FINAL TRANSCRIPT

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AOL - Q1 2011 AOL Inc Earnings Conference Call

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PRESENTATION

Operator

Good day ladies and gentlemen, and welcome to the AOL first-quarter 2011 earnings conference call. My name is Tawanda and I will be your coordinator for today. At this time all participants are in listen only mode. Later, we will facilitate a question and answer session. As a reminder, this conference is being recorded for replay purposes.

I would now like to turn the conference over to Mr. Eoin Ryan, Vice President of Investor Relations. Please proceed.

Eoin Ryan - *AOL Inc - VP IR*

Thanks, Tawanda. Good morning. Thanks for joining us on our first quarter earnings call. You can find our earnings press release and accompanying slides and trending schedules on our website. On the call with me today is our Chairman and CEO, Tim Armstrong, and our Chief Financial and Administrative Officer, Artie Minson. Tim and Artie will make some brief remarks on the quarter and our overall strategy, and then we will open up the lines for Q&A.

But first I will remind you that during this call we may discuss our outlook for future financial and operating performance, corporate strategy, marketing and product plans, technology improvements, cost initiatives, planned investments, as well as our expectations for the economy and online advertising in general. These forward-looking statements typically are preceded by words such as we will, we expect, we believe, we anticipate, or similar statements. These forward-looking statements are subject to risks and uncertainties and our actual results could differ materially from the views expressed today. The quarter's results should not be indicative of future performance. Some of these risks have been set forth in our quarterly report on Form 10-Q for the three months ended March 31, 2011, and in our annual report filed with the SEC. All information discussed on this conference call is as of today, May 4, 2011, and we do not intend or do we undertake any duty to update this information to reflect future events or circumstances.

We will also discuss certain non-GAAP financial measures including adjusted OIBDA and free cash flow. I will refer you to the press release and the investor relations section of our website for all comparable GAAP measures and full reconciliations.

With that, I will turn it over to Tim.

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

Thanks, Eoin, and thanks to all the investors who are joining us this morning. Q1 is a milestone quarter for us at AOL. And we made many difficult changes to the Company over the last two years. I think those changes are clearly paying off in the Q1 results, I think. I have very happy expectations for the Company. And even our Q1 beat my expectations of where we were going to end up. Q1 was an incredibly busy quarter for us, as all the quarters have been. But if you cut to the bottom line of the quarter, I think reducing our cost structure overall, the bureaucracy and really increasing the operational speed and technological speed has allowed us to be lighter, faster and stronger. And I think that is clear in these Q1 results. And, I believe it is also the strategic leverage that is going to move us forward as a business.

AOL is building a content company for the digital age. We have one vision, one strategy and one execution plan. And, we operate our business now not just across our own properties but across 25,000 other publishers and publishing properties. We haven't been really loud about this point, but all of the systems we have been building, all the technology we've been investing in works for the AOL properties, it also works for all of our publishing partners, as well. And I think the net outcome of that is consumers are going to get better and faster content, advertisers are getting better and faster engagement, and publishers are going to get better and faster yield management.

When you go through the quarter and look at the substantial things we have done, I think in the content business, specifically we put some major investments into things like video. And I will talk about the acquisitions in a minute. But AOL became the number two video player on the web after YouTube. Sitting here two years ago, AOL was nowhere in video, it didn't have data, it didn't have systems, it had 28,000 videos we hadn't transcoded properly. And for us to get to the point less than two years later, actually, where we are number two in video on the web on a reported basis of unique viewers on video, that is an amazing accomplishment. Video is and will be one of the fastest growing categories of advertising. I think that is a tremendous outcome for us as a Company and for our users.

The second piece was the real changes that we made to the content businesses. The acquisition of Huffington Post, which has been -- I worked on very large acquisitions in the past on the Internet over the last 15 years, it is the fastest, best integration I have seen at any company I have been at. And, I think the love, passion, obsession the Huffington Post has with content is going to get translated into all of our properties. I would say both on the AOL side of our properties as well as the Huffington Post side, the integration has gone very well. And roughly 60 days after agreeing to the deal, we had the companies completely integrated, including a lot of the technology.

And, there were some real highlights for us in the content business during Q1. One, the Huffington Post had another great quarter of growth, 27% in March alone, versus December. So I think almost a 30% growth rate over the course of Q1 is tremendous. The second thing is, we've been focused on this 80-80-80 strategy of women, local and influencers. A significant category for us is women, and our StyleList site, which had 34 million unique visitors in Q1 became number one in style, fashion and beauty. And that is a very important category for advertisers, it's a very important category for our consumer base.

In the influencer category we have some of the most influential auto content and we moved up to number four in comScore. There, when you subtract people like eBay and Autoguide, the people who do more buying and selling information of autos, we really are probably number two in that category in terms of the eyes of advertisers, so that is a significant change. We also did our integrations on the health and sports side which have gone very well. And, all four of AOL's entertainment properties held top 3 positions in comScore category for the first time since 2009. So, overall, things in the content business are going well. From a consumer, public standpoint, AOL got nominated for 12 Webby awards, up from three last year. So I think the work we are doing in the content business is alive and well and growing.

The other piece is connecting mobile to content, which, as we talked about in the last earnings call, is one of our strategies. We have over 40 mobile apps for our brands, and we are at the point now where we have tens of millions of downloads across our portfolio of brands. And as mobile continues to grow, our strategy of being a big content player in mobile not just on the Web, is paying off.

On the advertising side, and I'm going to triple underline highlight these, first growth in display advertising since Q4 2007, first growth in domestic display since Q4 2009, first-quarter ad revenue did not decline since Q2 2008. And really, the most important thing is, we remove roughly 65% of the impressions off of our services last year in an effort to make our revenue really healthy and to work with the right customers. I think from that standpoint, you look at the huge reduction in inventory with our ability to be able to grow, that's a really tremendous outcome for us. Also, I'd just point out, one of the things we focus on is quality and the quality of advertisers. The AdAge 100 advertisers, which is the largest advertisers in the world, spent more with us in Q1 than they did year-over-year. And we are going to continue to work with them and we have some exciting things happening.

