with first-mover advantage
9. Brand leadership, leading reach and market share
10. Global presence

...Attributes of Winning Companies

11. Insane customer focus and rapidly growing customer base
12. Stickiness and customer loyalty
13. Extensible product line(s) with focus on constant improvement and regeneration
14. Clear, broad distribution plans
15. Opportunity to increase customer “touch points”
16. Strong business and milestone momentum
17. Annuity-like business with sustainable operating leverage assisted by barriers-to-entry
18. High gross margins
19. Path to improving operating margins
20. Low-cost infrastructure and development efforts

Global Internet

Internet Data Points: Global...

Global → N. America = 23% of Internet users in 2005; was 66% in 1995

S. Korea → Broadband penetration of 70%+ - No. 1 in world

China → More Internet users < age of 30 than anywhere

...Internet Data Points: Communications...

- Broadband** → 179MM global subscribers (+45% Y/Y, CQ2); 57MM in Asia; 45MM in N. America
- Mobile Messaging** → 1.1T SMSs sent with \$50B in revenue in 2004 (Informa 5/05); more emails sent in Japan via mobile than PC (DoCoMo 2005)
- VoIP** → 61MM registered Skype users (10/05) - fastest product ramp ever?
- Denmark** → VoIP minutes > landline voice minutes
- Tencent** → 16MM peak simultaneous Instant Message users, China, CQ2

...Internet Data Points: Content...

Google	→	7.6B global searches (+74% Y/Y, 5/05); 384MM global unique visitors (+36%, 5/05) per comScore
Personalization	→	40MM+ estimated My Yahoo! users
Blogging	→	27% of US Internet users read blogs, 11/04
Yahoo!	→	~1.6B streaming video (music...) sessions (+100% Y/Y, CQ3)
Digital Media	→	695MM cumulative iTunes as of 9/05; 7MM iPods sold in CQ3:05 (+220% Y/Y); 1MM videos sold in 20 days (10/05)
Ringtones	→	\$3B annualized ringtone sales (Informa 5/05) - vs. \$495MM cumulative iTunes sales (7/05)

...Internet Data Points: Payments

PayPal → 87MM accounts (+53% Y/Y, CQ3); 25MM users (+41% Y/Y)

Mobile Payments → 4MM+ NTT DoCoMo wallet phone users (CQ1) in Japan

Top 5 Global Internet Market Cap Leaders

Google + Yahoo! + eBay + Yahoo! Japan + Amazon.com

- \$ 2B = market value - pre-2000 IPO
- \$178B = market value - Nasdaq peak – 3/10/00
- \$ 32B = market value - Nasdaq trough – 10/9/02
- \$273B = market value - 10/28/05

For Google we include \$100MM in post-money valuation

Significant Infrastructure Builds...

Capital Expenditures

(US\$ in Millions)	C2003	C2004	C2005E
Google	\$177	\$319	\$796
Y/Y	375%	80%	150%
Yahoo!	\$117	\$246	\$405
Y/Y	128%	109%	65%
eBay ⁽¹⁾	\$365	\$293	\$381
Y/Y	163%	(20%)	30%
Amazon.com	\$46	\$89	\$200
Y/Y	17%	94%	124%

Source: Company filings, Morgan Stanley Research. Figures exclude capital expenditures from acquired companies.

(1) C2003 includes \$125.1MM purchase of additional office space.

E = Morgan Stanley Research estimates.

...Significant Infrastructure Builds

To organize all the world's information and make it universally accessible and useful.

-Google's Mission Statement

Communications Changing / Being Changed

1975



Landline Phone

Pace of innovation across communication devices, services and networks continues to rise



