

Research in Motion Limited (NASDAQ: BBRY)

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Important Company Financial Data (from April 21 st , 2013)			
Price: \$13.84	ROE: (6.42%)	Cash: 1.549B	Debt/Equity: 0
P/E: N/A	ROA: (3.16%)	Market Cap: 7.13B	Profit Margin: 3.69%
EPS: (1.23)	Beta: 1.59	52 Week: 6.22 – 18.32	Shares as short: 30.22%

Thesis

➤ My original investment was to short BBRY due to its inability to regain smartphone market share, flop of its new operating system due to a lack of promotion, and a greater dependency on hardware sales. However, my bearish convictions have been partially offset by new research showing that BlackBerry can become a *profitable* company just as a niche player. This fallen angel will not rise to the likes of Apple or Google, but it does not have to. The next earnings report will be arguably be the most important one in BBRY's history, which would indicate if BBRY is a long term short or not.

Key Points

➤ BlackBerry has been **very slow to adapt** to the growth of smartphones where a combination of **decreasing sales** and its phones with **lower gross margins** have been detrimental

- Google and Apple have 90.1% of the smartphone market in the US while BBRY has 5.9%
- Subscribers fell to 76 million by 3 million last quarter, which is attributed to declines in Europe, Middle East, and Africa
- **MISPERCEPTION:** For this last fiscal year, US sales only accounted for 20.2%. Its success in the US is not too critical.
- **CORRECTION:** Despite a decrease in US revenue from 39.3% 3 years ago, revenue has decreased elsewhere at a slower rate. The absolute decrease in revenue with the greatest change in the US gives off the false idea that US sales are less important; ultimately **the pie as a whole has shrunk altogether with disproportionate geographic shrinking.**
- For the global smartphone market, Google and Apple have 87.8% of operating systems. Gartner has predicted through 2016, **BBRY will achieve less than 5% worldwide**
- Revenue decrease of 39.% from last year with a loss of 646 million in net income for this year

➤ The success of BlackBerry relies on its revenue from hardware, which is dependent upon its new phones (see **Exhibit 1**)

- Z10 phone release a few months ago in Europe/Canada and a month ago in the US while the Q10 phone will be released later in the spring. The Z10 is a touchscreen while the Q10 has the classic keyboard, both are high end phones.
- Service fees have been decreasing, expected to decrease in a single-digit percentage next quarter. Service fees have been declining as the carriers can demand lower fees as BBRY's command of the market has fallen.
- **MISPERCEPTION:** Service revenue increased from 22.1% to 34.9% in one year
- **CORRECTION:** Service revenue as a percentage increased only because **revenue from hardware fell 51.85%**
- So it is clear that the future of BBRY depends on the revenue from its hardware, which in turn is dependent on the success of its new phones.

➤ Despite being well reviewed, the new Z10 phone with its BB10 operating system is not well exposed and interest has not been extremely high

- Many analysts have reviewed the launch as very slow (see **Exhibit 2**)
- After asking 75 people, an **overwhelming 80%** has never even heard of the new Z10 phone (see **VAR 1**)
- In addition, Michael Genovese from MKM Partners surveyed 1,500 customers. 51% owned a smartphone with 37% planning to buy a smartphone in the next 12 months. Out of the smartphone owners, 3.1% owned a BlackBerry phone and out of those who intend to buy a smart phone, **5.9% intend to buy a BlackBerry phone**
 - All were asked if they were aware that "BlackBerry 10 was launched in Canada and Europe in late January," in which 82.6% said "No." They were also asked if they were "interested in, or at all curious about" BlackBerry, in which 68% said "No."
- Research house Raymond James asked over 250 consumers which smartphone they would never use (not disjoint). 19.7% responded iPhone, **71.4% responded BlackBerry**, and 31.3% responded Android.
 - It's interesting to note that this survey was conducted between March 14 and March 26, which reflects the negative preconceived notions consumers have about BlackBerry given how recent its smartphone is
- **Fewer than 10%** of top Android apps and **fewer than 5%** of top iPhones apps are available on the BB10, and it does not have a single top-50-grossing app from both. The lack of applications available will hurt sales as first, but it should not be a giant problem as the BB10 phones have longer market exposure
- **MISPERCEPTION:** BBRY was the most popular phone for professional usage and is still today
- **CORRECTION:** Globally, BBRY has 15% of the installed base of smartphone workers. Out of the 7% of information workers who own a BlackBerry phone, only 7% desire it for their next work phone, which is less than the demand for the iPhone and Android (see **Exhibit 4**)
- The Department of Defense, which traditionally endorsed BlackBerry phones, has now opened up to other operating systems. BlackBerry will now have to fight with Apple and Google for the contract.
- **MISPERCEPTION:** Its CEO, Thorstein Heins, said an "unexpectedly high proportion of BlackBerry devices will be purchased by new customers who previously had iPhones or Android smartphones," which is estimated at 40-50%.

