

Mary Meeker
+1 (1)212 761 8042
Mary.Meeker@morganstanley.com

Industry Overview

March 20, 2003

Late March 2003 — An Update From the Digital World

GICS SECTOR CONSUMER DISCRETIONARY	
US Strategist Weight	13.3%
S&P 500 Weight	13.3%

- Amazon.com, eBay, and Expedia posted high scores for customer satisfaction**
 In the latest American Consumer Satisfaction Survey, Amazon.com received the highest score ever recorded in any service industry.
- We believe that customer satisfaction for Internet leaders can continue to rise**
 Customer satisfaction should continue to benefit as broadband usage ramps and as the online companies continue to improve their user experiences and get savvier about leveraging their technology platforms.
- 'Satisfied customer' = 'Satisfied investor'?**
 Not necessarily, but we believe that high (and rising) customer satisfaction, when combined with compelling business models and early-stage market growth can be an especially powerful combo.
- Our Internet & PC Applications Software Industry View is Attractive**
 We continue to believe that, at the margin, online is gaining share from offline, that this will occur for some time to come, and that this should continue to benefit the Internet leaders. So far, it appears that trends in 2003 have been strong and support our investment thesis (see page 7) and our positive stance on the shares of Amazon.com and eBay.

Late March 2003 — An Update From the Digital World

Updates from the Digital World — An Overview

We published our first “Digital World” report in December, 2002. We thought that there were some major events and inflection points occurring related to the Internet that were underappreciated. In that report, we focused on online vs. offline momentum related to expanded global distribution, lower relative pricing related to transparency and the ramp in the sale of used goods, and the rising impact of replacement products.

In our February, 2003 report, we focused on the relevance and magnitude of sellers migrating online, as illustrated by eBay’s momentum.

In our March, 2003 report, we focused on what we believe is one of the answers to the “what just happened to assist such strong momentum in CQ4:02” question. In addition to improvements in the search/find/obtain (SFO) experiences of the Internet, a key part of the answer may be — the scale and ramp of residential broadband usage.

In this report, we focus on the strong relative results in terms of customer satisfaction that Internet leaders such as Amazon.com, eBay, and Expedia have scored recently in the highly regarded American Customer Satisfaction Survey (ASCI). Convenience, low (and transparent) prices/pricing, uniquely strong 24x7 customer service, and extensive selection have long been key factors behind the growth for leading online commerce (and information) sites, and it’s becoming increasingly apparent to us (and measurable) that these attributes are helping drive especially strong customer satisfaction and loyalty.

Links to aforementioned reports:

http://www.morganstanley.com/institutional/techresearch/digital_world1202.html

http://www.morganstanley.com/institutional/techresearch/digital_world0203.html

http://www.morganstanley.com/institutional/techresearch/digital_world0303.html

http://www.morganstanley.com/institutional/techresearch/online_classifieds1102.html

http://www.morganstanley.com/institutional/techresearch/digital_world03032.html

“The secret of successful retailing is to give the customers what they want...There is only one boss: the customer. And he can fire everybody in the company, from the chairman on down, simply by spending his money somewhere else.”

Sam Walton, Wal-Mart

“A business exists because the customer is willing to pay you his money. You run a business to satisfy the customer.”

Peter Drucker

“Customers are very interested in efficiency, and it's up to companies that want to succeed to make the entire process as efficient as possible.”

Michael Dell, Dell Computer

“Loyal is the most difficult of the customer service goals to achieve. But once you have it, you have something your competition will never have — the next order.”

Jeffrey Gitomer

“The key to building an enduring world-class company is to consistently exceed the expectations of your customers. However, to achieve that, you must first consistently exceed the expectations of your people.”

Howard Schultz, Starbucks

“Who comes first? The employees, customers, or shareholders?’ That’s never been an issue to me. The employees come first. If they’re happy, satisfied, dedicated, and energetic, they’ll take real good care of the customers. When the customers are happy, they come back. And that makes the shareholders happy.”