2005

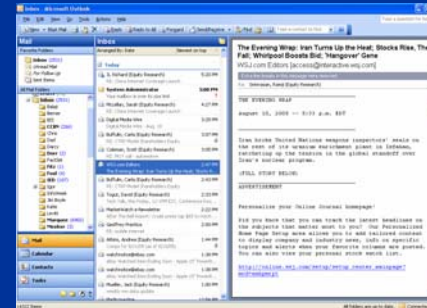
Mobile



VoIP



IM

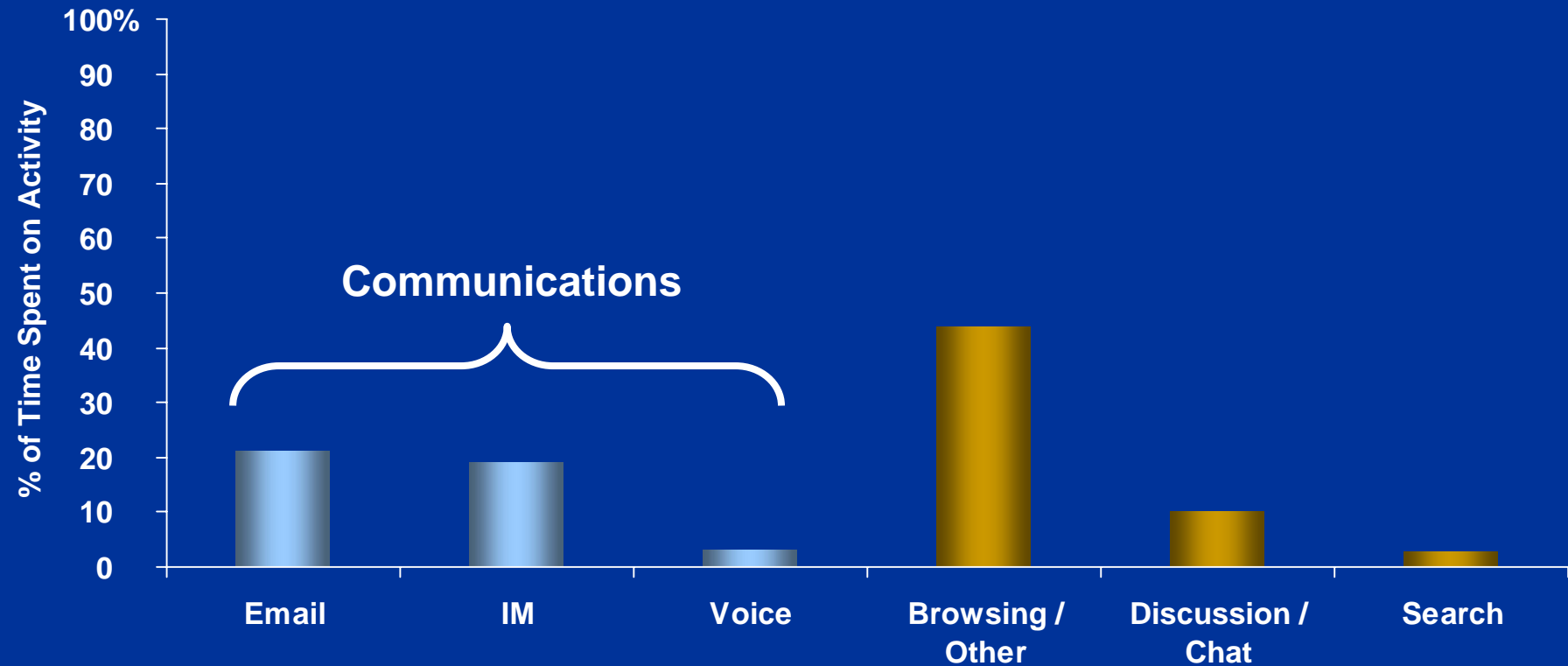


Email



Blogs

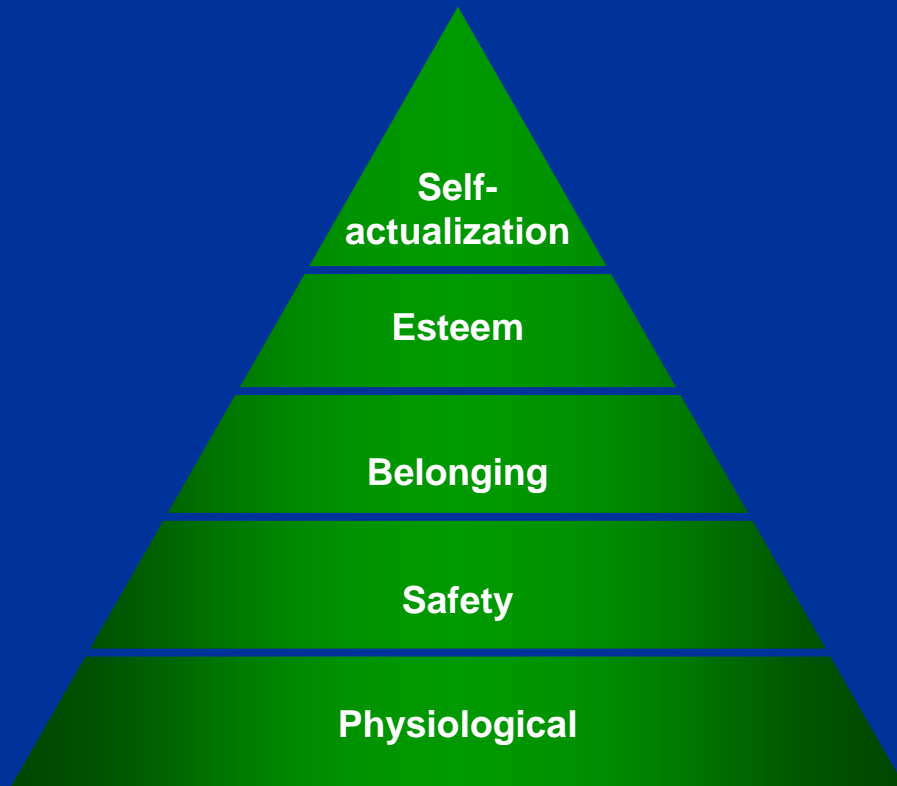
Communications = 44% (& Rising) of US Online Usage