And then, on some of the areas of our business which are more on the technology side of advertising, I think we've had some great outcomes, as well. One of them is Ad.com which I think had been under a lot of pressure and was an area we focused on last year. Was able to stabilize the performance in Q1, and I think we are excited about where Ad.com sits right now on a go forward basis, and that has been a great outcome for us as a business. Adtech, which is our ad serving product, had a great quarter, and really had double-digit rates, year-over-year, in terms of the number of impressions we served. And we continue to innovate on that product, launching Adtech Light during the quarter, as well.

The most substantial, new product that we have in advertising, which we are happy to spend time talking about, is Project Devil. And Project Devil is a product which we believe is a race to the top in the advertising market. If you look at where a lot of the growth is coming from in advertising, it is coming from customer acquisition at the bottom of the marketing funnel. Every major brand in the world needs a full funnel approach to advertising, and Project Devil is our product that will do that. If you saw the Wall Street Journal last night or this morning, there's an article saying how we are bringing Project Devil onto the Hearst properties, and we would expect our ability to grow Project Devil not just on AOL but on our partner sites, things like Hearst, will continue to grow, as well. And then from an industry perspective, Project Devil and Pictela, both of those products were recognized by the advertising industry this year and are on a fast track to become industry standards in the industry. So, where we sat here a year ago today, Project Devil was literally written on a sketch pad that we hand your drew of what we wanted our sites and Internet and advertising to look like. And to go fast-forward a year later, I believe it is the best brand product on the Internet right now. And it is live, endorsed by the IAB, endorsed by companies like Hearst. I think that is meaningful traction for us in terms of what we are able to produce and innovate at AOL.

And, when we moved into the local space, local continues to be a very exciting proposition for us. Patch is at over 800 sites. MapQuest was redesigned, as you know, over the last year. The uniques on Patch grew triple digits during Q1 to reach 6.5 million uniques on comScore. The Patch is a year or older so one of the things we look at closely is how the Patches are performing that have been around for a long time, and there is tremendous growth still within the Patches that have been out. The new Patches are growing quickly, the old Patches are growing quickly, and then other things like user comments, are growing quickly, as well. So, we as a Company, still believe heavily in local. We are going to continue to heavily invest behind it and we are going to continue to augment that product and improve the local products and services that we are doing.

In the subscription services business, churn is down 17% year-over-year in that business. We've spent time and energy and effort. That business had been orphaned at AOL. And the work that we did last year to reignite around that business has really paid dividends. The other piece of that has been the growth of the non-access subscriptions, or the consumer services subscriptions. Artie will touch on that a little bit. But we are very happy where that's going, as well.

And just at a comment level overall for the acquisitions and resources that we spent last year and this year on M&A, we have a dual approach to business which has been to innovate products and services like Project Devil and Patch and some of the things we really worked on that have been a little bit more homegrown. Patch was an acquisition but very small. Versus the acquisitions that we have done, the Huffington Post and goviral, and 5min. And we're being very careful about how we use our resources, time and energy. But very careful about our strategy to make sure that things we are doing our fitting behind that strategy.

And overall, all of the acquisitions that we have done have been doing very interesting things. Goviral in Europe is growing very quickly and dealing with tens of thousands of publishers. 5min is doing really well and we are aggregating and changing the video landscape very quickly in the United States. Acquisitions like StudioNow have signed very significant partnership deals, one with AT&T to digitize tens of thousands of yellow page advertisers over the next two years.

So as a culmination of our strategy and focus to be the premier digital content company, the business results you see today from advertising, the content results you're seeing from our content properties, and the results you're seeing from our acquisitions add up to a couple clear things. One is better outcome for consumers, better outcome and more scaled outcomes for advertisers, and better outcomes and services for our publishing partners. I remain very excited about AOL and very excited about the results during the Q1 quarter.

And, before I turn it over to Artie, I just wanted to also invite everybody on this call to come. We are going to hold an investor day on June 16. And what we are going to do at that day is spend about half a day really pulling the covers up on AOL and showing you what we have done, because the Company has made very significant changes which you are starting to see in these Q1 numbers. But, I think you'll be excited as investors. I am a personal investor in the Company and very excited. So we are going to do that. So if you're interested in coming to that, you can e-mail Eoin directly at Eoin.Ryan@teamAOL.com. I will warn you Eoin doesn't spell his name the same way I would spell it. Eoin spells his name E-O-I-N.ryan -- R-Y-A-N - @teamaol.com. And I will turn it over to Artie.

Artie Minson - *AOL, Inc. - Chief Financial and Administrative Officer*

Thanks, Tim, and thanks everybody for joining us this morning. We want to leave plenty of time for Q&A, but first let me provide a brief financial overview of the quarter. Let me just start off by saying I am very pleased with our results this quarter. Although, we still have a lot of work to do at AOL, I think you will see in this quarter's financial and operating performance, that after a year of significant restructuring efforts, that AOL is back on the right track.

Before I get into the main financial takeaways for the quarter, I want to briefly touch on a housekeeping item. You will note in our earnings release that we changed our definition of adjusted OIBDA so that it excludes restructuring costs and equity-based compensation expense. Because we believe this presentation is more indicative of how our operating performance and more consistent with how we think about the operations internally. Still included in adjusted OIBDA is retention-based compensation.

This is related to recent acquisitions where we have effectively converted part of the purchase price into employee retention incentives. Also included in the OIBDA are transaction related expenses of which there were $9 million in Q1. We reported Q1 OIBDA of $99 million. Excluding the transaction expenses OIBDA would've been $108 million. We have broken out each of the OIBDA component expenses as well as the equity-based compensation and restructuring expenses in the earnings release and trending schedules so that you can continue to model each as you see fit.

