# Which Motorola is the better investment?

By Dan Gallagher

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SAN FRANCISCO (MarketWatch) — As Motorola Inc. prepares to be split in two within the next few weeks, investors will be faced with a classic choice of risk versus reward.

Simply put, the separation of Motorola's MSI, -1.18% wireless handset business from its public-safety unit creates a choice between a cash-rich, but slow-growth government contracting business and a cutting-edge wireless device maker that has seen a remarkable turnaround over the last year but still faces significant hurdles in the brutally competitive smartphone market.

Company officials — and many analysts — believe the split will help both businesses unlock more value, given that the two businesses have few efficiencies they can share.

But the move could also cut the handset business off from the cash-flow generated by its more stable sibling, which has been key to its revival. For the public-safety business, the split may remove a catalyst that has helped the stock surge more than 35% over the past six months, as the company's Droid line of smartphones have become a key rival to the mega-popular iPhone from Apple Inc. AAPL, -0.64%

"The handset business is going to be more speculative, with more wild swings," Ed Snyder of Charter Equities Research said in an interview. "That will be a riskier, but potentially more rewarding business."

**Motorola Mobility's fuzzy reception**

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On its first trading day, Motorola Mobility disappoints, trading down 9%. The company will face many challenges to its smartphone business.

The split is set to take effect on Jan. 4. On that date, the handset business will begin trading under the name Motorola Mobility Inc., with the ticker MMI on the New York Stock Exchange. This business will also include the company's cable set-top box unit. Sanjay Jha will be chief executive officer of this unit.

The remaining part of the company, which sells radios and other public-safety equipment, as well as networking gear, will trade under the name Motorola Solutions, with the ticker MSI and Greg Brown as CEO.

Motorola shareholders will receive 1 share of Mobility for every 8 Motorola shares currently held. The main company stock will transition to the Solutions business.

How the market will react is still an open question. Both MMI and MSI began trading on a "when issued" basis on Friday, though official trades will not begin until Jan. 4.

Motorola Mobility closed trading Tuesday up 8.4% to $27.74 — back to the level it opened at on Friday. The stock got a late-day bounce after The Wall Street Journal quoted a Verizon VZ, +0.20% executive as saying that the carrier plans to distribute a Motorola handset for its 4G wireless network next year.

Motorola Solutions's shares were down 1% Tuesday to $39.25 — also on par with its opening price from Friday.

#### Unlocking value

The conventional wisdom heading into the split is that both companies are worth more apart than together.

"There are not a lot of synergies between the two businesses," said Matt Thornton of Avian Securities in an interview, noting that the cash generated from the Solutions side of the business has been needed to fund the handset business while it restructures. Handsets finally turned profitable on a non-GAAP basis in the most-recent quarter.

"Solutions couldn't re-invest in its own business, because it's been propping up handsets," Thornton said.

According to materials presented at investor road shows earlier this month, the Mobility business had about $8 billion in total revenue for the first nine months of this year, down slightly from $8.2 billion in the same period the previous year.

Cash flow has improved greatly, with Mobility generating about $381 million in operating cash flow for the first nine months of this year, compared to more than $1.3 billion in negative cash flow last year. Still, the business generated an operating loss of $72 million on a non-GAAP basis in the first nine months of this year.

The Solutions business saw total revenue of $5.6 billion in the first nine months of this year, compared to $5.2 billion in the same period last year. Operating earnings on a non-GAAP basis were $851 million for the first nine months of 2009 — up 17% from last year.

Snyder of Charter Equities says while the Solutions business is a far better generator of cash, it is also saddled with about $1.9 billion in pension obligations and $2.9 billion in debt carried over from the old company, which may limit some of its options.

"Although the company plans to compete 'surgically' for high-growth services business, the bulk of its revenue will still come from public-safety communications and enterprise handheld computing," he wrote in a note to clients last month.

#### Size matters in handsets

For Motorola Mobility, several analysts say the key for the company will be getting big enough, quick enough to survive the brutally competitive smartphone market against larger rivals, such as Apple, Research in Motion RIMM and Nokia NOK, -0.48% .

Apple in particular is a looming threat, as the company is widely expected to expand its iPhone into Verizon in early 2011.

Verizon has been a key customer for Motorola, backing the company's first phones built for the Android operating system from Google Inc. GOOG, -0.40% . This has turned devices such as the Droid and Droid X into top-sellers and the carrier into a key player in Motorola's turnaround.

Motorola has expanded significantly since then, launching a total of 23 Android products with additional carriers, including AT&T T, -0.03% . The company is also expected to announce its first tablet device at the Consumer Electronics Show in Las Vegas in early January.

Pierre Ferragu of Bernstein Research believes that Motorola Mobility will be challenged by its smaller size compared to its peers. It's smaller global market share means the company has "limited R&D firepower" to expand its product base, he wrote in a Nov. 30 report.

"Also, a lower overall scale means that the company can only spread its R&D cost over a smaller base of handsets, resulting in a relatively poor operating-expense ratio when compared to other large-scale competitors (Nokia, Samsung) operating in the same mass-market 'value-brand' segment," he said.

Snyder of Charter Equity points to the example of Palm earlier this year, which had developed a well-regarded mobile operating system and new devices, but was unable to compete effectively against much bigger companies in the space.

"There is no good proxy for a company of this size to last in handsets," Snyder said. "Sanjay Jha [CEO of the Mobility business] has done a very good job. It's not a lack of competence or effort. It's just mass."

Matt Thornton of Avian Securities believes the market value of the Solutions business will likely remain stable — unless another company expresses buy-out interest. Mobility, he believes, is where the upside may come from the current combined valuation.

"There is a big difference between Motorola and Palm. Motorola has a very well known brand and a lot of carrier partners," he said. "The bigger picture here is that pure-play companies tend to execute better."

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