

“Brand-Aid” for Online Lead Generation
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Online lead generation (“OLG”) is a form of performance marketing that creates value by converting raw leads into qualified leads. In contrast to brand marketing, which is the (indirect) function of “warming” leads, performance marketing is the function of directly generating, qualifying and tracking leads. Online lead generation methods include paid search, lead generation, email marketing and sponsorships of content such as white papers and webinars.

Key Take-Aways

- ◆ Online advertisers are favoring performance marketing over brand marketing. Online performance marketing has the most quantifiable return on investment (“ROI”) and has been gaining share over online brand marketing. In the second quarter of 2009, performance marketing represented 58% of total internet advertising spending, versus 38% for brand marketing. (Both were roughly even in 2006).¹ The largest forms of online performance marketing are search engine marketing and lead generation.
- ◆ No more easy money. Most OLG companies are arbitrageurs. They acquire traffic through ad networks on a cost per thousand impression, or “CPM” basis or Google on a cost per click, or “CPC” basis, and sell those leads on a cost per lead or CPL basis. As markets become more efficient, it will be harder to produce attractive arbitrage profits. We believe that out-sized profits from pure arbitrage are short-lived and that content-driven value-add will be required as the OLG market matures.
- ◆ Traditional media companies should embrace OLG. Traditional media companies have historically focused their online efforts on brand marketing (i.e. selling display ads next to their content). Content-oriented companies that can attract visitors via brand equity can build more value by moving into OLG. *We think OLG is an attractive way to monetize traditional media brands in business-to-business and business-to-consumer verticals.*
- ◆ Brand-based companies present private equity opportunities. OLG companies that create future value in the marketplace will be those that leverage the power of their brand. Although arbitrage business models have been the dominant leaders in the online lead generation space in the past, Catalyst prefers a content-oriented business model that creates value through a strong brand image and producing or aggregating content that users can rely on.

Catalyst is looking to invest in lead generation companies with \$5 to \$50 million of revenue, a strong management team, a scalable digital media platform and brand equity. Catalyst will also consider acquiring traditional media brands if coupled with a strong digital platform and an OLG-focused management team.

¹ IAB 2009 Internet Advertising Revenue Report

Overview

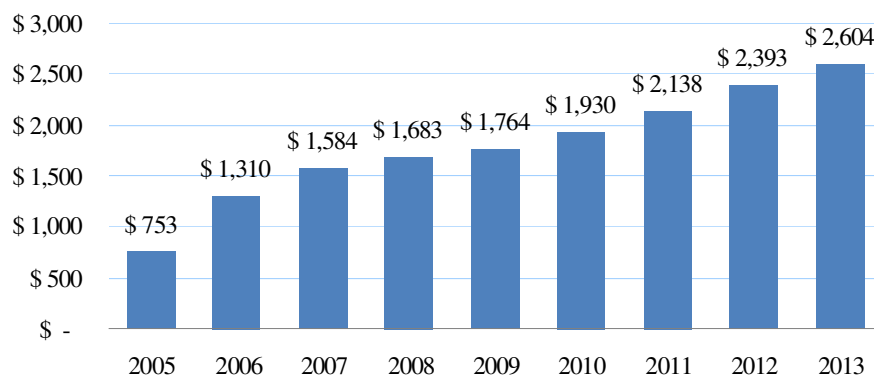
Online Lead Generation, (“OLG”) is a form of performance marketing that generates potential customers (leads) for business clients. As a performance marketing tool, OLG companies provide marketing professionals with details surrounding each lead’s origin and quality therefore supplying clients with a measurable return for their marketing spend.

In a time when marketing budgets are being scrutinized, marketing departments must be sensitive to where they spend their advertising dollars and be able to quantify their return on investment (“ROI”). By choosing to spend their budgets on performance marketing tactics instead of brand marketing, marketing managers can produce higher quality leads and focus their attention on converting those leads into customers as soon as possible. Brand marketing is still an important part of a company’s overall marketing strategy as brand marketing “warms” leads by building brand and product awareness, but performance marketing is a more direct approach to lead nurturing.

Lead Generation Industry

According to the Internet Advertising Bureau “IAB,” lead generation is the fastest growing segment of internet advertising. eMarketer expects the industry to grow at a CAGR of 10.2% from 2009 to 2013 as seen in the chart below. Advertisers have increased their spending on this marketing method as advertising spend has shifted from traditional media to online advertising.

