

# State of the Mobile Internet Market

## Mobile Internet Usage Is on the Rise

With 84% of Americans using mobile phones (CTIA), the mobile market has significant scale and reach across US demographics. Given this level of reach and better mobile internet technologies and hardware, we think this medium is becoming attractive to advertisers. As a result, Google, Yahoo!, and MSN are strategically focusing on establishing market share in this industry.

- **Although mobile phone penetration is high, the mobile search market is in the early adoption stage.** In 1Q08, only 15.6% of wireless subscribers were using mobile internet services, according to Nielsen Mobile data. Even within this small subset of mobile internet users, usage drastically trails that on PCs. Nielsen Online reports that the PC internet user visits more than 100 domains per month, whereas mobile internet users visit 6.4 individual websites per month, on average.
- **We think that mobile internet adoption will accelerate with the introduction of better phones and technologies.** 3G networks perform up to 6x faster than prior mobile internet networks (Nielsen), which we think will greatly improve the user experience and make it more comparable to that on a PC. Additionally, new phones such as the iPhone have improved the size and resolution of the screens. As a result we think mobile internet users will grow at a 37% CAGR over the next 3 yrs.
- **With its 40M mobile internet users, we think the market will begin to attract advertising dollars.** According to Nielsen, 26% of mobile internet users recall having seen some form of advertising. Thus, we think mobile advertising has good potential. According to eMarketer and JPMorgan est's, US mobile ad revenue totaled only \$805M in 2007 vs. our 2007 internet advertising market estimate of \$18.9B. We think that complex user interfaces, small screens, and slow-loading browsers have limited mobile advertising use. However, as mobile internet penetration increases, we expect that advertisers will begin to test the medium. We expect mobile advertising spend to reach almost \$3.8B by the end of 2010.
- **According to Nielsen, Google has garnered the lead in the mobile search market.** Google commands a 61% market share in WAP search according to Nielsen, with Yahoo! trailing at 18% market share. However, as mobile search adoption is in the early stages, we think that it is too early to declare a winner. All three of the big players are quickly innovating in the space, with Google's Android project, Yahoo!'s carrier partnerships, and MSN's mobile portal and Screen Tonic acquisition.

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### Internet

#### Imran Khan<sup>AC</sup>

(1-212) 622-6693

[imran.t.khan@jpmorgan.com](mailto:imran.t.khan@jpmorgan.com)

#### Bridget Weishaar

(1-212) 622-5032

[bridget.a.weishaar@jpmchase.com](mailto:bridget.a.weishaar@jpmchase.com)

#### Lev Polinsky, CFA

(1-212) 622-8343

[lev.x.polinsky@jpmchase.com](mailto:lev.x.polinsky@jpmchase.com)

J.P. Morgan Securities Inc.

## The Mobile Market

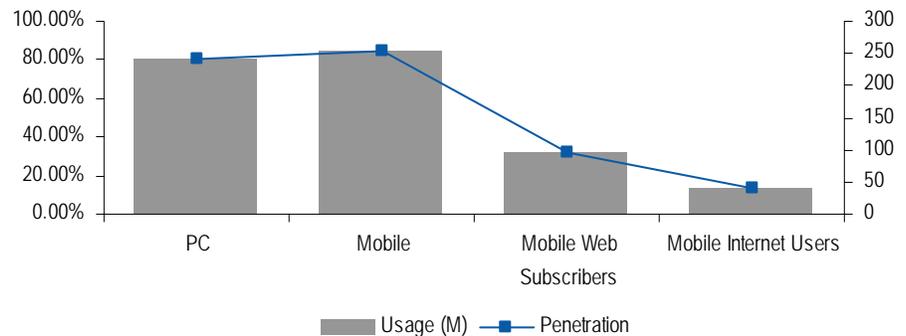
### 84% of the U.S. Population Has Mobile Phones, But Mobile Internet Usage Trails

The mobile market is a large and quickly growing industry, with Nielsen estimating 254M U.S. mobile subscribers. Mobile phone usage has surpassed PC ownership, which has an 80% U.S. penetration rate. Given this level of scale, it is apparent that the market is attractive to internet companies.

However, despite the widespread use of mobile phones, mobile internet use dramatically trails it. Nielsen data show that only 37% of US mobile users paid for access to the mobile internet and only 15.6% of mobile subscribers actively use mobile internet services. We think this is due primarily to hardware and technology issues that include slow web page loading times, complex user interfaces, small screens, and low resolutions. We expect mobile internet penetration growth to accelerate given the recent improvements made to wireless services and phone hardware.

