The Sunday Brief: Can Motorola Save Google?
22 July 2012

Greetings from Dallas and Austin, where last summer's triple digit temperatures are returning. Speaking of heat, there was plenty of it this week in the telecommunications world. From the Suddenlink ownership change, to Cogeco's $1.36 billion acquisition of Atlantic Broadband, to WOW's closure of the Knology acquisition, to Sprint's first LTE markets launch, to Alcatel's earnings warning and Nokia's earnings reality, it was a very busy news week in telecom.

On Thursday, however, three of the titans in the telecom and Internet arena announced earnings: Verizon, Google, and Microsoft. This week, we'll focus on Verizon and Google, given Google's Morotola dependence on Verizon for US revenues. Next week, we'll weave in findings about Microsoft with Facebook and AT&T earnings (although, if you want a 30-second read, try Barb Darrow's piece over at GigaOM).

Also, I am going to be doing two in-depth pieces on small cells and cloud computing in August (with a focus on the smaller companies who are innovating in the space), so if you have any specific questions or topics you would like see addressed, you know where to send them.

Verizon announced earnngs on Thursday, and their message was about growth and cash flow. All of the headline statistics (except wireline profitability) were in line or better than expectations:

- 880,000 post-paid retail net adds which were helped by 0.84% postpaid churn
- 2.5 million iPhone shipments; 2.7 million Android shipments, of which 2.3 million were 4G
- 11 million or 12% of the total retail postpaid connections are on 4G devices (all Android)
- 49.3% cash flow (EBITDA) margin in wireless
- 50% of retail post-paid customer base are on smartphones (73% of phone sales)
- Verizon Wireless' net debt = $2.4 billion ($10.8 billion gross debt less $8.4 billion in cash)

The most important statement, however, came from CFO Fran Shammo early on the earnings conference call:

> To put this in perspective, while consolidated revenue increased $310 million sequentially, operating income is up over $450 million. This clearly demonstrates that our product rationalization, cost management, and process improvement efforts are starting to payoff. We continue to be very focused on improving profitability, moving more of every dollar we generate to the bottom line.

Simply put, scale matters and Verizon is playing the scale of their 94.2 million retail connections to their advantage. They are translating this advantage into cash generation, which is feeding the continued growth of the LTE network expansion as well as a myriad of product rationalization initiatives. Speaking of product, Verizon revealed the following about the Enterprise/ wireline business:

> We currently have more than 700 different products and thousands of variations that are defined by particular geography, network or system. This portfolio simplification effort will dramatically improve our go-to-market speed and operations quality. In the near-term,

> these actions create revenue impacts. Over time however, the actions will result in margin benefits and improved profitability.

Scale also can yield complexity, and the above statement shows that untangling these products (imagine the effect on customer service alone!) will yield massive savings while improving the customer experience. (It reminds me of the days of long-distance when Sprint, MCI, and AT&T had state-based plans).

As mentioned above (and in last week's column), Verizon continued to emphasize the effects of customer migration to their LTE network. From a cost perspective alone (estimating the variable cost of 1GB of LTE to be in the $2.50-4.50 range compared to nearly double that for EVDO services), Verizon needs a continued line of products and services coupled with new pricing plans that drive up satisfaction and drive down churn.

Enter Motorola, a subsidiary of Google who now has the backing of $44 billion in cash and marketable securities and is generating $16-20 billion in operating cash flow per year. Can Motorola solve additional problems for Verizon, and, in the process generate more value for Google than they ever imagined? The short answer is yes, but it's going to take some cultural changes at Moto and Google to maximize the value.

(To live up to the Sunday Brief's name, we are not going to focus on Google's earnings in this edition, but an excellent summary can be found here. From the analysts' perspective, metrics were good, and their foreign currency exposure was minimized this quarter through effective hedging).

Imagine an unfettered Motorola walking in to Verizon Wireless with plans to address:

a) 4G-only tablet and Machine-2-Machine solutions for both Enterprises and Consumers;
b) Bloatware-free smartphones that leverage Google's and Verizon's network/cloud capabilities (improving the customer experience dramatically through better battery life and faster applications response);
c) Content solutions for both home and mobile that (finally) integrate YouTube and High Definition (again, using an intelligent network that knows how much bandwidth FiOS can deliver and optimizing the stream automatically, including caching, to deliver favorite YouTube channels);
d) An alternative to Apple's Facetime that is ad-free and Verizon-branded;
e) In-home solutions that offload the network on to Wi-Fi;
f) Third-party paid data application solutions (e.g., "Toll Free Search" or "Free Fridays for YouTube")

All of this delivered as integrated solutions in 2013 to improve Verizon's profitability. No wonder Blackberry/ RIM, Nokia, Ericsson and Alcatel Lucent are getting the shakes – Motorola's post-RAZR wandering in the desert has ended, and they have entered into the Promised Land, filled with engineering talent ("milk") and plenty of cash ("honey").

Best of all, Motorola/ Google and Verizon share many of the same goals: a) improve the data and application experiences while keeping them affordable; b) make the interaction between devices (set-top box to tablet; smartphone to tablet, etc.) intuitive; and c) reduce Apple's influence on their respective businesses (including the upcoming subsidy hit Verizon faces with the "rumored" launch of the next generation iPhone in 4Q – Fran Shammo referred to this on the Verizon earnings call).

Certainly, there will be any areas of disagreement (Isis vs. Google Wallet having the largest ramifications to both parties), but if Motorola and Verizon can pull off a successful sequel to the establishment of the Droid franchise, Motorola will actually improve Google's relevance with their largest Android customer. It may not have the same impact as the Apple + AT&T partnership that started in 2007, but there are many problems to solve and common motivations.

Next week, it's earnings and operations analysis for AT&T, Facebook, and Apple with some more commentary on Microsoft. Until then, if you have a friend who would enjoy getting this brief, please send an email to sundaybrief@gmail.com and we'll get them on the list. Thanks for your help, continued readership and comments!

Jim Patterson
Patterson Advisory Group
816.210.0296 mobile
Jim@pattersonadvice.com
Twitter: @Pattersonadvice