

Research in Motion Limited (BBRY) Memo

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Year: 2014

Important Company Financial Data

- Price: 14.33
- P/E (ttm): N/A
- EPS: -1.23
- Beta: 1.59
- Market Cap: 7.38B
- Debt: 0
- Cash: 2.65B
- Short Interest: ~32%



Thesis / Key Points

- Despite significant time and effort devoted to the Blackberry 10 (BB10) operating system, reviews have been mixed about both the operating system and its flagship phone (the Z10).
 - Blackberry 10: overall, reviews for BB10 have been mixed, but generally positive
 - However, I view this as disappointing given the amount of time, effort, and importance that BBRY placed on its new operating system.
 - BB10 does not appear to reach the high level of quality that both the iOS and Android platforms reach.
 - Some common complaints about BB10 include the following:
 - Low ability to customize the user experience
 - Lack of pop-up notifications
 - All user actions are gesture-based, which (according to reviews) is difficult to become accustomed to initially
 - The OS is further hurt by a lack of apps compared to other popular operating systems
 - Google Play (the Android app store) and Apple's App Store each have more than 700,000 apps available to download.
 - In contrast, BB10 launched with only about 7,000 apps available for customers and is now up to around 80,000 native apps.
 - In addition, Blackberry's App World also has the ability to port some applications directly from Android (currently about 20,000 Android apps are capable of running on Blackberry systems).
 - While these ported apps provide customers with a way to use services that are not yet natively supported on BB10 (most notably, Netflix and Instagram), they do not fully take advantage of BB10's features.
 - Neither Netflix nor Instagram have even announced plans to develop official Blackberry versions of their apps.
 - Similar to the BB10 OS, reviews for the OS's flagship phone, the Z10 have also been mixed but generally positive.
 - The theme among most reviews is that the Blackberry Z10 is a solid phone, but not an extraordinary device.
 - In my opinion, Blackberry needed to create an extraordinary device in order to attempt to recapture some of the market share it has lost over the past few years.
 - The Z10 is very similar in appearance to the iPhone 5 and does not have a physical keyboard.
 - I think that the decision to make the first flagship BB10 phone a device that lacks a physical keyboard was an error in judgment by Blackberry. Many loyal customers had waited a long time for the new BBRY device and many of these customers have been loyal to the company primarily because of its continued use of the physical keyboard.
 - The Z10 also faces very strong competition. In the US, it retails for about \$200.
 - This price places the phone in direct competition with devices such as the iPhone 5 and Galaxy SIII, both of which, according to reviews, are significantly better devices than the Z10.
 - BBRY is planning to launch another BB10 device, the Q10 – a smartphone with a physical keyboard
 - The Q10 will more closely resemble the "traditional" Blackberry phone.
 - However, while the Q10 will be attractive to BBRY's enterprise customers who will be looking to upgrade their handsets, I think the phone will struggle to compete in the mainstream market, where BBRY must gain market share to ensure a viable future for the company.
 - The Q10 will also face intense competition for mainstream customers.
 - The phone will be released around the time the new iPhone is released, meaning that the Q10 will have to compete with either the iPhone 5 and the Galaxy SIII (the S IV is being released in the coming months) or the Galaxy SIV and the next-generation iPhone, depending on its price point (\$249 in Canada with a 3-year contract).
- Blackberry is seeing its subscriber base deteriorate and is losing many key corporate/institutional clients.

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- BBRY's subscriber base declined by 3 million from 79 million to 76 million during the last quarter.
- Another major issue for BBRY is the fact that the company is beginning to lose many of its government clients.
 - The New Zealand Police force chose iOS devices for its next mobile devices contract. The police force chose iPhones and iPads based on frontline office feedback during a nearly year-long trial period.
 - The Department of Defense has ended its exclusivity agreement with Blackberry and has opened its mobile communication contracts to several device makers, including BBRY, Apple, and Google.
 - Losing its position as the DoD's primary supplier of mobile devices would be a huge blow to BBRY.
 - The US Immigration and Customs Enforcement (ICE) agency ended its 8-year partnership with BBRY and purchased iPhones for its personnel. ICE ended the partnership because it felt that BBRY "can no longer meet the mobile technology needs of the agency."
 - The National Transportation Safety Board (NTSB) also moved from Blackberry devices to iPhones. The NTSB stated that BBRY devices "have been failing both at inopportune times and at an unacceptable rate."
 - Other government agencies to switch from Blackberry's devices to Apple's include the Bureau of Alcohol, Tobacco, Firearms, and Explosives, the National Oceanic and Atmospheric Administration, and the TSA.
- Corporate clients who have left Blackberry include Yahoo and Booz Allen.
- Despite recent positive investor sentiment, BBRY's sales are trending downward
 - Sales are down about 60% over the last two years.
 - In the last quarter, sales of legacy BB7 products (still used by most enterprise clients) were down 1 million.
 - Despite investors being pleased about BBRY's ability to generate a profit in the previous quarter, the company actually sold 2.9 million fewer devices than was expected.