Turning to the quarter, for me, there are 10 main financial takeaways, so let me quickly run you through them. First, we made significant progress, as Tim mentioned, on the display advertising front. With global display advertising growing for the first time since Q4 2007. As a reminder, on the Q4 call, we noted we were hopeful we would close the gap to display growth in Q1. Clearly, our actual performance was better than that. Which for me, it's just indicative of the success of our efforts to reorganize our ad sales force and improve the advertiser experience. Excluding the impact of acquisitions, domestic display ad revenue was up 6% year-over-year, as compared to the 11% recorded growth.

What I think is interesting is if you look at it on a pro forma basis, including the full quarter's impact of the acquisitions in both years, our domestic display growth would also have been 11%. And, that is partly due to the 100% year-over-year growth at the Huffington Post. Also keep in mind that international display revenue was impacted by the absence of revenue from Bebo and ICQ which we sold last year. As well as the result of our reduced operations in Germany and France. So, if you exclude these items, international display was up slightly year-over-year. Overall, display growth was driven by year-over-year price improvements across the board, thanks in large part to an improved ad sales operation and significantly improved yield management. We expect to continue to benefit from both in 2011. And further advertiser adoption of Devil advertising formats we believe represents a significant, additional long-term opportunity.

The second takeaway for me is that we continue to monitor our expense base very carefully. Total adjusted OIBDA expenses excluding TAC, as well as excluding acquisition related expenses, and that includes transaction expenses, incentive comp and the operating expense of acquisitions, those were essentially flat sequentially. And they are up only 2% year-over-year with the latter reflecting our increased investment in Patch. As we look out to Q2, keep in mind that we will have a full quarter's impact of the Huffington Post and Goviral acquisitions, including retention compensation. So, this will cause adjusted OIBDA expenses, excluding TAC, to increase approximately $20 million sequentially related to these deals. Offsetting that will be the absence of the $9 million of transaction related expenses in Q1. And we are also going to begin to realize cost savings as a result of the Huffington Post integration. So net-net, our current expectation is that adjusted OIBDA expenses, excluding TAC, will increase in the range of $5 million to $10 million sequentially. Also, while we recently restructured our India operations, many of the impacted employees are on retention through the end of June so we won't begin to see any benefit from this initiative until the back half of the year with the full impact being realized in 2012 and beyond.

The third take away is our integration of the Huffington Post is ahead of schedule. We are on track to achieve all of our cost cutting goals and we are very pleased with the financial and operating performance to date of the Huffington Post, as it exceeded its budgeted revenue in Q1.

Fourth, Q1 free cash flow was negative, principally due to the timing of year-end bonus payments and deal transaction costs, as well as restructuring payments. However, we expect strong free cash flow conversion rates during the remainder of the year. Our balance sheet remains strong with approximately $380 million of cash on hand at the end of the first quarter.

Fifth, we saw stabilization in our core, domestic third party network business, which was essentially flat, year-over-year, with the reported decline of 21%, driven by our exit from certain products such as our search engine and affiliate marketing offerings, which were essentially shut down during Q1 last year. What is important to know is that this is the last quarter we will have meaningful year-over-year comparison issues here. Note, this is the third quarter in a row where global, third-party revenue has grown sequentially.

Sixth, while our global search and contextual business declined 21% year-over-year, on a reported basis, it declined only 15% when you exclude ICQ, the de-emphasis of contextual products, and fewer searches from countries where we have reduced operations. The decline moderated, due in part to growth in search revenue on aol.com. Essentially, all the domestic decline was due to lower search traffic to AOL properties, driven principally by co-branded portals and a 22% decline in AOL brand access subscribers. The cobranded portals are declining due to a distribution deal we exited last year, which provided revenue and traffic but failed to provide long-term AOL users, and as a result were a significant money loser for us.

Search revenue from cobranded portals should go from about $60 million in 2010, to about $30 million in 2011. Similarly, international search, which represents approximately 15% of our revenue in this category, was down approximately 50% year-over-year, as we deal with the roll-off of certain countries we have exited, and the termination of certain international cobranded deals. As we look to the rest of the year, keep in mind we had approximately $5 million in revenue from ICQ in Q2 last year that we will not have this year. So, without having the ICQ comparison in Q3 and Q4, I expect the full year decline in search will be slightly better than what we saw in Q1.

Seventh, our subscription operations continue to show resiliency as we ended Q1 with a little over 3.6 million access subscribers at an ARPU of just under $18 a month. Churn in Q1 tends to be the highest of the year, and it was 2.5%, down from 3% in Q1 last year. I am also happy to report that we are making good progress against our goal of selling online products outside of our traditional access product and we now have over 500,000 customers across a number of different products. I just want to spend a few moments here on how this revenue is classified. To the extent we are the principal in the transaction, meaning we are responsible for providing the subscription service to the end-user, we record that revenue as part of subscription revenue. If however, we are not the principal in a product, say for example, ID Vault, we record revenue earned as part of domestic display revenue because we are, in essence, promoting a third-party product and receiving performance compensation on those services. We recorded $3 million of domestic display revenue related to these types of transactions in Q1. Approximately $6 million of subscription revenue was recorded in Q1 for products where we are the principal.

Eight, as usual, there are a number of items impacting our EPS. First, our tax provision was actually a benefit of approximately $16 million. And this was driven by a $7 million benefit from an anticipated worthless stock deduction related to the sales of a subsidiary, and an $8 million benefit related to escrow disbursements from prior acquisitions where we have now determined that we will be able to recognize the tax benefit. The key takeaway on the cash tax side is that we continue to benefit from a meaningful tax shield as a result of our worthless stock deductions, and we still have approximately $165 million of net cash tax savings to go. In addition, we had approximately $28 million of restructuring charges during the quarter, as we reorganized AOL Huffington Post Media Group post acquisition, as well as reorganized our India operations. Our restructuring liability stands at approximately $33 million, approximately $28 million of which we expect to be paid out over the next 12 months.

Ninth, Patch continues to be a meaningful investment for us in Q1 with Patch expenses at approximately $40 million, essentially flat sequentially to Q4. Our expectation is we will begin to see Patch losses decline in the back of the year as we begin to generate more meaningful revenue across the Patch properties.

