Yahoo's ad slump overshadows 1Q earnings gain (Update 2)

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In this Friday, Jan. 25, 2013, file photo, Marissa Mayer, CEO of Yahoo!, listens during the 43rd Annual Meeting of the World Economic Forum, in Davos, Switzerland. Yahoo Inc. reports quarterly financial results after the market closes. (AP Photo/Keystone, Laurent Gillieron)

Yahoo's Internet advertising revenue crumbled further during the first three months of the year, renewing doubts about the company's turnaround efforts despite a surge in earnings.

The results released Tuesday seemed to dim some of the aura surrounding Yahoo CEO Marissa Mayer, who was lured away from a top job at Google Inc. nine months ago to revive revenue growth at a company that has been mired in a malaise for years.

Mayer, though, assured analysts that her plans are falling into place. She characterized her strategy as a "series of sprints" that will eventually produce a "chain reaction" of more appealing online services, more engaged users and, eventually, more advertising sales. She cautioned it will be several more years before Yahoo is growing anywhere near the rate as other major Internet players such as Google and Facebook.

"We are on course to do what we said we would do: stabilize and grow with the market," Mayer said during a Tuesday conference call.

There have been signs of encouragement since Mayer's arrival, most notably the first increase in Yahoo's annual revenue since 2008. Although the 2012 gain was just 2 percent, it raised hopes that growth would accelerate this year.

Instead, Yahoo's total revenue shrank by 7 percent in the latest quarter from the same time last year.

The weak spot was in one of Yahoo's former strengths—display advertising. After subtracting the commissions that Yahoo pays its partners, the company's display advertising revenue fell by 11 percent from last year to $402 million. That development suggests that Yahoo is losing more ground in a key area of Internet advertising to Google Inc., which already dominates search advertising, and Facebook Inc., whose online social network is becoming a more powerful marketing magnet.

Yahoo's revenue from ads appearing alongside search results rose 6 percent from last year, excluding commissions. But that wasn't enough to prevent a 3 percent decline in Yahoo's total ad revenue, minus commissions.

On the plus side, Yahoo's first-quarter earnings climbed 36 percent to top analyst estimates. But much of the higher profit flowed from investments such as Yahoo's 24 percent stake in Alibaba Group, a rapidly growing Internet company in China. Yahoo's earnings from its investments totaled nearly $216 million in the first quarter, outstripping its operating income of $186 million.

"They are making more money (as) an investment house," BGC Financial analyst Colin Gillis said.

Yahoo also is benefiting from cost-cutting measures imposed by some of the five other CEOs, including interim leaders, who have run the company since mid-2007.

Investors seemed more dismayed with the downturn in Yahoo's display advertising than the growth in earnings. Yahoo's stock fell $1.08, or 4.5 percent, to $22.71 in extended trading. The shares had been up by more than 50 percent since Mayer's arrival.

Yahoo Inc. earned $390 million, or 35 cents per share, in the first quarter, compared with $286 million, or 23 cents per share, at the same time last year.

If not for expenses covering employee stock compensation and certain other costs, Yahoo said it would have earned 38 cents per share. That was well above the average estimate of 25 cents per share among analysts surveyed by FactSet.

Revenue totaled $1.14 billion, down from $1.22 billion at the same time last year.

After subtracting ad commissions, Yahoo's revenue stood at $1.07 billion, about $30 million below analyst projections.

Analysts accepted Mayer's assessment that change will take time.

"You have to remember that turnarounds take a long time and we are still in the early innings of that," Gillis said.

Some of Mayer's predecessors also had stressed that it would take years for Yahoo to snap out of its financial funk.

Gartner analyst Andrew Frank noted that first-quarter earnings were stronger than expected and "they didn't miss revenue by a lot." He called the results positive overall and said he didn't see any alarming signs.

Mayer, 37, has been trying to make Yahoo's online services more compelling in hopes that the improvements will encourage Web surfers to visit more frequently and stay for longer. That would help Yahoo sell more advertising to marketers who have been funneling more of their online budgets to Google and Facebook. Mayer also has been trying to recast Yahoo's services so they are better suited for the growing audience consuming content on smartphones and tablet computers.

As part of a makeover under Mayer, Yahoo has redesigned its home page, email service and Flickr photo-sharing service. The company, which is based in Sunnyvale, California, also has made a series of small acquisitions aimed primarily at attracting more engineers with expertise in mobile applications and social networking.

Mayer told analysts that her efforts to infuse Yahoo with more talent and energy are paying off. She said the number of candidates applying for jobs has doubled and the attrition rate has been cut in half from a year ago.

Despite those changes, Yahoo still appears to be falling further behind its biggest rivals in the Internet ad market. Google's ad revenues have been climbing by about 20 percent in recent quarters while Facebook's has been surging by about 40 percent. Google is scheduled to report its first-quarter results Thursday, while Facebook plans to post its numbers on May 1.

Yahoo still has a long way to go just to attain Mayer's goal of matching the growth of the overall Internet ad market. In Yahoo's main market, the U.S., the company's ad revenue this year is expected to increase by about 3 percent, according to the research firm eMarketer. That contrasts with an anticipated 25 percent gain in overall spending on digital ads in the U.S. this year, eMarketer said.

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