Research Desk – Update

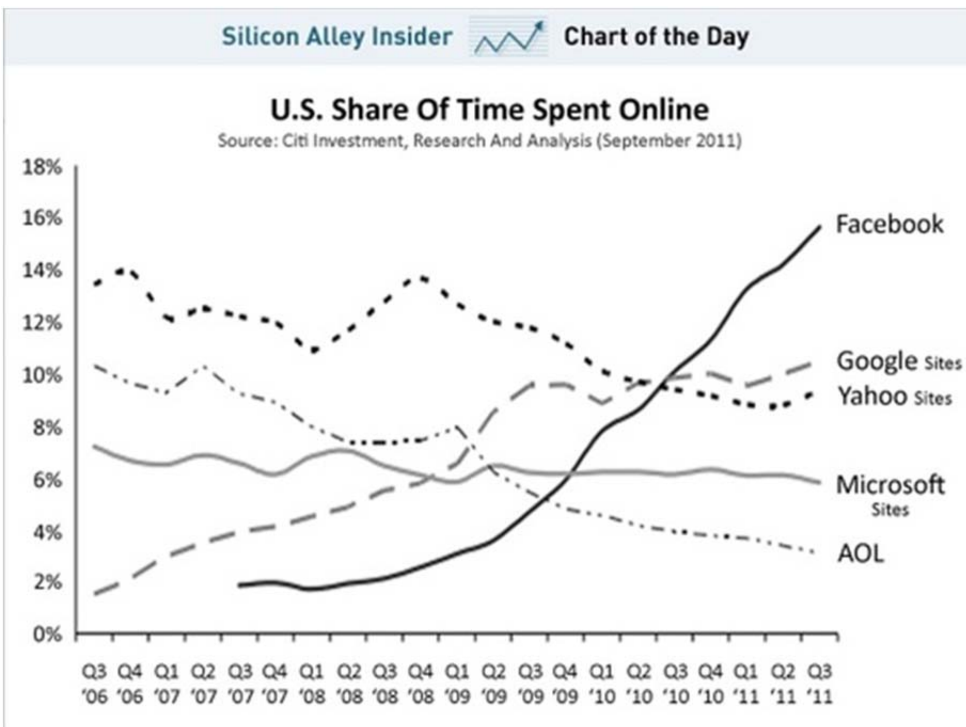
October 11, 2011

How Big Can Facebook Get? - $800 billion market cap by 2016

Facebook has been eyeing the $411 billion global advertising market and is now currently sitting at 1% market share. They are only just scratching the surface of the market right now!

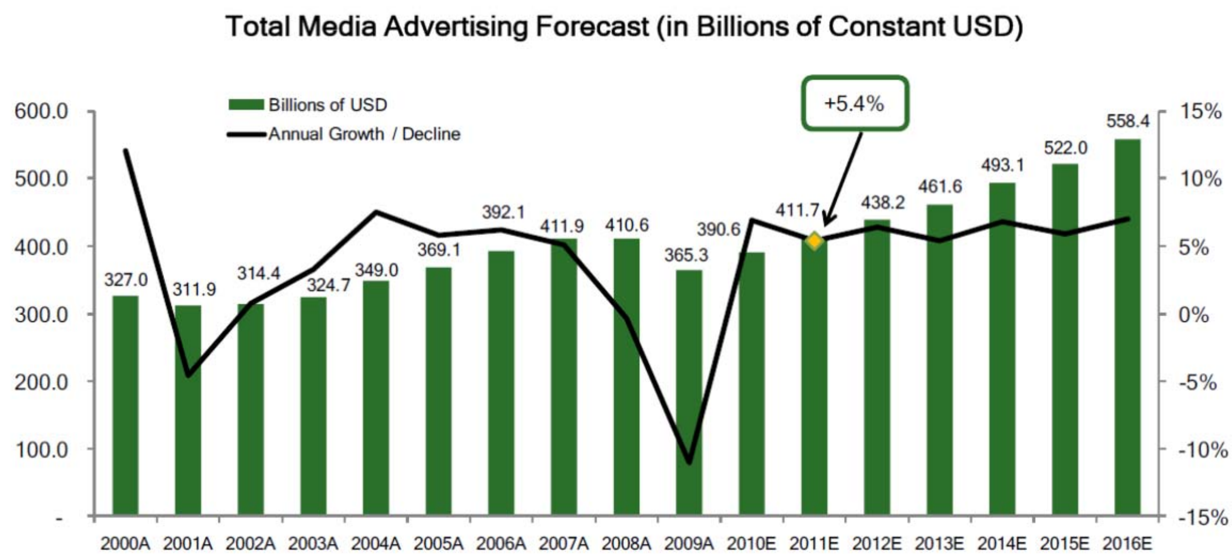
Summary

On September 22, 2011 Facebook held their F8 developers conference in San Francisco and announced significant additions to their platform. The first change announced was the Facebook Timeline which allows Facebook users to document their life story in the form of a visual timeline. The strategy behind the creation of Facebook Timeline is to increase the user time on the platform. In 2009 user time on the platform was 20 minutes per day versus 60 minutes per day in August 2011 and is expected to grow to over 90-120 minutes per day in 2016.

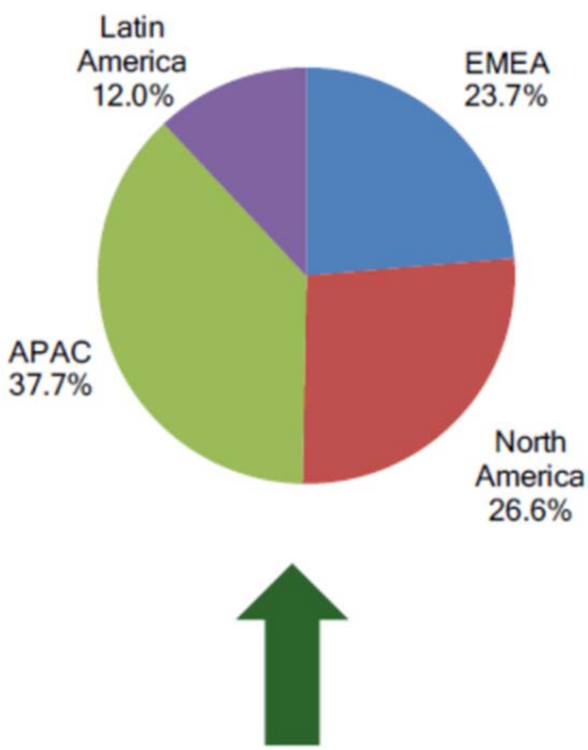


The second major enhancement was the "Read, Watch, Listen" media enhancement to the Open Graph. This facilitates applications such as Netflix for video, Spotify for music and Print media to be integrated into the social graph which enables the users to see what their friends are watching, reading and listening to. This signifies a major jump in daily user retention and an increase in potential revenue projections for integrated radio, movie and print use. This new functionality, of which the total impact is yet to be determined, gives Facebook an opportunity to expand its revenue from the online ad display segment to all segments of the advertising market.

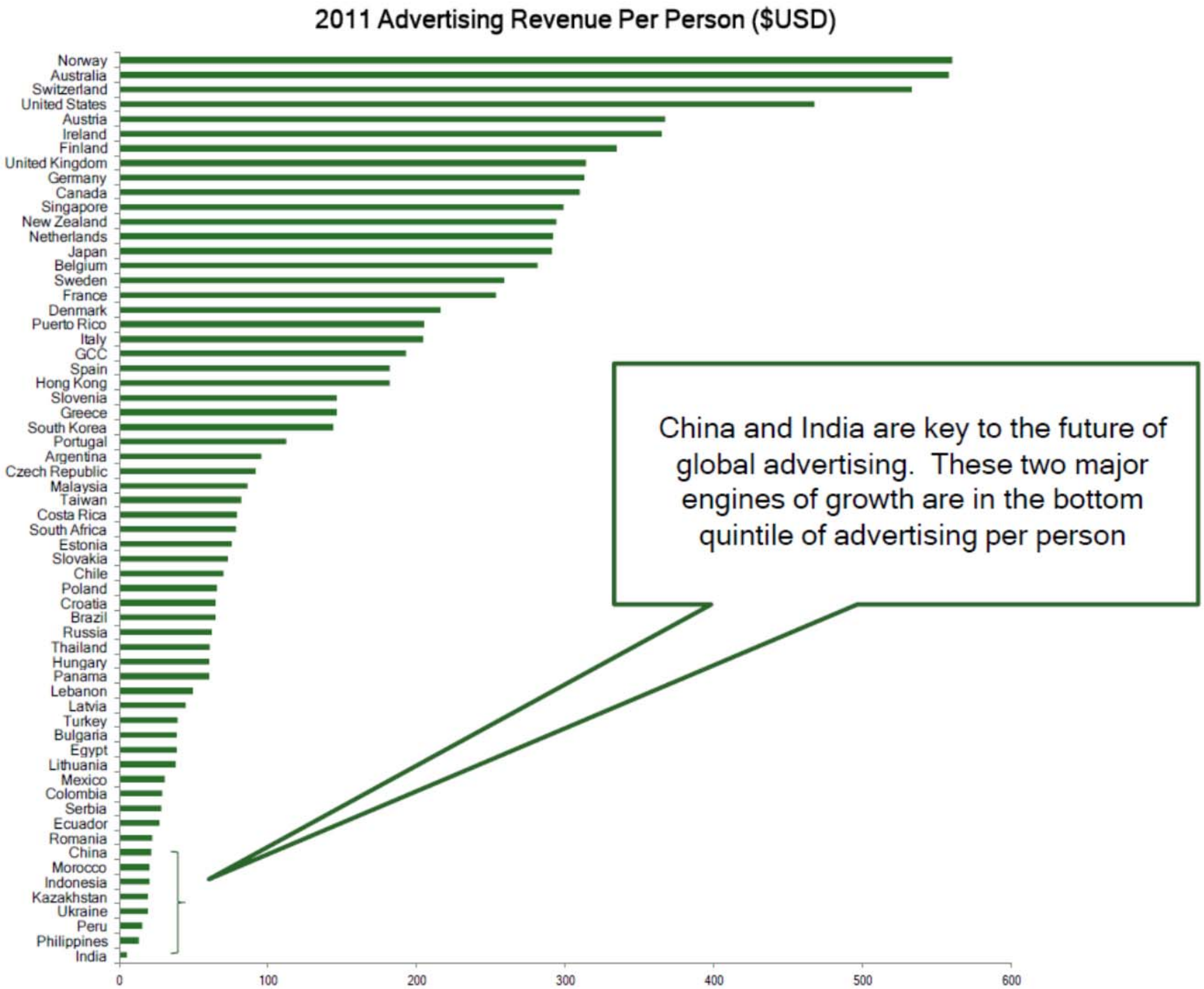
Global advertising is currently spending over $411B across all media delivery segments and Facebook is making their move to transform each of these delivery channels. Global advertising is growing year over year as the emerging economies ramp up their spending:



