

FOCUS Bankers

Internet & Digital Information Group

Quarterly Insights Report

Q2 - 2009 Report

Volume 1, Number 2

FOCUS

Investment Banking

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INVESTMENT BANKING AND ADVISORY

FOCUS' INTERNET & DIGITAL INFORMATION GROUP PROVIDES FOUR HIGHLY-TAILORED INVESTMENT BANKING SERVICES TO MIDDLE MARKET FIRMS:

Sellside Engagements
Buyside Engagements
Capital Formation
Valuation & Intangible Asset Assessment

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Economic Outlook: The Consensus Among Economists is There is no Consensus

By **Brad Fleisher**, FOCUS Managing Director, Internet & Digital Information Team Leader

The major macro-economic issue in the first quarter was whether Bernanke's "[Green Shoots](#)" economic outlook was really a withering "[Yellow Weeds](#)" reality. In our Q1 Report we stated that there appeared to be some mainstream consensus that the general economy may have bottomed and that a turnaround could be at hand as soon as Q4-2009 or Q1-2010. The Green Shoots gardeners continue to point to quarterly stock market gains (11% for DOW, 15% for S&P), increases in April and May of the Conference Board's Leading Economic Index and Consumer Confidence Index, among other indicators, for their sunny-day-is-right-around-the-corner position. But the Yellow Weed pullers have only to cite the one point monthly increase in the unemployment rate from 8.5% in May to 9.5%, and that we'll likely see 10% before year end, to predict a chilly winter.

No matter. The debate for this quarter is not when the economy will eke out some growth and officially end the recession, but rather whether the country is headed into a period of inflation or deflation. We're investment bankers, not economists, so we'll predict that it will be one or the other . . . or, of course, a combination (first deflation, then inflation, or vice-versa). However, here are some excellent arguments from prominent economists / money managers on opposite side of the debate, and a third viewpoint from Bill Gross, who manages more money than most countries' GDP:

FOR THE DEFLATIONISTS, [Nouriel Roubini](#), Publisher, RGE Monitor: "Deflationary pressures are still present in the U.S. economy. Demand is falling relative to supply and excess capacity is still promoting slack in the goods markets." Moreover, the rising slack in labor markets, which is pushing down wages and labor costs, implies that

deflationary pressures are going to be dominant this year and next year. This implies that the Fed will keep monetary policy loose for a while longer. (See also [Paul Krugman's The Big Inflation Scare](#).)

AND IN THE INFLATIONIST CORNER: [David Swensen](#), Chief Investment Officer, Yale University, and appointee to President Obama's Economic Recovery Advisory Board: "We've had this massive fiscal stimulus, massive monetary stimulus, and it's hard to see how that doesn't translate into pretty substantial inflation, or at least pretty substantial risk of inflation." Interview with WealthTrack, May 22, 2009. (See also [Marc Faber, Publisher, Doom, Gloom and Boom Report](#).)

FOR THE REFEREE? [William H. Gross, Managing Director, PIMCO](#): "...[W]hen potential spenders feel less rich by that much [\$13 Trillion], the only model one can use to forecast the future is a commonsensical one that predicts higher savings, lower consumption, and an economic growth rate that staggers forward at a new normal closer to 2% as opposed to 3½%. There's no magic in that number, and no model to back it up, just a lot of commonsense that says this is how people and economic societies behave when stressed and stretched to a near breaking point." (See also "[The New Normal](#)," by [Dr. Mohamed El-Arian, CEO and Co-CIO, PIMCO](#)).

For 2i We generally agree with PIMCO that the economy will perform at a slower pace with less growth coming out of this recession. We will be posting a blog on [Intangible Insights](#) during the first week of August on how the "New Normal" argument affects middle market company valuations and M&A transactions.



