



Vinay Menon
November 11th, 2010

AOL INC.
(NYSE: AOL)

Agenda

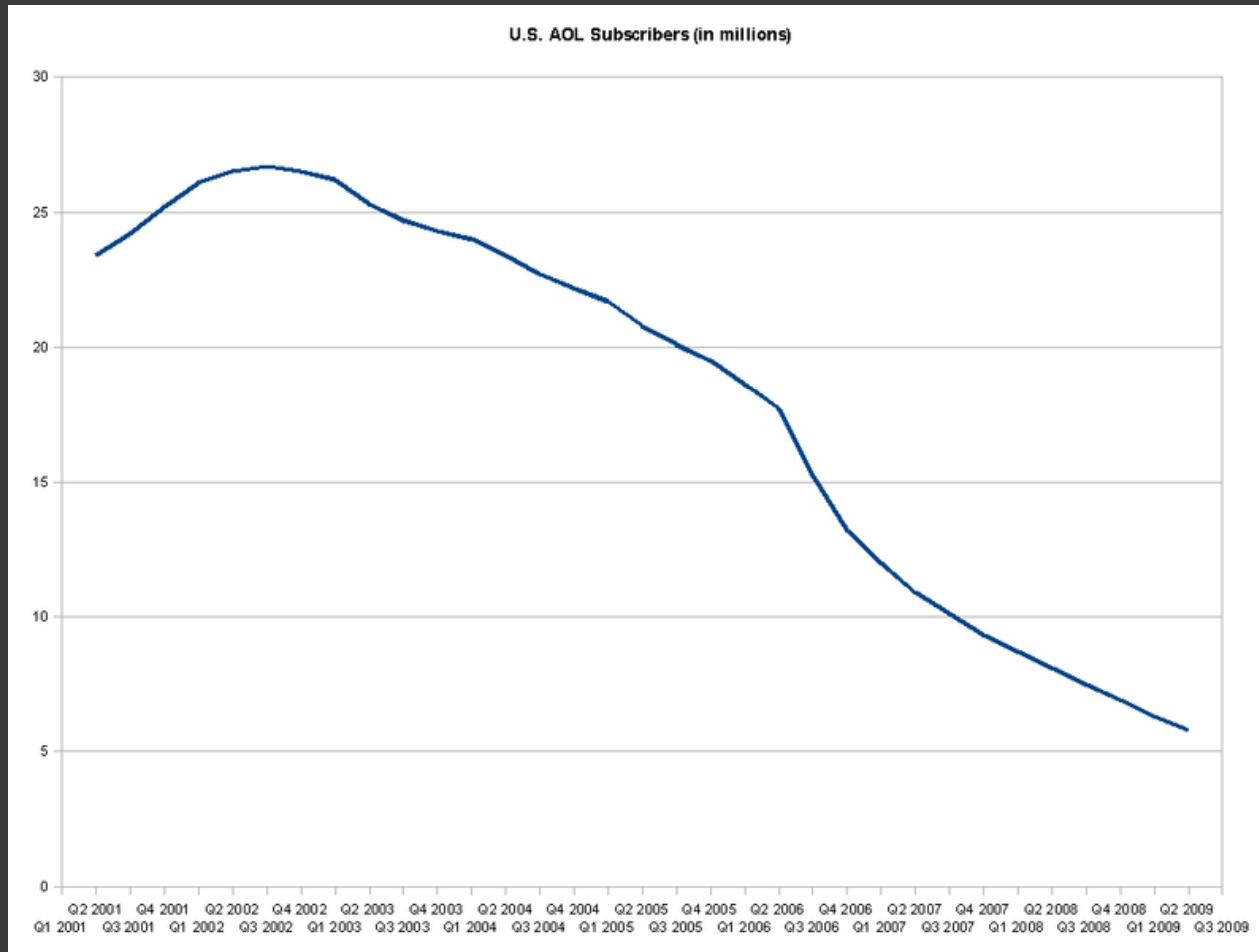
- ① Business Overview & Stock Information
- ② Short Thesis
- ③ Investment Risks
- ④ Recommendation

AOL's History

- Founded in 1983 in Vienna, Virginia
- Known as one of the largest dial-up ISP with 30+ million subscribers
- Merged with Time Warner in 2001



AOL's History



AOL Today

- Spun off from Time Warner in December 2009.
- **New strategy:** shift to advertising
 - Providing content through a **diverse** portfolio of **niche** websites.