Herb Kelleher, Southwest Airlines

Back to the Future

Keeping the customer satisfied — the concept is as old as business. Picture a gathering of history’s most successful entrepreneurs and business builders in the same room, and ask the simple question: “What was the key to the ongoing success of your enterprise?” We imagine that “working tirelessly to provide off the charts customer satisfaction” would be on everyone’s short list.

To borrow a phrase from Peter Drucker, we have long believed that some Internet companies have the potential to not only satisfy, but to delight their customers. And the latest in a series of encouraging data points, which we have been highlighting in our *Digital World* series, shows some Internet companies are doing just that.

As users of Amazon.com, we weren't surprised that the company ranked No. 1 in customer satisfaction in the recent American Customer Satisfaction Survey. That said, when we began to review the results for the 200+ companies and brands included in the survey and to think more about the relevance of the data, we began to appreciate that there may be a trend.

We believe there's still more upside potential for customer satisfaction for the likes of Amazon.com and eBay — and the relative advantages of the Internet leaders (vs. their offline competitors) may continue to widen. At the core, the Internet as a distribution channel (for information and/or products/services) is about efficiency, and efficiency alone can go a long way toward providing customers with satisfaction. We think that the Internet leaders have the potential, owing, in part, to the power of their technology platforms, to set new standards for customer satisfaction, and in turn, drive revenue growth as online continues to gain share from offline.

The simple concept that the Internet leaders allow you to search/find/obtain (SFO) a best selling book, an obscure collectible or door-to-door reservations for a vacation within minutes from the comfort of your home 24x7 is a key part of their customer satisfaction success and competitive advantage.

Customer satisfaction isn't the be all and end all for companies, as high customer satisfaction without a compelling financial model is typically a disaster. And customer satisfaction without a powerful value proposition, customer growth, usage growth, and high or rising customer loyalty isn't that exciting either.

But we do know one simple thing — high customer satisfaction has been at the essence of many of the most successful growth companies and stocks in history. And, based on the data, the Internet leaders are stacking up well...

Amazon.com Leads in Customer Satisfaction

In the latest American Consumer Satisfaction Survey, Amazon.com received the highest score ever recorded in any service industry (88 on a scale of 100, up 5% Y/Y). Amazon.com's score in the CQ4:02 survey, conducted by the University of Michigan and others, is especially

notable, as it is 21% higher than the 72.9 average score for the 200+ companies/brands surveyed (up 0.4% Y/Y).

Amazon.com received the highest score of the 57+ companies surveyed in the retail, finance/insurance, and e-commerce categories, in which scores ranged from high scores of 87 for Barnes&noble.com, 82 for eBay, and 81 for PUBLIX Super Markets to low scores of 64 for Aetna and 62 for McDonald's.

Looking at all of the 200+ companies/brands in the survey, Amazon.com tied for first with Heinz Food Processing, the 134-year-old purveyor of brands such as Heinz Ketchup, Ore-Ida, Weight Watchers, and Wyler's.

Regarding the survey, Professor Claes Fornell of the University of Michigan Business School noted the following: "Amazon.com continues to show remarkably high levels of customer satisfaction. With a score of 88 (up 5% Y/Y), it is generating satisfaction at a level unheard of in the service industry. At the same time, however, Amazon is followed very closely by Barnes and Noble (87, up 6%). This might make one believe that the task of book selling online has now been mastered. Perhaps so, but Amazon has branched out far beyond books and is now selling myriad other products on its way to becoming the first online department store. Can customer satisfaction for Amazon climb more? The latest ACSI data suggest that it is indeed possible. Both service and the value proposition offered by Amazon have increased at a steep rate. On the other hand, customer expectations are now also extremely high. A minor glitch in service or mistakes that are quickly corrected will not dent the satisfaction the company now enjoys, but repeated problems in any aspect of service could have devastating effects on satisfaction and customer retention."