Figure 1: Technology Penetration in the US (2008E)

as labeled

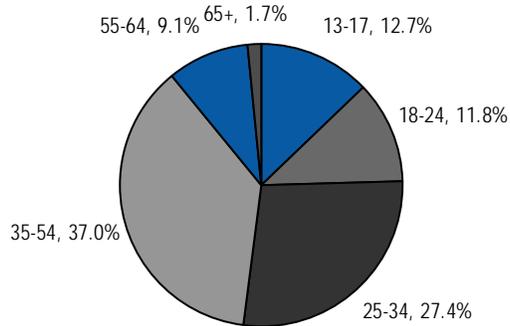


Source: CIA Government Stats (<http://www.cia.gov/cia/publications/factbook/index.html>) (Feb 2008); International Telecommunications Union (<http://www.itu.int/ITU-D/ict/statistics>); CIA Government Stats (<http://www.cia.gov/cia/publications/factbook/index.html>) (Mar 2008) for Vietnam and Hong Kong mobile phone data, "OECD Broadband Statistics to June 2007", OECD; [www.point-topic.com](http://www.point-topic.com); [mybroadband.co.za](http://mybroadband.co.za); Hong Kong and India government statistics; European Travel Commission; [www.bezeq.co.il](http://www.bezeq.co.il); Santiago Times newspaper; Nielsen Mobile data, JPMorgan estimates.

### The Mobile Internet Has a Broad Demographic Reach

Not only have mobile phones been proven to be a vehicle of scale, they also have a broad reach across various demographic segments. Surprisingly, Nielsen data suggest that mobile internet usage is prevalent across age groups. As of May 2008, the US mobile internet audience was about evenly split between those over the age of 35 (48%) and those under the age of 35 (52%).

Figure 2: US Mobile Internet User Age Profile (May 2008)



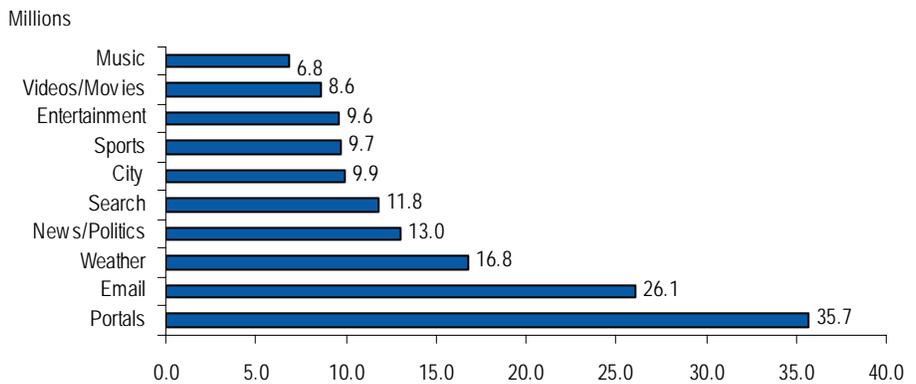
Source: Nielsen Mobile data.

Reach is also found across genders and income levels. Nielsen data show that 56% of mobile internet users are male and 44% are female. And, while 24% of mobile internet users have household incomes of \$100K or more, 26% have a household income of less than \$50K. We think this reach will broaden the medium’s appeal to advertisers.

### Internet Visits Scan a Variety of Verticals

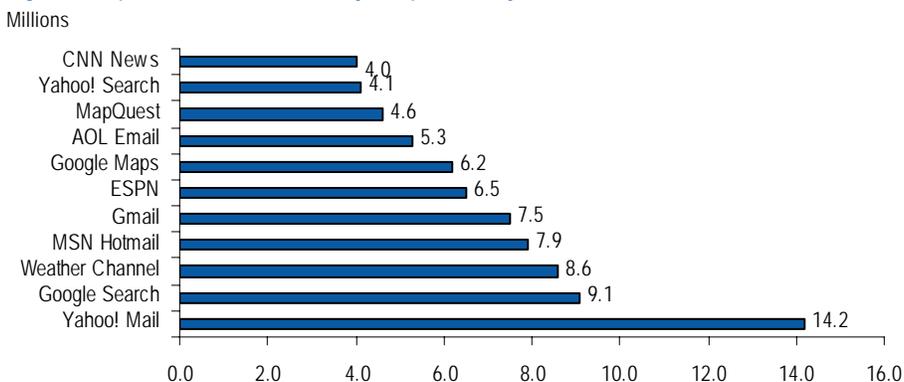
Although usage is less frequent than on PCs, mobile internet visits span a variety of verticals. According to Nielsen Mobile data, 40% of mobile internet users find sites through search engines, 22% through direct navigation, 18% through their favorite links, and 17% from their carrier’s portal. Yahoo! Mail has the largest unique audience, with 14M unique monthly users in May, with Google Search and The Weather Channel coming in next with 9M unique monthly users.