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- **CORRECTION:** Given the small amount of BB10 sales compared to the number of iPhone and Android users, even if 40-50% of new BB10 costumers were previously iPhone or Android owners, this number is a **very small conversion rate**.
- There has been 2 pieces of news that need to be discussed
 - On April 5th, Stockhouse.com posted a supposed report from China Central Television (CCTV) claiming that the “Chinese Bureau of Economic and Cultural Development has signed an intent to purchase 2 million BlackBerry Q10 handsets”
 - The stock has not reacted at all on that day and there has not been any further information. I would not take this seriously until further confirmation
 - Detwiler Fenton’s analyst Jeff Johnston issued a statement saying that “[w]e believe key retail partners have seen a significant increase in Z10 returns to the point where, in several cases, **returns are now exceeding sales**, a phenomenon we have never seen before.”
 - BBRY immediately responded that the claim was “false and misleading” and has asked securities regulators in Canada and the US to probe its report. Peter Misek, an analyst from Jefferies & Co, has countered the claim and stated that “our checks indicate typical return rates”
 - Detwiler Fenton is defending its report and is “welcoming and regulatory inquiry.” I personally believe this report is nonsense since BlackBerry would have more information to back up its side.
- Given all this information, it really seems that BlackBerry cannot rise to its position it was at a few years ago. However, does BlackBerry really need to fight so exhaustingly for market share or can it remain a solid company even with less than 5% of the smartphone market like Gartner predicted?
 - There has been some positive news recently from Verizon. Chitika, an online advertising network that can identify the model of a phone and its operating system, stated that the Z10 accounted for 2.7% of all BlackBerry traffic after 45 days of sales in Canada. After AT&T and T-Mobile began selling the Z10, it rose to 2.9%. However, the Z10 rose to 5.3% of all BlackBerry traffic in the US after its arrival at Verizon stores.
 - Analyst James Faucette of Pacific Crest says that if the Z10 could maintain its “current sell-through run-rate, it would still amount to less than 1 million units per month,” it would be hard for BBRY to return to long-term growth profit.
 - **So, how much would BlackBerry need to sell?** I calculated that BBRY would have to sell 3.175 million Z10 and 5 million other phones to break even (see **Exhibit 5**), something that most analysts believe will not happen. This number shows that BBRY does not have to capture an extremely large market to remain profitable. From **VAR 3**, John Gold doesn’t think “Blackberry’s chances of pulling of a big comeback are good at all,” but “BlackBerry will remain a niche player, at best, battling it out with the Windows Phones and Firefox Oss of the world.”
 - Therefore, I think there are **chances** BlackBerry can pull off a surprise profit next quarter and perhaps even the quarter after that (the Q10 is expected to be more well-received than the Z10 due its keyboard), and ultimately BlackBerry has the **potential** to remain a profitable company with a small market share. It is really too early to tell as BBRY is heavily traded stock and they are just as many bulls as bears. In the long term, BlackBerry could be considered a short investment, but right now it is too speculative to bet.

VAR

- VAR 1: Conducted a survey from 75 people (See **Exhibit 3**)
- VAR 2: John Jonson, representative from Verizon’s Public Relations (See **Exhibit 2**)
- VAR 3: John Gold, Staff Writer at Network World

How It Plays Out

BBRY is now entirely dependent upon its new operating system, the BB10. While it will not elevate itself to a dominant position, BBRY’s main fight is to just keep a small but profitable market share. If BBRY can establish itself as a niche player, it will remain in the market and its price will not drop any lower. The Z10 and Q10 will be crucial for BBRY, and honestly it is too early to tell what will happen. I would honestly recommend a hold on this stock as it can really lean to either direction. I will be following it and be providing updates.