Internet Leaders Have Come a Long Way in a Short Time

A little over a year ago, many observers thought that Amazon.com was en route to bankruptcy or some form of oblivion. Fifteen months later, its stock has been one of the best performers in the market, and the company ranks No. 1 in the leading US-based customer satisfaction survey. In our view, Amazon.com's high customer satisfaction has been one of the key factors that have allowed the company to drive the unit and revenue growth that has allowed the company to move its momentum in the right direction.

Other Internet-related companies and brands have also been posting relatively strong results: 12 of the 22 Internet

companies in the survey scored above the average score for all the companies surveyed in 2002 (see Exhibit 1).

Exhibit 1

ACSI Consumer Satisfaction, 2002

Company	Score
Amazon.com	88
Barnes&noble.com	87
eBay	82
Buy.com	80
Expedia	80
Google	80
1-800-Flowers.com	78
Orbitz	76
Travelocity.com	76
Yahoo!	76
ABCNews.com	74
MSNBC.com	73

Source: American Customer Satisfaction Survey, (www.acsi.org)

While we don't have specific data for Amazon.com and eBay on two key attributes that are important to measuring the financial impact of customer satisfaction (specifically, loyalty and repeat purchasing), we do have some relevant qualitative measures that point to rising customer loyalty and improving repeat sales.

For Amazon.com, gross merchandise sales (GMS) per active customer remained steady in C2002 (flat to up 1%) despite negative pressures from: 1) an increasing mix of new international customers — non-US rose to 30% of revenue in C2002 from 14% in C2000, and these customers tend to spend less than their US counterparts; and 2) the broadening list of service partners (where Amazon.com earns a commission on the Partners' sales rather than the full value of the sale). We also note that in C2002, units sold rose 34% Y/Y, surpassing 26% Y/Y customer growth. We also note that the ramp in usage of Super Saver Shipping has been correlated with a ramp in repeat purchases.

Similarly with eBay, for C2002, the ratio of listings-to-registered-users increased 2% Y/Y across a broader base of categories, indicating increased bidding/buying on a more robust variety of products. eBay's active users increased 56% Y/Y, to 28MM, while registered users increased 46%, to 62MM. Repeat activity also seems to have increased, as GMS-per active customer rose 3% Y/Y, to \$537 in C2002.

Internet – March 20, 2003

The American Consumer Satisfaction Survey collects data related to more than 200 leading companies/brands (primarily US-based) ranging from Adolph Coors to Niagara Mohawk Power to Pontiac to Wachovia and measures customer satisfaction through interviews with more than 70,000 consumers annually.

Established in 1994, the ACSI is produced through a partnership of the University of Michigan Business School, the American Society for Quality (ASQ), and the international consulting firm, CFI Group. For more information, check out <http://www.acsi.org>.

For perspective:

Manufacturing Non-Durables data from CQ3 included a high score of 88 for HJ Heinz and an 87 for Hershey Foods and The Quaker Oats Company, with a low score of 74 for Philip Morris Companies.

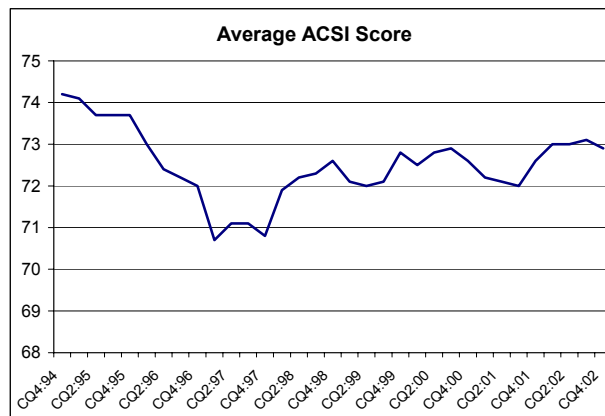
Manufacturing Durables data from CQ2 included a high score of 86 for Bayerische Motoren Werke AG (BMW), GM-Buick and GM-Cadillac and a low of 59 for AOL.

Transportation/Communications/Utilities & Services data from CQ1 included a high score of 82 for Federal Express and a low score of 56 for Qwest Communications (US West).