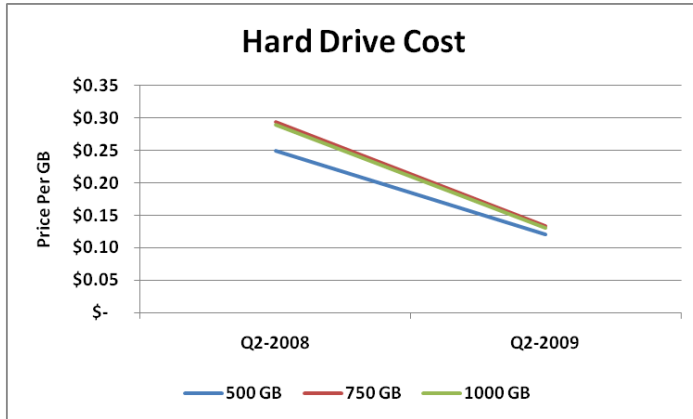
research, and other information help our readers gain insights into opportunities for, or threats to, their business. We also encourage you to read more about our philosophy at [Why We Blog: More About 2i](#).

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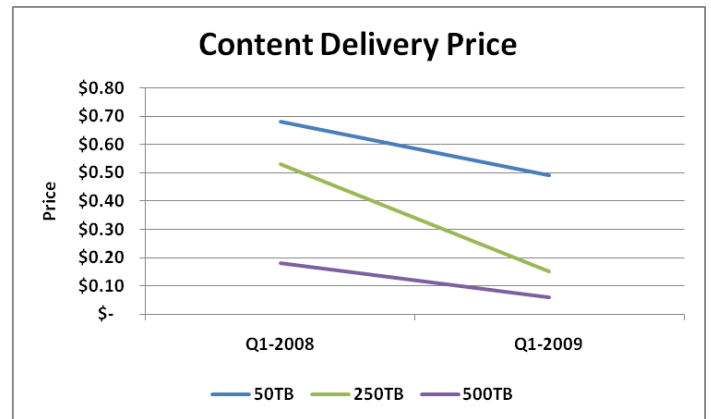
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Technology Deflates, Lifestyle Inflates

Although these don't bear on the national economy, the following statistics of major technology inputs for the internet and digital information sectors show, not surprisingly, a persistent drive for faster, better, cheaper.



Source: Nextag.com (compiled by Spudart.org)



Source: CDNpricing.com

Content delivery prices (250TB) decline by 72% from Q1-2008 to Q1-2009. Hard drive costs decline (750GB) by 55% year-over-year. Processor costs (below) are down as well. Notably, the Intel Core 2 Duo 2 GHZ - 3 GHZ, one of the most popular processors, were reduced 14% year-over-year to let them compete with AMD chips, which are significantly less expensive than Intel chips.

Processor	Q1-2008	Q2-2009	Year-over-Year % Change
Celeron - 2 -2.2 GHZ	\$ 57.00	\$ 56.00	-2%
Athlon 64 2.5 - 3 GHZ	\$ 70.00	\$ 60.00	-14%
Intel Core 2 Duo 3 - 3.5 GHZ	\$ 210.00	\$ 206.00	-2%
Intel Core 2 Duo 2 - 3 GHZ	\$ 140.00	\$ 120.00	-14%
Phenom II 2.5-3 GHz	\$ 170.00	\$ 160.00	-6%
Intel Core i7 3 GHZ	\$ 420.00	\$ 410.00	-2%
Intel Core 2 Quad 2 - 3 GHZ	\$ 240.00	\$ 215.00	-10%

Does the content follow the technology? Check out the recently published book “Free: The Future of Radical Price”, by Chris Anderson, Editor-in-Chief of Wired magazine, and first apostle for the Long Tail and Free Business Models. His hypothesis: Moore’s Law drives the price of digital information down by 50% per year. Eventually, the incremental cost of one more digital unit *and its distribution* is nearly zero. The business of digital information – news, music, games, video entertainment, etc. – is on track to be given away for free as a means to up-sell other products and services (e.g. give music away to sell concert tickets; give book away to gain thought leadership and sell consulting services, etc.). While we don’t agree that all information should, or will be free, internet entrepreneurs, whether B2C, B2B or P2P, must address the Free (Internet) Economy.

© Cartoonbank.com



“It’s free, but they sell your information.”

