

LookSmart Wises Up

Motley Fool

By Tom Taulli

This week, I talked to the founder of a fast-growing comparison shopping site. "Several years ago," he said, "I used LookSmart (Nasdaq: LOOK - News) to get quality traffic to my site. But all I was doing was paying thousands of dollars every month to LookSmart." In October 2004, when David Hills came on board as CEO of LookSmart, he realized he needed to change this quickly. It was a painful process (who wants to give up revenue?), but he knew it was critical.

Now, the company is seeing progress. In the fourth quarter, LookSmart posted revenues of \$10 million, which was a 9% increase from the third quarter. The company expects year-over-year growth in revenue for 2006.

But the company is still losing money, with a fourth-quarter loss of \$0.17 per share or \$3.8 million. This compares with a net loss of \$4.3 million or \$0.19 per share in the third quarter.

The problem with LookSmart's ad network business is the low margins. Here's how it works: The company gets leads from many partners such as InfoSpace (Nasdaq: INSP - News), Motley Fool Rule Breakers pick CNET (Nasdaq: CNET - News), Snap.com, and Lycos. LookSmart then resells the leads to advertisers, although this is done with value-added tools (traffic analysis, keyword management, campaign development, and so on). In effect, the company powers search functionality for major sites and also provides analytical tools to advertisers in order to more effectively manage campaigns. The problem is that the revenue split on such services has traditionally skewed to its partners, thus pulling revenues down.

That's why LookSmart is expanding into two higher-margin revenue streams. First, the company is licensing its sophisticated advertising management software to major publishers, such as Viacom, Ask Jeeves, and New York Times (NYSE: NYT - News). For example, these companies use LookSmart's Furl technology, which allows online users to tag content (such as saving it or sharing with colleagues). Tagging is definitely a hot area in the online world. For example, Yahoo! (Nasdaq: YHOO - News) recently purchased several companies that use tagging, like Flickr and del.icio.us.

Next, LookSmart launched 181 vertical websites. The sites cover 13 categories, such as autos, health, music, money, and travel. The sites are fairly low-cost since they're heavily automated. Another attraction: Advertisers can better target an audience (in terms of gender, age, and interests). At present, these sites are chock-full of content, and the obvious challenge is in developing and delivering on relationships with advertisers.

It's still early for LookSmart's initiatives, and experimentation and mistakes are likely to occur. Yet the company has the wherewithal to pursue its strategies -- with \$51 million in the bank, moderate operating expenses, and a solid technology platform. But most importantly, LookSmart finally has a coherent strategy for growth.

CNET is a Rule Breakers pick.

Fool contributor Tom Taulli does not own shares mentioned in this article.