"AOL is the place to go for the best content online, period."



Business Overview



Business Overview

Aol Personals.

PIXCETERA

PlaySavvy

POLITICS
DAILY

PopCenter

Propeller

Aol Radio.

Aol Real Estate.

rentedspaces

ShelterPop

Aol Shopping.

SHOUTcast

/SLASHCONTROL

Slashfood

Aol Small Business.

spinner

streampad

STREETLEVEL

stylelist.com

SWITCHED

tecnopadres

Aol Television.

that's fit
get healthy • be strong • live well

Aol Travel.

TOURTRACKER

tripvine

tuvida

TuVoz

TV Squad

TUAW

urlesque

Aol Video.

WalletPop

Aol Weather.

WHERE IT'S
AT

when.com

WOW.COM

AOL's Makeover Timeline

- ❑ **April 2009** **Tim Armstrong**, who had been a Google senior vice president, takes over as chief executive of AOL.
- ❑ **June 2009** AOL buys local online-media companies **Patch Media Corp.** and Going Inc. for less than \$10 million each.
- ❑ **December 2009** Time Warner completes spinoff of AOL.
- ❑ **January 2010** Buys online-video company StudioNow for about \$36.5 million.
- ❑ **February 2010** AOL sells digital ad firm Buy.at to Digital Window for \$16.4 million, after buying it for \$125 million in 2008.
- ❑ **April 2010** AOL says it will sell ICQ instant-messaging service to Digital Sky Technologies for \$187.5 million.
- ❑ **June 2010** AOL sells social-networking site **Bebo** to private investment firm for small fraction of the \$850 million it paid for the site in 2008.
- ❑ **September 2010** Acquires tech website **TechCrunch**, online video company 5min Media and software maker Thing Labs. Paid around \$30 million for TechCrunch and \$65 million for 5min.

Stock Summary

- Price: \$24.92
- 52 week range: \$19.61 - \$29.45
- Market cap \$2.66B
- EPS: \$-8.90
- Forward P/E: 8.37

Stock Summary - Chart



Short AOL

- **Flawed business model**
 - Legacy dial-up business affects more than just subscription revenue
 - Main source of traffic will slowly evaporate
 - Profit from cutting costs & asset sales
- **High competition given low barriers to entry**
 - Establish players are a threat → Ex: Google & Patch
 - Easy industry to enter
- **Tarnished brand**
 - Legacy affects brand image (VAR)
 - Over diversified = synergies?

Legacy business has consequences

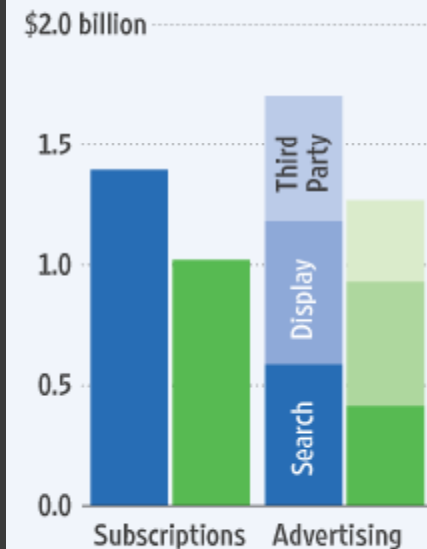
- AOL's dial-up business is **shrinking** at **25%-30%** per year.
- These lost subscribers will result in lower traffic to **AOL's family of sites.**
- If the subscriber base shrinks by half in the next two years, the 25%-50% of the traffic to AOL's media properties these folks generate will also shrink by half. AOL's media traffic will likely decline by 12%-25% **just from the loss of subscribers**

“As our subscriber base declines, we need to **maintain the engagement of former subscribers and increase the number and engagement** of other consumers on AOL Properties.” – Tim Armstrong

Shrinking Sales

A major piece of AOL's revenue comes from subscriptions, despite efforts to diversify.

