

Calling The Bottom For Motorola

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As “leaked” images of a slick Motorola phone running Google’s Android mobile platform blazed through the Internet on Wednesday, Motorola seemed, once again, like an innovative, nimble company.

The problem? Though the images popped up on a respected blog, Boy Genius Report, it’s not clear whether the phone really exists. Analysts, including Matt Thornton of Avian Securities, are skeptical. “The timing doesn’t make sense,” he says. “Those images have been floating around for awhile,” he adds.

What’s clear is that Motorola Android phones are coming. Thornton’s own sources tell him that Motorola is preparing between two and five Android-powered devices for release at two large, North American carriers—possibly T-Mobile and AT&T—before the end of the year. The inclusion of AT&T is notable because of the carrier’s size and the fact that it has repeatedly expressed skepticism about Android’s prospects.

Answers may arrive Thursday morning when Motorola holds its first-quarter earnings call. Most analysts expect a loss of 11 cents per share on revenues of \$5.55 billion. A year ago, the company reported a loss of 5 cents per share on revenues of \$7.45 billion. Amid those grim results, talk of cool Android phones would likely be welcome.

Competitors including Samsung, LG, Research In Motion and Apple have already posted results that indicate they stole share from Motorola. Analysts are now wondering whether Motorola remains the world’s fifth-largest handset maker.

Disastrous first-quarter results from rival Sony Ericsson mean Motorola could move up a position to No. 4, despite its continued weakness. Most analysts believe Motorola shipped between 14.5 million and 15 million handsets, compared with 14.5 million for Sony Ericsson.

Company watchers aren’t expecting an uptick in handset sales until the end of the year when Moto’s Android phones hit the market. (The company’s handset unit is not expected to break-even until 2010.) Motorola did debut a catchy, touchscreen phone called the Evoke in March. But without pickup from the large “tier one” carriers, the phone will have a limited effect on the company’s bottom line.

Chatter about Motorola’s plan to spin off its handset unit is escalating as the economy worsens. Analysts expect the company to address the issue on Thursday, but reiterate that it has no immediate plans to separate the unit.

In past quarters, Motorola’s other divisions—Home & Networks Mobility and Enterprise Mobility Solutions—compensated for losses in its handset unit. But analysts believe the economic downturn is now weighing down these businesses too.

“The enterprise unit is heavily focused on corporations and retail, so you know it will struggle,” Thornton says. The other unit, which caters mostly to government and public safety organizations, may also be pressured by state and local budget cuts, he adds.

Motorola has a relatively healthy business in network infrastructure. But operators have been putting their build-out plans on pause. (One bright spot: China’s booming mobile market. Motorola recently announced a major contract with China Unicom.)

Even Motorola’s set-top box operation is expected to take a hit as fewer consumers sign up for pricey cable plans. “There will be weakness all around,” says Edward Snyder, a principal at Charter Equity Research. “It won’t be a pretty quarter.”

These challenges will have analysts listening for reassurance that Motorola is managing its cash. After losing about \$1.2 billion between the end of 2007 and the end of 2008, the company has \$7.4 billion on hand.

None of this is news to Motorola. The company has been slashing costs for months, including several rounds of layoffs since it reported its 2008 earnings in February. Thornton says the company may even be ahead of schedule in its bid to squeeze operating expenses.

Another hidden upside? As the company's low-margin handset business shrinks, it may also report some gross margin improvement. Thornton, in fact, called this quarter "the bottom for Motorola's earnings" in a research note Tuesday.

Mark McKechnie of Broadpoint AmTech was similarly optimistic in a recent report. "Business has likely improved since [the] December report," he wrote Wednesday, adding, "There should be greater savings in [the second half of 2009] than in [the first half]."

Analysts say they continue to believe co-Chief Executive Sanjay Jha is the right man for the job despite Motorola's gloomy short-term outlook and recent debates about his compensation. Jha is viewed as the architect of Motorola's Android strategy, having praised the platform's buzz factor, developer interest and low price.

Under his direction, Motorola has said it will focus 40% of its resources on smart phones going forward and target consumers in North America, China and Latin America. "He is a good addition," Snyder says. "I think he understands the severity of the problems."

Investors know that this quarter will be dismal, Thornton says. What they want to hear, he adds, is that things will get better—and that Android phones are on the way.