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The Canaries in Q2: The End, Beginning, and Continuation of an Era(s)

The Internet is perhaps the fastest evolving industry sector ever. We offer these tidbits not because we know the absolute direction of this evolution -- no one does, of course -- but there are a few firms that get it right more often than wrong, and, in the case of AOL, vice versa. Whether successful or not, we try to identify the canaries and their significance.

Merging Old Media with New Media. In May, Time Warner announced official plans to spin-off AOL, ending years of speculation of what obviously needed to be done. In 2002 the merger between AOL and Time Warner was being hailed as the beginning of a new trend: the coming together of traditional and new media companies. Instead, the \$147 billion merger became the iconic symbol of failed mergers and management hubris. There are many stated reasons for the failure of the merger, not least of which was the bursting of the internet bubble. Most likely, however, was the inability of very smart and well-intentioned executives to integrate corporate cultures. We're headed into another period where traditional media is vigorously being challenged by new media (see Example #1 below). If you're considering a corporate transaction, it might be worth some time to learn from this merger's mistakes. Here's a summary of just one [case study of the botched merger](#) that can be purchased for about \$10.00.

Example #1. Twittering in Tehran. You may not see the value of tweeting your friends what you had for lunch, but cable news channels would have been far behind the Iranian Revolution news story had they not regurgitated (with all the disclaimers in place for, "It's not real journalism") the tweets from Teheran. As David Weir of BNet Media points out, "in the all-important battle for eyeballs seeking news online, Twitter has utterly eclipsed The Times over the past few months of Q2-2009, and now is closing in on CNN. Compete.com ranks CNN as the 27th top website in the U.S. Twitter the 42nd, and The Times as 64th." Anyone in the news business – broadcast, cable, print, online, whatever – must consider how to compete with instantaneous information, fickle users, low barriers to entry, and end-user stickiness. Keep an eye out for an announcement by Twitter on how they intend to monetize their user base.

Apple® Keeps on Ticking. On April 24, Apple announced delivery of its 1 billionth download from the App Store, which currently features over 35,000 apps built by thousands of

developers. In nine months from the date of opening the App Store, it is estimated consumers download more than 100 million paid apps per month at an average cost of 50 cents each from the App Store. That's a pittance of Apple's total gross revenue. The real question, of course, is how many people buy the iPods and iPhones because of the apps. Similarly, how many business people will choose Salesforce.com over other CRMs because of its app store and the promise of other future developments?

Which Canaries Do You Trust? . . . Millward Brown Optimor published its [Brandz™ Top 100 Most Valuable Global Brands for 2009](#). Every company on the list has an online presence and most have substantial ecommerce platforms. Five of the 100 were Internet companies, as we define them, with an aggregate of over \$205 billion in total brand value. Google was number one on the list with a brand value of over \$100 billion, higher than Microsoft, Coca Cola, IBM, and McDonalds (the next four leading brands), and more than the bottom 14 *combined*. The other internet brands are Apple (#6), Amazon (#26), Ebay (#54), and Yahoo (#81).

Top 2 Worldwide Brands Fight Over Search Market. Still wondering how important search is for the advertising industry? When the #2 brand in the world (according to the report referenced above) goes after the #1 brand's core business, again, then it's probably safe to say that search is a key component of the future of digital information. Microsoft made another attempt in Q2 to make a dent in the search market by launching Bing.com, which is a revamp of Livesearch in combination with several technologies Microsoft bought in the past few years (i.e. Farecast for travel, and Multi Media Mapping & Caligari for mapping). Unfortunately for Yahoo and Ask, it's at their expense, and not Google's (yet). See the table below and more on [what 13 experts are saying about Bing](#).