■ 2009 ■ 2010 Projected

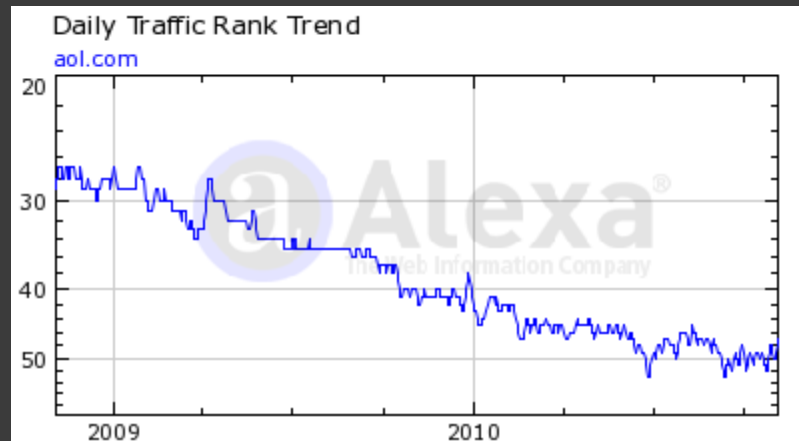


Notes: Search and display advertising owned and operated by AOL; Third-party ad sales comprise revenue from Advertising.com unit.

Source: RBC Capital Markets

Aol.com – a dying portal

- ⦿ Aol has diversified portfolio – but most popular site is still their portal, Aol.com



Source: alexa.com

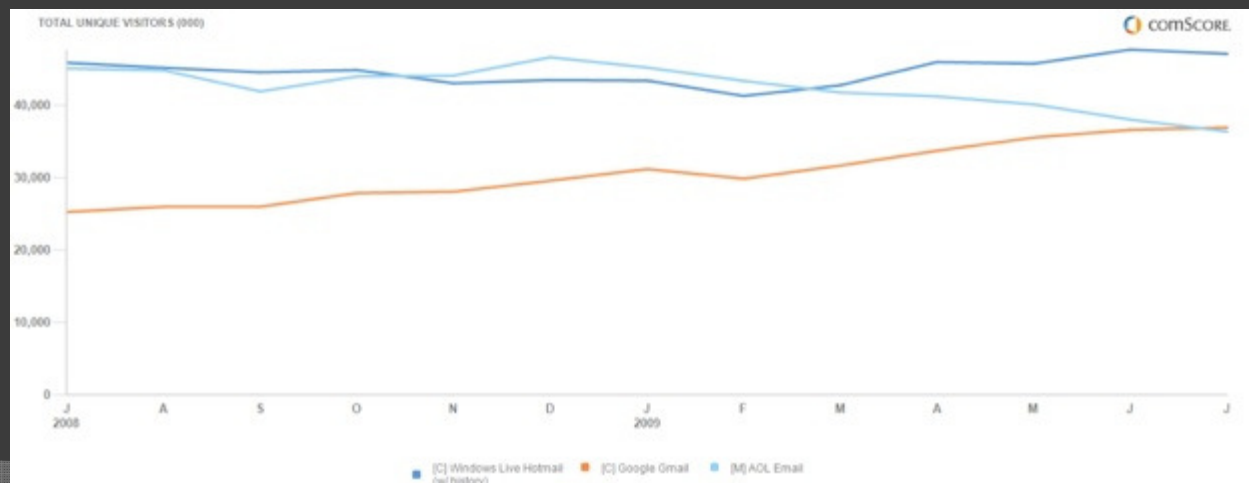
Where Visitors Go on Aol.com

Subdomain	Percent of Site Traffic
webmail.aol.com	35.0%
aol.com	20.8%
screenname.aol.com	10.3%
search.aol.com	7.6%
hp-desktop.aol.com	2.2%
More	

Aol's email and IM are fading

- AOL Email is steadily **losing** users . This will continue and reinforce the decline of their portal.
- Decline in IM is largely attributable **to rise of text messaging and social networks.**
- Networks effects result in shift to Google Chat, FB Chat, etc

"Rather than shifting away from instant messaging, people are using the functions of instant messaging on different platforms." - Paul Armstrong, Director of Social Media, Kindred



Aol's 2010 3Q Results

- Earnings more than doubled in the third quarter due to sale of assets, yet **revenue declined sharply as online ad sales fell** and its dial-up Internet access business continued to falter.
- Competitors such as **Google** and **IAC/InterActiveCorp** showed growth. Research firm eMarketer estimates that overall online advertising spending grew nearly 12 percent in the third quarter from last year, to \$6.15 billion.
- Advertising revenue dropped 27 percent to \$293 million.