Tenth, our OIBDA expectations for the full year remain intact. We currently expect Q2 to be the trough for us in terms of adjusted OIBDA performance. And our current expectation is that the decline in adjusted OIBDA from Q1 to Q2 will be in the range of the percentage decline we saw in Q1 to Q2 last year. A 17% decline. We then expect to see meaningful sequential OIBDA growth in the remaining two quarters of the year.

Before I turn it back to Tim, I would like to reiterate that this quarter was a very important milestone for us as we return to display growth. Our aspirations and our expectations are certainly higher than our Q1 growth, but I think you will agree that it is a meaningful improvement over prior quarters and as a trend we expect to improve on as we move through the remainder of the year.

With that, I will turn it back to Tim before we go to Q&A.

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

Thanks, Artie. Also just for investors, I think Artie and I have spent a lot of time being aligned on where we think future growth is going to come from. And before we go to Q&A, I would just close off with, we are very focused on the following five items. One is continued growth in display. And that is also meaning growth in content and how well our content properties do. Second is significant growth and improvement in Patch, and Patch monetization. Third is growth in the acquisitions and also in the B2B business. The 25,000, 26,000 publishers we service is a very big opportunity for us. Four is moderation in search and the decline of the subscription business and the incline of the new subscription business. And number five is really expense management, and tight austerity program around expenses. So just so you know, we are on the same operating plan we were before. We're more focused, we actually have less things to juggle on our plate. I think if you saw the amount of things we were juggling six months ago, it was a lot. Now we are very focused on those five items.

So why don't we turn it over to Tawanda to Q&A, if we can.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Brian Pitz with UBS.

Brian Pitz - *UBS - Analyst*

Thanks so much. Tim, I would like to start with a couple questions on Devil ads. Can you give us any update in terms of user engagement increases, brand list, and maybe profitability and penetration across some of those sites? And separately, how extensible is the platform and how should we basically think about Devil ads running on a network, how interested are advertisers and publishers in these formats? Thanks.

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

Sure, thanks, Brian. So, let me just start at a high level. Most of the people who are covering what Devil is are calling it bigger ads. And I just want to clarify one thing. We measured our pages very closely and found that a lot of pages had 20% plus of the page was dedicated to advertisers. Meaning two years ago, we had an average of about 14 different ads on a page, and that's really bad for end-users and it's really bad for advertisers because the users don't like it and the advertisers don't get great results. So, we said what if we took that same amount of space and gave it to one advertiser to be able to tell a real deeper end story with content. And I think that the core of what Devil is, what we are doing is taking the same amount of ad space and giving it to one advertiser not 14. And, that works for users and works for the advertiser. So, that is a benefit.

On the engagement side, the engagement rates are basically interactions, roughly at about 6.4 times the industry benchmark. So, we are seeing interaction rates with Devil ads above 10%. The industry benchmark for engagement is about 1.5%, so meaningfully better results. The interaction rate, meaning how often people actually touch the ad itself, or use one of the individual components and click all the way through, is substantially better. It's about 1.9 times the industry rate. And then the thing that is really meaningful is the time that people actually spend with the ad. So roughly people spend about 14 seconds with an ad if they are going to engage in it, on average, on the Internet. They spend about 47 seconds with a Devil ad, so it's 3.4 times the industry average. So, overall, when you look at almost any major metric, when people put video ads inside of a Devil ad, they get two times the industry rate of viewership. So, on every single benchmark, Devil ads perform better than the Internet ads do, and that is a substantial. When you serve a lot of these ads, that is a substantial lift for us as a business.

The profitability of the ads are much better than the normal way we run ads, also, when you look at it on an individual ad basis. Because, one is, it allows us to focus our time, energy, sales, resources and metrics down to one or a couple of units that actually have higher engagement rates. So, it's better for the sales team to sell, the customers get better results, we can program it more thoroughly in the ad server because having one ad on a page versus 14. So there's a lot of network effects inside of Devil. Devil is currently a very, very small part of our inventory, but it is a small part of the inventory, it's a growing part of the revenue picture. So, with Devil, because the engagement rates are higher and we can price them higher, you can use less inventory and get a lot bigger bang for the buck off of the advertiser and for us, on a profitability standpoint.

And I would say the interest rate is really high on Devil. We actually have a bunch of Devil programs rolling out with significant MBC partners, which is a major, creative investor in the creative agencies. We have a Project Dare Devil which we announced, and that project is going to go into more and more of the creative agencies and clients. And two, I was at the WPP Video Summit last night with Sir Martin Sorrell. And, actually Queen Latifah came with us because she's a content partner of our. One of the things we talked about was Devil there. And WPP, which is the largest agency in the world, had a lot of their major customers there. Lots of interest in Devil. So I think from the advertising side, it really has gotten a lot of traction and will get more and more traction as we go forward.

On the publisher network side, I think this is a really substantial opportunity because everything we did with Devil was, one, us being a publisher, figuring out how do you have better consumer experience and how do you have better advertiser experience. So the success we've had with Devil doesn't just apply to us, it applies more broadly to the Internet. And I think we have seen a lot of interest. You saw the Hearst announcement last night or this morning. And we've had a lot of interest from different publishers, so my guess is Devil will not just grow on our properties but will grow on other people's properties. And then again, I love to talk about the plumbing behind the business, it may not be your most exciting topic. But one of the other things we did, which is a huge, strategic advantage, versus our competition, we also designed all of our CMS systems behind putting Devil, so over 90% of our sites are now enabled for Devil. We went from having a couple years ago, over 20 content management systems down to having two right now. So having two content management systems also is a big benefit inside the ads system, as well. So we have a lot of innovation going in Devil, we are just starting the process but it is very exciting and my guess is it's going to grow not just on our properties but out to the web through Advertising.com, as well.

Operator

Laura Martin with Needham.

Laura Martin - *Needham & Company - Analyst*

Tim, great color on Devil and great numbers, so thanks for those. I'm going to push you on Patch a little bit. You'd said by the end of the year you might give us some age market results, and I know you said that age markets were strong. Can you give us a little more granularity on the markets that have been outstanding more than a year, what kind of user metrics and profits, specifically revenue and if you hit profitability after a year?

