

Google, Inc.

It is difficult not to like this company, (pricing may be another story for the value crowd). Google has had spectacular growth in an industry, the Internet, which remains in the early stage of its own secular expansion. Google's revenues have risen from \$19.1 million in 2000 to \$939.3 million in 2003, with Q2 2004 revenues alone hitting \$432.8 million.

As worldwide Internet usage rises through increased broadband, increased information/search, products/retail and telephony, along with the ability to more clearly target and measure Internet advertising, Google is in a unique position to not only be the next Internet search leader, but the next portal destination and beyond. With that said, how Google defends and extends this turf will ultimately define Google's growth and margins, which in turn will drive its stock price. Fortunately for Google its stock is keeping good company with the most esteemed names in Internet Services, such as eBay, Yahoo!, and Amazon; however, those stocks sport lofty valuations and can be quite volatile. Thus, *caveat emptor*, as it is vital for investors to gain a handle on the key drivers of Google's business to set targets for future performance.

Investment Highlights

- **Strong, Secular Growth:** There are nearly 750 million Internet users worldwide; a number which has nearly doubled since 2000 and that is expected to grow to over 1 billion by 2006. The amount of data on the Internet is increasing at an exponential rate with more than 7 million new web pages created each day.
- **Highly Profitable with Strong Performance Anticipated:** Google has generated Net Income of \$99.7 million, \$105.6 million in 2002 and 2003, respectively. Profitability continues on an upwards pace, as Net Income in H1 2004 alone reached \$143.0 million. We are projecting Google's revenues will grow 65%-70% over the next two years from \$939.3 million in 2003 to \$2.63 billion in 2005, with operating income of \$583.4 million in 2003 improving to \$1.35 billion in 2005
- **Online Advertising Continues on Long-term Growth Trajectory:** Online Ad Spending is expected to grow 15% to 20% over the next five years. In the US, less than 3% of the total advertising spending takes place online, presenting substantial room for future penetration. Jupiter Research estimates the US online ad market will grow from \$7.3 billion in 2003 to \$14.8 billion in 2008.
- **Search-based Advertising Leading the Charge:** From a starting point of just over \$100 million in 2000, the search-based advertising market in the US has grown to over \$2.5 billion in 2003 and is expected to continue growing at rates of over 50% for the next two years. With over 50% share of global search, and with a blossoming network of ad partners, Google possesses the reach, audience, and opportunities to continue to grab an even larger share of a growing market.
- **Competition Looms in Search:** Google faces competition on all fronts including giants such as Yahoo! and Microsoft. Industry consolidation is causing smaller firms with novel technologies to pose an even greater threat to Google in this fast moving, ever evolving environment. We feel that the greatest risk to Google is that Search technology alone is highly vulnerable to novel products and services. There are low barriers to entry, development and distribution can occur at low costs and users have very low switching costs.

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