Figure 3: Top Mobile Web Categories by Unique Monthly Visitors



Source: Nielsen Mobile data.

Figure 4: Top Mobile Web Channels by Unique Monthly Visitors



Source: Nielsen Mobile data.

### Tech Improvements Likely to Push Mobile Internet Usage

In our opinion, the largest impediment to widespread mobile internet adoption has been the exceedingly low data transfer speeds. Nielsen Mobile estimates that network quality is the most important driver of satisfaction. Network quality is second only to cost as the top reason former data users cancel their data services. Recently, 3G networks have become more widespread in the US and address low speeds by improving data transfer throughputs by about 6x over 2G and 2.5G networks (Nielsen Mobile estimate). In the US, 28% of consumers have a 3G-capable handset.

Phone improvements have also encouraged mobile internet use. Probably the most recognizable of phones, the iPhone, increased awareness of mobile internet capabilities. With a handset geared toward improving mobile internet use, consumers significantly increased their use of mobile internet services. Nielsen Mobile data show that 82% of iPhone users access the mobile internet, making them 5x as likely to do so as the average mobile user.

Table 1: Top Devices among Mobile Internet Users

Device	Percentage
Motorola RAZR/RAZR2	10%
Apple iPhone	4%
RIM BlackBerry 8100 series (Pearl)	2%
RIM BlackBerry 8800 series	2%
Motorola Q Series	2%

Source: Nielsen Mobile data.

### Mobile Internet Usage Likely to Grow at a 37% 3-Yr CAGR

We think that the growth rate of mobile internet usage will accelerate in the future as a result of the improving technology and increased availability of unlimited data packages from ISPs. Specifically, we are looking for a 37% 3-year CAGR for active mobile internet users.

Table 2: Mobile Internet User Projections

Millions	2005	2006	2007	2008	2009	2010
Subscribers	207.9	233.0	255.4	263.1	268.3	271.0
<i>US Penetration</i>	<i>69.0%</i>	<i>77.7%</i>	<i>84.0%</i>	<i>87.4%</i>	<i>89.1%</i>	<i>90.0%</i>
Active Mobile Internet Users	22.4	29.7	40.4	55.8	76.9	104.6
<i>% of Mobile Subscribers</i>	<i>10.8%</i>	<i>12.7%</i>	<i>15.8%</i>	<i>21.2%</i>	<i>28.7%</i>	<i>38.6%</i>
YY Growth						
Subscribers		12.1%	9.6%	3%	2%	1%
Active Mobile Internet Users		32.6%	36.0%	38%	38.0%	36.0%

Source: CTIA, Nielsen Mobile, and JPMorgan estimates.

## The Dawn of Mobile Advertising

With approximately 40M Americans now actively using mobile internet service, we think that the market has reached enough scale to begin to be attractive to advertisers. A Nielsen Mobile survey revealed that 26% of mobile internet users recalled seeing some form of advertising while using the mobile internet. We have subdivided mobile internet advertising into 3 categories: Message Advertising, Mobile Display, and Mobile Search.

Table 3: US Mobile Advertising Forecast, 2005-2010

millions	2005	2006	2007	2008E	2009E	2010E
Mobile message advertising	43	296	750	1436	2298	3332
Mobile display advertising	1	9	26	78	125	162
Mobile search advertising	1	9	29	99	168	269
<b>Total</b>	<b>45</b>	<b>315</b>	<b>805</b>	<b>1613</b>	<b>2591</b>	<b>3763</b>
YY Growth						
Mobile message advertising		585%	153%	91%	60%	45%
Mobile display advertising		950%	175%	90%	60%	30%
Mobile search advertising		950%	207%	90%	70%	60%
<b>Total</b>		<b>600%</b>	<b>156%</b>	<b>100%</b>	<b>61%</b>	<b>45%</b>

Source: eMarketer, Yankee Group, Strategy Analytics, Nielsen Mobile, and JPMorgan estimates.