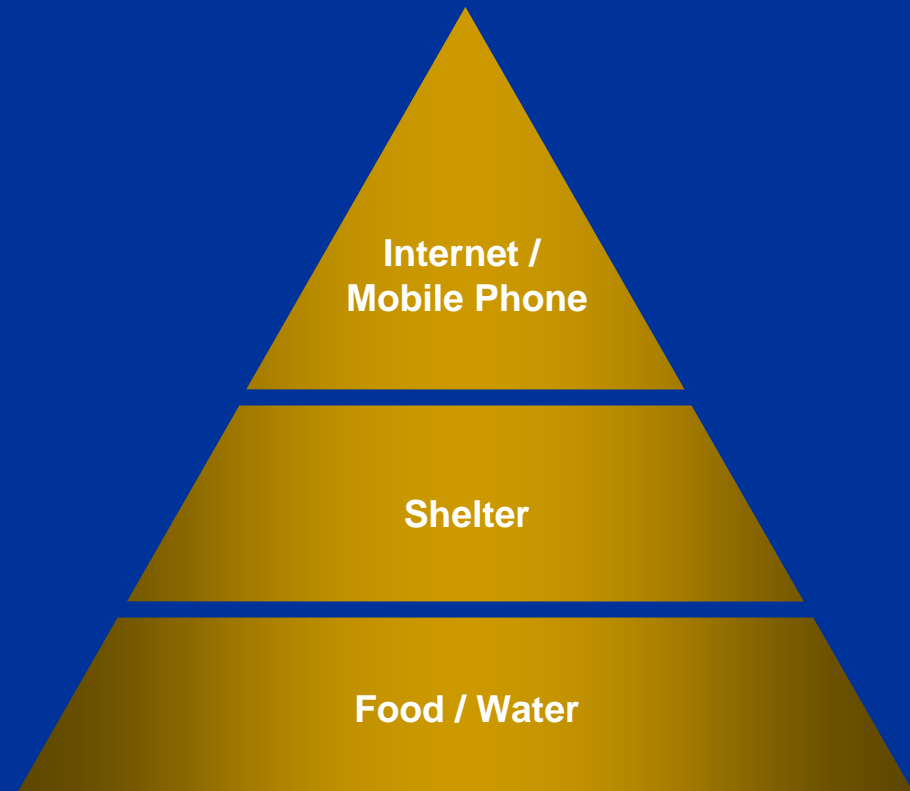
Source: comScore Media Metrix, based on average minutes per visitor by category (8/05). Browsing / Other includes general web-surfing activity not listed in other categories, including anything from news sites (cnn.com) to retail (Amazon.com) to job sites.

Hierarchy of Needs?

1943 - Maslow



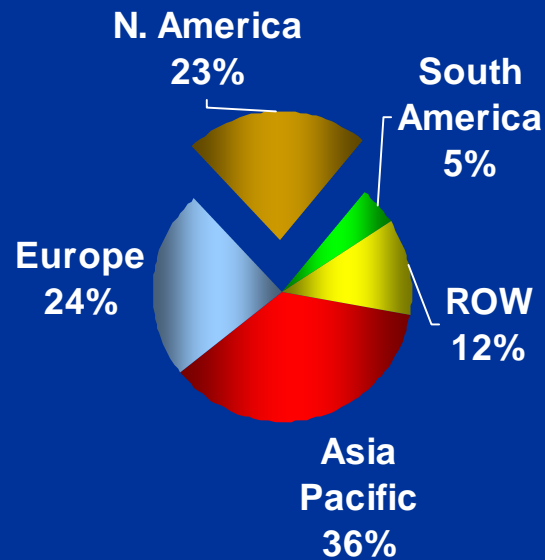
2005 - ? ;)



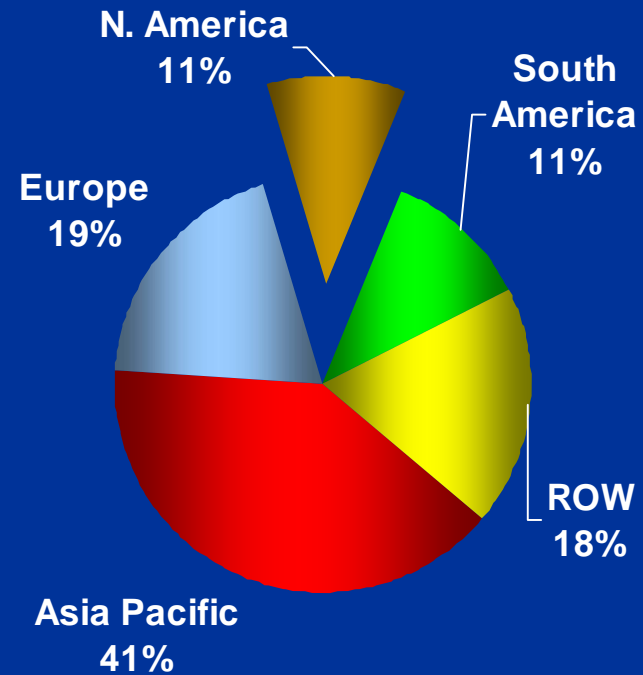
Created for discussion purposes and perhaps a bit of humor. Not intended to discredit Maslow's hierarchy of needs which we believe to be accurate.