U.S. Lead Generation Ad Spend
(\$MM)



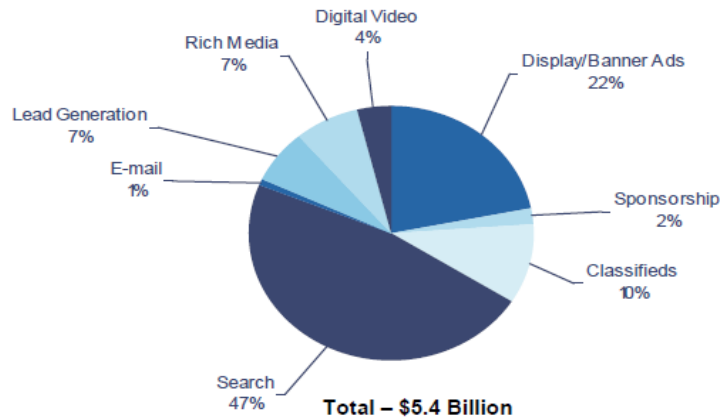
Source: eMarketer, April 2009

Online lead generation accounted for approximately 7%, or \$361 million, of 2Q09 internet advertising revenues of \$5.4 billion.² According to a 2009 Online Lead Generation (B2C) Report conducted by Clash-Media in June, 2009, 88% of companies surveyed expected that OLG would become more important to their marketing departments in the next 12 months. While offline methods such as newspapers, magazines, direct mail, and radio budgets have been reduced,

² IAB 2009 Internet Advertising Revenue Report

online lead generation budgets have increased to 61% of 2009 advertising budgets vs. 53% in 2008.

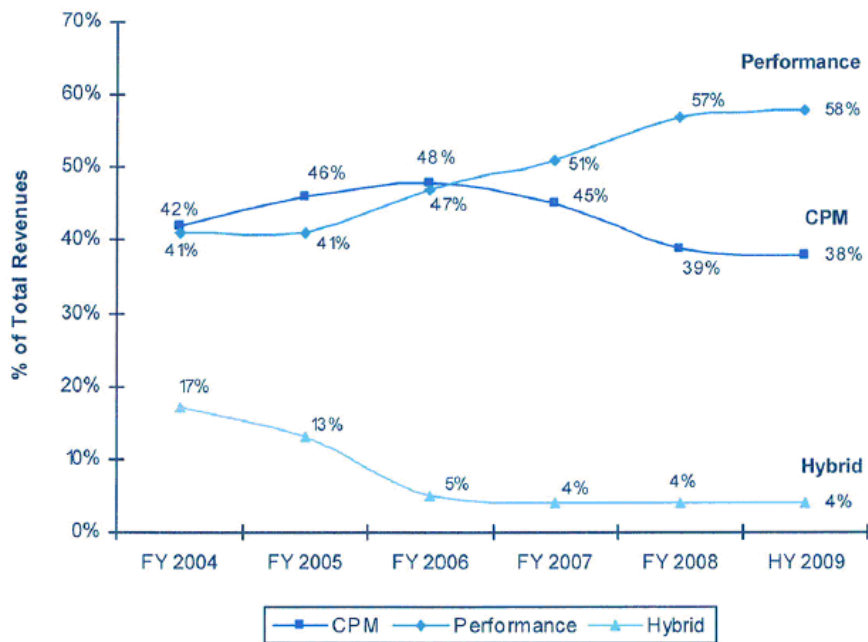
Internet Ad Revenues by Advertising Format – 2009 Second Quarter Results
% of 2009 Second-Quarter Revenues



Source: 2009 Second-Quarter IAB Internet Advertising Revenue Report

As illustrated in the following chart, performance based pricing models have grown significantly since 2006, and CPM (cost per thousand impression) models have declined as a percentage of revenue over the past several years.