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

Sure. So, basically, Patch, the first three Patches we launched, which are well over a year, coming up on two years ago that we launched, those in Q1 grew roughly about 24% to 25%. And so, I think if you think about the fact the implied penetration rate on those Patches is getting up to 100% of the people in those towns. So to be able to grow 24%, 25% in Q1 after we are at an implied penetration rate between 80% and 100% in those towns. Patch is having a big influence on the consumer side. And I would just make the point, I think there are two interesting parts of our business. One is Patch and one is video, because both of those two components for us have outsize consumer traffic growth. And we basically on both of those decided to go consumer traffic first and then ads second. So the implied penetration rates, the growth of the Patches, the Patches that have been around for more than a year as a total category on average grew 97% during Q1. So, I think the growth of the Patches overall have been very strong and continue to be strong on the consumer side.

And let me rotate into the advertising side of the Patches. This is something I've been spending a lot of personal time on. Since we focus so much on the consumer experience of Patch, one of the things from the monetization front that we are just starting to do right now, is something I call Patch 360. Which is, we have a lot of people on the Patch properties themselves on the website. We have a lot of Patch newsletters and a lot of people signing up for Patch newsletters, as well. And then mobile is becoming increasingly an important part of Patch. So, we hit our metrics in terms of the expectations around revenue that we've had for Patch in the plan. I think there is an opportunity to have Patch accelerate in the future, but we want to do it very carefully.

And job one is getting consumer traffic going. Job two is on the advertising front. And Patch is basically being monetized right now almost 100% by local zip code level advertisers or people. One of the things that is growing quickly on the revenue side is people buying multi-town segments together. But the majority of revenue during Q1 came from very, very localized merchants. And I think, that is something from a category perspective, that is a very big opportunity.

So, as you fast-forward to this year, I'd expect consumer traffic to continue to grow quickly, number one. Number two I would expect us to actually come out with simplified advertising products for Patch. We have a self-service system in Patch right now. We have a lot of localized ad products. But there are two things we're looking at specifically for monetization. One is to continued work on an FSI product with the big box retailers. Patch covers, with the Patches we're in right now, we hit about 70% of the big box retailers in the United States are within 10 miles of a Patch in the states that we're in right now.

The second thing is, on the localized front, we are making the product simpler and simpler for local advertisers. And I think from a local advertising perspective, that is a very important progress for us. So I would expect huge focus at this Company now going forward on Patch monetization. I think by the end of this year we will release more metrics on Patch. I would hope to have rolling under a Patch profitability across Patch towns. It may or may not be related directly to how long they've been around because it's more related to where we roll out the monetization products first and there may not be 100% overlap with the length of the Patch and where we roll out the monetization and salespeople. But, overall, remain very happy with Patch, very focused on it from a corporate standpoint. And personally, me and John Brod and other folks spending time on this. And I would just point to Project Devil. The success we've had with Project Devil is because we try to understand the market very well and understand our consumer usage. The same thing is happening with Patch now. So it's a long-winded answer to your question. Consumer traffic is growing great. Monetization will catch up behind it and we are focused on it. I'd expect to have more Patch products coming out shortly on the advertising front that will simplify the process for advertisers.

Operator

Heath Terry with Canaccord. Please proceed.

Heath Terry - *Canaccord Adams - Analyst*

Great, thanks. Tim, I was wondering, there's been a lot written in the press about the evolution of the content strategy, content development strategy around Patch. I was hoping you could give us a sense of what this does in terms of Patch's expense structure. And then if you could give us a sense of how Patch is monetizing versus your overall business?

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

Sure. So, the content strategy on Patch remains the same which is we want to be hyper local in content overall. And I think the content strategy here are picking up. First of all, let me take a step back. Everything we do at this Company is going to get an outsized press coverage because it is the media on media. And so when we announced the fact that we're going to work with local bloggers for Patch, all of a sudden, and I think there was a thing in the press basically saying Patch is changing its total strategy. What we are actually doing with Patch is, Patch is a core platform, it is basically community networking as a platform. We're putting content up ourselves, users are putting up content and events, and then the new leg of the strategy stool that we've added is local blogging. A lot of towns have local bloggers who cover very specific items.

On the way into work this morning before the earnings call, I was on Patch Brookline, which is in Boston, and looking at the localized bloggers there. And when you look at the localized bloggers there, they are very specific, very germane to the community. I think one was about real estate, one was about local events around comics, actually, happening in Boston. And that is a huge opportunity for us to have local bloggers put partnerships together with Patch. So I think what you're going to see from us on the content side is original journalism, aggregation of local content. That's part of the Outside. In acquisition we did. And then the blogging platform from Huffington Post. And then overlaid on top of that is this notion of this community platform, or community networking. So, we want to be a platform for the community for our consumers, for content producers, for businesses, for schools. And I think overall, we like where that strategy is going and has higher and higher engagement. I think I mentioned earlier, there was a 300% increase in the amount of people commenting on Patch during Q1. So, I think we are touching these communities. On the monetization front, how this monetizes differently or better or different acceleration path than the rest of the AOL properties, Patch tends to be a very targeted buy for advertisers. It is similar to Project Devil in terms of pricing and how we are actually able to monetize it. It monetizes at a much higher rate than the overall Internet. Somebody sent me an article a couple months ago that somebody wrote about Patch saying Patch was going to monetize at an average of a $3 CPM. We wouldn't be in this business if that were the case. So, I think from a cost structure standpoint, we're looking at the cost structure very closely. My guess is we will get more usage at a lower cost as we go forward on Patch. And on the advertising side, we will have more advertisers locally and nationally on more scalable products at significantly higher rates than the average Internet site at a global level or national level to monetize that.

Operator

Ross Sandler with RBC Capital Markets.