Contribution to global growth by region from 2011-2016



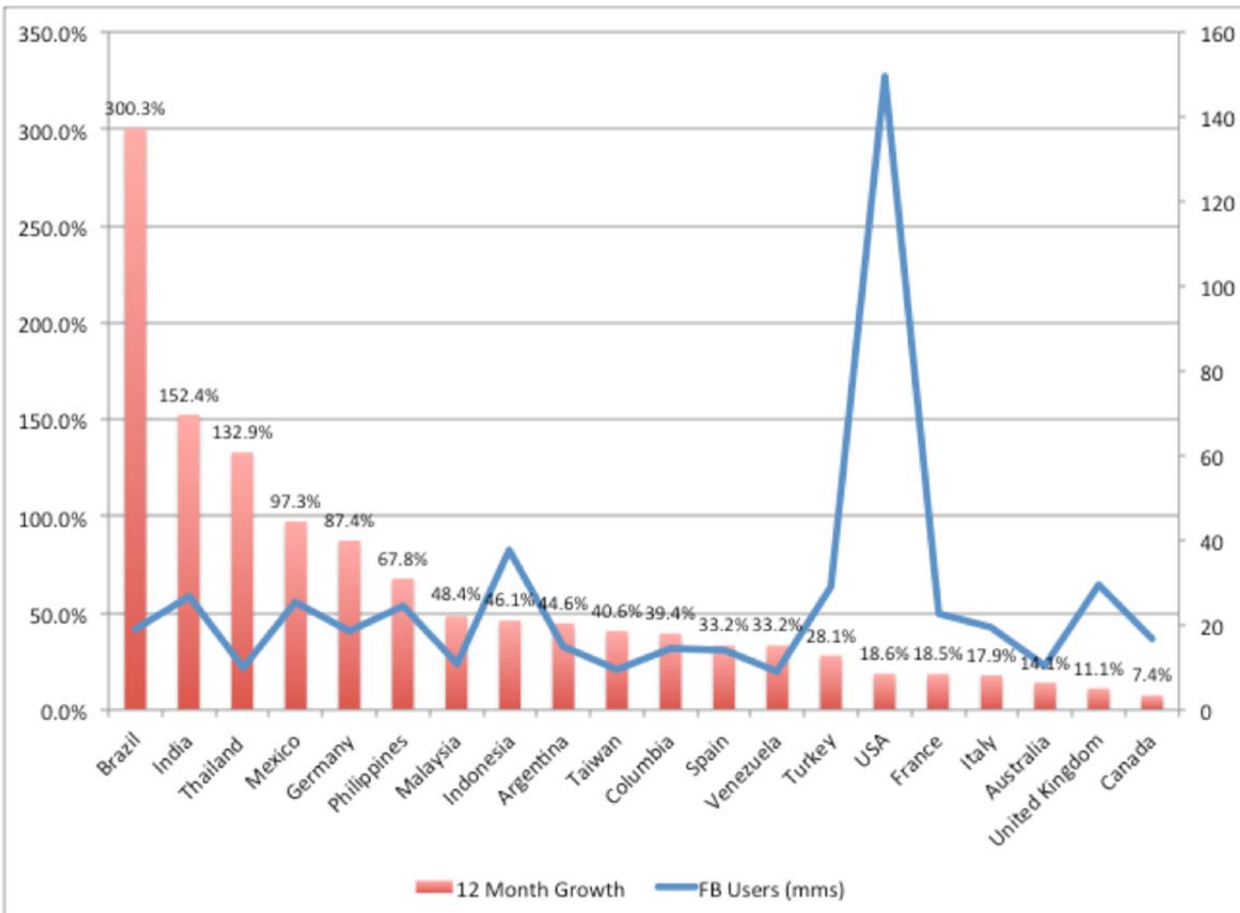
China and India together account for 26% of total industry growth between 2011 and 2016, when APAC revenues will rise from $96bn to $151bn



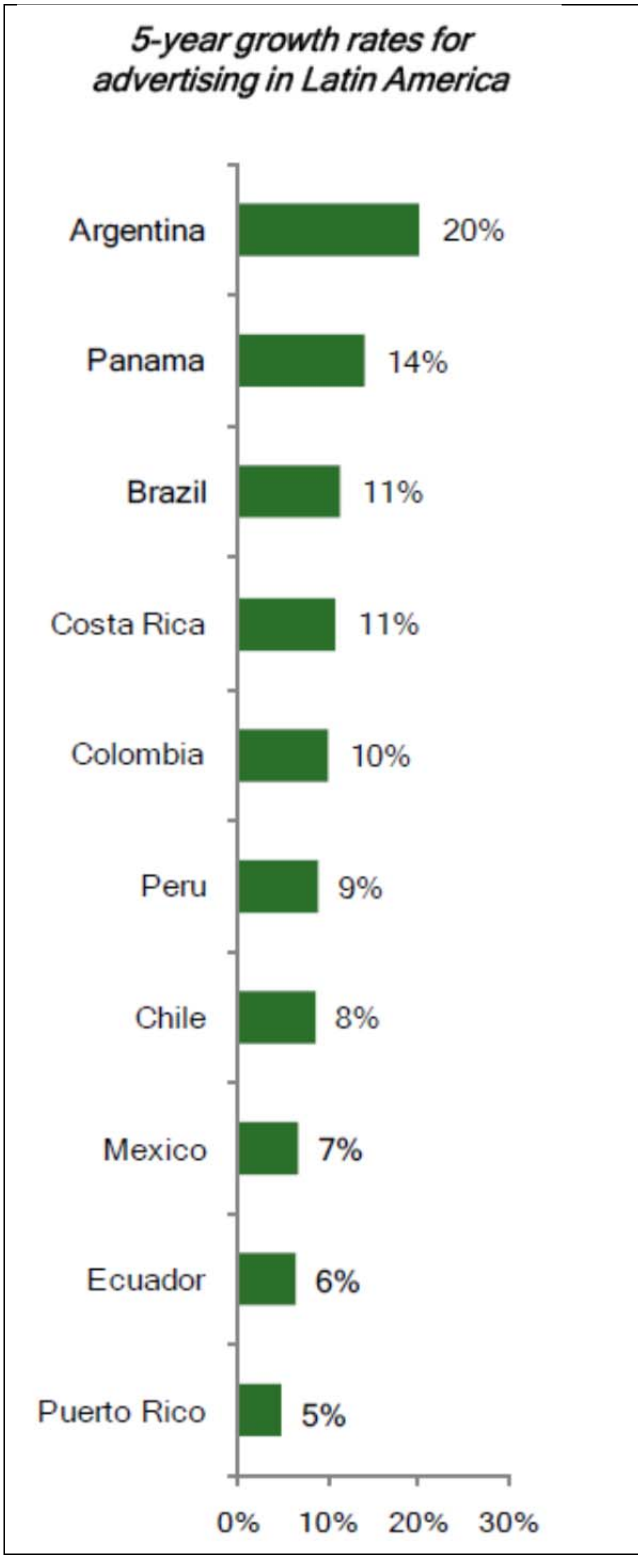
In 2011, we expect the fastest growing markets to include Argentina, China, India, Kazakhstan and Ukraine. Over the years leading up to 2016, the same countries and Serbia are expected to be the fastest growing countries in the global market. The slowest growing countries in 2011 include Croatia, Greece, Ireland, Portugal, and Spain and we expect France, Ireland, Japan, Portugal and Spain to grow the least between 2012 and 2016.