Misperception

- Since hitting a low price of \$6.31 on Sep. 24, 2012, BBRY's price has increased more than 120%. Investors were further excited by BBRY reporting positive net income in the previous quarter, when a loss was expected.
 - I believe that many investors are now more positive on the stock and expect another positive quarter; however, the short interest is also high, indicating that opinions on BBRY are very mixed.
- Based on research, it appears that many people expect the impending release of the Blackberry Q10 to help the company stem the loss of government and corporate clients to Apple, Google (Android), and Windows Phone (Nokia). The general sentiment seems to be that these new devices will help Blackberry reclaim its position as the third largest mobile phone provider.
 - However, I do not think the Q10 will be attractive enough to keep large clients from switching to more popular devices that are now as secure as Blackberry (a previous reason that many companies chose BBRY products).
 - Further, the International Data Corporation (IDC) forecasts that in 2016, Blackberry will hold only 4.1% market share (based on phone OS), compared to 63.8% for Android, 19.1% for iOS, and 11.4% for Windows Phone (WP).

VAR

- Please see Exhibit 1: VAR

How It Plays Out

- I believe that MII should initiate a short position after BBRY's next quarterly earnings report. I believe that the company may again surprise investors, leading to a short-term price increase. This increase could also result in a short squeeze, further driving up the price. I believe that MII should enter after both of these potential events occur.
- In the long-term, I believe that BBRY will be unable to grow its market share and will continue losing the institutional clients that drove the company's original growth.

Risks / What Signs Would Indicate We Are Wrong?

- Large corporate orders for the Q10 would indicate that larger institutions are satisfied with BB10 and the new device and may signal future success for the company.
- If enterprise-level security issues are exposed in iOS, Android, or WP, large clients may move back to BBRY.
- Growth in emerging markets, particularly Indonesia:
 - BBRY's devices are very popular in some rapidly growing markets, such as Indonesia; this growth may be able to propel the company forward if it is able to retain customers in these markets.
- BBRY has indicated that a new flagship BB10 phone will likely be released in time for the holiday season; if this phone is exceptional and is able to generate strong sales, it will have a positive impact on the company.

Signposts / Follow-Up

- Smartphone market share
- Sales of BB10 devices vs. BB7 devices
- Profit margins on the Q10
 - Margins on the Z10 are significantly higher than other phones, such as Nokia's Windows Phone devices
 - If the Q10 has similar margins, even moderate sales growth could significantly help the company
- Reviews of new BB10 devices
- Reviews and sales figure for a potential BB10-based tablet

Company Description

BBRY is a Canadian company that designs, manufactures, and markets mobile devices and services around the world. Its most popular products and services include the Blackberry line of mobile phones, the Playbook tablets, and BBM instant messaging service. The company also provides enterprise service software, which led to its position as the most widely-used corporate mobile solutions provider. Originally known as Research in Motion, the company changed its name Blackberry in January, reflecting its focus on the new BB10 OS and BB10-based products.