### SMS Advertising

We think that mobile message advertising is currently the largest medium for mobile advertising as text messaging usage does not require high data speeds or advanced phone capabilities. Campaigns can include placement in text messages, direct spending on a message campaign, and spending on promotional coverage of end-user messaging costs. We expect this market to reach \$3.3B by 2010.

### Mobile Display Advertising

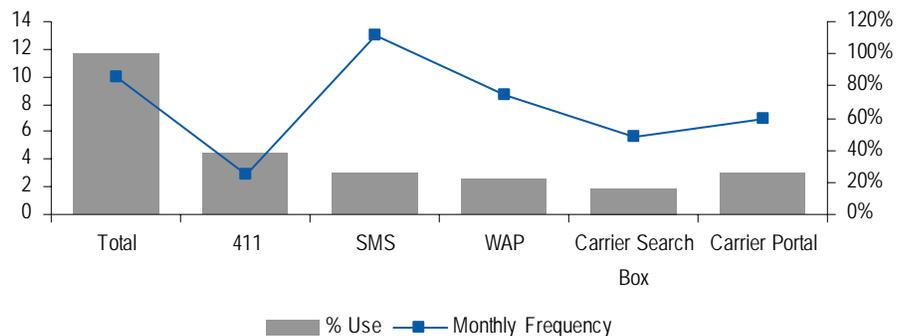
Mobile display advertising includes spending on display banners, links, or icons placed on WAP, mobile HTML sites or embedded in mobile applications such as maps or games and videos. We think mobile display advertising will be a high-growth area over the next few years as improvements to data-loading speeds and better phones fuel mobile internet usage. However, we see growth in mobile internet users and increased advertiser spend slightly offset by declines in CPMs due to available inventory increases. We expect the mobile display market to reach \$162M by 2010.

In addition to high growth, we think that the mobile display market will undergo a competitive shift favoring traditional internet display companies. Early mobile display advertising was dominated by mobile-specific ad networks, such as Third Screen Media and AdMob, that specialize in delivering ads for phone browsers. However, the latest browsers, like MobileSafari on the iPhone, are designed to bypass mobile websites and display full-size hi-fi websites and ads. Thus, the iPhone browser loads an ad the same way a computer does, eliminating the need for a special mobile ad network with different technology. We think that the trend toward these advanced phones will favor existing internet players who already have many advertiser partnerships.

**Mobile Search Advertising**

Mobile search advertising includes spending on sponsored display ads and text links that appear alongside mobile search results as well as spending on audio ads played to mobile phone callers making a directory inquiry (e.g., GOOG-411 and 1-800-FREE411). We think mobile search advertising will be a high-growth area given its high volume and starting point status. We are expecting search advertising revenue to reach \$269M by 2010.

Figure 5: Search Use and Monthly Frequency by Type

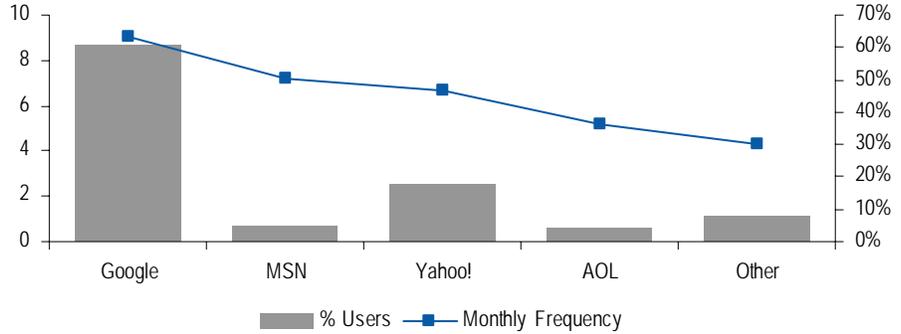


Source: Mobile Q1 2008 Mobile Media Survey and Q1 2008 Device Census.