Internet Ad Revenues by Pricing Model – 2004 – 2009

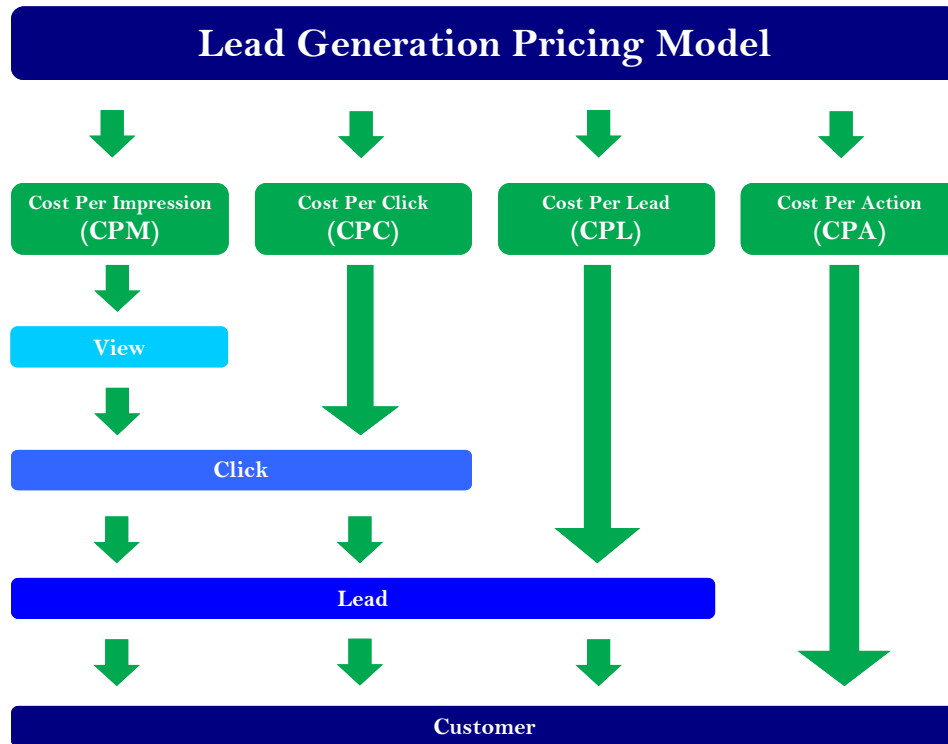


Source: 2009 Second-Quarter IAB Internet Advertising Revenue Report

Lead Generation Pricing Model

Lead generation providers create value by converting views (acquired directly through content or through display advertising) or clicks (acquired through search engine marketing) into qualified leads or customers.

The OLG value chain has the following layers:



Source: BMO Capital Markets and Catalyst Investors

- ◆ **Non-premium Display ads -> Views -> CPM:** Display ads come in two forms; (i) “premium” inventory, which is located on prime spots on websites and are usually sold to brand advertisers and ii) “remnant” or non-premium inventory which is often sold to ad networks or to lead generation companies at low prices (sub \$2 CPMs). An OLG company may attract potential consumers by using display ads that an individual can view and click. Clients pay per thousand impressions (known as cost per thousands or “CPM”), or the number of times the advertisement is displayed on a potential customer’s screen.
- ◆ **Paid search -> Clicks -> CPC:** Paid search advertisers place ads next to search terms, or keywords on search engines like Google, Yahoo or MSN/Bing. Advertisers bid on keywords that are relevant to their product. Advertisers pay on a “cost per click” or “CPC” basis, where they pay each time a prospective customer clicks on the client’s link. A click is a much more valuable lead than a non-premium impression (roughly a thousand times more valuable), because the customer has demonstrated interest by actually clicking on the link rather than just viewing the ad.



- ◆ **Content/lead qualification -> Lead -> CPL:** After clicking on a display ad or a (paid or organic) search link, prospective customers are directed to a landing page of a website. The content on the landing page provides information on education options, insurance, car sales etc, and is used to “qualify” leads by obtaining their product needs and contact information. The client pays on a “cost per lead” basis or “CPL”. Because of the extra lead qualification performed by the site, the cost of a lead is more valuable than a cost of a click (anywhere from 10 to 50 times more valuable, depending on the vertical).
- ◆ **Lead Conversion -> Customers -> CPA:** Cost per Action businesses gather leads from CPM, CPC or CPL initiatives and converts those leads into actual customers for their client. Often times a CPA model is acting as a broker or agent for the client. Examples include InsWeb in insurance, LendingTree in banking, and Priceline in travel. The “action” or lead conversion creates the highest value in the OLG value chain and could be 50 to 100 times more valuable than a click.


The role of advertisers: Advertisers can be lead generators themselves by employing any of the above methods to generate leads. For example, it is common for advertisers to run their own Google campaigns, generating clicks to their own landing page optimized for lead conversion. They can run performance-oriented display ads or create their own media content, designed to generate clicks and lead information. They can also buy qualified leads from lead generation companies and just worry about conversion. In other words, advertisers have the choice to outsource or perform in-house various layers of the lead funnel.




Payment depends on how far along the customer moves through the lead funnel described above. The ability to measure each customer’s “click” allows marketers to better understand potential customer’s online behavior and to attribute which marketing campaigns capture the most attention.