The ACSI is compiled on a rolling quarterly basis, with data for various industry groups published as compiled. Quarterly average data for the ACSI and C2002 data by company are noted in Exhibits 2 and 3.

Exhibit 2

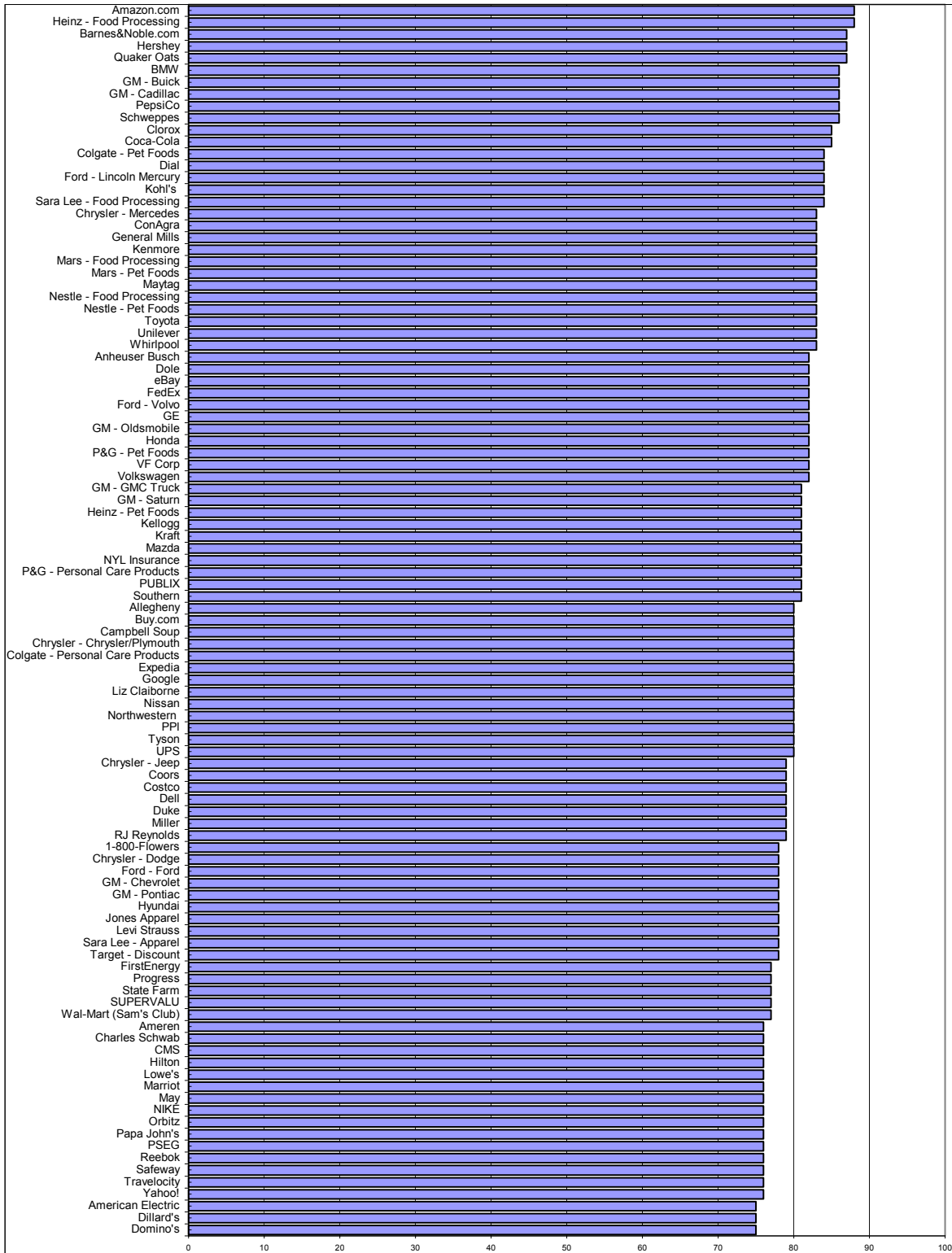
ACSI Consumer Satisfaction by Quarter, 1994–2002