Web Search Market Share and Volume (with Club Live/Bing)

(Top web search engine's share of searches, volume, performance and sponsored search referrals as a % of all referrals)



Engine	Market Share			Query Volume (millions)			Volume Change		Sponsored Referrals		
	Jun-09	May-09	Jun-08	Jun-09	May-09	Jun-08	M-O-M	Y-O-Y	Jun-09	May-09	Jun-08
Google	72.7%	71.3%	64.6%	9,065	9,145	6,199	-0.9%	46.2%	6.1%	6.2%	6.8%
Yahoo!	16.3%	16.5%	20.1%	2,035	2,118	1,931	-3.9%	5.4%	6.4%	6.4%	NA
Microsoft	9.1%	8.2%	9.9%	1,002	1,120	1,025	-10.6%	-2.3%	5.6%	3.1%	2.0%
Ask	2.1%	2.4%	3.1%	257	312	296	-17.8%	-13.3%	6.4%	4.2%	2.3%
AOL	0.8%	0.8%	1.1%	100	105	105	-5.1%	-4.6%	2.5%	1.9%	NA

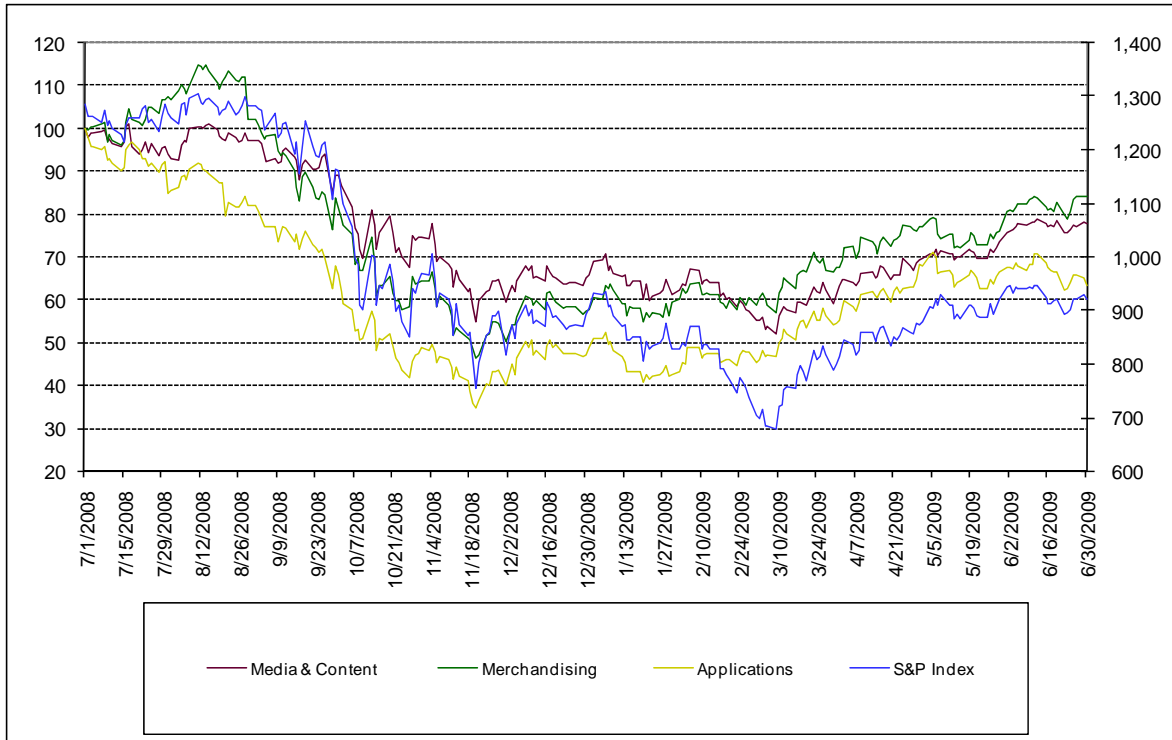
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Internet & Digital Information Sector M&A Activity and Insights



INTERNET & DIGITAL INFORMATION STOCK INDEX¹



Index Insights

- All three functional categories continue to fare better over the year than the S&P.

Segment Index	Quarter-over-Quarter change	Year-over-Year Change	% Over/ Under S&P on June 30
S&P 500	15%	-28%	-
Content/Media	16%	-35%	8% over
Merchandising	25%	-15%	18% over
Application	27%	-23%	44% over

- During Q2-2009 each functional category made significant improvement compared to the lows in Q1 -

2009. The Application and Merchandising Index gained 27% and 25% over the quarter while S&P and Content/Media Index increased 15% and 16%, respectively.