Online Lead Generation Business Models

There is a whole ecosystem of business models that supports the lead generation function. These include (1) franchise value models such as Content Masters and paid search; (2) arbitrage models such as display ad arbitrage, SEM arbitrage, ad networks, and lead brokers, and (3) adjacent models such as web analytics/ data and digital marketing agencies. Individual companies may employ one or more than one of the following models:

<i>Franchise Value</i>	<i>Business Model Description</i>	<i>Catalyst's Outlook</i>
<p>Content Masters</p> 	<p>Content Masters drive traffic to their site via the quality or applicability of their content with the intent of using that content to qualify leads to be sold to their clients. Either a customer chooses to go to a specific website such as Edmunds.com or LendingTree.com because of its well-known brand or the customer is being directed there through <u>search engine optimization</u> (“SEO”), an email newsletter or <u>content syndication</u> (e.g. Bankrate posting mortgage rates on a real estate site).</p>	<p>Content Masters are the most compelling business model long term. Successful content masters will have a good brand franchise to attract consumers and advertisers. The most compelling Content Masters are those that can aggregate and create leads from third-party content and <u>user-generated content</u>, generating high gross margins (60-70%) by not having to pay the high cost of buying advertising or producing content.</p>
<p>Paid Search</p> 	<p>Paid Search or Pay-Per-Click marketing is the model most identified with Google AdWords, whereby companies or agencies pay for search keywords relevant to their target market. The advertisement will appear on the screen near related search results to attempt to capture the attention of a potential customer. Once a consumer clicks on an ad, they will normally be directed to the advertiser’s webpage and the advertiser will be charged a fee (Cost-per-Click) depending on the level of competition for that specific keyword.</p>	<p>PPC companies are not likely candidates for growth equity investments as there are already dominant leaders within this space with mature business models. (Google, Microsoft, Yahoo!)</p>

<i>Arbitrage</i>	<i>Business Model Description</i>	<i>Catalyst's Outlook</i>
<p>Display Ad Arbitrage</p> 	<p>Display Ad Arbitrage companies buy a large amount of non-premium advertisements in order to try to capture leads through clicks. They will generally buy by CPM and sell to their clients on a CPC, CPL or CPA basis. The clicks are usually qualified into leads via content on the lead generation website. Successful display ad arbitragers are able to efficiently convert cheap clicks into quality leads or customers.</p>	<p>Display Ad Arbitrage is likely to suffer from margin pressure going forward.</p>

<p>SEM Arbitrage</p> 	<p>SEM Arbitrage is similar to display ad arbitrage except that the company acquires potential leads via their skill at running keyword campaigns on search engines (“Search Engine Marketing” or “SEM”), rather than at developing compelling display ads. SEM arbitrageurs buy on a CPC basis and sell leads to their clients on a CPL or CPA basis.</p>	<p>SEM Arbitrage is likely to suffer from margin pressure going forward.</p>
<p>Ad Networks</p> 	<p>Ad Networks allow an advertiser to extend its reach by aggregating display inventory on niche content sites and may provide technology to allow targeting of a specific audience. A variety of targeting technologies like behavioral, contextual, geographical, and semantic targeting are employed to better target potential leads. Ad networks provide an efficient way for Display Ad Arbitrageurs to acquire deep reach.</p>	<p>Ad networks will continue to provide a valuable service to marketers and OLG companies, but are in a very competitive market. We expect the ad network market to consolidate over the next several years.</p>
<p>Lead Brokers</p> 	<p>Lead Brokers acquire, package and re-sell pre-qualified leads to clients. Brokers operate in sectors (like automotive) where the lead purchaser base is very fragmented and creating a lead distribution network is a large undertaking.</p>	<p>Lead Brokers will generally have low margins and are vulnerable to disintermediation going forward.</p>

