

Spinoffs

Some thoughts on AOL 4Q results

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AOL reported on February 3rd its 4Q results for the first time as an independent entity. The report provided few positives but the overall picture remained extremely weak.

Positive notes Domestic display, which accounts for 30% of total revenue, grew 1% Y o Y and 25% Q o Q, indicating that AOL is participating in the cyclical recovery of online advertising.

The balance sheet remains strong with 147 mm in cash on hand and 130 mm of FCF generated in the quarter. The stock currently trades around 3x 2010 EV/EBITDA based on an estimated EV of 2,468 mm and EBITDA of 823 mm for 2010.

Several negative notes Advertising revenue declined 8% Y o Y, impacted primarily by weaknesses in the international market, where display revenue decreased 22% Y o Y. AOL called for an accelerated decline and possible closing of its international properties in the recent future if the negative trend continues. Domestic AOL subscribers declined 27% Y o Y, affecting subscription revenue significantly. Overall, revenue declined 17% Y o Y, although this was "less worse" than the 23% experienced from Q1 to Q3, it remained very weak as expected.

It's important to add that the management team is fairly new and unproved at AOL. At least four top level employees, including the CEO, have joined the firm less than a year ago (Tim Armstrong, Jeff Levick, Brad Garlinghouse and Jon Brod). They certainly bring a fresh prospective to the Company, but it will take some time before they will be able to make a turnaround at the firm. However, there is no guarantee that a turnaround can or will happen anytime in the future.

AOL outlook The Company remains on my watch list for the "stocks to short" for 2010. I guess the question that I would like to ask AOL management would be "What are you planning to do with cash on hand and how do you plan to capitalize on your strong balance sheet position?" AOL has certainly a lot of cash and could potentially use some more leverage to finance new projects like the acquisition of content sites or the purchase of new technologies to build platforms. As of now, I don't see any initiative from the management team into that direction. Let's wait and see.