Risks / What Signs Would Indicate We Are Wrong?

- With a very high short percentage, a short squeeze is a viable threat
- Higher conversion from other smartphones to BBRY than expected
- With no debt and 1.549B in cash, BBRY’s strong free cash flows will buy it time if needed

Signposts / Follow-Up

- Q1 earnings report will be crucial
- Smartphone market share
- Release of other smartphones
- Contracts with governments and orders

Company Description

Founded in 1984 and originally known as RIM when it IPOed in 1999, this Canadian phone company was extremely popular until late 2000s when smartphones entered the market. Currently, it has 12,700 employees and Thorsten Heins has been its CEO since January 2012.

Idea for MII:

Besides working on the MII “booklet,” I was toying with the idea of having different industry groups incorporated within MII. Perhaps, the stocks that associates are assigned to should reflect the particular industry as well. For example, if an associate is assigned to ASC.L, then that associate team is also responsible for providing some type of routine report on the fashion industry. This report should be made available to all of MII so other members can use them as potential sources of new stock ideas.

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Exhibit 1:

Z10

Q10



Exhibit 2:

Name	Takeaways/Quotes
Simona Jankowski Goldman Sachs	The launch “was disappointing, with limited marketing and tepid sell-through at AT&T stores and Best Buy stores alike”
Jim Suva Citigroup	His checks around the stores revealed “shockingly low support by AT&T with extremely limited signage and more signage for Samsung and Apple products”
Hudson Square Research	Hudson reported there were no lines, promotional signs, and very few pre-orders from the AT&T stores they have checked. Stores did not highlight the Z10 or give it prominent shelf space at several stores in NY and San Francisco. At two stores in Manhattan, fewer than 20 arrived to specifically check out the new Z10.
T-Mobile	T-Mobile said they were not planning to push the new BlackBerry as aggressively as they expect to push Apple’s iPhone (which it would start carrying) or the Galaxy S4
David Thorton Verizon Wireless	David, the Director of Purchasing, said he won’t be giving the phone the “hero” status afforded to top devices, and any special marketing support will have to come from BBRY – “if they’re going to provide it and put it up on their dime, we’d be interested, but we don’t have anything planned”
John Johnson PR at Verizon Wireless (VAR)	John said the consumer for BlackBerry is a different from those of the other smartphones and they are usually already BlackBerry users
Analysts Deutsche Bank	Surveyed 150 stores in the U.K. and Canada and reported no stores have sold out of the phone. Also, very few customer service representatives mentioned the Z10 without being asked directly.
Michael Genovese MKM Partners	“We have been testing the Z10 and like the operating system, especially the touchscreen BB10 keyboard predictive text functionality, but we do not think it is differentiated enough the save the brand. The Z10 hardware seems bulky and heavy, but the biggest problem by far is the lack of available applications for BB10”
Joe Fersedi ITG	The Z10 launch “started poorly and weakened significantly as the days passed” and the Z10 sales are “in line-to marginally ahead of anemic sales”
James Faucette Pacific Crest	“Even if the Z10 were able to maintain its current sell-through run-rate, it would still amount to less than 1 million units per month, a level below which we believe it would be very difficult for the company to return to long-term profit growth”

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Exhibit 3: Asked 75 people if they have heard about the new Z10 smartphone from BlackBerry.