**Google Leads in Mobile Search**

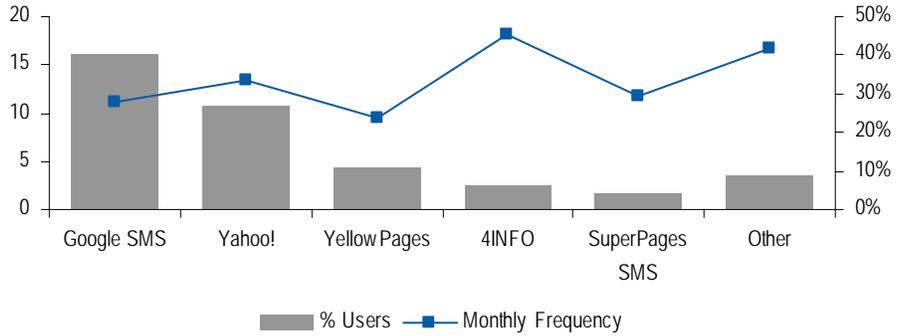
Google has already taken a dominant role in the mobile search market, leading in usage of two of the five search methods. Google is currently the leader in both SMS and WAP searches and, while not dominant in market share, Google is also the leader in satisfaction among 411 search providers. Currently, Google has a 61% market share of WAP searches and a 40% share of the SMS search market. Yahoo! trails Google with an 18% WAP search market share, while MSN and AOL follow with market shares of 5% and 4%, respectively.

Figure 6: Market Share and Monthly Frequency of WAP Searches by Provider



Source Mobile Q1 2008 Mobile Media Survey and Q1 2008 Device Census.

Figure 7: Market Share and Monthly Frequency of SMS Searches by Provider



Source: Mobile Q1 2008 Mobile Media Survey and Q1 2008 Device Census.

## Company Initiatives

### Google Works on Android

Google decided to address distribution difficulties head-on with the creation of the Open Handset Alliance, composed of leading technology and wireless companies committed to the development of an open platform for mobile devices. The Android platform is a fully integrated mobile “software stack” consisting of an operating system, middleware, user-friendly interface, and applications. The first phones based on Android are expected to debut in the fourth quarter of 2008. Google hopes that bringing the internet developer model to the mobile market will make the phone features more attractive, affordable, and user friendly for the consumer.

Despite speculation about the development of a Google Phone or GPhone, we believe that it is unlikely that Google will choose to enter the hardware business. First, none of Google’s core competencies lies in this business, and it would take much investment in technology, marketing, and people to ramp it up. Secondly, the handset business is a much lower margin business than on-line advertising. We estimate that operating margins for handset makers range from 10% to 20% and are skewed toward the lower end of the range. In contrast to this, we believe that Google will achieve an operating margin north of 50%.

Instead, we believe that it is more likely that Google will pursue methods to increase the distribution of its products and services, so that they may later be monetized. If the Android open platform is widely rolled out, more consumers would have access to Google features. Google has introduced many mobile products including search, Gmail, YouTube, Picassa, maps, and GOOG-411. We believe that Google is well positioned to capitalize on the mobile space with its search dominance. Currently, advertisers can elect to place mobile search or content ads through AdWords.

## Yahoo! Emphasizes Mobile

Yahoo! has introduced a comprehensive mobile offering that includes:

- Mobile Homepage
- Yahoo! oneSearch, which provides instant answers to any query and not just web links
- Yahoo! oneConnect, an all-in-one communications application offering
- Yahoo! onePlace, a content management application

Similar to Google, Yahoo! has created an open environment that enables developers and publishers to make their offerings mobile. Yahoo!'s Mobile Widget Platform gives developers an easy-to-use XML-based blueprint and instant scalability across all mobile devices that Yahoo!'s own mobile services run on. Yahoo! has promoted uptake of its mobile services through carrier partnerships. Just this month, Yahoo! exceeded 60 oneSearch partnerships.

Yahoo! has also begun to monetize the space. The company currently offers mobile display advertising in 23 territories across Europe, Asia, and the Americas. Search marketing solutions are available in the United States, the United Kingdom, and Japan. In addition to being Vodafone's exclusive advertising partner in the UK, Yahoo! recently announced a strategic partnership in the UK that will deliver the first graphical advertising to appear on T-Mobile's Web'n'walk service. Recently, Maxis Communications Berhad in Malaysia and Idea Cellular Limited in India extended Yahoo!'s mobile graphical advertising reach through new partnerships.

## MSN Updates its Mobile Portal and Adds Features

Last year, Microsoft launched MSN Mobile, a redesigned portal providing customers with access to email, news, sports, entertainment, local movie listings, maps and directions, Windows Live Messenger, and Live Search. Like Yahoo!, Microsoft is pursuing strategic alliances. As of February, Windows Mobile runs phones from 50 device makers used by 160 mobile operators. Microsoft software and services include Windows Mobile, Windows Live Messenger, Hotmail, and Windows Live Spaces are also used by device makers including HTC Corp, LG Electronics, Motorola, Nokia, Palm, RIM, and Samsung.