Ross Sandler - *RBC Capital Markets - Analyst*

Yes, guys, just two quick questions. First a follow-up on Project Devil and then one on Ad.com. So, on Devil, the ads are going from beta on a few select sites in 1Q to full rollout mode across most of your properties in 2Q. So Artie or Tim, can you put some revenue numbers or revenue growth numbers around what Devil could be in 2Q once you get the full roll out? Could this be $20 million per quarter incremental? And then what kind of CPM are you seeing from these Devil ads versus your normal ads? And then on the Ad.com side, revenue is up 4% sequentially, bucking the seasonal downtick that we usually see in the ad network space. So can you give us a little color on what was driving the sequential uptick? Thanks.

Artie Minson - *AOL, Inc. - Chief Financial and Administrative Officer*

Sure. It's Artie. Let me take those. On Ad.com, very pleased with the Ad.com performance. As we said on Q4, we frankly had not been thrilled with the Q4 performance, and very much the team got back to basics and really focused on working with their clients and driving their product and explaining in the marketplace all the benefits of their product. So very, very nice turnaround in that business quickly, and I think the trend line continues to look pretty good on the Ad.com business. On Devil, I'm not going to get into specific revenue guidance in the back half of the year. What I will tell you is the CPMs we are seeing are multiples of the current CPMs we see on the rest of the business. Keep in mind, we are starting from a low base on Devil, and we do expect certainly strong, very strong growth from Devil. But, I'd rather just stay away from specific Devil revenue guidance at this point.

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

One thing I would just say also, quickly, is the B2B business that we've gotten organized around to launch, one of our executives, Ned Brody is running, is a very significant opportunity for us in the future because of the relationships through Ad.com. And I think we've had a renewed focus, both on the people and technology side, for Ad.com. So, part of this is getting just operationally very focused on what publishers need and what advertisers need, and I think that's been a big benefit.

Operator

Ben Schachter with Macquarie.

Benjamin Schachter - *Macquarie Research - Analyst*

Can you give us some sense of how you are doing on mobile? If you want to talk about engagement, revenue, mobile search. What is the position of the Company for what you want to do with mobile going forward? And then just a point of clarification. Tim, when you say Patch implied penetration rates of 80% to 100%, are you saying 100% of people in those communities are looking at Patch? Thanks.

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

Sure. So let me hit the Patch one first. So, Patch, we look at the population in the towns, and we look at the amount of business that we are getting as best as we possibly can on a localized basis. And so, if you take the number of visits that are coming in to the Patches versus the population, we are, the Patches have been around for a while, in between 80% and 100% penetration rate. So, we don't know exactly who those people are and what they are doing, but I think from the standpoint of whether or not we are having an effect on the community, I think we are touching a lot of the people in the community every month. We think the engagement rates can be higher, and that is one of the things that we are working on. So when we say implied penetration, one of the other things that happens is, neighboring towns tend to look at Patches next to them. And then the second thing that has been interesting is that people who grew up in those towns, ex-pats of those towns, tend to sign up for Patch alerts and stuff because they're interested in where they lived or what happened at their school or those things. We get a lot of anecdotal stories from people who want to see what their basketball team did, they played on in high school So, as best we can tell, that's the numbers we're using. And we're trying to be conservative about it. I'm sorry, the first question was?

Benjamin Schachter - *Macquarie Research - Analyst*

Mobile.

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

Mobile. So mobile, from a landscape perspective, and again I'm just going to be direct about this because we've said it in the last couple earnings calls, mobile is something that we are focused on from a consumer experience standpoint. And we basically have broken mobile down into two buckets. One is the current AOL properties that we want to have mobile applications for and focus on the ones that are going to be successful. So let me give you an example of that. MapQuest turn by turn directions is the number one turn by turn directions on the iPhone store. It's got over 5 million downloads there. And if you look at things like Moviefone, we just launched a new iPhone app that got 1 million downloads. AIM, I think last year in December Apple ranked it as the number 11 most downloaded application for mobile. So we have a bunch of current properties. We have 40 mobile apps that we are doing.

I think when you look down the segmentation of how many mobile users we are having across those 40 different apps, there are 10 apps that are getting significant traffic, there's 10 apps that are getting in the millions of traffic. There's 10 more apps that are getting in the hundreds of thousands of people using them. And then the bottom 20 are getting tens of thousands to hundreds of thousands. So, mobile is a big improvement area for us that we can focus on.

The second part of the mobile strategy has been Mobile-First applications. So, we have acquired Rally Up, a team of people. It's in Brad Garlinghouse's group out in Palo Alto. And we have a pretty significant set of engineers and products that I consider to be some of the best people in Silicon Valley working on Mobile-First applications. You're going to see some of those things coming out soon. And, we believe that mobile is a very, very key part of AOL's future. We are focused on it, we have mobile experts working on it. The Company wasn't. It's like video wasn't too far along in mobile a couple of years ago. We've gotten organized around it. On mobile monetization, I just think on mobile monetization, it has not been our core focus. We have some exciting hires coming in for mobile monetization, and some products with Adtech and other things that we're doing. So I would expect mobile monetization to be a 2012 initiative, working on it heavily this year. But if you're looking for mobile revenue from us this year, we've said it's not going to be a huge focus. Consumer traffic would be. So I would expect to have us focus on that.

Operator

Mark Mahaney with Citigroup.

Mark Mahaney - *Citigroup - Analyst*

Thanks. Two questions. Artie, you'd mentioned that pricing was a major factor behind the turn in display advertising. Could you peel that back a little bit? Of the growth you're seeing in display advertising, what percentage, if it is quantifiable, would you say is pricing driven versus volume? And then secondly, if you're willing to put a stake in the sand on Patch and whether that turns profitable next year. And I couldn't tell whether you were trying to do that or if you want to hold off on making that kind of statement? Thank you.

Artie Minson - *AOL, Inc. - Chief Financial and Administrative Officer*

Sure. A couple things. I would say, basically, all of the growth was really driven by how we think of it as yield management, not necessarily price. But, yield management was basically the driver of the revenue increase. In terms of Patch and timeframe for Patch profitability, I think what you will see, as we get to the back half of this year and next year, a steady stream of Patches turning profitable. But I would expect overall next year for Patch not to be -- and this is me being a finance person -- for Patch overall to be profitable. But I think you will see basically declines in the losses. As Tim talked about, what are our drivers of growth and how do we get back to our stated 2013 is the year when AOL returns to OIBDA growth. I think Patch and the performance of Patch over the next three years will clearly be a contributor. Meaningful contributor to that.

