

## Online Ads: 2009 Another Banner Year?

### Executive Summary

China's online advertising market had a banner year (pun intended) last year thanks to the Beijing Olympic Games. BDA estimates that China's online advertising market was worth RMB 17 billion (USD 2.4 billion) in 2008, representing year-on-year (YoY) growth of 53%. Given the credit crunch and global economic downturn, what are the prospects for 2009?

While growth is slowing from last year, we believe China's online advertising market will still grow at a relatively impressive clip of 20% or so in 2009. More internet users and usage, continuing national economic growth, the growing influence of online media and the cost advantages of online vs. offline ads are all fuelling the sector's development.

In a cost-conscious climate, advertisers are keen to measure carefully their ROI and the interactive nature of online advertising holds an appeal as results are relatively easy to measure. As China's exports continue to decline due to the collapse of traditional markets such as the US, the economy needs to re-orientate itself to domestic consumers. The competition for domestic audiences will boost ad spending online.

The principal beneficiaries of this burgeoning online advertising sector will include Baidu, Sina, Sohu and Tencent. Emerging formats are unlikely to gain much share.

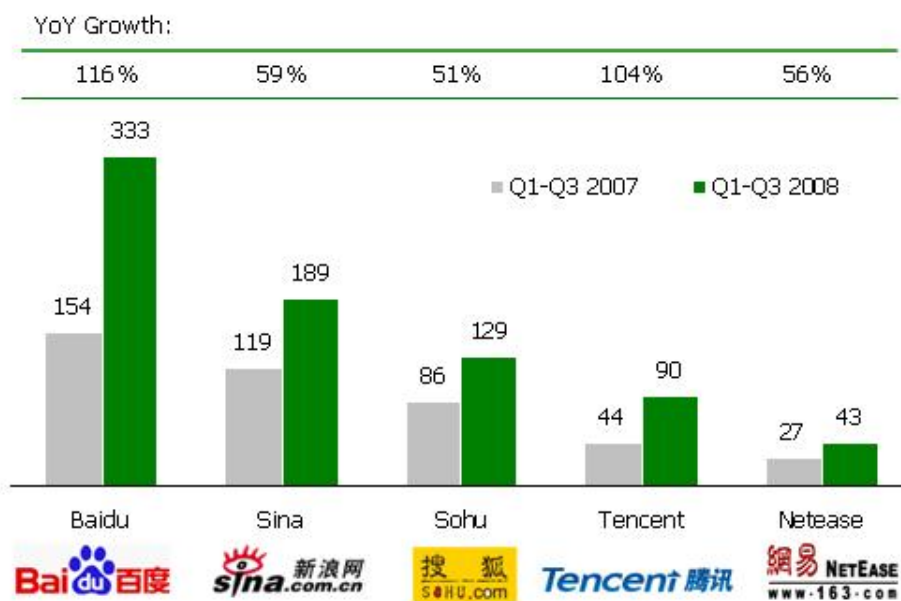
At the same time, traditional media will continue to dominate the advertising market, given their established industry structure and concerns in the general public about the credibility of new media. The traditional media industry will do all it can to protect their turf, as competition from the new media sector becomes more significant.

### Robust Growth in 2008

Online advertising is the fastest growing advertising sector in China. This can be attributed to the rocketing internet and broadband penetration rates, the shift from traditional to online media, and the robust growth resulting from the underlying rise in GDP. We estimate that China's online advertising market was worth RMB 17 billion (USD 2.4 billion) in 2008, which represents YoY growth of 53%. A growing number of advertisers are turning to internet media, attracted by the wide reach and interactive nature of online adverts, as well as the fact that results are easy to measure.

The Beijing Olympic Games helped make 2008 an historic year in the development of online advertising in China. In the first three quarters of 2008, revenues for Baidu, Sina, Sohu, Tencent and Netease were up from 56% to 116% on the same period a year before. Other leading search engines and portal sites all reported significant revenue increases during this period, also achieving YoY growth rates that surpassed those of the previous year.

#### Exhibit 1: Online Advertising Revenue for the Leading Websites (USD Million)



Source: Company info

However, in Q4 a post-Olympic slump and uncertainty brought about by the global financial crisis applied a brake to the spectacular growth experienced in the first three quarters of the year. Sohu recently announced its Q4 2008 earnings, with advertising sales up by 38% YoY, well down on the 51% growth rate in the first three quarters.