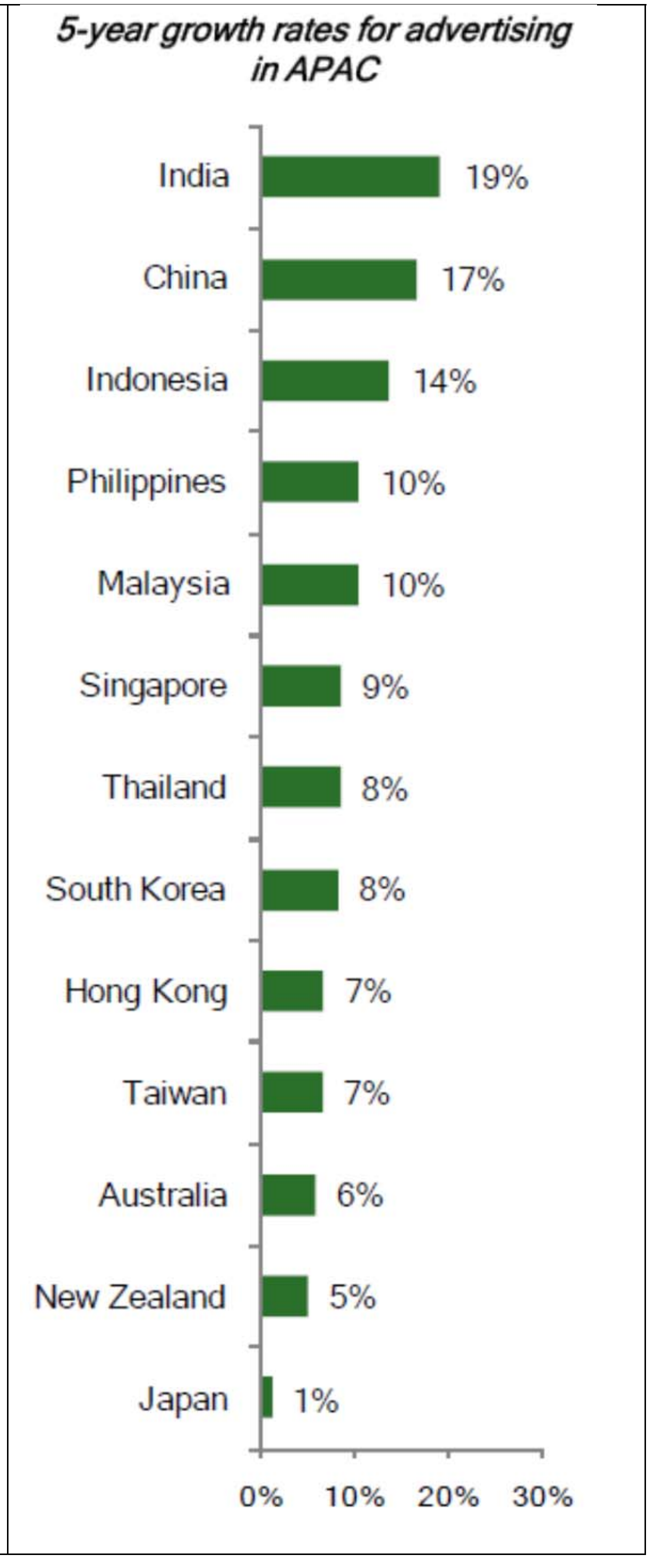
Varying growth rates will result in a gradual transition in the rankings of the world's dominant advertising economies. The fast rising large markets, including China, India, Brazil and Russia, will sit alongside the historically dominant US, Japan, Germany, the UK and France as countries whose advertising trends and technologies increasingly set the pace for the rest of the world.

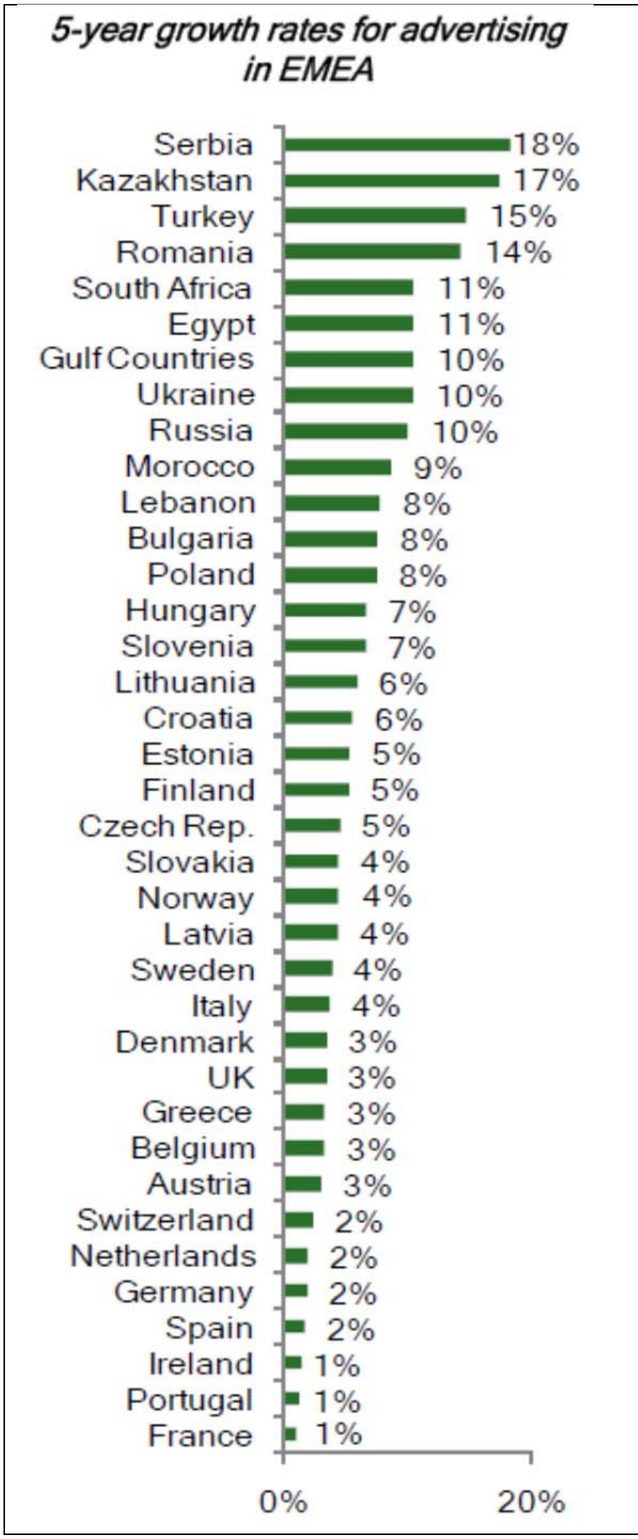
Each of the four major regions and their projected growth rates are shown in the pie chart above. The highest growth regions are the emerging markets which ironically are Facebook's highest growth regions as well:

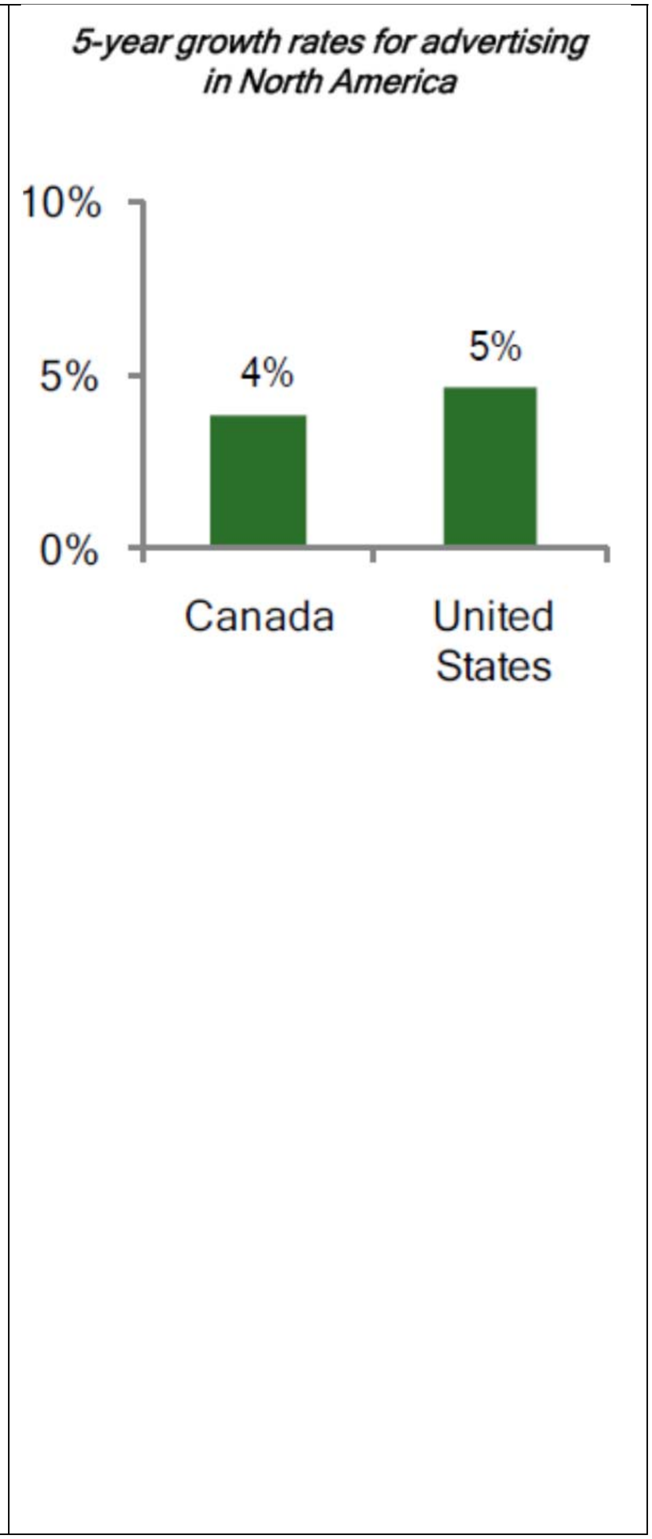


There is a direct correlation between Facebook's user growth and the growth rate on Facebook's global advertising revenue. As we previously reported, India, Brazil and other Asian countries are experiencing high growth rates on Facebook and high advertising spending growth rates within each country. When you correlate these trends, Facebook's strategy to focus on these markets will provide the highest impact on revenue and earnings. The following slides show the advertising spending growth rates within each country and region:


5-year growth rates for advertising in Latin America
Argentina
20%
Panama
14%
Brazil
11%
Costa Rica
11%
Colombia
10%
Peru
9%
Chile
8%
Mexico
7%
Ecuador
6%
Puerto Rico
5%
0%
10%
20%
30%


5-year growth rates for advertising in APAC
India
19%
China
17%
Indonesia
14%
Philippines
10%
Malaysia
10%
Singapore
9%
Thailand
8%
South Korea
8%
Hong Kong
7%
Taiwan
7%
Australia
6%
New Zealand
5%
Japan
1%
0%
10%
20%
30%

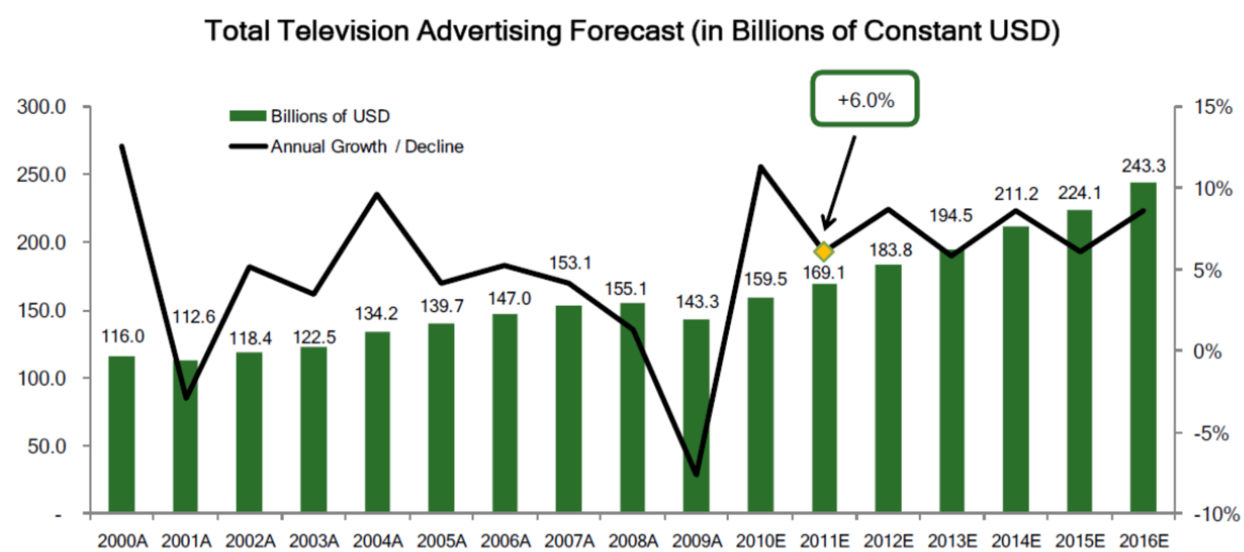

5-year growth rates for advertising in EMEA
Serbia 18%
Kazakhstan 17%
Turkey 15%
Romania 14%
South Africa 11%
Egypt 11%
Gulf Countries 10%
Ukraine 10%
Russia 10%
Morocco 9%
Lebanon 8%
Bulgaria 8%
Poland 8%
Hungary 7%
Slovenia 7%
Lithuania 6%
Croatia 6%
Estonia 5%
Finland 5%
Czech Rep. 5%
Slovakia 4%
Norway 4%
Latvia 4%
Sweden 4%
Italy 4%
Denmark 3%
UK 3%
Greece 3%
Belgium 3%
Austria 3%
Switzerland 2%
Netherlands 2%
Germany 2%
Spain 2%
Ireland 1%
Portugal 1%
France 1%
0%
20%


5-year growth rates for advertising in North America
10%
5%
0%
4%
5%
Canada
United States

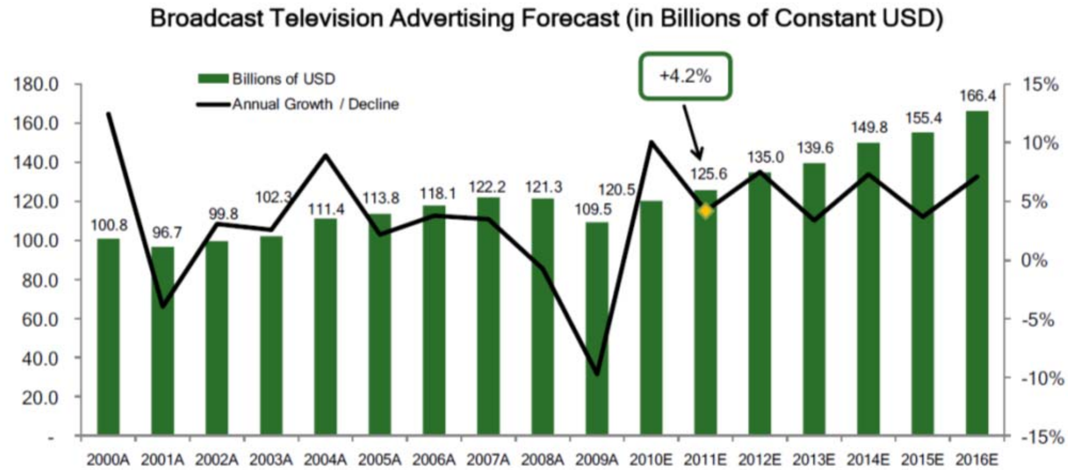
The Four Major Advertising Categories (TV, Internet, Radio and Print)

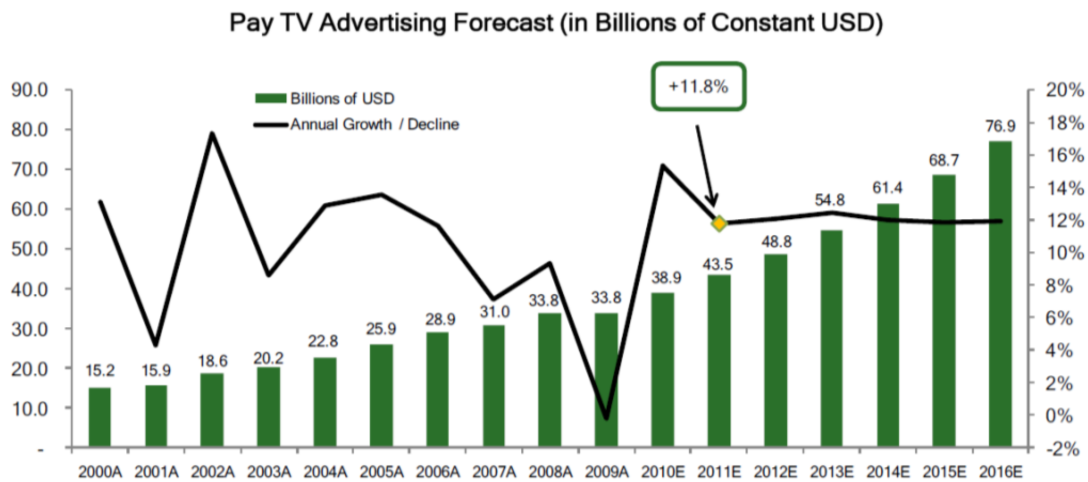
We are seeing a convergence of media channels into social media through the recently announced changes to the Open Graph interface to integrate Read, Watch and Listen media types. As Facebook continues to retain the user's attention, basic media channels will continue to decline under their traditional delivery mechanisms and migration to Facebook and the Internet for delivery of new wave media will be the increasing trend. Galt views the growth rate within each advertising segment to be influenced by Facebook's growth within the emerging economies. Each of the advertising categories discussed in this report, Galt believes that they will be trending towards Internet delivery and not traditional cable or broadcast which creates a massive growth opportunity for Facebook. The following categories (Television, Internet, Radio, Print and Out of Home) are discussed below.