<i>Adjacent</i>	<i>Business Model Description</i>	<i>Catalyst’s Outlook</i>
<p>Digital Marketing Agencies</p> 	<p>Digital Marketing Agencies develop, execute and manage a company’s online marketing plans on an outsourced basis. These companies implement OLG channels such as SEM, email marketing, social marketing and display media for their clients. Digital Marketing Agencies often work with ad networks and OLG companies to execute on marketing strategies, while many of the large advertising conglomerates may house digital marketing agencies, ad networks and lead gen companies all under one roof.</p>	<p>Digital Marketing Agencies are people-oriented (similar to consulting companies) and therefore lack the operating leverage that makes for an attractive growth equity investment.</p>
<p>Web Analytics and Web Data</p> 	<p>Web Analytics is the process of monitoring and analyzing consumer traffic to web traffic from view through the individual pages on a company’s website. Data providers aggregate online behaviors that can be provided to marketers segmented by demographic, geography, lifestyle, past purchases, recent product research, etc. Learning what factors contributed to a specific conversion rate can potentially raise a client’s ROI and optimize an ad campaign.</p>	<p>Web Analytics has dominant leaders within this space with mature business models (Google, Adobe/Omniture). There are several relatively young Web Data companies that serve both the OLG and the display ad market. We expect this market to expand rapidly over the next several years.</p>

OLG Business Model Investment Considerations: Franchise vs. Arbitrage

Although **arbitrage business models** have been the dominant leaders in the online lead generation space in the past, Catalyst questions if these models are building long-term value. Search engine marketing is already a very efficient market, and advances in technology surrounding the display ad marketplace are making that market more efficient as well. As the cost of acquiring customers increases, margins will be squeezed.

Ironically, those lead generation companies that create future value in the marketplace will be those that leverage the power of their brand. **Content-oriented companies** with a strong brand will be able to attract raw leads for the lowest price, creating a large margin advantage over arbitrage-based lead generation companies. (Although the two can co-exist.) Strong brands can assist in SEM, as well. A paid search link from a company with a recognized brand will be more likely to be clicked on than one that is not. Thus the branded company may be able to pay a lower cost-per-click than a non-branded company, since it will still generate more revenue for Google by receiving more clicks.

Of course building a brand is expensive. Some internet-only lead generation companies like Priceline have invested heavily in traditional media to build up brand equity over time. Others have been fortunate by having first-mover advantage. In general, those companies that have already built brand equity, either online or offline, will have an advantage over those starting from scratch in today's cluttered digital media landscape.

What makes a good lead generation market vertical?

Investment bank Portico Capital has laid out some characteristics of attractive OLG companies and verticals. We believe the most important are the following:

- ◆ Vertical industry with a fragmented customer and/or advertiser base
- ◆ Differentiated, content-oriented business models that provide key competitive advantages
- ◆ High industry information barriers
- ◆ High profit end-market product means high value leads
- ◆ Scalable technology platform
- ◆ Defensible gross margins

Examples of OLG Verticals

- **Financial Services.** OLG first emerged in the financial services industry as a way to encourage consumers to complete applications online for products such as credit cards or insurance. Bankrate.com, LendingTree.com, Insurance.com and CreditCards.com are examples of financial services lead gen companies.

- **Education.** OLG for education attempts to reach prospective students who are utilizing online sources to learn about educational opportunities. Education lead generation companies such as QuinStreet, EducationConnection.com and Education Dynamics, allow advertisers to reach a national audience and provide information on a broad range of programs.
- **Personal Services.** OLG for the personal services sector such as Angie’s List and ServiceMagic.com support the shift from traditional advertising such as the Yellow pages to online search to find home service professionals or other “do-it-yourself” jobs via a CPL model.
- **Local Marketing.** Local marketing OLG companies such as Yodle (SEM Arbitrage) promote local businesses by providing listings on leading search engines such as Google, Yahoo Ask.com etc and then track the success of each client’s marketing plan. Yelp, another local marketer, provides local businesses with a platform to advertise their business and connect with potential clients. Potential customers are drawn to Yelp because of its user-generated content such as local business details and customer reviews and feedback.

Regulatory Issues: Black Hat vs. Grey Hat vs. White Hat

Early forms of OLG carried a negative reputation as many advertisements were misleading. Some lead generation companies simply tried to drive as much traffic to their client’s sites as possible, no matter the level of interest or likelihood of converting those leads to potential customers for their clients. Clients were rarely aware of where their advertisements were located or what types of customers were viewing their ads. Incentives that were created to lure the customers into a client’s site or as an attempt to retrieve customer information were disingenuous and client’s brand name were therefore tarnished. Although some “**black hat**” tactics continue, several players were reprimanded for their practices.

In late 2007 and 2008, the Federal Trade Commission (FTC) investigated several lead generation companies and penalized firms for unfair and deceptive practices relating to “free” online offers. Companies were fined for not disclosing related terms and costs associated with promotional items such as a free iPod or gift card.³ New guidelines are now outlined by the Interactive Advertising Bureau and Online Lead Generation Association detailing the importance for an online lead generation company to be transparent with potential customers and protecting them from unwanted solicitations.⁴

“**White hat**” OLG companies create higher quality leads by establishing a permission-based/opt-in structure that is transparent to potential customers. Customers are able to bypass offers that are not of interest and only see offers that are directly related to the perceived consumer’s needs. The higher quality OLG companies target customers by advertising specifically to their client’s targeted demographic criteria.