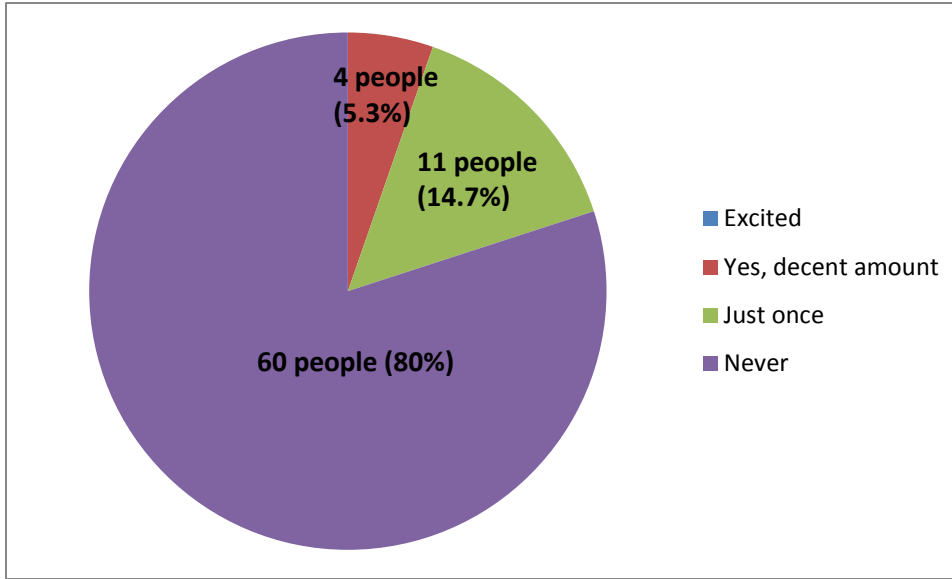
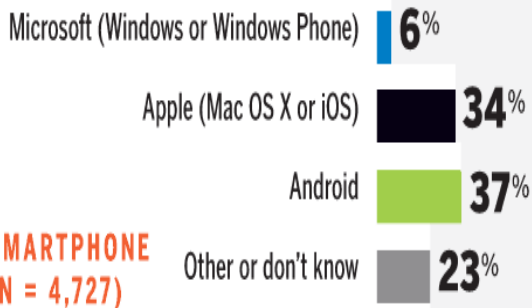


Exhibit 4:

Apple and Android are the new enterprise mobile platforms

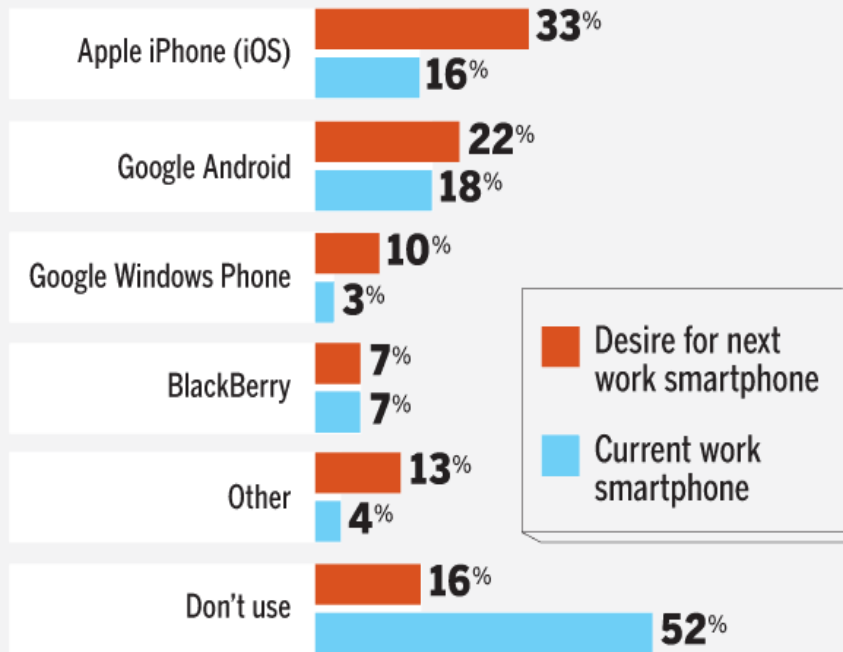
Which of the operating systems do you use on your primary work device?



BlackBerry has 15% of the installed base of smartphone workers globally, 26% in the financial sector, and 20% in North America.

BASE: GLOBAL INFORMATION WORKERS USING EACH DEVICE

Apple's smartphone star will soar



208 million global information workers want iPhones.