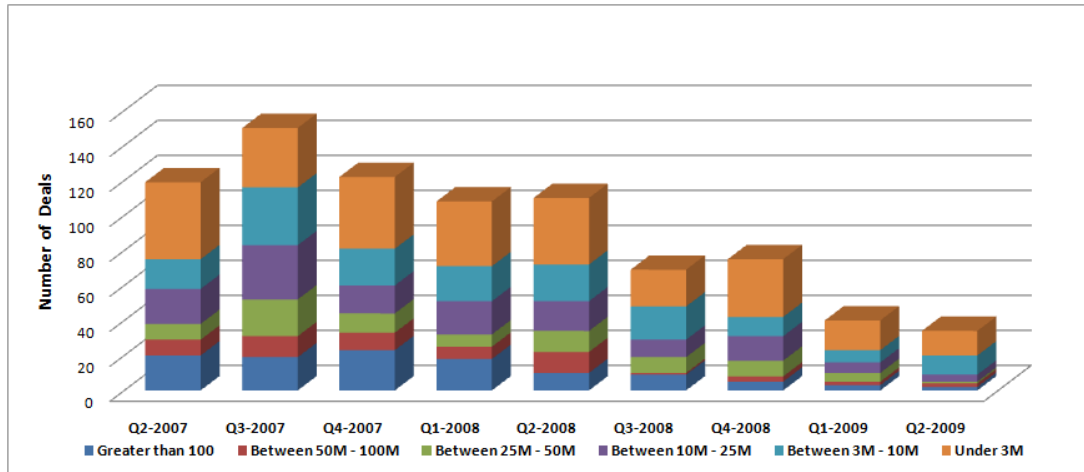
- The Application Index was greatly affected by the outlier transaction attributable to OpenText's (OTEX) offer to buy Vignette (VIGN) on May 1, 2009 for a total consideration of \$304 million at a valuation multiple of 1.0X Revenues and 35.0X EBITDA. The offer was a 91.7% premium over Vignette's one month prior stock price.

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Internet & Digital Information M&A Activity

Quarter-over-Quarter IDI Disclosed Transactions by Volume



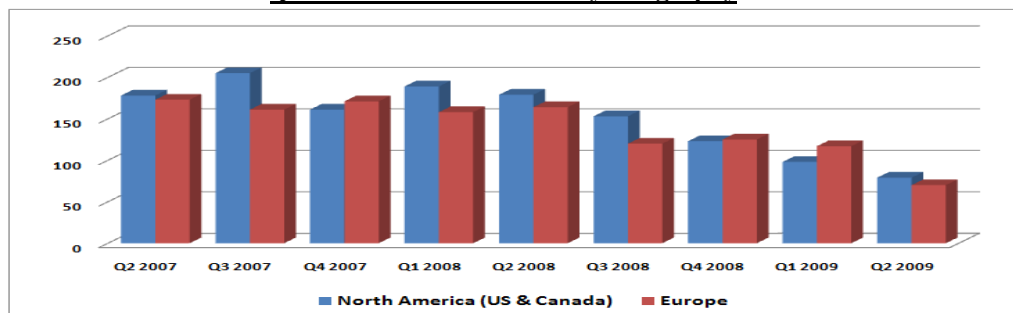
Source: Capital IQ, Disclosed Data as of July 2, 2009.

- In Q2-2009 there were a total of 149 reported internet deals (*includes disclosed and undisclosed deals*), including announcements, down from 215 in Q1-2009, and down from 343 deals in Q2-2008. Of the 149 reported IDI deals in Q2-2009, 34 were disclosed and are represented in the table above. In Q2-2009 there were two disclosed deals over \$100 million compared to 10 deals in corresponding quarter last year.
- Of the 149 reported deals, 115, or 77%, were of private companies and no disclosure was made or required. We don't consider this information to be decidedly helpful for valuation purposes. Instead we try to draw meaningful insights, if not valuation data, from the transactions for which we have better information and offer greater detail

on the Intangible Insights site under the category Deal of the Week.