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Exhibit 1: VAR

- VAR Contacts included the following individuals:
 - o Salvador Rodriguez, Technology writer at the LA Times
 - o Devindra Hardawar, National Editor, Mobile Lead at VentureBeat
 - o Sal Barrese, VP of Technical Services – IT at Affinion Group (in charge of technology purchasing decisions)
- Salvador Rodriguez and Devindra Hardawar
 - o *Do you think the Z10 poses a real threat to the iPhone 5, Galazy SIII, or other similar phones? Do you think consumers view the Z10 as a viable alternative to these more popular phones?*
 - SR: No and no.
 - DH: No the Z10 doesn't pose a threat. It doesn't do anything better than the iPhone or popular Android phones, its apps and OS are still pretty half-baked, and it's simply not "cool."
 - o *Do you think Blackberry erred launching BB10 with the release of the Z10, a phone without a physical keyboard, before launching a phone with a physical keyboard? Do you think this will alienate some people who were waiting for BB10 to be released and have been loyal to the company primarily for the keyboard?*
 - SR: I think that was an error, but they have made much bigger errors than that one. It will alienate other users who have been waiting a long time to get devices that are up to today's standards but also have a physical keyboard.
 - DH: Honestly BB's problem wasn't launching a touchscreen phone first -- it was taking so long after the iPhone to come back with a legitimate competitor. Had the Z10 been released a few years ago it might have stood a chance. Today, it's dead in the water. I figure BlackBerry faithful are annoyed that the touchscreen BB10 phone was released first, but at this point they're used to waiting.
 - o *How do you feel about the prospects of the upcoming Q10? Do you think it will struggle to compete in the market, with the iPhone 5 and GSIII being discounted after the introduction of new models and the potential introduction of cheaper iPhones?*
 - SR: The Q10 should do good among loyal BB fans, but it probably won't dent the market share of the iPhone 5 or GS3.
 - DH: The Q10 has a good shot at being the go-to device for enterprises to upgrade their current BB handsets. I have a feeling it'll fair much better than the Z10, since it actually offers something legitimately better than other modern smartphones (a good hardware keyboard).
 - o *Do you see Blackberry continuing to lose institutional/corporate clients, both to Apple and to Nokia, whose adoption of Windows Phone may enable easier mobile work access?*
 - SR: Yes to Apple. Maybe to Nokia, but that's a pretty small fish.
 - DH: With the Q10, BB will likely stop losing corporate clients so consistently, but I still expect its numbers to continue to fall over the next few years. As iPhone, Android, and Windows Phone become more prevalent with consumers, IT departments will have no choice but to support them, which gives them less of a reason to continue distributing BlackBerries
- Sal Barrese
 - o *Why do you choose to use Blackberry for your organization?*
 - Blackberry was originally chosen for the ability to provide safe, secure, and reliable delivery of EMAIL and phone services.
 - o *When looking to upgrade mobile devices, will you consider the new BB10 devices? Or will you look outside of the Blackberry family at other options such as the iPhone or Nokia's Windows Phone?*
 - As technology progresses, the evaluation of alternative mobile devices continues to be evaluated on its capabilities to provide the same functionality as above. Since we presently have a substantial base of Blackberry devices, it would be a natural progression to include the BB10 in future considerations.
 - o *Do Blackberry's struggles over the last year concern you about their ability to provide reliable service over the long-term?*
 - Yes.

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Exhibit 2: Market Share Projections

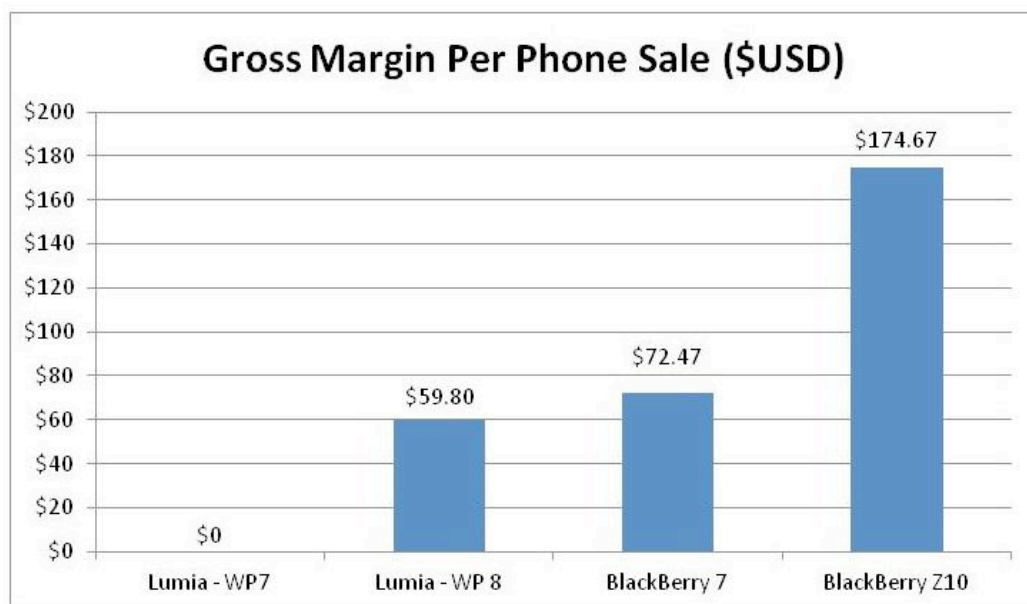
Top Smartphone Operating Systems, Forecast Market Share and CAGR, 2012–2016

Smartphone OS	2012 Market Share	2016 Market Share	CAGR 2012 - 2016 (%)
Android	68.3%	63.8%	16.3%
iOS	18.8%	19.1%	18.8%
BlackBerry OS	4.7%	4.1%	14.6%
Windows Phone	2.6%	11.4%	71.3%
Linux	2.0%	1.5%	10.5%
Others	3.6%	0.1%	-100.0%
Total	100.0%	100.0%	18.3%

Source: IDC Worldwide Mobile Phone Tracker, December 3, 2012

As referenced in the memo, this IDC forecast indicates that BBRY will lose its third-place position to Windows Phone (made primarily by Nokia) over the next few years in the global smartphone market. This forecast indicates that by 2016, Windows Phone will have almost triple the market share of BBRY.