Television Advertising (The largest of all Advertising delivery channels)



It is broken down into Broadcast TV and Pay per View as follows:





Growth within the TV advertising segment is driven mainly by the growth in the emerging economies and the advertisement spending as their middle class demographic grows. Galt has not forecasted revenue for advertising delivery over broadcast TV on the Internet, but does believe that this will become an important revenue component within the Television segment in the future. As the younger generation continues to grow up using Facebook, their time spent online eliminates their passive time in front of a television. We expect to see the online delivery of TV advertisements to increase over the next 10 years. Facebook's recent announcement of integrated social "Watch" may be the start of total disruption in this industry segment, the same way iTunes disrupted the music industry.

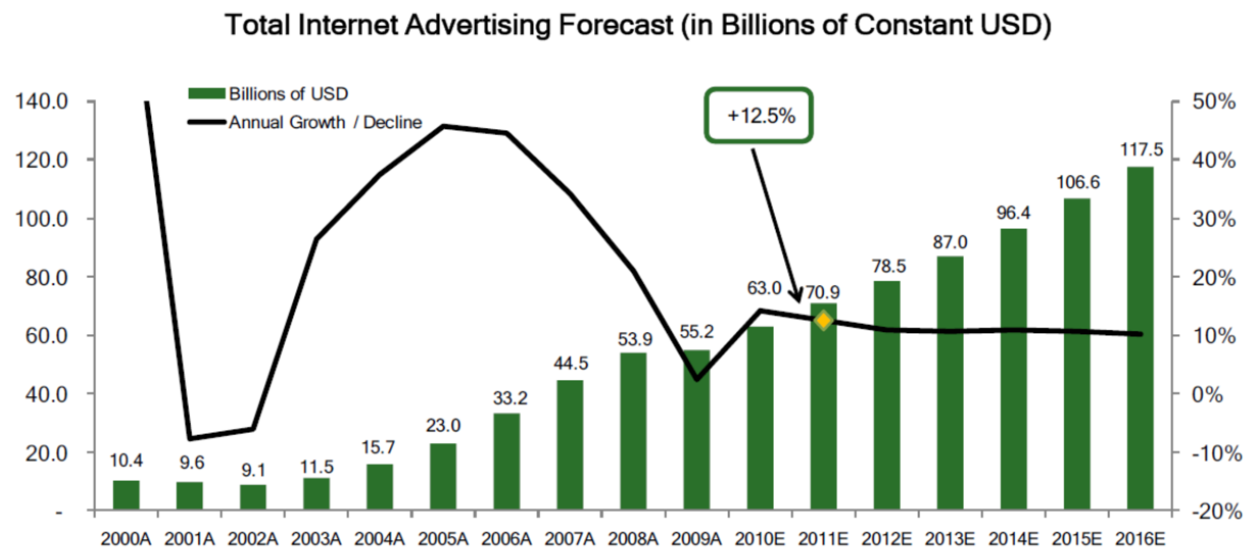
Internet Based Advertising

Internet access is now critical for many of the world's largest advertisers, even if their brand objectives cause them to prioritize television for a larger reach in viewers. For most of these companies, online has become a clear priority in terms of budget importance, typically at the expense of print and radio.

Although brand-based advertisers are the key to long-term growth for the medium, the current heart of online advertising lies in two key segments, endemics and small and medium-sized enterprises (SMEs). Endemics include e-commerce players such as Amazon, eBay, Rakuten (based in Japan) and Taobao (based in China), and any other entity with an online storefront. With near perfect end-to-end feedback loops, commercial exposures can be tracked and associated with actions to optimize marketing efforts. Virtually all potential customers can be reached online, making the Internet the primary medium for these marketers. Small and medium-sized enterprises represent what we believe to be large, identifiable segment of online advertisers. With smaller media budgets and fewer total campaigns with fewer people to coordinate, this segment can easily identify and change the impact of any given media campaign, while being more cost-effective when accomplishing its goals with the discrete and highly targeted units available through digital media. Online search has been a primary beneficiary to date and SMEs are likely to account for the majority of paid search ad revenues while other emerging media will continue to capitalize on SMEs in the near future.

In total, we expect online advertising to grow by 10.6% each year through until 2016 after it the increase in 2011 by 12.5%. The medium will account for $70.9 billion in global advertising during 2011, and $117.5 billion by 2016; a gain from 17% of the global total in 2011 to 21% in 2016. The largest markets will remain the same throughout this time horizon, with the US, Japan, Germany, the UK and China dominating.. China will account for 9% of the world's online advertising by 2016, up from 5% in 2011 which will account for the largest gains and growth in the years ahead.

Online video is the fastest growing internet-based segment. There is a divide between online video and traditional TV in many countries where conventional Pay TV penetration is low and consumer habits associated with accessing content are not entrenched. Online video will be viewed as an extension of TV, and eventually will be an extension of other online activities. The sector is expected to grow by 19.6% each year on average through 2016, after growth of 40.0% in 2011. The sector should also rise in value from $4.7 billion in 2011 to $11.4 billion in 2016.



Leaders in this space represent 70-75% of the revenue generated in the Internet Ad space which is currently dominated by Google and their search advertising revenue. Yahoo, Facebook, Microsoft and AOL represent the other major players that make up this market share value. The following chart published in March 2011 which shows the projected market share of the total online internet marketing space by the top 5 players:

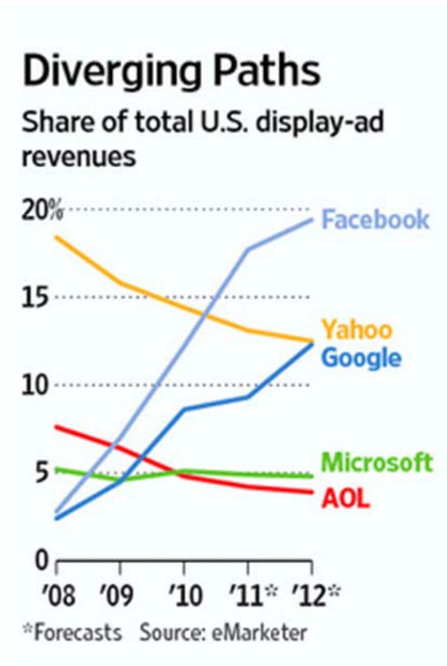
Net US Ad Revenues at Top 5 Online Ad Selling Companies as a % of Total Online Ad Spending, 2009-2012

	2009	2010	2011	2012
Google	34.9%	38.9%	43.5%	47.6%
Yahoo!	16.1%	13.4%	11.9%	10.8%
Facebook	2.4%	4.7%	7.7%	8.8%
Microsoft	4.7%	4.9%	5.4%	6.0%
AOL	4.4%	3.4%	2.8%	2.4%
Total top 5	**62.6%**	**65.3%**	**71.2%**	**75.5%**

Note: net ad revenues after companies pay traffic acquisition costs (TAC) to partner sites; numbers may not add up total due to rounding
Source: eMarketer, March 2011

125251 www.eMarketer.com

While search revenue will be a key focus, display advertising (shown in the other category below) is the second largest segment that also Facebook dominates. The following series of charts shows Facebook gaining share of the search market with the Microsoft Bing social integration which has proven that social search generates better results than Google's current search algorithm. As Facebook continues to retain user's each day, tools for search inquiries will soon be developed within Facebook and will continue the growth of Facebook and Microsoft's market share in search:



Percentage of U.S. searches among leading search engine providers

Domain	Jul-11	Aug-11	Month-over-month percentage change
www.google.com	66.05%	65.09%	-1%
Bing-powered search	28.05%	28.99%	3%
search.yahoo.com	15.07%	15.89%	5%
bing.com*	12.98%	13.10%	1%

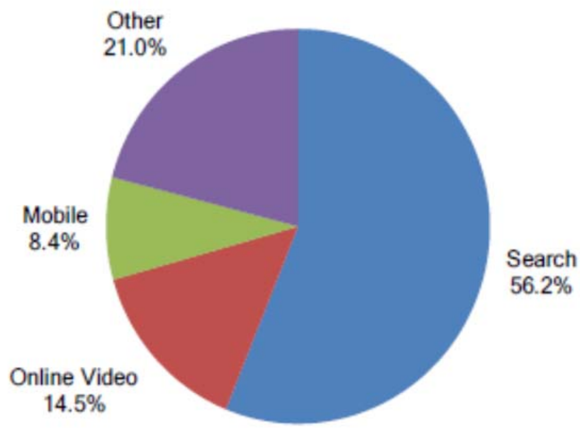
Note: Data is based on four-week rolling periods (ending July 30, 2011, and Aug. 27, 2011) from the Hitwise sample of 10 million U.S. Internet users. Figures are for Web searches only. Data does not include mobile search.

