TELECOM REPORT

Motorola's wireless woes deeper than expected

Analysis: Sharp deterioration pressures company to consider exit

By Jeffry Bartash, MarketWatch
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WASHINGTON (MarketWatch) - Motorola Inc.'s surprise decision to consider the sale of its wireless-phone division suggests the problems with that business are even worse than the company has acknowledged.

And the news itself, though giving a big lift to Motorola shares on Friday, is likely to put added pressure on the stock after the initial euphoria wears off. The company's first-quarter results are sure to be poor and uncertainty about the division's future could delay its turnaround. See full story

More troubling signs emerged late Friday, after the Wall Street Journal reported on its Web site that Motorola CEO Greg Brown has taken over direct management of the unit, shifting aside division chief Stu Reed.

Ed Snyder, a longtime wireless analyst at Charter Research, said Motorola faces the same issues that Sweden's Ericsson LM faced in 2001, after the company sustained sharp losses and sought outside partners. The move later led to a joint venture with Sony, the Japanese electronics powerhouse.

"Defections from Motorola's Libertyville, IL design center were running high before management put a 'For Sale' sign on the group," Synder told clients Friday. "We expect they'll increase even further as morale and the division's prospects wane."

The mounting difficulties and slowing U.S. economy -- Motorola derives 80% of handset sales from North America -- could make it hard to find a buyer. Nor is it certain that the handset division could survive on its own, especially since executives have been so tight-lipped about Motorola's first-quarter outlook.

"It's baffling," said Tero Kuittinen of Avian Securities. "I can't believe anyone would buy Motorola without visibility in the current quarter."

A joint venture similar to Sony Ericsson might be the best solution, analysts say. Potential partners could include Korean electronics giants Samsung Electronics or rising

Chinese vendor Huawei Technologies. Private-equity buyers could also show interest, analysts say.

Just last week, Motorola executives seemed to brush off the idea of a sale or spinoff during a conference call to discuss their fourth-quarter earnings report. Although Wall Street analysts speculated that Motorola might explore its options, most believed the company would focus primarily on restoring its handset business to profitability.

After all, Motorola has always found a way to resuscitate its flagship wireless unit despite several major slumps over the past decade. What's more, the company's brand name and image have long been associated with handsets. Motorola built the first prototype mobile phone in 1973 and the company helped create the wireless market in the early 1980s.

Yet new Chief Executive Greg Brown, whose two predecessors lost their jobs because of prior stumbles in wireless, evidently realizes that the problems are much deeper this time around. The cutthroat handset market is more competitive than ever and new entrants such as Apple Inc. have only exacerbated matters.

Additional steep losses in the handset business could undermine the company's two other major divisions -- the so-called "batwings" of Motorola -- and saddle investors with a dramatically underperforming stock.

Last year, the handset division suffered a $1.2 billion operating loss, a dramatic reversal from operating profit of $2.7 billion in 2006. The loss effectively erased the gains from Motorola's most profitable unit, the enterprise mobility division. The company reported a net loss of $49 million in 2007.

There's no quick fix, either. Motorola has made little progress in high-growth Asian countries such as India and China and the company is virtually AWOL in Europe in the high-end handset market. What's worse, Motorola clung too long to the aging Razr platform of wireless phones, and the vendor is unlikely to roll its next big wave of handsets until late 2008 at the earliest.

Its tardiness in developing new models threatens to further erode Motorola's falling market share and raises the possibility that the company will never recover its preeminence. Motorola has fallen to third place in global market share of wireless phones and could even slip into fourth before the end of 2008.

Motorola's other businesses

By themselves, Motorola's batwing divisions are more stable and generate steady profits. The company's fast-growing enterprise-mobility unit, for example, reported a 43% increase in 2007 sales to $7.7 billion, with operating income of $1.2 billion. The division, long a Motorola cash cow, provides an array of public-safety services and equipment to governments around the world.

The home and networks unit, though growing less quickly, totaled $709 million in operating income on $10 billion in annual sales. That unit makes broadband modems, settop boxes for pay-TV operators and other entertainment-related products.
Those two units are forecast to deliver a combined $18 billion-plus in sales in 2008. By contrast, handset sales are expected to plunge to $16 billion or less from $28.4 billion two years earlier.

As a result, wireless devices could account for less than 47% of Motorola's sales in the current fiscal year compared to two-thirds of revenue in 2006.
"I don't see them being able to turn its handset business around with the current management structure," said longtime Motorola watcher Jane Zweig, president of the wireless consultancy Shosteck Group. "I think Motorola is going to end up as a public-safety company."

If Motorola does, it won't be the first time the 80-year-old company has made a dramatic exit from a business it once dominated. Decades ago the company was a major manufacturer of car radios -- hence its name -- and it was also a pioneer in the television business until the Japanese took it over. ■

Jeffry Bartash is a reporter for MarketWatch in Washington.