Exhibit 3: High Margins on BB Z10 vs. Windows Phone devices



Source: Seeking Alpha

While this chart shows numbers that include both gross hardware margins and gross service margins for BBRY devices, the estimated gross service margin per phone is only \$20.66. The gross hardware margin for the Blackberry Z10 are \$154.01, which is still more than 2.5x the gross hardware margin for Nokia's Windows Phone 8 device.

** It will be important to monitor if the Q10 has similar margins to the Blackberry Z10 or is more similar to BB7 devices, which it will more closely resemble.

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Exhibit 3: Device Comparison

Spec	Samsung Galaxy S4	Apple iPhone 5	HTC One	BlackBerry Z10
Operating system*	Android 4.2.2	iOS 6	Android 4.1	BB10
Dimensions	5.38 x 2.71 x 0.31 inch; 4.6 ounces	4.87 x 2.31 x 0.30 inch; 3.95 ounces	5.41 x 2.69 x 0.37 inch; 5.04 ounces	5.12 x 2.58 x 0.35 inch; 4.78 ounces
Display	5-inch full HD Super AMOLED; 1,920x1,080 pixels, 441ppi	4-inch IPS LCD; 1,136x640 pixels, 326ppi	4.7-inch LCD; 1,920x1,080 pixels, 468ppi	4.2-inch LCD; 1,280x768 pixels, 355ppi
4G LTE	Yes	Yes	Yes	Yes
NFC	Yes	No	Yes	Yes
Rear camera and recording	13-megapixel, 1080p HD video	8-megapixel, 1080p HD video	4-megapixel (Ultrapixel), 1080p HD video	8-megapixel, 1080p HD video
Front-facing camera	2-megapixel	1.2-megapixel	2.1-megapixel	2-megapixel
Processor	1.9GHz, quad-core Snapdragon 600; or proprietary 1.6GHz octa-core Exynos 5 Octa	Proprietary A6	1.7GHz, quad-core Snapdragon 600	1.5GHz, dual-core Snapdragon S4 Plus
Capacity	16GB, 32GB, 64GB	16GB, 32GB, 64GB	32GB, 64GB	16GB
Expandable memory	Up to 64GB	No	No	Up to 64GB
Battery	2,600mAh	Not disclosed by Apple	2,300mAh	1,800mAh
Price	TBA	\$199.99, \$299.99, \$399.99	U.S. pricing TBA	\$199 on Verizon
Carriers	AT&T, Cricket, Sprint, T-Mobile, U.S. Cellular, Verizon	AT&T, Cricket, Sprint, Verizon	AT&T, Sprint, T-Mobile	AT&T, T-Mobile, Verizon
Available colors	Black, white	Black, white	Silver	Black, white (Verizon only)

Credit: Lynn La/CNET
At time of introduction*

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Ideas for the Club

- I like many of the ideas we discussed and implemented during this semester, such as office hours.
 - o I think that office hours were a great idea, but I think that we need to be more pro-active about advertising this during the week. Often times, we would wait after the meeting and there would only be a few people who remained to talk with us. I think that more people would be interested but are either unaware of office hours or unsure of its true purpose (office hours suggests that members should have a question to ask). To address this issue, we could explain in the first few emails each semester that office hours are just a time to have conversations with managers and that we can also answer any questions that members may have.
- I also like the new membership training initiative that we plan to implement in the fall semester.
 - o I think that the 4-week program will go a long way in further improving the quality of member pitches and will also be beneficial to our new members.
- I think that we need to continue working on expanding managers' accessibility and create even more opportunities for interaction among all levels of MII members.
 - o I also think that we should look to interact more with other investment-related organizations through social events or jointly-hosted events.
 - I think that interacting more with other organizations would help further our reach and image.
 - o For example, we hosted an MII-AIF basketball game last year, but did not have such an event this year. I believe these events are a great way for members of the club to interact and get to know each other.
- I have been working on an online portfolio that would allow us to track all of the positions in real time and am planning to continue working on this task.
 - o I am having difficulty finding an accurate portfolio management tool, but have a few more options with which I will try working.
- In addition to the training program we are planning to implement, I think we could also hold 1-2 sessions throughout the year for students that are interested in learning more advanced skills, such as financial modeling.
 - o This would be beneficial to first and second-year students because it would help them learn an important skill that they will be able to use if they choose to pursue a career in finance, and could potentially give them a head start if they choose to go to McIntire. For non-commerce students, this would be a great way to learn a skill they may not otherwise learn in a classroom setting. In addition, this would also provide another method of evaluating companies for MII, if these models were incorporated into pitches.
- Lastly, I really liked that we made a conscious effort to recognize Associates for their efforts throughout the year. I think that we could take this a step further, in one of a few ways:
 - o If the budget permits, I think that having an Associate dinner would be a nice way to recognize and reward the Associates for their work.
 - o I also think that we could implement an award (Star Associate) to recognize the Associate who produces the highest-quality work during the semester.