**This includes executed searches on Bing.com but does not include searches on ClubBing.com.*

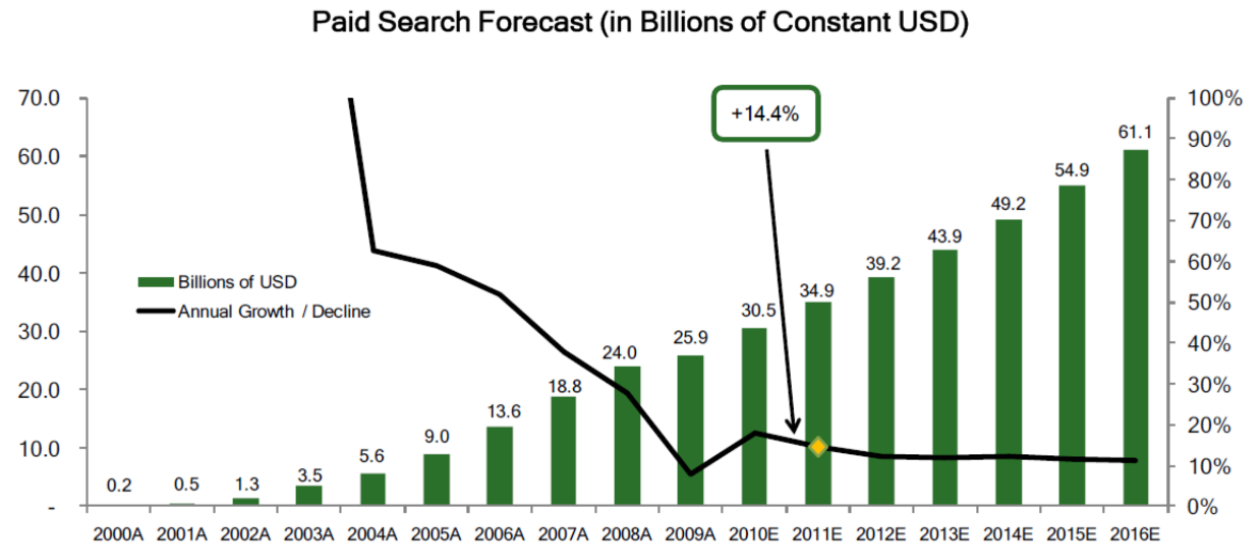
Source: Experian Hitwise

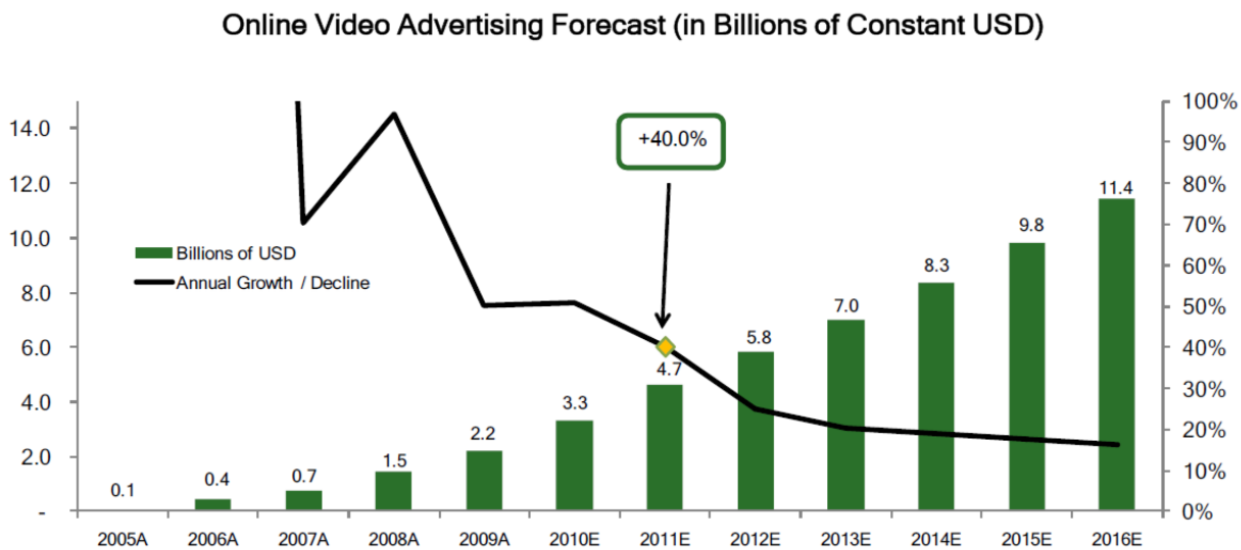
If you combine Bing Powered (which is currently Facebook controlled) and Bing.com, you will see that Microsoft is the second largest in market share and is currently rising. Social search is a new phenomenon and we expect to see Facebook/Microsoft to grow their market share in the Search revenue space, while continuing to dominate the Online, display advertisement market in years to follow.

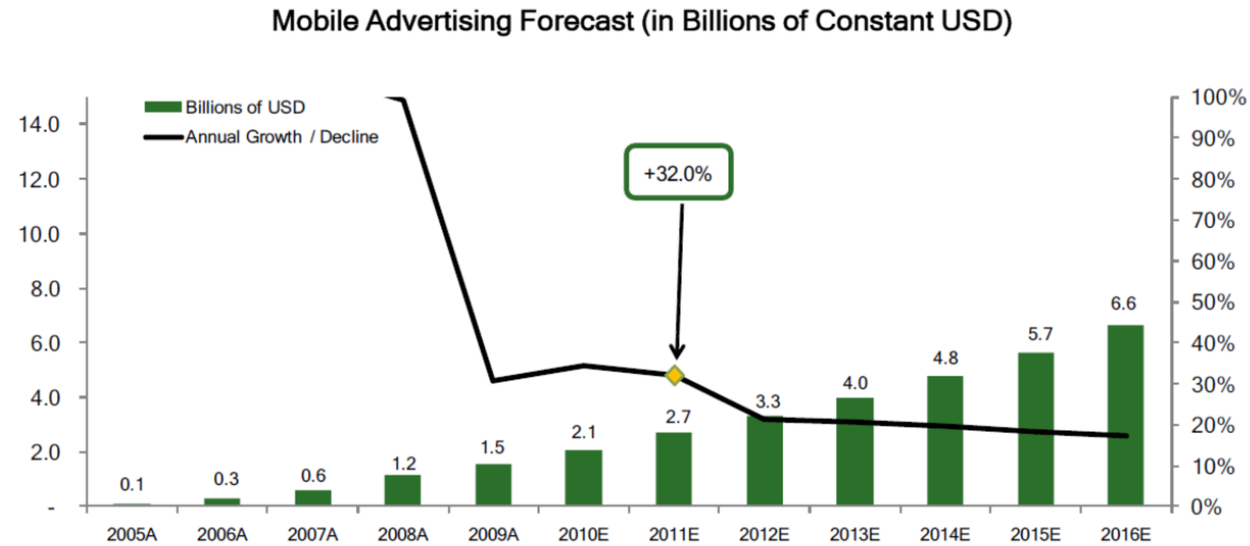
Contribution to global Internet growth from 2011-2016

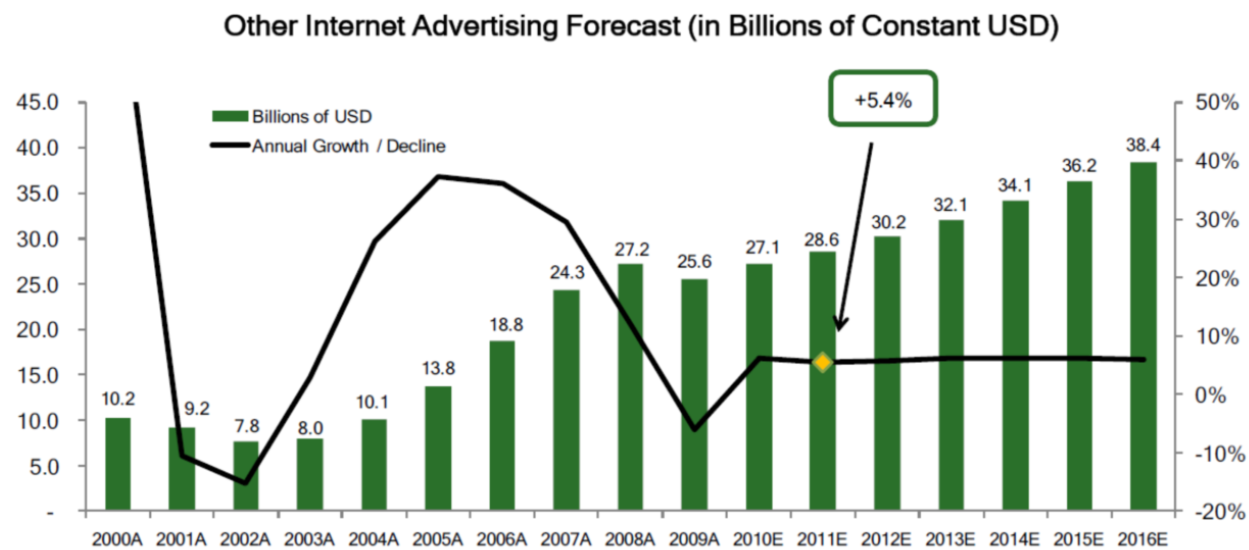


Paid Search will grow from $34.9 billion in 2011 to $61.1 billion in 2016, sustained by rise of small and medium-sized enterprises, and furthered by large brands' increased use of the medium