Source: American Customer Satisfaction Survey (www.acsi.org)

Exhibit 3

ACSI Scores by Company, 2002 — Ranked by Score (Highest to Lowest, Equal Scores Listed Alphabetically)



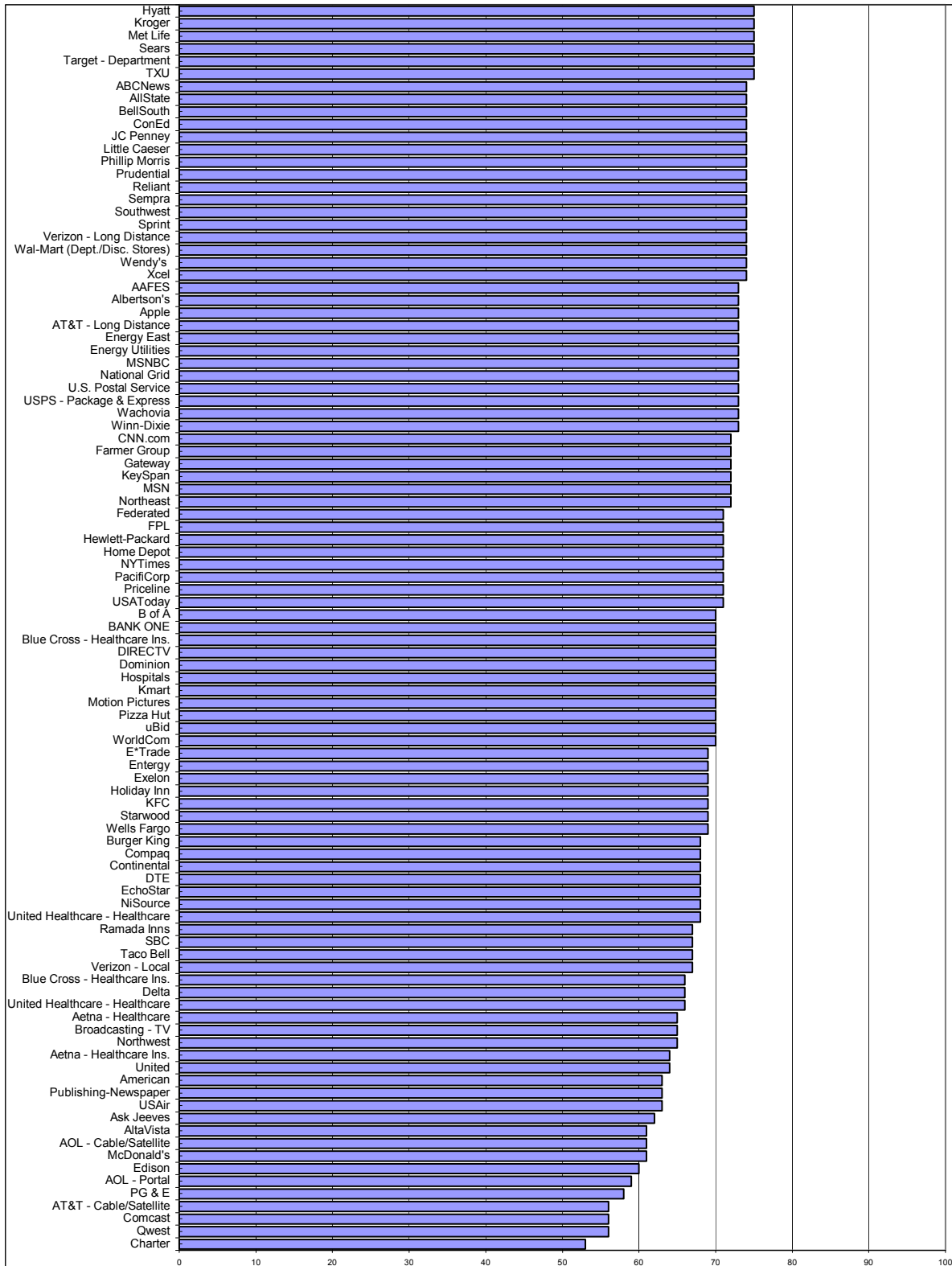
Source: American Customer Satisfaction Survey (www.acsi.org)

Internet – March 20, 2003

Please see the important disclosures at the end of this report.