Microsoft now has firm footing in the mobile advertising world. Last spring, Microsoft announced the acquisition of Screen Tonic, a Paris-based company that specializes in delivering location-based ads to mobile devices. ScreenTonic's platform, called Stamp, enables delivery of text or banner links on portals, ads in SMS (Short Message Service) messages, and ads in mobile Web pages that vary

depending on where the reader is located. Recently, Microsoft made two more acquisitions. TellMe provides a voice search recognition platform. Danger provides communication, organization, and information services through real-time mobile messaging, social networking, web browsing, and personal information management applications.

## Other Company Initiatives

### **AdMob**

AdMob is a mobile ad network that connects advertisers with mobile publishers. It allows advertisers to create ads, choose landing pages, and target ads to specific sites, audiences, locations, carriers, phone platforms, and phone manufacturers. All ads are run on an auction-based pricing system. AdMob clients include ESPN, CBS, Geico, and Starbucks.

AdMob offers advertisers a mobile landing page creation called Landing Page Builder for advertisers who want to enter the space but do not have mobile landing pages. AdMob recently launched a new product, AdMonitor, that shows live data of who is viewing mobile ads around the world.

### **Amobee**

Amobee delivers a unified, telco-grade system for funding mobile content and communications through advertising revenues. Amobee dynamically inserts targeted, interactive advertisements into all types of mobile entertainment and communication channels, including videos, music, messaging, games, and WAP.

### **Enpocket**

Enpocket, acquired by Nokia in 2007, allows brands to plan, create, execute, measure, and optimize mobile advertising campaigns around the world. The Enpocket platform is a mobile advertising campaign management and delivery system distinguished by advanced consumer insight, targeting, and measurement. The platform can deliver mobile advertising across multiple formats, including SMS, MMS, mobile internet advertising, and video.

### **Greystripe**

Greystripe's AdWRAP products provide mobile content free to consumers in an ad-supported model through the operation of an in-game mobile ad network and mobile game distribution platform. The ad network takes full screen images, videos, and scrolling banners and dynamically delivers them into mobile games and applications. Recently, Greystripe announced that it is launching an iPhone 3G API for game developers.

### **JumpTap**

JumpTap reaches over 150 million mobile subscribers through partnerships with 17 mobile operators and numerous content publishers. JumpTap's search and advertising solutions enable carriers to maintain a position in the mobile marketing value chain, drive traffic and revenue opportunities to content publishers, and give advertisers access to targeted customers.

### **Medio Systems**

Medio Systems is a provider of mobile search and advertising solutions. Created specifically for mobile, Medio Mobile Search combines a user interface with recommendation and personalization technologies. Using the targeting capabilities of the mobile search platform, the Medio MobileNow Search Advertising Network enables advertisers to identify and reach interested audiences. Through Medio's unique partnerships with mobile carriers and publishers, ads are integrated into the consumer mobile search experience, where increased relevance drives response.

### **Millennial Media**

Millennial Media is a mobile media network which specializes in the "millennial" audience. With Millennial Motion rich media for engaging user experiences, the MBrand network for targeted audiences across premium content, and Decktrade for performance-driven campaigns, Millennial Media has a broad advertising offering.

### **MoVoxx**

MoVoxx is an interactive advertising agency focused on mobile advertising via SMS/text. Solutions offer traditional and interactive agencies, media buyers, and brand managers a quick, silent way to have a 1-to-1 dialogue with mobile consumers. INTXT allows advertisers to append ads to the outgoing SMS messages of MoVoxx Publisher Network traffic, creating a method of instant mobile distribution. Ads can be targeted by geography, daypart, and content channel. INADS enables advertisers to build their own mobile inventory through keyword/shortcode placements within their existing advertisements – print, TV, radio, internet, or in-venue. This product helps leverage existing ads with an interactive call to action and a method for successful reporting.

### **mSnap**

mSnap is a mobile ad network enabled by a platform for broadcasters and advertisers to easily create and manage mobile campaigns. The mSnap Network currently includes over 650 broadcast media partners, with the potential to reach over 200 million mobile users a week. Through exclusive relationships with broadcast partners such as Citadel/ABC, the company offers the ability to target mobile ad campaigns locally or nationally and by numerous demographic and interest-based criteria. Broadcasters can mobilize their programming, making it more interactive, engaging and measurable. SMS traffic can be monetized while increasing listener/viewer engagement and interactivity.