Paid Search Forecast (in Billions of Constant USD)
Billions of USD
Annual Growth / Decline
+14.4%
0.2
0.5
1.3
3.5
5.6
9.0
13.6
18.8
24.0
25.9
30.5
34.9
39.2
43.9
49.2
54.9
61.1
2000A 2001A 2002A 2003A 2004A 2005A 2006A 2007A 2008A 2009A 2010E 2011E 2012E 2013E 2014E 2015E 2016E


Online Video Advertising Forecast (in Billions of Constant USD)
Billions of USD
Annual Growth / Decline
+40.0%
0.1
0.4
0.7
1.5
2.2
3.3
4.7
5.8
7.0
8.3
9.8
11.4
2005A 2006A 2007A 2008A 2009A 2010E 2011E 2012E 2013E 2014E 2015E 2016E

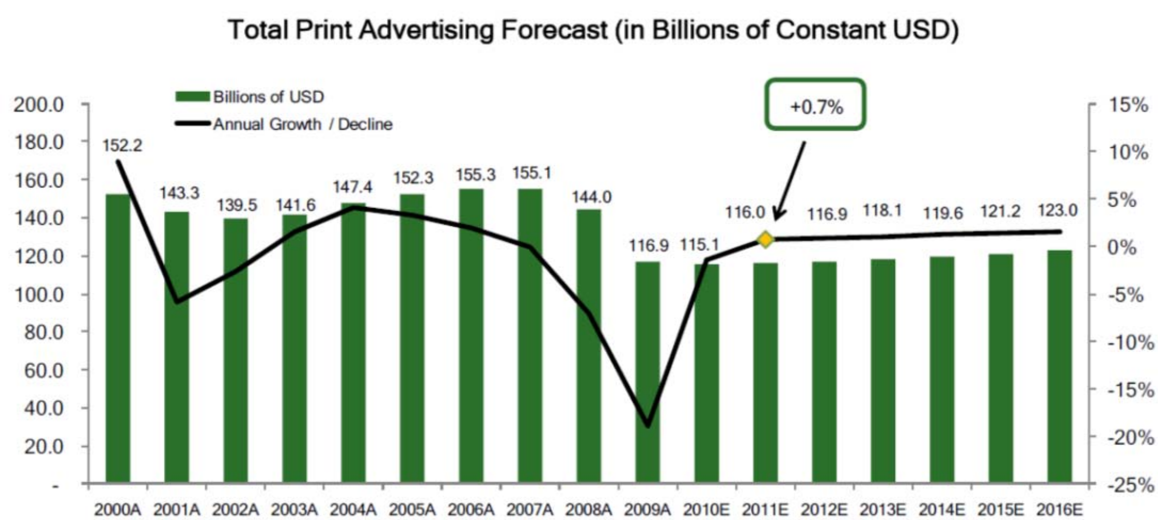




Print Media

Before electronic media became widespread, Print was the primary means by which advertisers reached consumers. Newspapers satisfied the objectives of advertisers seeking immediate awareness of sales and promotions in an environment that supports trust-building for brands. This advertising channel was effective because of the geographic targeting it offered since individual copies were primarily delivered to specific addresses. Magazines also offered advertisers trust in brand recognition since they offer a slightly different advantage, including the ability to target niche audiences, which is viewed as a medium for the continuous state of innovation of content and format. However, the Internet changed the fortunes of print publishers in most countries for the worse since print no longer uniquely satisfied many of the objectives which advertisers relied upon. Brands seeking engagement were presented with measurable engagement online and the desire to associate with trust-worthy content which can be fulfilled continuously. Arguably, in many countries, newspapers uniquely support advertisers who believe the medium drives retail traffic, although the declining trends in circulation make it harder to accomplish these goals. Newspapers are expected to grow at an average rate of 1.7% through 2016, after rising a modest 0.7% during 2011. This is because they tend to be popular in emerging markets where literacy levels are rising and internet connections are poor. India and Indonesia will be among the primary beneficiaries of this factor. Magazines also make it difficult to accomplish unique objectives for most advertisers, which are expected to decrease in usage more than any other medium globally in the next couple years. Magazines will struggle to stay positive and global, essentially staying constant with little change going forward into the future. Over the next five years, magazine advertising will decline in each of the world's 10 largest markets, with the exception of Brazil and Russia.

Loss of readership, real and perceived, is a driving factor behind these trends. Digital and online media will ultimately replace print media in a short period of time. The introduction of Apple's iPad during 2010 highlighted the potential for replacement of print editions with digital ones which encourages advertisers to explore sponsored content and designs for these devices, potentially using budgets allocated towards online media. However, even though it seems unlikely that more than a minority of the population will possess tablets over the next few years, the propensity to eliminate print subscriptions in favor of digital downloads still remains. Advertisers will eventually have to alter their media plans in the future to remain competitive and tap into a large, diverse population of consumers.



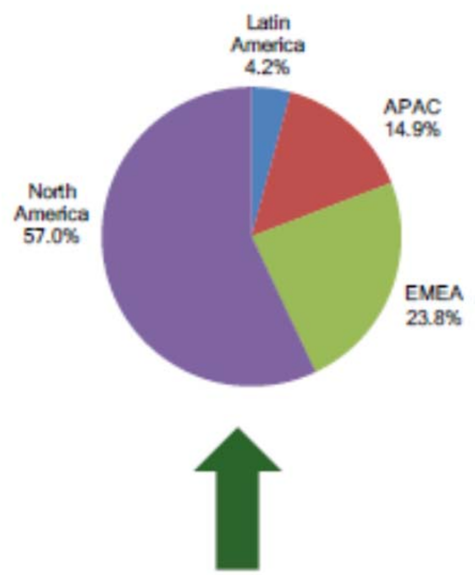
Radio and Online Music

Radio and online music currently satisfies a number of different consumer needs such as music discovery, local news, spoken word content and information sharing from a portable device. This is a low cost delivery platform that is embedded in Smartphones, tablets, and automobiles where areas with a large commuter and "on the go" population such as North America where market share is in the majority. This segment is not positioned for any major growth, with just 3.1% in 2011 and then averaging 4.1% through to 2016, but in aggregate generates $35.9 billion in advertising revenue, accounting for 6% of the global advertising market. Some of the key growth markets include India, China and South Africa.

Flat growth is projected within US, Canada, France and Germany due to the new forms of delivery of music in the digital world. These countries represent the largest segments of advertising spending. Consumers now have greater access to online music sites, communities, streaming radio and downloadable music. Online media has generally supplanted radio for news bulletins in many countries as well as GPS-based services which will eventually replace radio as the best source of on-the-go information about traffic and news. These alternatives are continually gaining traction with consumers and new technologies that have integrated mobile data services which may result in even faster growth. Furthermore, prospects for revenue growth among terrestrial broadcasters will not be determined in the foreseeable future by successful digital extensions of legacy platforms. Successful online music services such as Pandora (based in the US) and Spotify (based in Sweden) are able to sell different types of advertising, but it still remains questionable whether services such as theirs will ultimately capture budgets from radio or online advertisers.

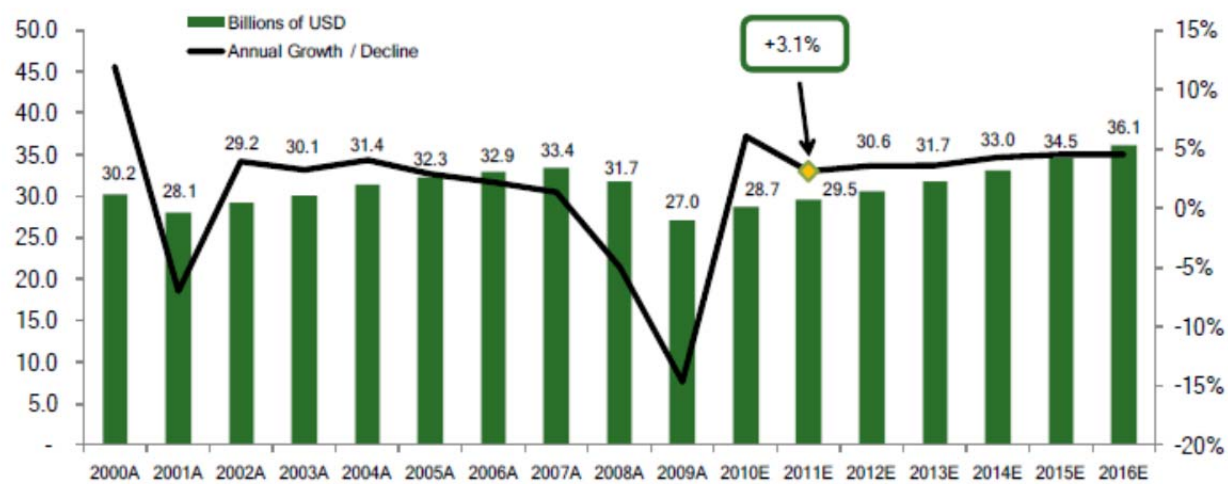
Future growth in this segment maybe attributed to the digital delivery over wireless data networks whereby more demographic information can be delivered to advertisers. With information being delivered at a higher quality, results from campaigns may drive revenue higher. This trend will build first within the USA as Facebook and independent internet music service's gain traction with the carriers, providing unlimited data packages to the new smart phones.