### Slower Growth in 2009



The increasing numbers of internet users, greater internet usage, continuing national economic growth, the growing influence of online media and the lower costs of online adverts compared to traditional types, are the main factors fueling growth in the sector. We believe the online advertising market will grow by roughly 20% in 2009.

According to CNNIC, China's internet users totalled 298 million at the end of 2008, representing a penetration rate of 22.6%. BDA forecasts the number of internet users in China will continue to grow steadily in 2009, reaching the 389 million mark and raising the penetration rate to 29%. Meanwhile, Chinese internet users are spending more time online. The average time spent on the internet was 16.6 hours per week in 2008. The internet has become a mainstream medium, attracting a broad and enthusiastic following, making it a compelling platform for advertisers.

China's continuing economic growth will drive up domestic advertising spending. Advertising spending as a percentage of GDP totals only 0.5% in China, still far below the US level of 2%. In addition, online advertising accounted for only 5% of the overall Chinese advertising market in 2008, much lower than the 13% share in the US and the over 19% share in Britain. We believe that the global trend towards online advertising, added to rising internet penetration rates and increasing acceptance on the part of advertisers, promises further growth in China.

Online advertising in China also benefits from an ongoing shift of advertising spending from offline to online. Indeed, with lower prices and better measurement systems, online advertising is likely to become the most popular method in difficult economic times. A price comparison between adverts on China Central Television (CCTV) and the biggest online portal, Sina, shows that online advertising is on the whole cheaper.

#### Exhibit 2: Price Comparison between Sina and CCTV

Advert Format	Prices in Q1 2009
	
Homepage First Banner	RMB 350,000 per day
News Channel First Banner	RMB 240,000 per day
Auto Channel First Banner	RMB 168,000 per day
	
CCTV-1 Teleplay	RMB 76,800 per 5 seconds
CCTV-5 Sports News	RMB 51,200 per 5 seconds
CCTV-8 Teleplay	RMB 48,600 per 5 seconds

Source: CCTV, Sina

The global economic crisis will mean that growth in total advertising spending in China is going to be flat in 2009. Most companies are cutting back their advertising budgets to prepare for the difficult times ahead. Nevertheless, CCTV's 2009 prime-time advertising auction secured bids worth a total of RMB 9.26 billion, up 15% YoY. In 2008 the auction raised 18% more than in the previous year, so a slowdown in the growth rate can be observed, but it is not too dramatic.

Despite the challenging global economic conditions, China's continued economic growth will neutralize some of the negative impact and shift the emphasis to the domestic consumer market. Although the GDP growth rate in 2009 is expected to fall to 8% from the 9% achieved in 2008, China's GDP growth will still contribute over a quarter of global GDP growth this year. The number of online advertisers is expanding rapidly; according to the China Association of National Advertisers, 600,000 advertisers invested in online advertising in China in 2008, and this number is expected to total 900,000 in 2009. The intense competition for Chinese consumers from both Chinese and foreign companies can only serve to boost spending in this field.

While overall advertising budgets remain flat, spending is increasingly being channelled online. The economic downturn has given advertisers the incentive to consider online marketing as a way of saving costs. Advertisers are attracted by online advertising's lower prices and the fact that results can be conveniently measured. We firmly believe that advertisers will reduce their budgets for some types of traditional media, such as outdoor billboards or newspapers, and spend more on online advertising. Online advertising is more targeted, flexible and interactive than adverts on traditional media, as well as having the advantage of easily measured results. For instance, an automotive company contacted by BDA reported it intended to reduce its overall 2009 advertising budget by 15% while increasing its budget for online advertising - which it now regards as a more cost-effective way of marketing its products - by 30%. The company plans to drop several expensive outdoor adverts, saving it tens of millions RMB per year.

The economic slowdown is expected to have a major impact on those industries that spend the most on advertising. Up to now the top three industries for online advertising in China have been IT, automotives and real estate. All three have seen sales growth slow in 2008, and this situation will continue well into 2009. Growth is likely to be generated by other sectors like telecoms, online services and fast moving consumer goods (FMCG). China issued 3G licenses in January and the new competitive landscape in the telecom industry will invigorate both online and offline marketing campaigns. Online services, such as games and e-commerce, are becoming increasingly popular, a trend that is expected to strengthen in tough economic conditions. In this context, online service providers can be safely relied upon to increase their online advertising expenditure. The FMCG industry, which is expected to suffer a less severe impact from the economic slowdown as its products are more or less essential for people's daily life, is also likely to increase its share of online advertising.