Global Users / Innovation

**Internet Users – 1B
C2005E (1)**



**Mobile Subscribers – 2B
C2005E (2)**



(1) Source: Morgan Stanley Research.

(2) Source: Morgan Stanley Communications Equipment Research: Scott Coleman, John Marchetti.

In / Entering Major Computing Cycles

4 major computing cycles over past 50 years

Mainframe → Minicomputer → PC → PC Internet (Narrowband)

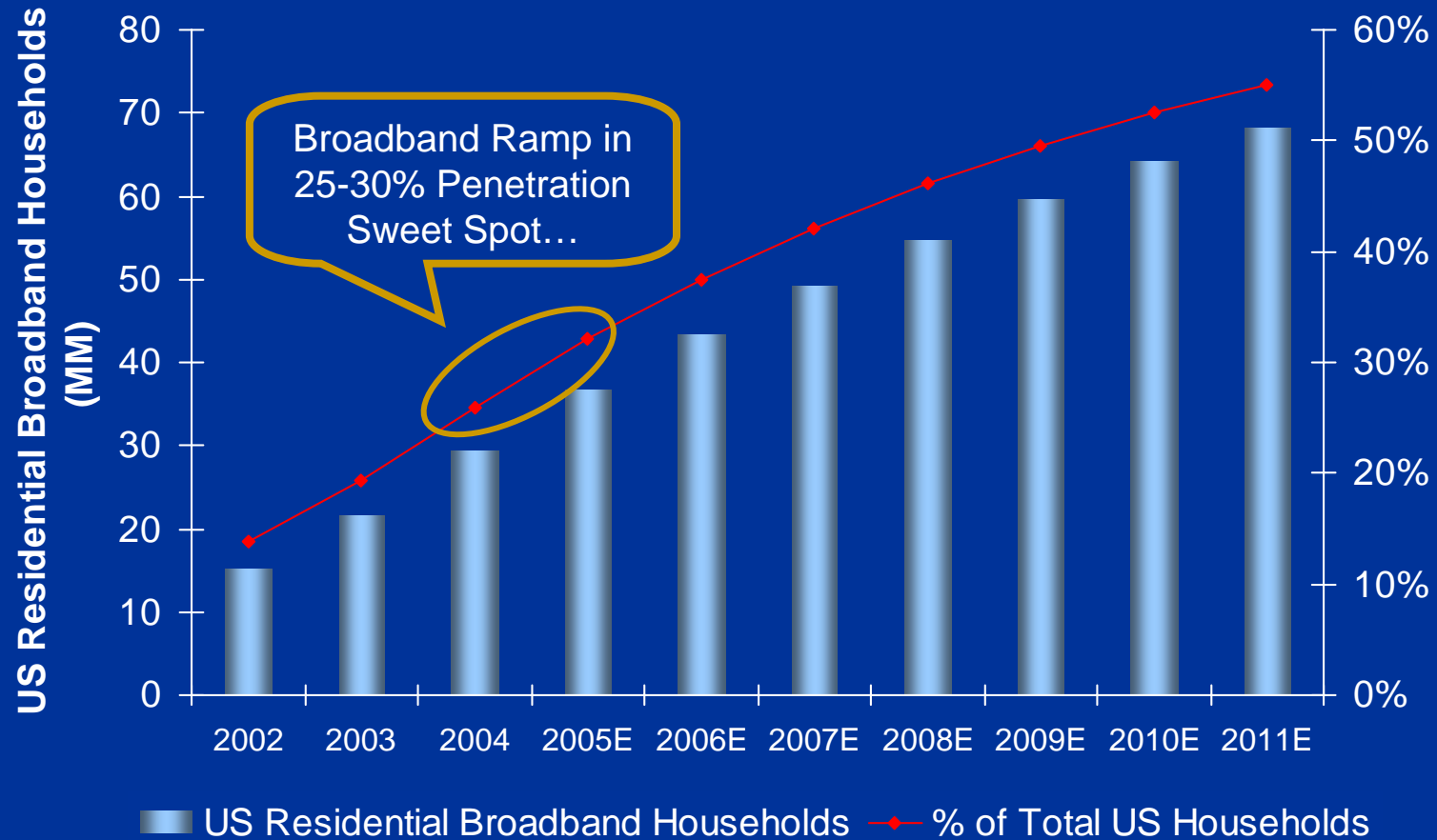
In / entering 2 most profound cycles ever

PC Internet (Broadband) → Mobile Internet

Why now?

