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Internet / e-Commerce

Microsoft targets AOL subscribers with \$50M promotion

Reason for Report: *Company Update*

Industry

Highlights:

- In response to AOL's price increase, MSFT announced a \$50mil promotion designed to get users to switch from AOL to MSN. MSFT is the #2 ISP in the US, with 5mil subscribers vs AOL's 23mil. MSFT has always aggressively competed with AOL so today's announcement is nothing new. In the last two quarters however, MSN has begun to gain momentum by adding approximately 1mil new US subscribers in 1Q vs 1.2mil for AOL. As a result, we believe that today's promotion might have a modest impact on AOL's subscriber growth. We have already factored an increase in churn into our AOL subscriber estimate as we anticipated the price increase and a possible promotion from MSFT might have an impact. Therefore, we are not changing our subscriber estimates.
- In the past, investor concerns about MSFT's impact on AOL has negatively impacted AOL stock. Therefore, although it will be several months before we know whether this current promotion is having a significant impact, we do believe MSFT's announcement could have a negative psychological impact on AOL's stock.

AOL Time Warner (AOL, \$53.53, C-1-1-9)

Microsoft (MSFT, \$70.91, C-2-2-9)

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Opinion Key [X-a-b-c]: Investment Risk Rating(X): A - Low, B - Average, C - Above Average, D - High. Appreciation Potential Rating (a: Int. Term - 0-12 mo.; b: Long Term - >1 yr.): 1 - Buy, 2 - Accumulate, 3 - Neutral, 4 - Reduce, 5 - Sell, 6 - No Rating. Income Rating(c): 7 - Same/Higher, 8 - Same/Lower, 9 - No Cash Dividend.

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