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Yahoo profits jump

By Mike Swift

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Yahoo recorded sharply higher profits that reflected a strengthening economy and its search alliance with Microsoft, seeing strong growth in online display advertising during the first quarter of 2010. But it also saw a worrisome decline in search ad revenue over the same period last year.

Yahoo said Tuesday that it earned $310 million, or 22 cents a share, for the first three months of 2010, compared with about $118 million or 8 cents a share in the first quarter of 2009. The 2010 results were boosted by Yahoo's sale of its Zimbra e-mail service and initial cost reimbursements from Microsoft as the companies begin the transition to Microsoft's Bing providing Yahoo search results.

Excluding those one-time results, Yahoo said it would have delivered earnings of 15 cents a share — well above the 9 cents forecast by analysts polled by Thomson Reuters.

"The economy continues to improve. We delivered what I would call a solid quarter; revenues stabilized and profits were up," CEO Carol Bartz said in a conference call with analysts. Large advertisers are returning to Yahoo, and "their purse strings are starting to loosen up," she added. "As the market leader in display, we are well-positioned to benefit from this trend."

Revenues were up a modest 1 percent over the first quarter of 2009, to $1.6 billion, lower than analysts had expected. However, it was the first year-over-year quarterly revenue gain Yahoo has enjoyed since the third quarter of 2008 and the first since Bartz took leadership of the struggling Internet portal and content provider in January 2009.

Yahoo recorded a healthy 20 percent growth in display advertising over the first quarter of 2009, but said those gains were offset by a 14 percent decline in search advertising revenue, leaving revenue from marketing services on Yahoo-owned websites flat at $875 million.

The jump in display advertising "is great news for Yahoo because it's their core business," said Karsten Weide, an analyst with the research firm IDC. "But what the result also shows is how important it is for Yahoo to fix search."

Bartz and Tim Morse, Yahoo's chief financial officer, said Yahoo's share of the search market has "bottomed" and would begin trending up in the second quarter of 2010. During most of the past year, Yahoo has steadily been losing market share of U.S. Internet searches to Google and Bing.

"For the past 18 to 24 months, we've had a tough row to hoe with search," Bartz told analysts, saying Yahoo's previous efforts to increase search volume "weren't aggressive enough" but that the company is focused on that effort now.

While trading slightly higher during the day, Yahoo shares were down about 3.5 percent, or 65 cents a share, in after-hours trading, to $17.73 a share.

The quarter was the first reflecting Yahoo's 10-year Internet search collaboration deal with Microsoft, following antitrust approval from U.S. and European regulators, and the deal delivered $78 million in payments from Microsoft. Bartz and Morse said Yahoo is on track to have Bing begin providing Yahoo's underlying U.S. search results by the holiday season.

Some analysts still have a show-me attitude about how effective a combined Yahoo-Microsoft search will be competing with Google.

"I just think it's a really tall order," said **Laxmi Poruri, a partner/analyst who follows Yahoo for Primary Global Research**. "That's just a huge question mark. There is a lot of uncertainty. The thing they are banking on is how good is the Microsoft back-end search engine."

Bartz said Yahoo is seeing strong interest from big advertisers like Wal-Mart and Toyota in its efforts to bundle entertainment content with targeted online advertising.

"We're talking to advertisers about taking the digital canvas we own and doing something unique with it," Bartz told analysts. "The display market is coming back. With this comeback, the quality of advertisers is on the rise, and that means the quality of ads is also up. These advertisers are looking for creative new ways to get in front of consumers."