- After the last two quarters in which Europe slightly outpaced the US in the number Internet and Digital Information M&A transactions, the US region now has more Internet and Digital Information M&A transactions for Q2-2009. For the US region deals were down 19% compared to last quarter in comparison to a decline of 40% for the Europe. We note this as a reminder that the Internet and Digital Information space is truly one that has buyers and sellers across the globe regardless of geography. At Focus, we have seen an increase in cross border deals that we have been completing over the past few years. Over 40% of our transactions for 2008 had a buyer or seller based outside of the US.

Q2-2009 IDI Transactions by Geography



Source: Capital IQ, Data as of July 2, 2009.

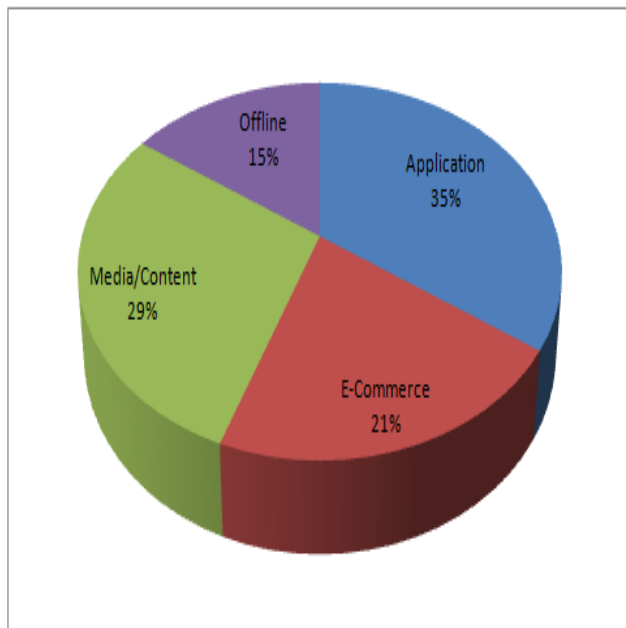
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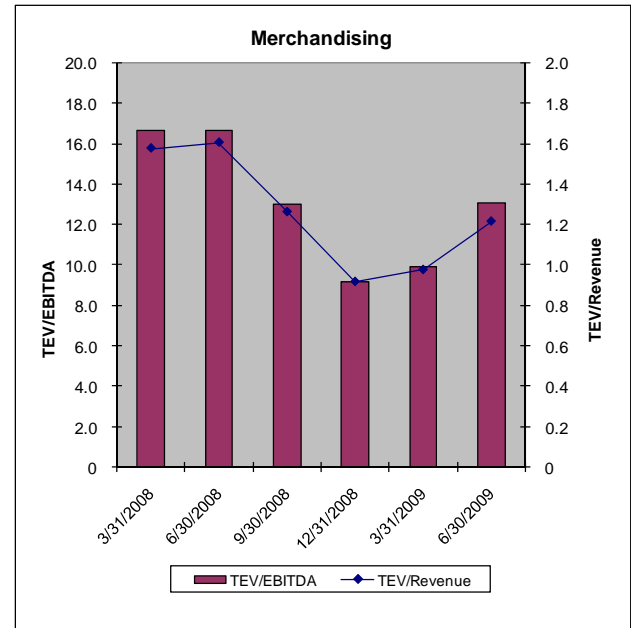
Internet & Digital Information Transaction by 2i Function²

The below charts show the breakdown of IDI transactions by the seller's functional category. Application transactions were the most active sector within the category. This sector has the largest pool for potential transactions, as we mentioned earlier that cash strapped technology companies will continue to grow their product portfolio and capabilities.