BASE: 9,766 GLOBAL INFORMATION WORKERS

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Exhibit 5: Calculated gross margin of regular phones in Q3, then gross margin of Z10 in Q4, projected revenue else hardware and operating expenses into new quarter, determined linear relationship between sales of Z10 and BB7 to break even

	Q3 in 2012	Cost of Sales (millions)	\$1,603		
Revenue from hardware (millions)	\$1,627	R&D, selling, marking and administration expenses related to CORE included in Cost of Sales (millions) ²	\$161.40		
Playbooks sold (millions)	0.255	Cash Cost of Playbooks (millions) ¹	\$48.84		
Revenue per playbook	\$132	CORE included in Cost of Sales (millions)	\$4		
Revenue from playbooks	\$33.66	Amortization included in Cost of Sales (millions)	\$213		
Remaining revenue from hardware (millions)	\$1,593.40	Unit cost of Phone	\$186.86		
Phones shipped (millions)	6.9	Phones sold (millions)	5		
Revenue per phone	\$230.93	Cash cost of phones (millions)	\$934.30		
		Hardware cost of Z10 (millions)	\$241.46		
Cost of Sales (millions)	\$1,897	Phones shipped (millions)	1		
R&D, selling, marking and administration expenses included in Cost of Sales (millions)	\$191	Unit cost per Z10	\$241.46		
Cash Cost of Playbooks (millions) ¹	\$33.66	Revenue per Z10	\$430.09		
CORE included in Cost of Sales (millions)	\$33	Profit without amortization per Z10	\$188.63		
Amortization included in Cost of Sales (millions)	\$350				
Hardware cost of phones (millions)	\$1,289.34			Full Year	
Phones shipped (millions)	6.9	Revenue from software and services (millions)	\$4171		
Unit cost per phone	\$186.86	Cost of sales from services and software	\$579		
Revenue per phone	\$230.93	Gross margin for services and software³	86.12%		
Profit without amortization per phone	\$44.07	Gross margin for other ⁴	25%		
	Q4 in 2012		Q4	Projected Q1	Gross Profit
Revenue (millions)	\$2,678	Revenue from services (millions) ⁵	\$947.00	\$885.45	\$762.55
% from hardware	61%	Revenue from software (millions) ⁶	\$63.00	\$59.85	\$51.54
Revenue from hardware (millions)	\$1,656	Revenue from other (millions) ⁷	\$28	\$28	\$7
Revenue per Playbook	\$132	Total (millions)	\$991	\$973.30	\$821.09
Playbooks sold (millions)	0.37				
Revenue from Playbooks (millions)	\$48.84	Operating Expenses	Q4	Projected Q1	
Revenue per phone (not Z10)	\$230.93	R&D (millions) ⁷	\$383	\$383	
Phones sold (millions)	5	SG&A (millions) ⁸	\$523	\$784.5	
Revenue from phones (millions)	\$1,154.65	Amortization (millions) ⁹	\$181	\$226.25	
Remaining revenue for Z10 (millions)	\$430.09	Total (millions)	\$1087	\$1393.75	
Z10 sold (millions)	1				
Revenue per Z10	\$430.09	Hardware Gross Profit Needed in Q1 (millions)	\$572.66		

$$158.46x + 13.90y = 572.66 \text{ M (x = \# of Z10, y = \# of BB7)}^{10}$$

Millions of BB7	Millions of BB10	Millions of BB7	Millions of BB10
1	3.52619	5	3.175312
1.5	3.48233	5.5	3.131453
2	3.43847	6	3.087593
2.5	3.394611	6.5	3.043733
3	3.350751	7	2.999874
3.5	3.306891	7.5	2.956014
4	3.263032	8	2.912154

Assumptions:

- 1) Many analysts seem to think Playbooks have a negative gross profit. I will be optimistic and assume the gross profit is 0.
- 2) Same proportion in Q3
- 3) Gross margin from FY is same as next quarter
- 4) Found online as another analyst's estimates
- 5) 6.5% decrease, as per earnings call of single-digit percentage decrease
- 6) 5.0% decrease based on quarterly trend
- 7) Assume no change
- 8) 50% increase, as per earnings call of marketing spending
- 9) 25% increase based on YoY trend
- 10) Amortization for Q4 was \$181. Given 6 million hardware units sold, assume an amortization/unit of \$33.17. This gives a gross margin of 6.02% and 36.84% and a gross profit of \$13.90 and \$158.46 for the regular phones and Z10 respectively.