Industry giants a threat to expand

- AOL has \$50 million in Patch.com
 - Patch.com is a fast-expanding “local source for news, events, business listings, and discussion”
 - Has limited inventory model – rotating slots of advertisements – which advertisers dislike
 - Local newspaper competition – cheaper to advertise, more exposure – Patch cannot discount given sales based on commission & still zero profitable locations.
- Google – a threat to Patch?
 - **Google Places** gives users more information about local, small businesses (photo, reviews, ratings)
 - **20%** of Google’s search queries focus on local places
 - “Boost” – ads for local businesses that appear above Place Search ads



Threat of New Entrants & Competition

◎ Low barriers to entry

- *Low customer switching costs*
 - Popular sites can change quickly
- *Low capital requirements*
 - Spending \$\$\$ on salaries expense – journalists – can it be profitable? Seed.com could mitigate this.
 - Sites like Huffington Post and Perez Hilton gain tons of visitors with little overhead & salaries

◎ Effects of Facebook, Twitter, etc

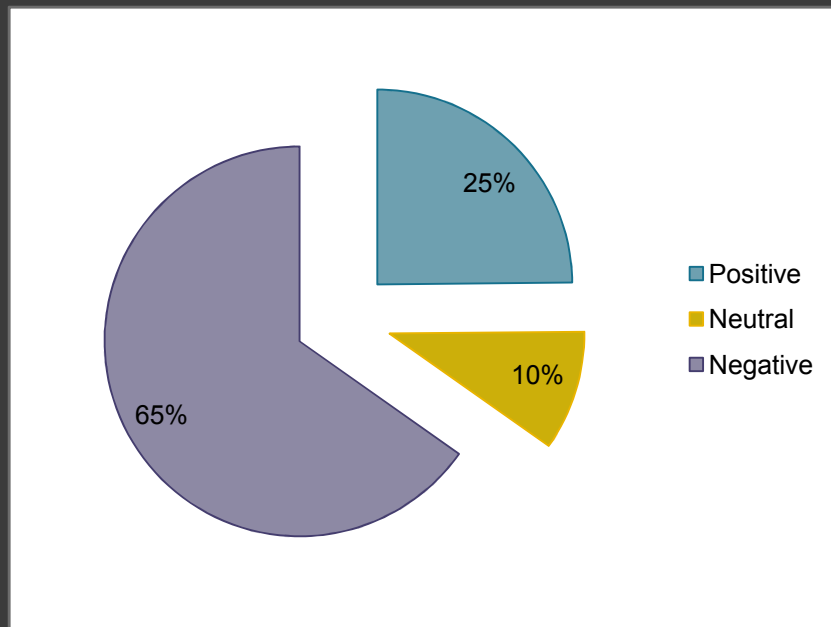
- 21st century platform for content?

facebook®



Legacy affects brand image (VAR)

Analysis of 300+
TechCrunch, HuffingtonPost, and WSJ
users reaction to AOL acquiring TC



“I say adopt the TechCrunch name (and maybe leadership) company-wide. What brand equity does AOL have anymore?”

“AOL's merger with Time Warner was a disaster and the whole world has passed AOL by. Without control of content (like Google) AOL is just going to struggle to keep alive. The company should have sold itself to a telecom like Verizon or AT&T. Netscape is where? Since its purchase, AOL has let a great browser die. “

AOL's new strategy

● What will be the effects of AOL's acquisitions?

- Research shows most users – from TC to WSJ – had a negative reaction to AOL's acquisition of TC.
- Idea of low switching costs referenced earlier – advertisers will go if viewers go
- Users did not appreciate fact that AOL now owns TechCrunch as well as engadget

TechCrunch

engadget

Risks

- ⦿ AOL is a massive company, either success or failure could take a long time
 - Fleet of acquisitions likely need time to see real results (either way) of AOL's new strategy
 - Fit in MII 1 to 2 year horizon?
- ⦿ AOL has a solid management team
 - CEO Tim Armstrong is Google alum; oversaw their advertising sales, marketing, and operations teams
 - No significant insider selling... Armstrong has purchased substantial amount of shares
- ⦿ AOL could be acquired
 - Talk of private equity firm teaming with AOL to buy Yahoo, merging with Yahoo, and others reports had Microsoft interested in AOL



YAHOO!

Summary: Short AOL

➤ **Flawed business model**

- Legacy dial-up business affects more than just subscription revenue
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➤ **Tarnished brand**

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Recommendation

Initiate a short position of 1.00%
Exit at \$19.00

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