- 1) Broadband becoming pervasive
- 2) Internet-enabled mobile devices becoming pervasive - in effect, becoming small / functional computers
- 3) Global technology innovation may be at all time high

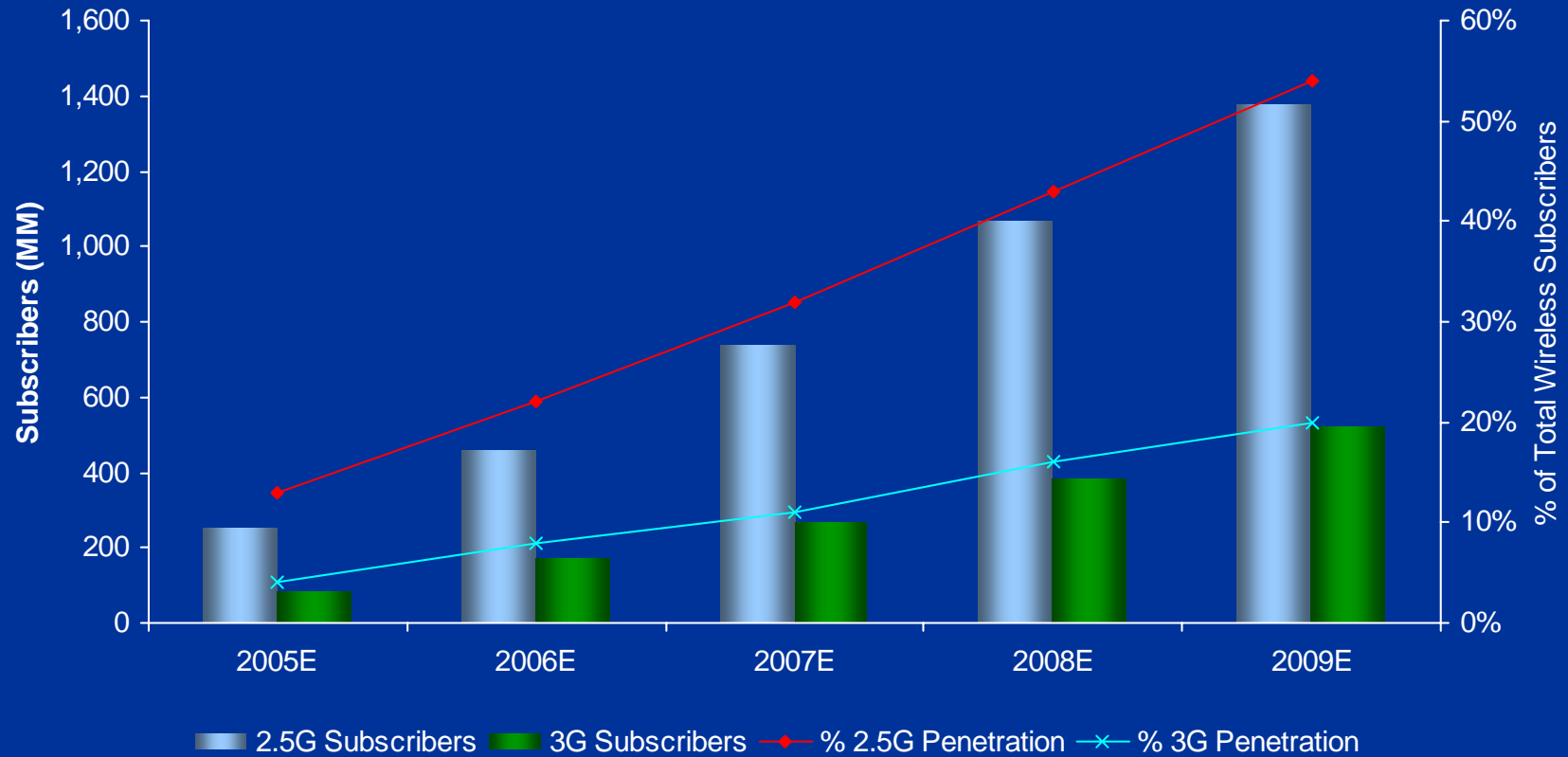
Broadband Becoming Pervasive



Morgan Stanley Research.