Operator

Rory Maher with Hudson Square Research.

Rory Maher - *Hudson Square Research - Analyst*

Now that you are starting to get some leverage on the display front in terms of revenue growth, can you talk a little bit about how you turn your content business into a profitable business? And, if you hit that second half industry revenue growth mark that you've talked about, can we then assume you're going to be hitting industry level type margins from that business? And then finally, with video, about how much of your video strategy, going forward, is going to be from videos being produced in house? And then how do you manage those costs versus typical articles that are a little less expensive to produce?

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

Sure. So, just so you know, as a management team, we had an off-site, I guess it was a week-and-a-half ago. And I think one of the things we are big on is a alignment around what the goals are and how we are all focused and how everybody works together to get to them. I would just say content profitability is a North Star goal for us. Our goal is to run a high profit, high-margin content business. And I think from our standpoint , the business has been, if you go back a couple of years, and I've said this before in some of the earnings calls, and Jeff Bewkes was talking to me about the AOL job, it comes down to a very simple formula, which is you've got to turn the red to green. And, I think when you go through each of our individual properties, some are green and some are red, but overarching I think the reds are going down and the greens are going up. And I would hope as we get through this year and into next year, for us to have a profitable media business that you are happy with and we are happy with . And I think that is in scope of what the executive team expects to happen.

And I think on the margin front, I don't want to give any future looking margin results, but any healthy content business, media business would have margins attached to it that are attractive. So, we are working heavily on making sure the cost structure here will allow us to do that. The video question -- which is in-house versus out-house I guess -- the in-house video is something that we continue to work on. And we do things like AOL Sessions and we are doing a lot of other interesting stuff around in-house video. The Huffington Post is a great news brand for us, and a great brand overall to continue doing more in-house video around news. And one of the benefits of doing an acquisition was Huffington Post didn't have a lot of video on their property and we're going to increase that. There is also in-house video stuff around Patch we're doing and a bunch of exciting things like that.

And then, I would say, but one of the things that is a significant benefit for us and our partners, is 5min and goviral allow us to do relevant video for ourselves and other publishers at low cost, high monetization. So I think you're going to see us in an iceberg type mode where the very high quality premium stuff we are doing ourselves you're going to see, but then there's this giant network business which is substantial growth, substantial opportunity, dealing with tens of thousands of publishers. So I would expect us to do both but I would expect massive scale on the network side of the video business for us overall.

Operator

Ken Sena with Evercore partners.

Ken Sena - *Evercore Partners - Analyst*

Hi, thanks for the question. So my question has to do with the Company's stated goal for OIBDA growth inflection in 2013. With approximately 90% margin in access and search, which still represents more than half of the business, but are declining close to 20% a year, how does AOL achieve the OIBDA growth without cutting its cost basis? I was wondering if maybe you had a more specific plan that you could share on achieving this goal. Thanks.

Artie Minson - *AOL, Inc. - Chief Financial and Administrative Officer*

Ken, it's Artie. I'm sure you'll be at investor day, but let me hit some of the drivers that Tim hit on his proactive remarks this morning. The way for us to get there, and let me just start by saying, our plan is to not artificially take 2012 down to help us get back to growth in 2013. But how we're going to get there in 2013 is continued strong performance in display, we're going to see significant improvements in Patch, the acquisitions we expect to be meaningful contributors to growth, including those in the B2B business which we are very excited about. You're going to see moderation in search and subscription declines over that time period. And we are going to continue to focus on tight expense controls. So, in my mind, there's five key variables and we are maniacally focused on them every day when we come to work. So, that underpins the plan.

Ken Sena - *Evercore Partners - Analyst*

Just a follow-up. If you don't see the moderation in search and access to clients, would you then look to potentially cutting costs in order to continue to make sure that you do achieve that inflection? Or, would you reassess at that point?

Artie Minson - *AOL, Inc. - Chief Financial and Administrative Officer*

We look at our cost base all the time, and we often look at it just as a matter of course independent, frankly, of how the revenue is doing. So, we are going to be all over our expense base. And my expectation is we are going to see the revenue growth we talked about on display, and we are going to see the moderation as we laid it out. That's part of our plan. But to be clear, significant expense controls is always a part of day-to-day life.

Operator

Ingrid Chung with Goldman Sachs.

Ingrid Chung - *Goldman Sachs - Analyst*

Thanks. Good morning. So, I just have a couple of questions on the Huffington Post. First off, it sounded like you exceeded budget in the first quarter. So does that mean you are on track to meet the metrics that you spoke about when you acquired the company, $50 million in revenue, $10 million EBITDA this year, and I think $100 million annual revenue run rate, and 30% EBITDA margins beyond 2011? And then the second question is, how much of a swing factor is election related revenue in 2012?

Artie Minson - *AOL, Inc. - Chief Financial and Administrative Officer*

Ingrid, the answer to your question on are we on plan is yes. We exceeded performance in Q1, and we continue to remain on plan. Obviously, we think political will provide upside in 2012, and that leads us to say we remain on plan for the goals we laid out for the Huffington Post for 2012, as well. We are excited about the business when we bought it, we are more excited now that we have it in-house.

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

On elections I would just say, one of the benefits of having Huffington Post and AOL and Patch is, in a very meaningful way, I think we are going to be able to have an effect on the elections and interest overall. Meaning that, even on Patch today, most of the mayors or selectmen in towns around the US that we're in, as well as the local senators, representatives are actually engaged on Patch overall. So I think on the Patch local side, it brings a unique angle to the elections. I think the Huffington Post clearly is one of the things that is heavy-duty in the political realm and a well-known brand. And, I think they are different brands for us. We are not basically planning on trying to augment the elections, we're trying to cover the elections overall. And then two or three is AOL. AOL tends to have a very significant audience and very interested in terms of where the country is going, how it is going, those things. So I think if you take those three assets individually, elections should be a benefit for us. I don't think we built in a huge premium in what we've talked about today around the elections specifically, but I think it is going to be an upside opportunity.

