

What Will Cure Motorola?

3/22/2007 @ 6:00AM

Now what?

Once-mighty Motorola shuffled its management ranks on Wednesday, warned Wall Street that it was in worse shape than expected and tried to appease minority shareholder Carl Icahn with a \$2 billion share buyback.

But none of those moves is going to solve the company's fundamental problem: It can't seem to make enough money on each cellphone it sells. Yes, Ed Zander and other Motorola executives note, the cellphone industry is becoming increasingly competitive. But what business isn't? Meanwhile, other phonemakers have been able to figure out how to thrive in the same climate.

Most notably, Finnish rival Nokia has been able to do what Motorola can't. The world's largest handset-maker has been able to figure out how to sell both cheap phones to emerging markets and high-end gadgets like the N73—a \$430 smartphone that the company says was its biggest profit contributor in the last quarter.

According to Jefferies and Co. analyst Bill Choi, Nokia's wireless division posted 17% operating margins in the last quarter; while Motorola's mobile division had an anemic 4.5%.

"Without fixing your product portfolio, you can't generate higher margins, and you can't generate higher revenue," Choi says. "That's why I think the issue here is going to take a little longer to fix than what most people anticipate."

Wednesday, Motorola warned investors of a surprise first-quarter loss and shook up its management team. The company said it expects to post a first-quarter net loss between 7 cents and 9 cents per share, including one-time charges of roughly 9 cents per share, on sales of between \$9.2 billion and \$9.3 billion. Analysts had expected the company to report earnings of 17 cents a share, excluding one-time items, on sales of \$10.44 billion.

The Schaumburg, Ill.-based company also installed Greg Brown as president and chief operating officer and Thomas J. Meredith as acting chief financial officer. Brown previously ran the company's networks and enterprise business, while Meredith, a Motorola director, previously served as Dell's chief financial officer.

Now the reshuffled executive team must produce some new ideas. But they don't necessarily need to produce a huge hit phone.

Zander has had one of those: The Razr launched more than two years ago for \$500. It started the thin, fashion phone trend and became the world's best-selling cellphone. Motorola's U.S. market share jumped from 28% in January 2005 to 34% this January, while Nokia slipped from 28% to 16% in the same period, according to research firm M:Metrics.

Razr prices inevitably fell—today the phone is often free after carrier subsidies—but Motorola execs thought they had a long line of hits waiting in the wings, such as the Slvr, Pebl and Krzr. But none has taken off, and competitors like Samsung and LG have caught up with similar fashion phones. Meanwhile, Motorola has struggled in its attempt to take on high-end smartphone manufacturers like Research In Motion, which makes BlackBerry devices, and Palm, which sells Treos. And its attempt to sell low-end phones in emerging markets flopped too; competitors cut prices faster, the company said Wednesday.

"I think for a while we proved that at the low end we can compete, it's just that it got expensive," Zander said in a conference call Wednesday evening. "I think market share is great, but sometimes it gets in the way of getting back to basics and that's what we've got to do here."

You don't need a huge hit like the Razr every time to win in wireless, says Forrester Research analyst Charles Golvin: "Look at Nokia. Look at Samsung. They have a wide range of successful products, but I defy anyone to point to an iconic single Nokia or Samsung device that epitomizes the brand in the same way the Razr does for Motorola."

And if Zander, who took over the company in 2004 after holding the No. 2 slot at Sun Microsystems, doesn't turn things around soon, he could go next. "This is probably one of the fastest falls from grace I've ever seen in handsets," says Charter Equity Research principal Edward Snyder. "He's taken a company that was really screaming, and now it's practically on its knees. If things go the way I think they'll go, I think he'll be gone by 2008. The trajectory is not pretty."