Exhibit 3 (continued)

ACSI Scores by Company, 2002 — Ranked by Score (Highest to Lowest, Equal Scores Listed Alphabetically)



Source: American Customer Satisfaction Survey (www.acsi.org)

Internet – March 20, 2003

Please see the important disclosures at the end of this report.

Internet & PC Applications Software -- Mary Meeker, David Joseph & Brian Pitz**Industry Investment Thesis (Attractive)**

We continue to believe that the Internet is still in the early stages of becoming a central communications, information, commerce, and entertainment medium. We estimate there are 550-600 million Internet users worldwide using the Internet an estimated average of roughly 30 minutes per day. We expect the number of Internet *users* to grow at 10-20% annually for the next several years, with stronger growth in non-US markets. And we estimate that *usage* growth (in part because of ongoing broadband adoption) should continue to be higher, thus, we believe, demonstrating relatively compelling underlying growth trends.

Given this robust underlying growth, we continue to believe that the leading Internet companies should, over time, be able to generate strong double-digit top-line growth, and as the financial models scale towards higher long-term margins, should be able to generate even stronger earnings growth — AKA leverage. If the leaders execute to their opportunities, we believe that the leaders could demonstrate classic growth-stock undervaluation characteristics.

While the general economic environment continues to be challenging — we note that according to our analysis, most GDP forecasts for 2001 were too high by 90%+ *and* 97% of the companies in the S&P 500 missed earnings estimates at least once in 1999–2000 — we point out that many of the leading Internet companies are supporting very strong revenue growth, and that CQ4:02 appears to have been a positive inflection point. In C4Q:02, we note that Y/Y growth rates for the Internet leaders were compelling — 100% Y/Y growth for Expedia (70% pro forma with Classic Custom Vacations acquisition), 51% for Yahoo! (34% pro forma with HotJobs acquisition), 89% Y/Y growth for eBay (55% pro forma for PayPal acquisition), and 28% for Amazon.com.

In general, near term, we remain focused on what we consider to be key underlying positive trends:

- 1) **The Internet should prove to be the growth distribution channel of the decade** — As companies that benefited from leveraging the PC as their distribution channel — like Microsoft (MSFT, \$26, Overweight-V) and America Online (AOL, \$11, ++) — created significant new businesses and shareholder wealth, we believe an emerging group of still relatively early-stage companies should do the same with the Internet.
- 2) **Search/find/obtain (SFO) is becoming a global reality** — Google, eBay (EBAY, \$88, Overweight-V), Amazon.com (AMZN, \$27, Overweight-V), Yahoo! (YHOO, \$22, Overweight-V), Expedia (EXPE, \$47, ++), Microsoft and Overture have driven this, and it benefits users and vendors as it helps reduce friction and makes inefficient markets more efficient.
- 3) **Broadband (with an estimated 44MM+ global subscribers as of CQ4:02) has hit critical mass** — The early stage (and strong growth momentum) of consumer broadband adoption, and the powerful usage patterns of broadband (vs. narrowband) users should help pace strong growth for leading beneficiaries.
- 4) **Strong underlying growth rates for global Internet usage/users** — in spite of (and, perhaps, in part, because of) a very challenging economic environment.
- 5) **Online market share gains from offline markets** — such as Expedia in travel and eBay in collectibles. In the US, e-commerce accounts for only 1.65% (and rising) of retail sales.
- 6) **“Mind share” well above “market share” demonstrates growth opportunity** — an estimated 550-600 million-plus Internet users and, for example, only 31 million active Amazon.com customers?
- 7) **The consumer seems to be alive and well for key technology-related purchases** — Internet, digital cameras, video games... could the consumer (vs. the enterprise) drive the next leg of technology-related growth and a PC upgrade cycle? In addition, we believe that many **small to medium-sized enterprises (SMEs)** have benefited from the increased usage of the Internet as vendors/users/sellers.
- 8) **Convenience, low (and transparent) prices/pricing, uniquely strong 24x7 customer service, and extensive selection** have been key factors behind growth in leading online commerce (and information) sites and should continue to spur growth for the leaders. In addition, we believe that positive trends for the ramps in *used* and *replacement* goods continue to be quite strong, assisted by rising user confidence in obtaining these types of goods/services.

