

**BroadbandSM
Directions**

Broadband Video FocusSM
Best Practices and Market Intelligence

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INDUSTRY REPORT

How Broadband is Creating a New Generation of Video Distributors:

*The Market Opportunity for
Google, Yahoo, Microsoft, AOL, Apple and Others*

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This report is designed to provide general information on the subject matter covered. It is not intended to provide personalized advice or guidance. You are responsible for properly analyzing and verifying any information you intend to rely on.

About Broadband Directions LLC

Broadband Directions LLC is a market intelligence and consulting firm focused on broadband-delivered video. Broadband Directions provides its clients with detailed best practices and market intelligence, as well as hands-on business development and marketing consulting services. **Broadband Video FocusSM**, the firm's market intelligence service, consists of industry-focused market intelligence, best-practices case studies and executive interviews, along with dedicated consulting time.

The firm is led by Will Richmond, a veteran of the cable TV, broadband, content and technology industries who brings a unique and pragmatic perspective to this emerging industry. More information about Broadband Directions LLC can be found at www.broadbanddirections.com.

Definition of Broadband-Delivered Video

Even for industry professionals, it is all too common to find oneself in the midst of a conversation with a colleague only to discover that while both individuals are using the same words, they are actually referring to completely different things. In the case of early-stage yet fast-moving technology-based products and services, there are no dictionaries that anchor the words to universally-understood meanings. Rather, individuals choose words in an ad hoc manner – sometimes they are descriptive of the underlying technologies used, while other times they are referential, in that they piggy-back off of existing terminology (though the existing terminology itself may not yet have well-accepted definitions).

We continue to grapple with which words to use to convey as precisely as possible what we mean. As in the past, we believe “broadband-delivered video” is optimal. For us, this term means video that is currently delivered from a remote server to a user’s computer. Its delivery requires a high-speed, or broadband Internet protocol (IP)-based connection, as opposed to a dial-up connection. Others sometimes refer to broadband-delivered video as “Internet TV”, “broadband TV”, “web video” or “online video”. In the future, our definition may be further refined, depending on whether the video is actually viewed on the computer or another device, what underlying technologies are involved with its delivery, and countless other factors.

Importantly, we distinguish broadband-delivered video from “IPTV”, which is another term frequently used. We consider IPTV to be video which is delivered over a closed IP network to an advanced, IP-based set-top box connected to the user’s TV. Some of the underlying technologies IPTV uses are common to broadband-delivered video. Nonetheless, we believe IPTV’s set-top box and what it enables the service provider to do is a source of meaningful distinction vs. broadband video, in that it suggests that IPTV models will be relatively close to current multi-channel subscription TV services.

We contrast this with broadband-delivered video, where we believe the consumer experience is closer to (and will evolve from) today’s Internet-based consumer experience. This likely means that broadband-delivered video will have business models closer to those seen on today’s Internet.

About Broadband Directions' Reports and Methodology

Broadband Directions takes a unique approach in its market intelligence reports. Our primary goal is to generate meaningful and actionable insights about which of the myriad influences and market dynamics should be most important for our clients' focus. In doing so, we cut through the media's daily noise concerning the video value chain to help improve the probability of success for our clients' products and services.

We focus exclusively (and we believe uniquely) on broadband-delivered video, which is the most significant disruptive influence on the video value chain. Our many years of direct, industry-related experience in executive and operating roles, plus numerous industry relationships, provide us with a deep and pragmatic viewpoint on the subject area. Compared with other analyst firms that emphasize quantitative forecasts and adoption rates, we focus on understanding subtle marketplace biases and trends and then translating these to improve our clients' likelihood of marketplace success.

We are very familiar with the frenetic pace at which our clients operate, and so we strive to be the best possible strategic resource for them. Broadband Directions supplements our clients' marketing and competitive intelligence activities, delivering much-needed industry insight and perspective. We encourage reactions and debate on our conclusions as these serve to strengthen their accuracy.

Our analyses are based on our own research and extensive company briefings (for this report we spoke with executives in the video groups of Google, AOL, MSN and Yahoo), combined with our own observations about the market and discussions with its key participants, appropriate strategic frameworks, and relevant research and forecasts from other analyst firms which we respect.

The resulting reports and conclusions are fact-based, intuitive and actionable. We fully recognize that in new and dynamic markets such as broadband video, there are many uncertainties and it is not possible to have all the right answers. But we strongly agree with Mr. Pasteur's quote at the beginning of Section I, in that those companies which best prepare themselves in understanding the market's dynamics are the ones most likely to succeed.

Acknowledgements

A report of this scope can only result from the efforts and input of multiple people. We are very fortunate to benefit from a wide circle of relationships in the thriving broadband video industry. We are also grateful to the individuals at Google, Yahoo, Microsoft and AOL who briefed us. Finally we appreciate Rob Carney's perspective and attention to detail which were invaluable in developing this report's findings.

Executive Summary

This report seeks to comprehensively and rigorously describe why broadband is the most significant disruptive force in the current video value chain and the role and value of retail video distributors in this changing market. It also details why five companies, Google, Yahoo, Microsoft, AOL and Apple (the “Group of Five”) are the best-positioned to succeed as next-generation, broadband-centric video distributors.