Operator

Youssef Squali with Jefferies.

Youssef Squali - *Jefferies & Company - Analyst*

Thank you very re much. Two quick questions please. First, going back to Project Devil. How much of your inventory do you think should be monetized through Devil by year-end versus, say, Q1? I know, I think you said earlier, Q1 was still mostly beta. And, what kind of CPM lift would you see between now and year-end? And then the second question is around Google's Project Panda. What kind of impact have you seen on your traffic, if any, particularly maybe for half posts, and just reliance on search traffic overall? Thanks.

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

Let me start with Panda. So, positive. By the way, going right back to our core strategy as a Company, this is what we were expecting to happen. As devices and platforms become more competitive, they differentiate themselves in the quality of the content experience they bring to end users. Panda for Google, I know is a mix between real-time and quality. But we are exactly the type of company that is going to benefit from a Panda type release. My guess is, in the future, there is going to be Panda for Facebook and Panda for whatever platforms there are in the future. And as long as you're a high-quality brand that consumers recognize, and you do a good job of putting content out there, I think it's going to be a net benefit for us as a company, which is exciting.

And then on the Devil front, we are enabled right now at 90% plus of the inventory for Devil. We have a fraction of that actually running Devil right now. I think Artie and I stare at the ceiling at night dreaming of Devil being on all the sites all the time. But we are in the process right now of getting the clients and ad agencies involved, which tends to take a little bit of time. So, I had expected to continue to move up percentage wise our inventory, I'd also expect pricing to remain strong for Devil on a go forward basis. So, I don't have any exact predictions, but my guess is, more inventory, sustained pricing, and ability for us to continue to make advertisers' lives better and easier with better consumer engagement overall. And I don't know, Artie, if you've got any specifics. But We are expecting more Devil more of the time with better results for you as an investor and consumers as an advertising vehicle.

Youssef Squali - *Jefferies & Company - Analyst*

And then just going back to Panda. How much of your traffic is driven through search?

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

It's dependent by property. The spectrum ranges from about, on the low end, single-digit percentages, on the some of the older AOL properties that we are currently still enabling for search. On the highest properties it is probably 30% to 40% overall. So, I think there is, again, a spectrum of where it comes from. But search is very important for us for the future. And, again, I think we spend a lot of time optimizing the properties for that. I would also say social networking is incredibly important for us and growing very quickly. So, I think when you think about enablement, probably 30% to 40% plus of our traffic on all the properties are going to be enabled by search or social. And, I think one of the reasons we acquired Huffington Post is they are an expert in the social side of this, and we've done a very good job of enabling our properties for social. As a matter of fact, social engagement to AOL properties during Q1, a lot of it based on Huffington Post integration, went up double digit just in the first month we integrated.

Eoin Ryan - *AOL Inc - VP IR*

Tawanda, I think we have time for just one more question.

Operator

John Blackledge with Credit Suisse.

John Blackledge - *Credit Suisse - Analyst*

Thanks. Just a couple of questions. Just wondering how many Patches you expect to add in 2011 or how many Patches you would expect to end the year at? That is one. Two, would you expect domestic display growth to accelerate on a sequential basis over the course of the year? And then, lastly, the $5 million contribution to domestic display from Huffington Post and TechCrunch, how much contribution from Huffington Post and how much was the contribution from TechCrunch? Thank you.

Eoin Ryan - *AOL Inc - VP IR*

That's a lot of questions in there, John. I will hit a couple of them. On Huffington Post, TechCrunch, it was probably 75% Huffington Post. On domestic display, just to break it into its component parts, there will be a reported jump in domestic display growth in Q2, in part due to the acquisition, so keep that in mind. And then, what we've obviously said is, the back half of the year is where we are really looking to return to industry growth rates. So on an organic basis you're going to see more growth, more organic growth, in the back part of the year. And I will turn it back to Tim on Patch.

Tim Armstrong - *AOL, Inc. - Chairman, CEO*

On Patch, we've said publicly we are going to be over 1,000, we ended Q1 at over 800. And, we announced, you probably may have seen it, we announced the fact we are going to do a Latino Patch starting in Southern California. And we have other variations of Patch that we're going to be rolling out, which are exciting. So we said 1,000. We'd like to continue being as impactful as possible to the communities so we will probably, throughout the course of the year, come out with more expectations around that. But I think 1,000-plus right now is probably the best accurate judge at this point overall.

And, just wanted to say in closing, the following things. One is, I really wanted to thank the employees of AOL. We expected a lot out of everybody here, and we have done more work, even in Q1, than most companies do in a year. We are going to continue to do that, and I just want to commend them for their work effort, teamwork, those things.

Second is, I know AOL is getting covered a lot in the press, and there is a lot of ups and downs in the press about it. But, just overall the Company is healthy. I said last year we were a recovering patient. The patient is up and running around and having a good time doing it at this point. And I would expect us to continue to really focus on the rest of this year on growth. And the five bullet point list I gave you at the end of Artie 's comments, that's what we're spending our time doing here. And everybody's got their hands at 10 and 2. But more importantly, we have our foot on the gas pedal and that is an important part of this Company. Which is, we told you this went from a turnaround to a comeback and now we are playing offense. So, we are going to be aggressive about moving this Company forward and aggressive about great consumer experiences.

I know AOL has had a long-storied history, but we are at the point right now at rewriting the milestones on a go forward basis. So, I put more investment in the Company myself personally Q1. I wouldn't have done that unless I thought we were on track. I am a rational investor and we are going to have rational results here as we go forward as a business.

So, thanks for doing the call, and if you have follow up questions you can contact us or Eoin. Thank you.

Operator

Thank you for joining today's conference. That concludes the presentation, you may now disconnect and have a great day.