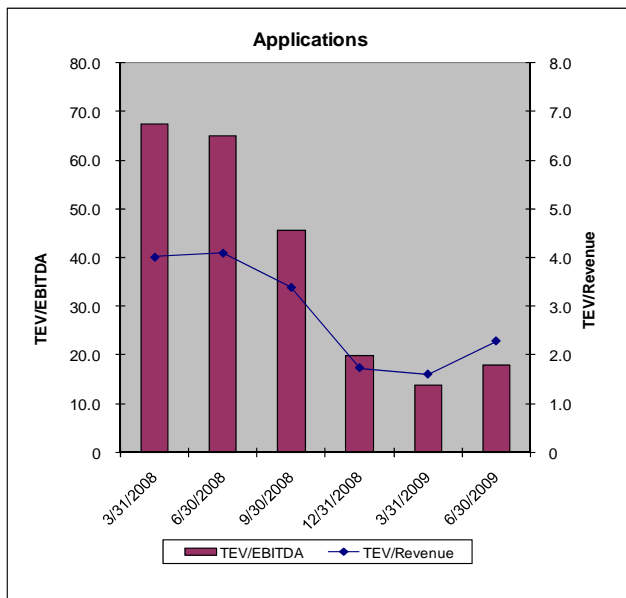
IDI Transactions by 2i Function



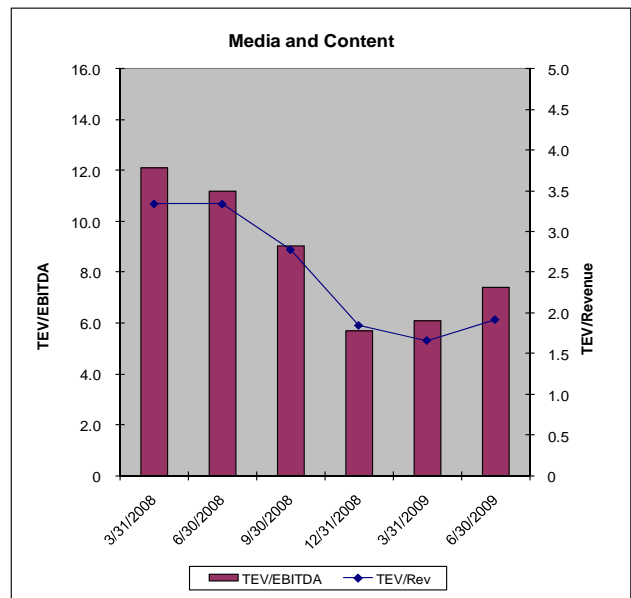
2i Merchandising: Market Trading Metrics



2i Applications: Market Trading Metrics



2i Media and Content: Market Trading Metrics



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IDI Active Buyers & Sellers

Most Active Buyers/Investors by Number of Transactions		Most Active Buyers/Investors by Total Transaction Size	
Company Name	Number Of Transactions	Company Name	Transaction Size (\$mm)
AOL, LLC	2	Hasbro Inc. (NYSE:HAS)	\$ 300.00
Cascadia Investments, Inc. (OTCPK:CDIV)	2	Systemax Inc. (NYSE:SYX)	\$ 206.27
Amazon.com Inc. (NasdaqGS:AMZN)	2	LLR Partners Inc.	\$ 67.33
CRESCES GmbH	2	Natural Gas Exchange, Inc.	\$ 42.67
imageTech Marketing	2	1-800-Flowers.com Inc. (NasdaqGS:FLWS)	\$ 38.30
OpenText (NasdaqGS:OTEX)	1	AOL, LLC	\$ 20.00
1-800-Flowers.com Inc. (NasdaqGS:FLWS)	1	Acme Packet, Inc. (NasdaqGM:APKT)	\$ 22.23
Accel Partners	1	CRIF SpA	\$ 11.00
Acme Packet, Inc. (NasdaqGM:APKT)	1	iomart Group plc (AIM:IOM)	\$ 9.23
Albury Investments Limited	1	SSE Telecommunications Limited	\$ 7.78
ARI Network Services Inc. (OTCBB:ARIS)	1	Objective Corp. Ltd. (ASX:OCL)	\$ 6.79
Total Number of Transactions:	16	Total Value of Transactions	\$ 731.61
Strategic %	81%	Strategic %	91%
Financial %	19%	Financial %	9%

*Table does not include Private Placement transactions
Source: Capital IQ

Notes

¹ The Internet and Digital Information industry is highly fragmented, dynamic, and largely dominated by small companies (number of companies, not necessarily by market share or share price). Innovations, and information in general, are closely guarded, since it can easily be replicated by competitors. We do our best to provide accurate information, particularly as it relates to valuations, but most deals are private and disclosure is rare.

