Yahoo's 3Q shows company remains in financial funk (Update)

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Ross Levinsohn, Yahoo Executive Vice President of Americas, speaks at the Web. 2.0 Summit in San Francisco, Oct. 17, 2011. Yahoo Inc., releases quarterly financial results Tuesday, Oct. 18, 2011, after the market close.(AP Photo/Paul Sakuma)

Yahoo keeps losing ground in the fast-moving Internet market, increasing the pressure on the struggling company to abandon its perpetual turnaround attempts and negotiate a sale with one of several prospective bidders.

The latest signs of Yahoo Inc.'s malaise surfaced Tuesday in its third-quarter earnings report. The lackluster results for the July-September period extended a streak of financial mediocrity that culminated in Yahoo's abrupt firing of Carol Bartz as CEO last month.

Although cost-cutting measures imposed by Bartz helped boost Yahoo's earnings after stripping out one-time gains, the company is still selling less advertising at a time when the overall Internet market has been growing.

After subtracting ad commissions, Yahoo's third -quarter revenue stood at $1.07 billion - a 5 percent drop from the same time last year.

That performance looks even feebler next to the 37 percent increase in net revenue that Internet search and advertising leader Google Inc. enjoyed during the third quarter. Analysts believe Facebook, the owner of the Web's most popular hangout, is growing at an even quicker pace, although there is no way of knowing for certain because the privately held company isn't required to reveal its finances.

Yahoo, which is based in Sunnyvale, Calif., doesn't anticipate an upturn in the final three months of the year - typically the busiest time for online advertising because it coincides with the holiday shopping season.

If it hits the mid-range of management projections, Yahoo's net revenue in the fourth quarter will fall by about 6 percent from the same time last year.

Normally, Yahoo's stock price would fall after a ho-hum quarter that offered little hope for better times ahead.

But that didn't happen Tuesday, largely because many investors are betting that Yahoo's struggles will make it more likely the company will sell itself as a whole or in part. The company's stock price already has climbed by more than 20 percent since Bartz's Sept. 6 ouster.

Yahoo shares gained 42 cents, or 2.7 percent, to $15.89 in Tuesday's extended trading.

Tim Morse, who is filling in as Yahoo's interim CEO while also working as chief financial officer, told analysts Tuesday that he couldn't discuss what the company's next step might be or when it might take it.

"The board is actively looking at the full range of options available to return the company to a path of robust growth and industry-leading innovation," Morse said. "The objective is to deliver on the company's potential and create value for employees, advertisers, users and shareholders."

Even before the third-quarter report came out, Stifel Nicolaus & Co. analyst Jordan Rohan issued a report putting the odds of Yahoo being sold at 80 percent.

Most of Yahoo's attraction lies in its Internet investments in Asia and a worldwide audience of about 700 million people each month. Before taxes, the value of Yahoo's 35 percent stake in Yahoo Japan now stands at $6.4 billion while its 43 percent stake could be worth about $14 billion, Morse said

That appraisal implies Wall Street is putting little or no value on Yahoo's U.S. assets, given the company's market value is $20 billion.

Although it's still recognized around the world, Yahoo's brand has been losing its luster as people increasingly embrace social networks such as Facebook and short-messaging service Twitter to keep track of what's going on instead of relying on a media hub like Yahoo's website.

"Yahoo isn't at the forefront of the Internet anymore," said Benchmark Co. analyst Clayton Moran. "Its assets have grown duller."

That hasn't discouraged opportunistic buyout firms from circling Yahoo like vultures hovering over a wounded animal.

The list of firms believed to be considering a run at Yahoo includes KKR & Co., the Blackstone Group, and Silver Lake. Silicon Valley venture capital firm Andreessen Horowitz's name also has popped up as a potential bidder. There is even talk of Yahoo co-founder Jerry Yang, who remains one of the company's largest shareholders, teaming up with one of the bidders in a leveraged buyout. Yang already took one unsuccessful stab at fixing Yahoo during an 18-month stint as CEO that ended with Bartz's hiring in January 2009.

Then there is this wild card: Microsoft Corp., Yahoo's jilted suitor, rival and now Internet search partner.

If Microsoft were to return with another bid for Yahoo, it would be at a much lower price than the $47.5 billion, or $33 per share, that it offered in May 2008. Microsoft walked away when Yang didn't immediately jump at the chance to sell at such a high price. Now, Yahoo would be fortunate to fetch as much as $20 per share or about $27 billion, in a sale of the entire company, Moran said.

Microsoft has less incentive to pursue a deal now because Yahoo now relies on Microsoft to process the search requests on its website. That arrangement, negotiated by Bartz, gives Microsoft the traffic and user insights it was seeking when it tried to buy Yahoo three years ago. The alliance so far isn't producing as much money as Yahoo envisioned, prompting it to persuade Microsoft to guarantee a certain amount of revenue through March 2013 - a year longer than the original promise.

In a late Tuesday appearance at an Internet conference, Microsoft CEO Steve Ballmer said it was a good thing the attempt to buy Yahoo in 2008 didn't pan out because the economy later descended into its deepest recession since World War II.

"Sometimes, you're lucky in life," Ballmer said at the Web 2.0 Summit in San Francisco. "With that said, there are a lot of great things at Yahoo." He wasn't asked if Microsoft is mulling another takeover attempt.

The only company that has publicly said it may make a bid for Yahoo this time around is the Alibaba Group, a Chinese Internet giant that has a testy relationship with Yahoo. The two companies are already linked through a 43 percent stake that Yahoo owns in Alibaba, but Alibaba CEO Jack Ma wants to find a way to turn the tables. Ma recently told a Silicon Valley audience that he is very interested in buying Yahoo. A Chinese news service reported this week that Ma says he has lined up $20 billion to mount a bid.

But even if Yahoo and Alibaba could agree on a price, they would still have to persuade U.S. regulators to allow a Chinese-owned company to buy a high-profile American company involved in communications.

Even if Alibaba doesn't make a bid on its own, Ma will likely be a key figure in any takeover attempt because his company is such a vital piece of the Yahoo puzzle, Moran said.

If Yahoo's board decides a sale doesn't make sense, then its next job will be picking a new CEO. The top internal candidates are believed to be Morse and Ross Levinsohn, the company's executive vice president of Americas. Recruiting an outsider could be daunting because of all the uncertainty and challenges still facing Yahoo.

"There is still some appeal in Yahoo, but it is going to require a lot of work to get them back on track," said S&P Capital IQ equity analyst Scott Kessler.

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