Mobile Broadband in Early Stages

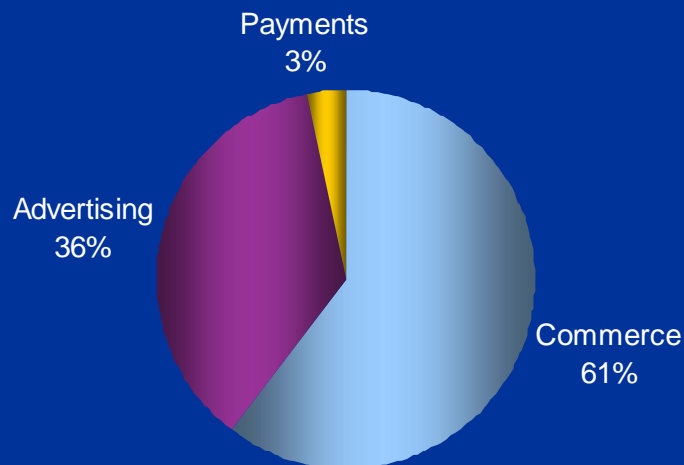
Global 2.5G / 3G Penetration



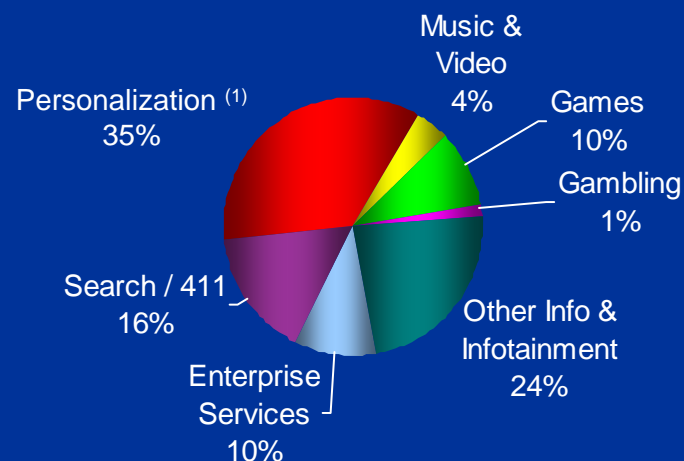
Source: Morgan Stanley Telecom, Internet Research.

Broadband vs. Mobile Internet Revenue Composition?

**Top 10 Internet Companies - Revenue Composition
CQ2 Annualized - \$28B**



**Revenue Composition - Mobile Internet
C2005E - \$19B**



Source: Left Chart - Morgan Stanley Research estimates: includes revenue from Google, eBay, Yahoo!, Yahoo! Japan, Amazon.com, T-Online, InterActive, Time Warner (AOL only), Microsoft (MSN only), and Rakuten. Right Chart - Morgan Stanley Research estimates, Global Data. Informa (5/05), Ovum (5/05). (1) Personalization includes ringtones, wallpapers, and screensavers. If SMS / MMS were added to Mobile Internet—it would add \$55B to total revenue and would account for 74% of total revenue.

Global Internet Thesis

10-15% user growth

20-30% usage growth

30%+ monetization growth

China Internet

China Internet

China

Most consumers
(1.3B)

Fastest
growing economy
(19x GDP expansion
over past 20 years)

Internet

Potential to reach more
Chinese consumers than
other industries

Fastest growing
industry in China

= *Size*

= *Growth*

-1-

Growing Faster than Other Markets...with More Potential

- **China leads world in mobile subscribers**
- **China ranks No. 2 in Internet users**
- **More Internet users under the age of 30 than any other country**
- **Growth drivers for Chinese Internet have been / are robust**

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China Internet is Mobile vs. PC-Centric

Country	Mobile Users (MM)	Internet Users (MM)	Mobile Phone to Internet User Ratio	Installed PCs (MM)
China	363	100	3.6:1	53
US	177	211	0.8:1	207
Japan	88	78	1.1:1	55
Germany	69	51	1.4:1	39
UK	54	37	1.5:1	26
Italy	54	32	1.7:1	16
S. Korea	37	32	1.2:1	27

Euromonitor, CNNIC, World Bank, Morgan Stanley Research (July 2005)

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Internet Helps Bring About Cultural Evolution

	Pre-Internet Age	Post-Internet Age
Status	Gaping holes	Filling in holes
Information	Regulated (Top 10 Newspapers all state-owned)	Portals (Sina, Sohu)- alternative news sources
Entertainment	Only 8 model movies during the Cultural Revolution	New entertainment formats, such as Online Gaming (Shanda, NetEase)
Interaction	Deficient due to one-child policy	Instant messaging (Tencent) and MVAS (TOM Online, Sina) offer connectivity

Source: Morgan Stanley Research.