³ Felter, Dan. “Government Scrutiny of Incentivized Lead-Gen Yields New Standards.” *MediaPost*. Web. 29 Nov. 2007. <http://www.olgassociation.org/resources/felter.html>

⁴ www.iab.net and www.olgassociation.org

“Grey Hat” companies may support an opt-in structure but are usually not based on consumer interest. What the consumers are looking for online may not be related to the advertisements that are flashing on the screen. OLG companies that practice this method generally do not target specific customers and instead pay for large amounts of advertising space to catch a consumer’s attention. Once a consumer enters in their information often under the guise of winning a prize or playing a game, and they may later be contacted by a third party trying to sell them unrelated products or services.

Needless to say, at Catalyst we believe that only White Hat business models will build long-term franchise value.

Public Comparables

Lead Generation Public Companies				(\$ in millions, except per share data)					
Company	Stock Price 2/1/2010	% of 52-Wk High	Market Value	TEV/Total Revenue			TEV/EBITDA		
				LTM	2009	2010	LTM	2009	2010
Google	\$534.50	(15.1%)	\$169,581.0	7.3x	9.9x	8.3x	17.5x	15.9x	13.5x
priceline.com Inc.	199.14	(14.0%)	8,752.4	3.6	3.4	2.8	18.0	15.3	11.7
Valueclick	9.47	(32.1%)	811.3	1.8	1.9	1.9	7.6	7.3	7.1
eHealth Inc.	18.27	(6.8%)	426.5	1.5	1.4	1.3	7.3	6.2	5.6
Comscore	13.54	(30.8%)	410.1	3.7	3.6	3.2	27.6	16.5	13.6
Infospace	9.39	(22.8%)	332.0	0.4	0.3	0.3	7.0	2.6	2.3
The Knot	9.23	(23.0%)	311.3	2.3	2.2	2.2	18.3	14.7	13.5
Move Inc.	1.76	(44.7%)	274.2	2.2	2.3	2.5	108.4	20.5	25.4
TechTarget	5.22	(34.8%)	217.9	1.1	1.2	1.1	14.8	6.2	5.0
Tree.com Inc.	7.30	(44.1%)	79.6	0.3	0.3	0.2	8.5	NA	5.1
Autobyte	1.10	(4.3%)	49.7	0.1	NA	NA	NA	NA	NA
Insweb	3.98	(9.5%)	19.1	0.3	NA	NA	NA	NA	NA
Median				1.7x	2.1x	2.0x	14.8x	14.7x	9.4x
Mean				2.0x	2.7x	2.4x	14.0x	11.7x	10.3x

Note: TEV/EBITDA LTM Median and Mean exclude Move Inc.

Source: Bloomberg Financial Data

The median OLG company trades for about 2x revenue, with some notable exceptions to the upside and downside. Stronger lead gen companies with brands like Google, Priceline, Move (Realtor.com) and the Knot trade at over 2x revenue and 10-20x EBITDA, while others (when applicable) trade at under 1x revenue and in the 5-7x EBITDA range.

Conclusion

At Catalyst we believe that online lead generation is an attractive way to monetize the brand equity of traditional media companies focused on B2B or consumer verticals. These brands can be used to aggregate a vertical community that provides a forum to acquire leads through a variety of channels, including display ads, lead qualification, webinars, email newsletters, white papers, sponsorships, etc. Companies with a strong market position can create vertical ad networks to sell premium advertising or syndicate content across a network of related niche sites that lack the scale to effectively sell ads or lead gen services on their own.

Brand-based companies also have a natural advantage in building a lead distribution network, as they already have ad sales relationships with major lead purchasers. While in the past there has been a reluctance to be aggressive online out of fear of revenue cannibalization, the recent collapse in B2B print advertising makes this far less of a threat today.

Targeted Investments

For expansion capital investments we are targeting high growth, content-focused OLG companies with \$5-50 million of revenue, strong management teams, scalable digital media platforms and strong brand equity. For buyout investments, we are seeking to partner with talented digital media executives to target traditional media brands with up to \$75 million of enterprise value that can be leveraged to build up a compelling OLG and digital media platform.