### Baidu and Major Portals Will Lead the Way

Among the various online advertising formats, we expect search engines and brand adverts to lead online advertising market growth in 2009, while emerging formats such as inserts in online videos, social networking sites (SNS) and in-game adverts (IGA) are unlikely to gain much share. Search engines and brand adverts have proved to be a great success and are widely accepted by Chinese advertisers. They have established relatively mature traceable and measurable advert placement systems, while other new formats are still in their infancy and have yet to be proven. In the past advertisers allocated a small part of their lavish budgets to innovative new formats, hoping they can achieve positive results for a relatively low price. However, now that they are more cautious and cost-conscious, advertisers are likely to ditch this policy because they are keen to achieve a decent short-term sales performance rather than invest in methods that promise returns at some unknown date in the future.

As a result, leading search engines and online portals, notably Baidu, Sina, Sohu and Tencent, are well positioned this year to gain share in the growing online advertising market. Many advertisers interviewed by BDA confirmed that they were satisfied with the effectiveness of advertising on Baidu and leading portals. They believe these leading sites, with their large and stable user bases as well as massive traffic, offer the best service to cost-conscious advertisers. Smaller sites will find it increasingly difficult to attract significant advertising. We expect Baidu and other leaders to enjoy a higher growth rate than the industry average in 2009.

### New, but Not Strong Enough Yet

Competition in the overall advertising market between traditional and online new media is now becoming more pronounced in China. As internet penetration has grown rapidly in the past few years, traditional media, including TV, radio and newspapers, are not only losing market share, but more importantly losing their appeal to users who are embracing new media. Time spent online has almost doubled from 8.5 hours per week in 2001 to 16.6 in 2008, approaching the average time spent watching TV - 28 hours - and already well ahead of the time devoted to other traditional media. For many young Chinese people the internet has become the predominant medium. In Britain, according to an Ofcom report, in 2007 the internet attracted for the first time greater advertising expenditure, GBP 2.8 billion, than the combined net advertising revenues of ITV1, Channel 4, S4C and Channel Five (GBP 2.4 billion), and as much as all outdoor and magazine advertising combined. Traditional media companies in China will do all they can to prevent this from happening here.

CCTV is not shy in taking on its online rivals when it suits. On 15 November 2008, just a couple of days prior to CCTV's important annual auction for premium time advertising, CCTV exposed Baidu's failure to properly check, and take action against, false claims made by medical advertisers in search results. This resulted in a 25% drop in Baidu's stock price in one day and its first sequential sales decline in Q4 2008 since it went public in 2005.

Traditional media will continue to dominate the advertising market, given the very strong power they exert and the concerns among the general public about the credibility of new media. Mainstream media organizations like CCTV and the Xinhua News Agency which come directly under the supervision of government, still have the strongest impact on public opinion. As China's only national TV station, CCTV enjoys a virtual monopoly in terms of broadcasting coverage; it beams more than 10 channels to over 1.3 billion Chinese people every day. At the same time there are only 0.3 billion internet users, over 70% of whom feel that at best only half of the information retrieved on the internet is reliable, according to a recently published World Internet Project report.

How to develop the delicate relationship with traditional media is therefore becoming a more and more important issue for internet companies, if they hope to achieve significant growth. In January Baidu spent millions of RMB sponsoring CCTV's prestigious Chinese New Year Gala, in an attempt to make up for the mauling of its reputation by the TV giant at the end of last year. Following on Baidu's heels, more internet companies can be expected to cozy up to mainstream media in order to secure themselves scope for development. They will have to do this until they are powerful enough to stick up for themselves.

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## **About BDA**

BDA is the leading advisory firm serving companies in Asia's telecommunications, media and technology (TMT) sectors and private equity firms in TMT and other fast-growing sectors. With a track record of 15 years in Asia, BDA has successfully guided the strategies of industry participants and investors since its establishment in 1994. Our teams of China- and India-based professionals are located at the heart of Asia's growth engines and specialize in dealing with challenging regulatory situations and highly competitive markets. For more information about our people, our company, and our services, please visit [www.bdaconnect.com](http://www.bdaconnect.com) or call us in Beijing at +8610 8529 6164.