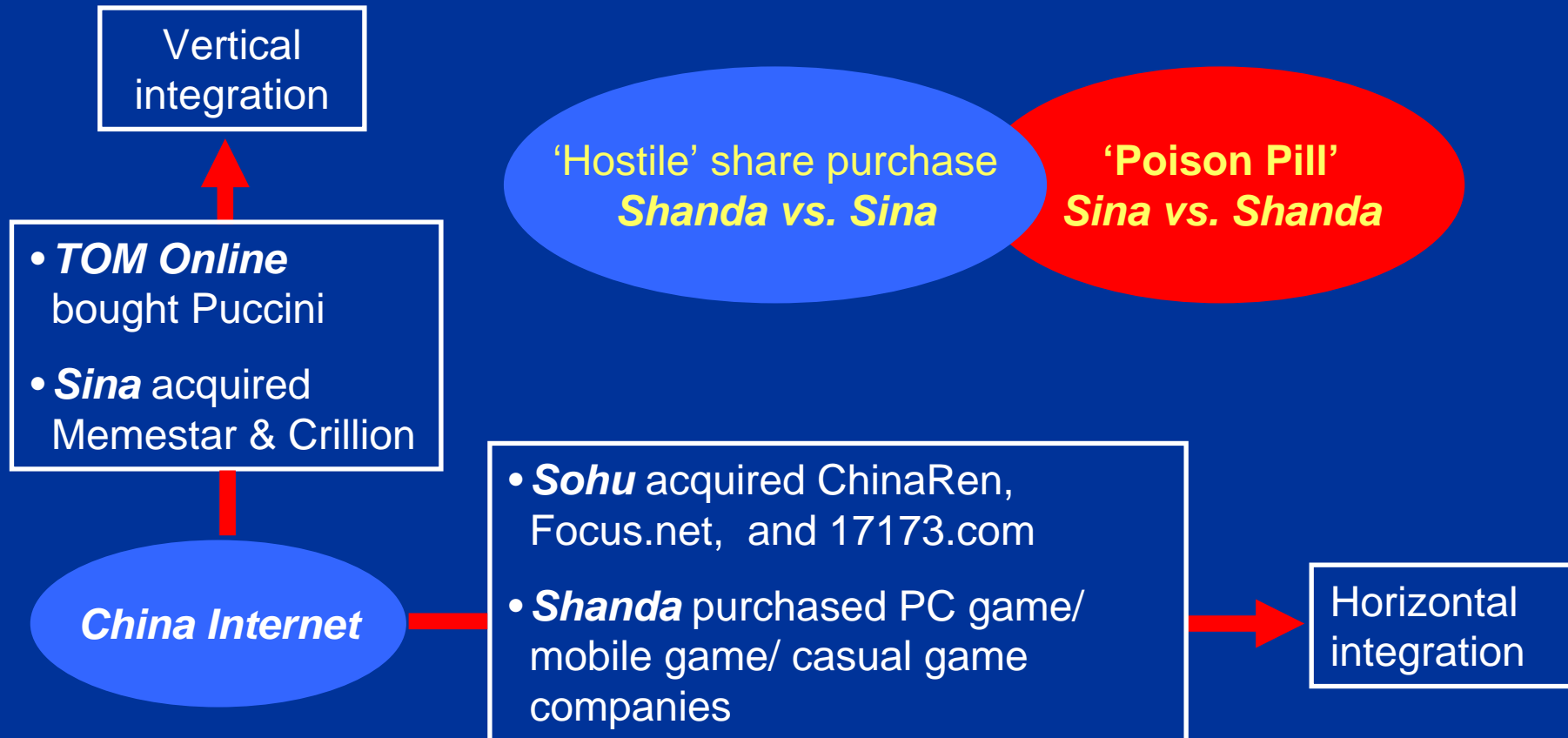
-4-

Foreign Interests Accelerating

Foreign Entrants	Local Targets	Dates	Transaction Type	Market Position of Target
eBay	EachNet	Jul-03	Acquisition	No. 1 in online auction
Yahoo!	3721.com	Nov-03	Acquisition	No. 2 in paid search
Google	Baidu	Jun-04	Bought 3% Stake	No. 1 in paid search
InterActive	eLong	Jul-04	Bought 30% Stake	No. 2 in online traveling
Amazon.com	Joyo	Aug-04	Acquisition	Leading ecommerce store
Monster.com	ChinaHR	Feb-05	Bought 40% Stake	No. 2 in online recruiting
Yahoo!	Alibaba	Aug-05	Bought 40% Stake	No. 1 in B2B marketplace

Source: Morgan Stanley Research (Market positions were based on our estimates on the dates of transactions)

Mergers and Acquisitions Active



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A League of Big Players

Industry	Companies	Industry Rank	Market Share
Online Advertising	Sina	No. 1	30%
	Sohu	No. 2	25%
		Total share =	55% of industry rev
Online Gaming	Shanda	No. 1	39%
	NetEase	No. 2	18%
		Total share =	58% of industry rev
MVAS	Sina	No.1	16%
	Tom Online	No. 2	15%
	Tencent	No. 3	10%
		Total share =	41% of industry rev
Instant Messaging (IM)	Tencent	No. 1	77% of IM users
Online Auction	eBay EachNet	No. 1	65% plus
	Alibaba/ Taobao	No. 2	29% plus
		Total share =	94% plus of GMV

Sources: Company data (2004), IResearch, Morgan Stanley Research; GMV- gross merchandise value