### **Quattro**

Quattro is a mobile ad network which provides targeted, interactive multimedia mobile ad units (Video, SMS, WAP, click-to-call, email, share), all tracked in real time. For publishers, the company offers its proprietary Juicing technology (allows publishers to run wired assets on wireless devices without feeds), handset expertise, and interactive feature sets.

### Companies Recommended in This Report (all prices in this report as of market close on 16 September 2008)

Google (GOOG/\$442.93/Overweight), Microsoft (MSFT/\$25.99/Neutral), Yahoo Inc (YHOO/\$19.26/Overweight)

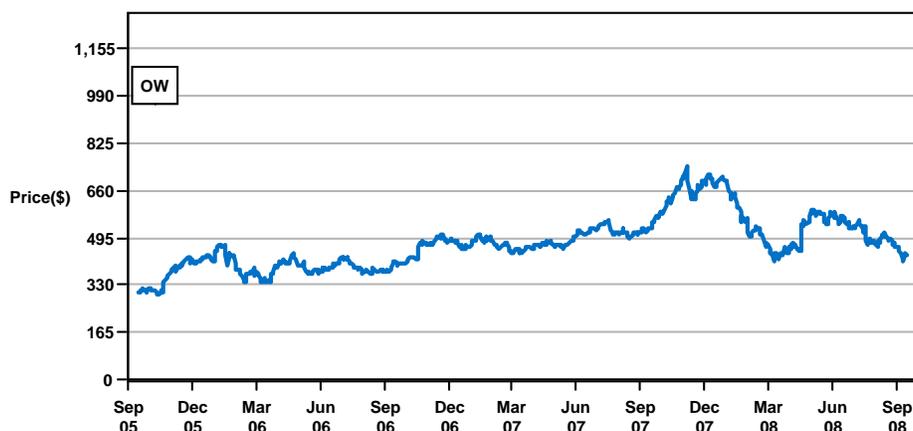
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#### Google (GOOG) Price Chart



Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.  
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JPMorgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

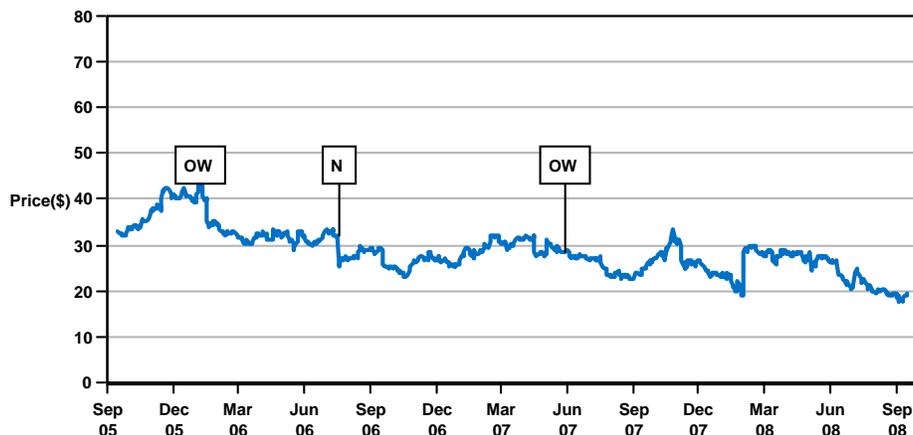
**Microsoft (MSFT) Price Chart**



Date	Rating	Share Price (\$)	Price Target (\$)
09-Feb-06	OW	26.91	--
02-Jun-08	N	28.32	--

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.  
 Break in coverage Feb 11, 2003 - Dec 19, 2003, and May 31, 2008 - Jun 02, 2008. This chart shows JPMorgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.  
 JPMorgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

**Yahoo Inc (YHOO) Price Chart**



Date	Rating	Share Price (\$)	Price Target (\$)
09-Jan-06	OW	43.21	--
19-Jul-06	N	32.24	--
31-May-07	OW	28.38	--

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.  
 Break in coverage Dec 30, 2001 - Apr 09, 2003, and Apr 30, 2004 - Jun 07, 2004. This chart shows JPMorgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.  
 JPMorgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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IB clients*	75%	70%	60%

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