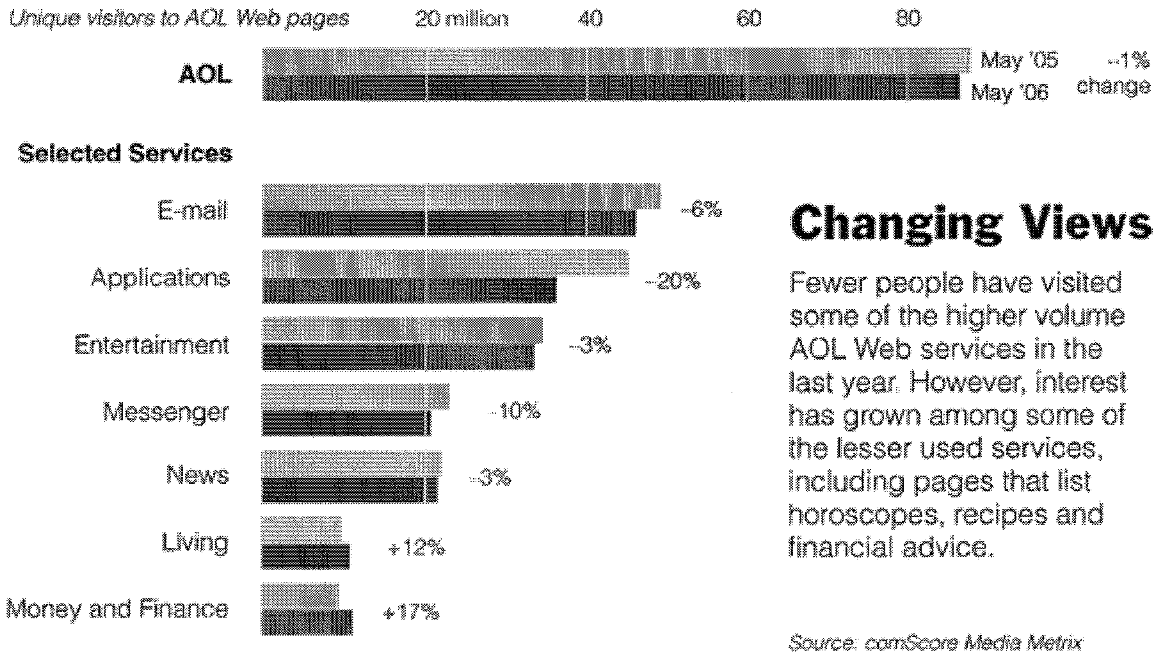
The New York Times

July 10, 2006



Changing Views

Fewer people have visited some of the higher volume AOL Web services in the last year. However, interest has grown among some of the lesser used services, including pages that list horoscopes, recipes and financial advice.

G110

ignore 'AOL' S'P.

Source: comScore Media Metrix

The New York Times

Close Window

Print This Image

The New York Times
nytimes.com

July 10, 2006

At AOL, a Plan for a Clean Break

By SAUL HANSELL

Should AOL sacrifice its cash cow in hopes of finding a prosperous future?

In two weeks, the board of Time Warner Inc., which owns AOL, will hear a proposal from Jonathan Miller, AOL's chief executive, calling for a near halt in marketing for AOL's 17-year-old Internet access service, price cuts for existing customers and thousands of layoffs. His goal is to devote all of AOL's energy into building its free Web-based services.

Traditionally, when companies have profitable but shrinking businesses, like AOL's access service, they try to milk as much money as they can from them without investing new cash. Indeed, that is what Mr. Miller has tried to do for the last several years.

Mr. Miller will defend his unusually draconian plan by arguing that trying to wring every last dime from its dial-up subscribers is preventing AOL from being as aggressive as it can in competing with Yahoo, Microsoft and Google on the Web, according to AOL executives involved in developing the proposal. With such powerful and fast-moving rivals, he wants to hasten the pain to speed the recovery.

This plan will require the board to accept lower profits at first until the advertising revenue grows further, the AOL executives said, although they declined to say how much profits would fall and at what rate. (The AOL executives spoke on the condition of anonymity because the plan is not scheduled for public announcement until Aug. 2.)

Jessica Reif Cohen, an analyst with Merrill Lynch, estimates that this plan could well cut its revenue from domestic subscriptions (both dial-up and high speed) by 52 percent, or $2.1 billion at an annual rate. And AOL's operating profit could fall by $251 million, 14 percent of her estimate for this year.

"Things are going to get worse before they get better," she said. It is unclear, she said, how long it will take to see improvements.

"Every conversation we have is: what is the inflection point? When do the subscriber losses get offset by the growth in advertising? Nobody knows this."

Mr. Miller will most likely say that his plan will help build the company faster because it will eliminate the conflicts between preserving the past and building the future.

Until now, AOL has been trying to promote its free Web sites even as its television advertising has promoted its dial-up access service, which to many people is the way Grandma gets her e-mail. AOL's employees, moreover, are locked in a constant battle over whether each piece of software or bit of content should be used to retain subscribers or to lure new Web users.

for years — even as they move to high-speed service. AOL hopes to work out deals with cable and phone companies to make it easy for AOL members to switch to high-speed service and keep their AOL e-mail addresses. They will also be able to use AOL's software client, which some have gotten used to as a way to navigate online, without an additional fee.

This is important, AOL executives say, because people who use the AOL software view many more of its pages, and thus its ads, than those who use a regular Web browser.

AOL further hopes it will be able to lure back members who quit recently by offering them their old AOL.com e-mail addresses.

Mark R. Goldston, the chief executive of United Online, a low-priced dial-up Internet access service, said AOL might not be able to lure very many customers back.

"Once you've moved on and given everyone your new e-mail address, you've moved on," he said.

Mr. Goldston also noted that dial-up Internet access had become phenomenally profitable in recent years as the wholesale telecommunications costs to providers like AOL have fallen from 45 cents an hour to less than 6 cents an hour.

Still, he suggested that AOL is making the right choice to pull away from its position as a premium-priced provider. (AOL's list price is $25.90 a month, for either dial-up or high-speed access, although it has many less expensive plans.)

"If I were AOL, and I had all the incentives Time Warner has, I would do what they are doing," said Mr. Goldston.

But even as AOL backs out of the Internet access business, it is still unclear what the thrust of its Web marketing will be.

"AOL is a brand in search of a strategy," said Richard Greenfield, an analyst with Pali Capital. "Ask any person what is AOL, and they are not sure anymore."

Some of AOL's highly promoted initiatives appear to have failed, he added, like a new version of its AOL Instant Messenger software that is slow and cumbersome. AOL has retreated and started to make its older, faster version available, too.

AOL has had more success with its new video-oriented sites, such as TMZ, a celebrity gossip site, and In2TV, a collection of TV reruns from Warner Brothers, its corporate sister. And it is developing a new video search service for later this summer.

"AOL is like Chicago after the Chicago fire," said Michael Zeman, the director of insights and analytics at Starcom MediaVest, a media buying agency. "They were so far behind the big guys, they are better positioned to come out with a broadband platform that is probably ahead of MSN or Yahoo."

AOL has other issues to confront. Over the last year, it has lost a number of top managers, including Michael Barrett, the head of advertising sales; James Riesenbach, who ran search; and David Gang, who was in charged of software development.