9) **Online advertising trends could surprise on the upside** in next 6–12 months, and we believe the compelling ROI will become more apparent to advertisers. We believe online advertising (including pay-for-placement) could grow 20-30% in 2003 and accelerate in 2004.

10) **Handful of industry leaders gaining share** with less competition on almost all fronts.

11) **Operating leverage with inherently scalable models is powerful** — for example, Amazon.com got big fast, spent lots of money, now what? Fixed costs and operating leverage, in our view.

12) **Positive earnings surprises are, more often than not, followed by more of the same...** and improving operating margins and revenue growth acceleration can be found in this group, in our opinion.

Global Stock Ratings Distribution

(as of February 28, 2003)

Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight	616	33%	239	38%	39%
Equal-weight	883	47%	289	46%	33%
Underweight	390	21%	104	16%	27%
Total	1,889		632		

Data include common stock and ADRs currently assigned ratings. For disclosure purposes (in accordance with NASD and NYSE requirements), we note that Overweight, our most positive stock rating, most closely corresponds to a buy recommendation; Equal-weight and Underweight most closely correspond to neutral and sell recommendations, respectively. However, Overweight, Equal-weight, and Underweight are not the equivalent of buy, neutral, and sell but represent recommended relative weightings (see definitions below). An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

ANALYST STOCK RATINGS

Overweight (O). The stock's total return is expected to exceed the total return of the relevant country MSCI index, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the total return of the relevant country MSCI index, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the total return of the relevant country MSCI index, on a risk-adjusted basis, over the next 12-18 months.

More volatile (V). We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Ratings prior to March 18, 2002: SB=Strong Buy; OP=Outperform; N=Neutral; UP=Underperform. For definitions, please go to www.morganstanley.com/companycharts.

ANALYST INDUSTRY VIEWS

Attractive (A). The analyst expects the performance of his or her industry coverage universe to be attractive vs. the relevant broad market benchmark over the next 12-18 months.

In-Line (I). The analyst expects the performance of his or her industry coverage universe to be in line with the relevant broad market benchmark over the next 12-18 months.

Cautious (C). The analyst views the performance of his or her industry coverage universe with caution vs. the relevant broad market benchmark over the next 12-18 months.

Stock price charts and rating histories for companies discussed in this report are also available at www.morganstanley.com/companycharts. You may also request this information by writing to Morgan Stanley at 1585 Broadway, 14th Floor (Attention: Research Disclosures), New York, NY, 10036 USA.

For a discussion, if applicable, of the valuation methods used to determine the price targets included in this summary and the risks related to achieving these targets, please refer to the latest published research on these stocks. Research is available through your sales representative or on Client Link at www.morganstanley.com and other electronic systems.

The information and opinions in this report were prepared by Morgan Stanley & Co. Incorporated ("Morgan Stanley").

This report is not an offer to buy or sell any security or to participate in any trading strategy. Morgan Stanley, Morgan Stanley DW Inc., affiliate companies and/or their employees may have investments in securities or derivatives of securities of companies mentioned in this report, and may trade them in ways different from those discussed in this report. Derivatives may be issued by Morgan Stanley or associated persons.