The core reason we believe the Group of Five companies are best-positioned to succeed is that their capabilities are very well aligned with the traditional and new video-related expectations of consumers, advertisers and content providers. To be successful, these are the three primary constituencies in the value chain that future video distributors will need to satisfy.

Section I

Section I of this report explains the traditional video distribution value chain in which three primary market participants bring video programming to market: **(1) producers**, which engage in the creative process of developing the TV programs and movies that consumers watch, **(2) wholesale packagers** (e.g. broadcast and cable TV networks), which procure under contract the rights to producers’ programs and movies, and **(3) retail distributors** (e.g. cable TV and direct broadcast satellite operators), who negotiate the rights to carry the networks as part of subscription service tiers marketed to consumers. The financial returns of TV programs and movies are optimized through an elaborate economic system known in the industry as “windowing”, which seeks to allocate a specific set of rights to each successive downstream market participant.

While the video content moves downstream in the traditional model, the money flows upstream. That is to say, retail distributors generate revenue from consumers in exchange for access to selected tiers of programming and, to a lesser extent, from advertising. Retail distributors pay the wholesale packagers. Advertising is also a key revenue source for the wholesale packagers. Wholesale packagers pay the producers. And finally, producers pay their talent.

Section II

In 2005, broadband’s impact on the video value chain accelerated. Section II of this report details how broadband enables, for the first time in history, a high-quality, open video delivery network. This is so significant because it means that video producers and wholesale video packagers are able to deliver their video directly to their target audiences, bypassing the traditional retail distributor. Equally important, robust business models to monetize this video have now become prevalent. These include consumer payments for individual episodes or subscriptions, as well as advertising.

Many wholesale video packagers launched “direct-to-consumer” initiatives in 2005, and often they struck deals with Group of Five companies to distribute their popular programming under innovative business models involving completely new consumer experiences. Despite this recent explosion of interest, we believe it is still very early in

broadband's ultimate disruptive evolution. In Section II we use a strategic framework found in Harvard Business School professor Clayton Christensen's classic book, *"The Innovator's Dilemma"*, to methodically analyze how broadband-delivered video has evolved to its current state.

Section III

Based on this analysis, we have concluded that broadband video is entering a period we label the **"range of uncertainty"**, in which it faces five key challenges to successfully establishing itself as a fully competitive, mainstream video delivery platform. We identify these challenges and discuss how they relate to a set of societal changes which all businesses are facing today. Along with these societal changes, we have identified a set of traditional and new video-specific expectations among three key constituencies - consumers, advertisers and content providers. These expectations are setting the bar for what will be demanded of retail video distributors to be successful in the future.

Based on this analysis, in Section III we have concluded that the "Group of Five" companies - Google, Yahoo, Microsoft, AOL and Apple - and possibly others in addition to the Group of Five, are the best-positioned to succeed as next-generation video distributors. In this section, we explain exactly how these companies might insert themselves into today's video distribution value chain, as either distributors of producers' and wholesale packagers' video content, or as enablers of new market participants (possibly independent startups, branded, non-video media companies, and/or new Group of Five-sponsored ventures). Indeed, the Group of Five are already pursuing this entire range of initiatives. We have also created a positioning map to explain what business models they are currently employing along with how active their programming strategies appear to be.

Further, we have scored each of the Group of Five companies' capabilities to meet both the traditional and new expectations of the three key constituencies (i.e. consumers, advertisers and content providers). These scores yield insights about where these companies may focus future investments and where current vulnerabilities lie. Beyond this scoring process, we have described three additional factors - financial strength, ownership of or access to video search technologies, and intangible factors (organizational culture, outsider status and motivation) - as being critical in predicting the Group of Five's future success.

We have also concluded that while the Group of Five companies are in the best position to succeed as next-generation, broadband-centric video distributors, there are a host of other companies, including leading cable operators, telephone companies, broadband ISPs, online publishers and others, which are also well-positioned to succeed. These companies make up a second group that may become significant retail video distributors, and this report analyzes their strengths and weaknesses. Any of these companies could yet become a leader depending on changes in consumer behaviors, technology advancements and business model success.

Section IV

In Section IV, the report describes in detail the Group of Five companies' actual broadband video strategies and implementations. As previously mentioned, we were extremely fortunate to have conducted briefings with executives in the video groups at each of these companies (except Apple). These briefings were conducted with:

Rob Bennett, GM, Entertainment and Video Services, MSN
Jennifer Feikin, Director of Multimedia Search, Google
David Katz, Head of Sports and Entertainment, Yahoo Media Group
Fred McIntyre, Vice President, AOL Video.

We have combined insights gleaned from these briefings with our own observations to carefully articulate how each of these companies intends to succeed in the broadband video space. This section of the report will be a particularly useful roadmap for companies either seeking partnerships with the Group of Five and/or focused on their competitive impact.

To provide greater discipline to our analysis of how this competition may unfold and the strategies that may be developed by the Group of Five, we have leveraged academic research by Harvard Business School professor John Gourville, which helps to explain how new products are adopted by customers.

Section IV concludes with our rationale for why we believe that in the long term, it is likely that broadband-delivered video services will compete with current multi-channel subscription video services. To the extent that the Group of Five companies successfully execute their broadband video strategies, this would eventually make them direct competitors of today's dominant retail video distributors - the cable and satellite operators.