Share of global Radio advertising by region: 2011



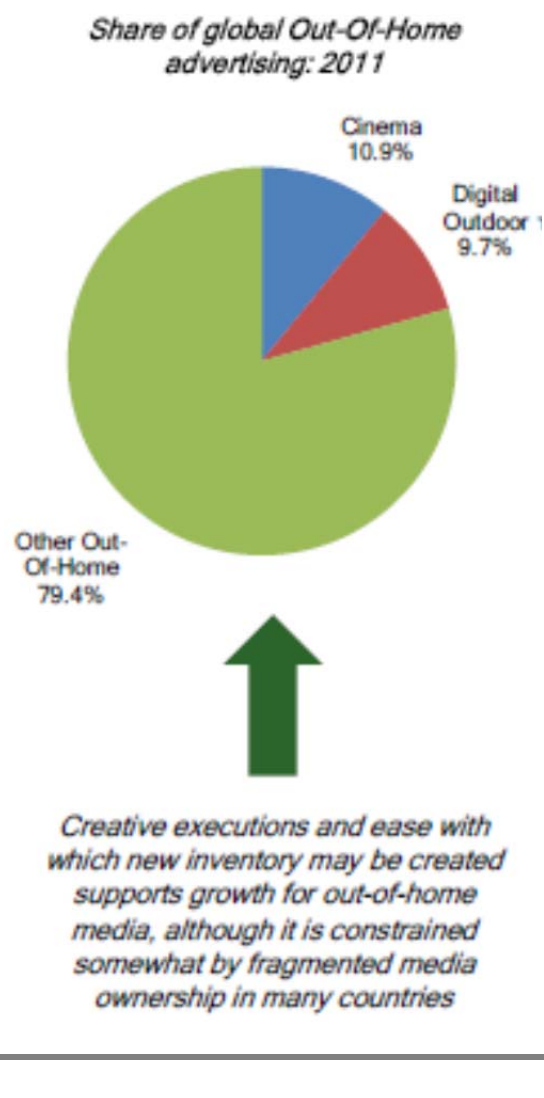
Radio remains skewed towards North American and European markets, where large local advertising markets have developed

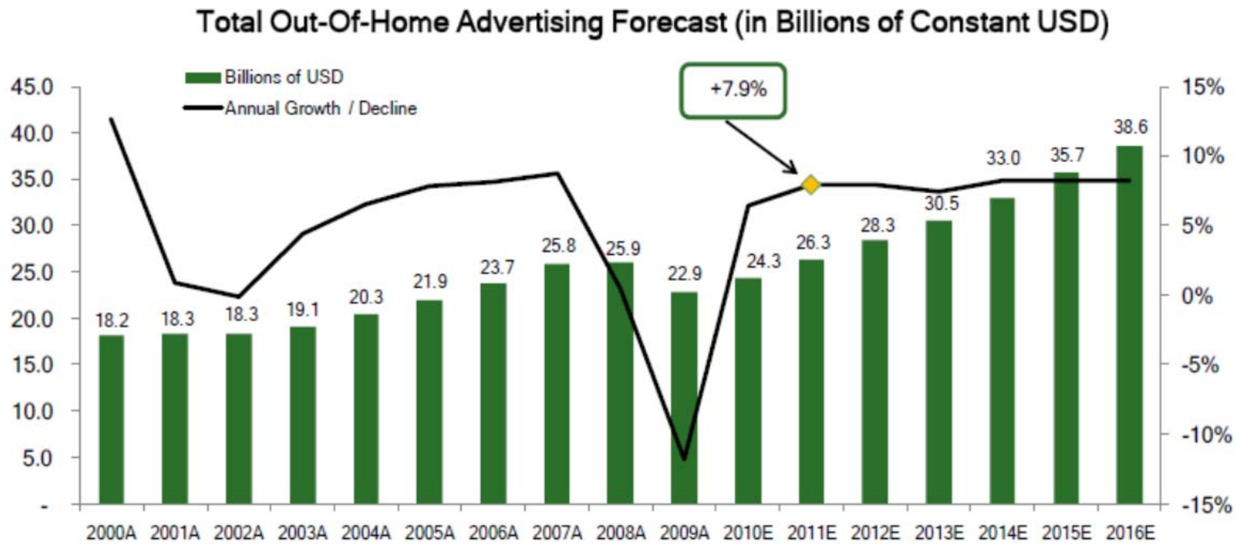
Radio Advertising Forecast (in Billions of Constant USD)



Out of Home Advertising

The Out of Home form of advertising is one of the oldest methods which include posters and signs. They have been around for centuries and still represent the largest percentage of the Out of Home segment. The growth in this sector is supported and driven by the ease of which the advertising can be deployed, which fuels the growth within this segment. Out of Home advertising grew 6.4% in 2010 and is expected to grow 7.9% in 2011 and beyond. This sector accounts for $26.3 billion in revenue during 2011 and is expected to increase to $38.6 billion by 2016. We do not see social media being able to cannibalize and replace this sector the way they that will be able to within the TV, Radio and Print sectors.





Conclusion

The total advertising market in 2011 is forecast to generate $411 billion in revenue and will grow to $558.4 billion in 2016 which is fueled mainly by growth in Asia, India and South America. As the overall market continues to grow, the highest growth segment will trend in the online advertising vertical which is forecast to grow to $117.5B.

Galt believes that this forecast does not include the recent and revolutionary changes that Facebook announced to their platform incorporating Read, Watch, Listen (Print, TV and Radio) since social computing will completely disrupt these traditional segments. It is currently too early to attempt to see the results of this disruption but we can ultimately draw some conclusions based on past trends.

Core Drivers of Facebook Revenues:

1. Continued leadership in online advertising: Currently Facebook is the leader in this space with $4 – $4.5B of revenue forecast in 2011. This segment represents $28.6 billion in total advertising spend for 2011 growing to $38.4 billion by 2016. We forecast that Facebook will command 60% of this market by 2016 with revenues forecasted at $23 billion.

2. Online Search Revenue (Google dominated market): Google is forecast to generate $36 billion of revenue for 2011 and is growing 25-30% annually. Google sits with 75% market share of the search space, or $26.2 billion in revenue. This market is forecasted to grow to $61 billion by 2016. We are expected to see Facebook's percentage of the search market moving from next to

nothing today to 25% of the market by 2016. This is based on the market share growth rate Facebook/Microsoft Bing has experienced since introducing Social Search capability. Google's growth rate will slow as China and India enter as the dominant growing markets using the integrated Facebook/Bing search capabilities and we see Facebook generating $15 billion annually within the Search segment globally.

3. Online Video Advertising: This segment is dominated currently by YouTube, a Google owned company, and revenue is reported on a consolidated basis. Video sharing and online delivery of social TV and on demand viewing will see accelerated growth from $4.7 billion to $11.4B as forecasted even without the impact and cannibalization of the traditional TV segments. Galt projects that Facebook will own 30% of the traditional online video advertising market segment by 2016 with their recent additions to the platform to include video. This will add $3.5B of revenue to Facebook by 2016.

   Galt also looked at the traditional TV advertising segment, which totaled $169.1 billion in 2011, and is forecast to grow to $243.3 billion by 2016. We factored in the delivery of TV viewing through the Facebook platform as Facebook recently added social TV capability. There is still some doubt as to the impact of this new technology and what it will do to traditional viewing media, but since the younger generation's projected online usage will go from 60 minutes a day on Facebook to 120 minutes by 2016, the trend signifies that an increase in users will be watching TV with their friends online. If Facebook captures just 10% of the revenue in this space, it will add $24 billion of revenue in 2016 without increasing their cost base of their platform, which will drive earnings to well above 50% of revenue.

   Facebook's 2016 aggregate Revenue now forecasted at $65 billion

4. Online Print Advertising: The print ad segment is forecast to generate $116 billion in 2011 with marginal growth into 2016 now forecasted at $163 billion. With the addition of the Facebook "Read" into their platform, advertisements targeted to the print market will go social onto the Facebook platform. Books, magazines, newspapers will eventually all be delivered to Facebook and their mobile applications. Online stores, publishers, distributors will transition to Facebook as their preferred delivery method. Once again, it is currently early to tell what impact Facebook will have on the Print Ad space, but we believe that at least 10% of the Ad revenue will be delivered through the Facebook platform, representing an additional $12.3B of revenue for Facebook in 2016.

   Facebook's 2016 aggregate Revenue now forecast at $77.3 billion

5. Online Radio Advertising: As radio and music trends transition to the Internet as the preferred delivery channel for these services such as Pandora and Spotify, they will now also be integrated into Facebook as social radio and music delivery. Galt sees Facebook gaining a sizable piece of the radio advertising market. The radio advertisement segment is forecast to grow to $36 billion by 2016 and we will eventually see Facebook gaining 15% market share of the radio advertisement revenue for a total of $5.4 billion of additional revenue by 2016.

Facebook's 2016 aggregate Revenue now forecast at $82.8 billion

With potential revenues of $82.8 billion in 2016 and earnings of $45.54 billion, by applying a conservative multiple of 20x on earnings, will value Facebook at over $800 billion. This value does not factor in the sales of goods such as software applications, books, music, video, Facebook Credits etc. Galt believes that Facebook will become the first trillion dollar valued company in history as it transitions itself to become the main operating system of the Internet for a world that is transforming itself from the Information Age to the Social Age.

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