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Leadership Positions Not Necessarily Secure

Sales (\$MM)	2Q2003	2Q2004	2Q2005
MVAS			
Sina	14	31	23
TOM Online	-	29	41
as % of Sina	-	93%	180%
Online Gaming			
Shanda	17	35	56
NetEase	4	16	40
as % of Shanda	24%	46%	70%
Online Advertising			
Sina	10	16	20
Sohu	7	13	17
as % of Sina	72%	86%	83%

**Narrowing gaps
or
Change in leadership**

Sources: Company data, Morgan Stanley Research

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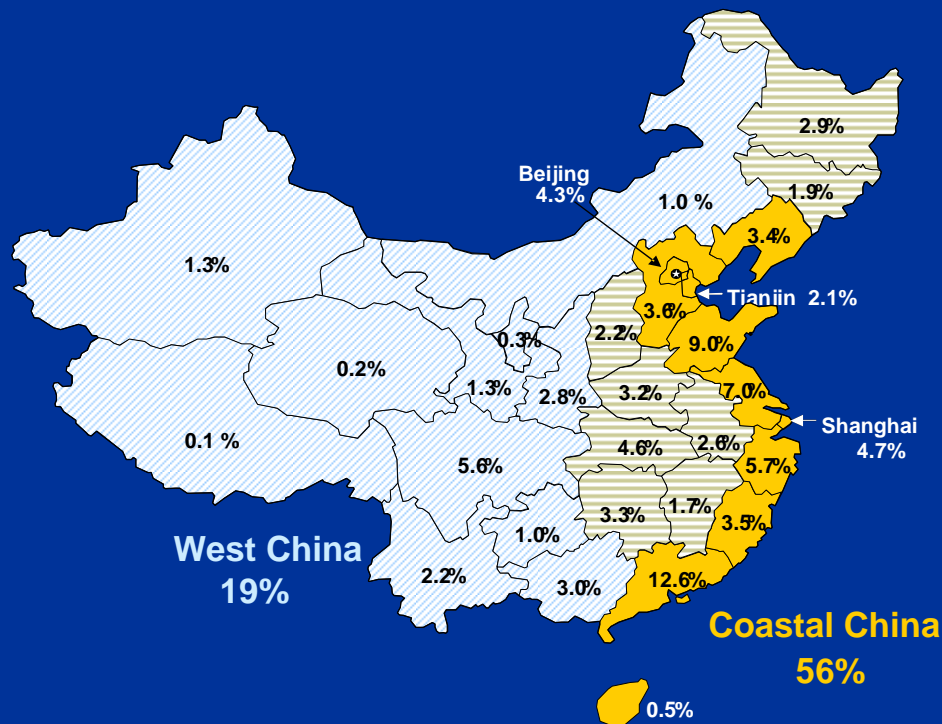
Purer Players Tend to Have Higher Market Share

Industry	Companies	Rank in the Industry	Industry Business-line as % of company's revenue
Online Gaming	Shanda	No. 1	87%
	NetEase	No. 2	83
Online Advertising	Sohu	No. 2	66
MVAS	TOM Online	No. 1	95

Company data, Morgan Stanley Research (Estimates are based on 2Q2005 results)

Regional Focus Can Vary

Distribution of Chinese Internet Users



Source: CNNIC

• *Geographical concentration*

- Chinese Internet users are concentrated in coastal areas (56% of total, 2004, CNNIC)
- Top 4 cities contribute 50% plus of advertising sales
- Top 5 cities accounted for 60% of Ctrip's hotel sales and 80% of its air ticket sales volume, 2004

• *Geographical dispersion*

- IDC estimates that 80%+ of online gamers came from non-top tier cities (2003)

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Content Becoming King

- **Content providers gaining pricing power**

- TOM Online paying out **40-50%** of revenue to music companies for distribution rights
- KongZhong paid **5x** more for wireless distribution rights for leading blockbuster movie vs. 2 years ago
- Foreign game developers, such as Actoz and Blizzard, command multiple fold higher licensing payment vs. several years ago

- **Rollout of new wireless and broadband services creates demand for quality content**

- China Mobile's color ringtone users have expanded at quarterly compound rate of **90%** over past 1.5 years
- Most popular song, 'Mouse Loves Rice,' downloaded **5MM** times in 2004 with potential profits exceeding the best-selling CDs
- Content providers, such as MTV, may produce more revenues from MVAS than from pay TV in a few years

Challenges

- Ecommerce / payment adoption in China
- Economic hard landing or soft landing?
- Long-term value vs. short-term profit
- Expect the unexpected!
- China's current business environment is more favorable to SOEs than start-ups, especially in areas like regulation and financing
- Hollowing of management – founder mentality
- Dearth of innovation
- Too much capital, too few good ideas
- All in, global / China, opportunities are significant as are dislocations and risks...

Your Questions

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