We draw on data from a variety of sources to compose the list of discussed in this section. Although we group all the Internet-Reliant M&A deals into our three functional categories, our criteria to compose the list includes over 100 key words or phrases and company sub-categories ranging, for example, from Agents and Spider Software to Web Usage Analysis. Certainly not perfect at any given time, our criteria are fluid and change as the industry and our reporting purposes evolve.

² Source: Capital IQ and Intangible Insights' Transaction Database. See our website for a list of firms that compose the 2i Stock Index, including the breakout of the companies by functional area.

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*This announcement appears
as a matter of record only.*

AY

Apply Yourself Recruiting Solutions

has been sold to

hobsons.

We acted as financial advisor to
and assisted with the negotiations
as the representative of
Apply Yourself Recruiting Solutions

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*This announcement appears
as a matter of record only.*

**VERTEX
SOLUTIONS**

has been sold to

ADAYANA®
Performance Through Learning

The undersigned initiated this transaction,
assisted in the negotiations, and acted
as financial advisor to Vertex Solutions.

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*This announcement appears
as a matter of record only.*

**PERFORMANCE
PATHWAYS**

has been acquired by

**SUNGARD®
PUBLIC SECTOR**

The undersigned initiated this transaction,
assisted in the negotiations, and acted as financial
advisor to Performance Pathways, Inc.

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*This announcement appears
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**Global
SOFTWARE**

has been acquired by

HARRIS

a division of

**CONSTELLATION
SOFTWARE
INC.**

Listed: CSU Toronto Stock Exchange

The undersigned initiated the transaction,
assisted in the negotiations and acted as
financial advisor to Global Software.

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*This announcement appears
as a matter of record only.*

Pradot®
Affirming Excellence

has acquired

GROUP ONE
healthsource

The undersigned initiated the transaction,
acted as financial advisor to, and
assisted with the negotiations as the
representative of Pradot.

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*This announcement appears
as a matter of record only.*

AGENTEK

has been recapitalized by

Edison
VENTURE FUND

\$8,000,000 Series A Preferred Stock

The undersigned initiated this transaction,
assisted in the negotiations, and acted
as financial advisor to Agentek, Inc.

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A Managing Director at FOCUS Investment Banking in Washington, DC and publisher of Intangible Insights, Brad Fleisher is an experienced investment banker, entrepreneur and attorney. Brad has over 15 years M&A, corporate finance, and business development and advisory experience in the internet & digital information, software, media, and education industries.

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A Managing Director at FOCUS Investment Banking in Washington, DC, Rick Thomas has over fifteen years of consulting, management and M&A advisory experience in the internet, software, information technology, and manufacturing distribution industries. Rick has significant buy-side M&A expertise for publicly and privately held companies in the middle market. Rick has lectured to hundreds of owners, CEO's and CFO's on M&A best practices and was previously an adjunct faculty member for The George Washington University.

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A Research Analyst at FOCUS Investment Banking in Washington, DC, Prashant Koirala has conducted research for private equity, M&A and consulting firms for over 5 years. Prashant has spent a significant time in India and China providing research on potential deal transactions, and is familiar with the deal landscape in the emerging markets. Prior to joining FOCUS, Mr. Koirala worked as an analyst with American Capital, a \$7 billion public LBO firm based in Maryland, and New Markets Venture Partners, an early stage Venture Capital Fund also headquartered in Maryland.

About FOCUS LLC

FOCUS, LLC provides a range of middle market investment banking services across the US and internationally with an emphasis on mergers, acquisitions, divestitures and corporate finance.

FOCUS is headquartered in Washington, DC with regional offices in Atlanta, Chicago, San Francisco and Los Angeles.

FOCUS specializes in businesses with transactions or revenues in the \$5-300 million range, serving entrepreneurs, corporate owners and various types of investors across a broad range of industries, throughout the US and worldwide. All FOCUS bankers are seasoned operating and financial executives with extensive transaction experience. For more information on FOCUS, visit www.focusbankers.com.

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