An employee or director of Morgan Stanley, Morgan Stanley DW Inc. and/or their affiliate companies is a director of AOL Time Warner Inc.. Within the last 12 months, Morgan Stanley, Morgan Stanley DW Inc. or an affiliate managed or co-managed a public offering of securities of AOL Time Warner Inc..

Within the last 12 months, Morgan Stanley, Morgan Stanley DW Inc. or an affiliate has received compensation for investment banking services from Microsoft, Expedia, AOL Time Warner Inc..

In the next 3 months, Morgan Stanley, Morgan Stanley DW Inc. or an affiliate expects to receive or intends to seek compensation for investment banking services from Microsoft, eBay, Amazon.com, Yahoo!, Expedia, AOL Time Warner Inc..

As of February 28, 2003, Morgan Stanley, Morgan Stanley DW Inc. and/or their affiliate companies beneficially owned 1% or more of a class of common equity securities of the following companies covered in this report: eBay, Amazon.com, Yahoo!, Expedia.

Morgan Stanley, Morgan Stanley DW Inc. and/or their affiliate companies make a market in the securities of Microsoft, eBay, Amazon.com, Yahoo!, Expedia.

The research analysts, strategists, or research associates principally responsible for the preparation of this research report have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors, firm revenues and investment banking revenues.

Morgan Stanley has no obligation to tell you when opinions or information in this report change. Morgan Stanley and its affiliate companies are involved in many businesses that may relate to companies mentioned in this report. These businesses include market making and specialized trading, risk arbitrage and other proprietary trading, fund management, investment services and investment banking. This report is based on public information. Morgan Stanley makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete.

This report has been prepared by Morgan Stanley research personnel. Facts and views presented in this report have not been reviewed by, and may not reflect information known to, professionals in other Morgan Stanley business areas, including investment banking personnel.

The value of and income from your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. There may be time limitations on the exercise of options or other rights in your securities transactions. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized.

This publication is disseminated in Japan by Morgan Stanley Japan Limited; in Hong Kong by Morgan Stanley Dean Witter Asia Limited; in Singapore by Morgan Stanley Dean Witter Asia (Singapore) Pte., regulated by the Monetary Authority of Singapore; in Australia by Morgan Stanley Dean Witter Australia Limited A.B.N. 67 003 734 576, a licensed dealer, which accepts responsibility for its contents; in certain provinces of Canada by Morgan Stanley Canada Limited, which has approved of, and has agreed to take responsibility for, the contents of this publication in Canada; in Spain by Morgan Stanley, S.V., S.A., a Morgan Stanley group company, which is supervised by the Spanish Securities Markets Commission (CNMV) and states that this document has been written and distributed in accordance with the rules of conduct applicable to financial research as established under Spanish regulations; in the United States by Morgan Stanley & Co. Incorporated and Morgan Stanley DW Inc., which accept responsibility for its contents; and in the United Kingdom, this publication is approved by Morgan Stanley & Co. International Limited, solely for the purposes of section 21 of the Financial Services and Markets Act 2000 and is distributed in the European Union by Morgan Stanley & Co. International Limited, except as provided above. Private U.K. investors should obtain the advice of their Morgan Stanley & Co. International Limited representative about the investments concerned. In Australia, this report, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act.

The trademarks and service marks contained herein are the property of their respective owners. Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability for any damages of any kind relating to such data. The Global Industry Classification Standard ("GICS") was developed by and is the exclusive property of MSCI and S&P.

This report or any portion hereof may not be reprinted, sold or redistributed without the written consent of Morgan Stanley.

Additional information on recommended securities is available on request.

The Americas

1585 Broadway
New York, NY 10036-8293
United States
Tel: +1 (1)212 761 4000

Europe

25 Cabot Square, Canary Wharf
London E14 4QA
United Kingdom
Tel: +44 (0)20 7513 8000

Japan

20-3, Ebisu 4-chome
Shibuya-ku,
Tokyo 150-6008, Japan
Tel: +81 (0)3 5424 5000

Asia/Pacific

Three Exchange Square
Central
Hong Kong
Tel: +852 2848 5200