

## **Google's hardware makeover to get uneasy welcome on Wall Street**

Reuters

(Reuters) - Wall Street has a long-running love affair with Google the search engine. But will it feel the same way about Google the hardware maker?

Google on Thursday will report quarterly results for the first time since closing its \$12.5 billion acquisition of smartphone maker Motorola in May.

Google's purchase of Motorola, as well as ongoing uncertainty about the global economy, mean that Google suddenly looks a lot less familiar, and less predictable, to many investors - a fact that will be underscored in the company's second-quarter report.

"This is the first quarter that Motorola is going to be consolidated into results, and it's going to be messy," said BGC Partners analyst Colin Gillis.

The absence of Chief Executive Larry Page from the public eye, due to an unspecified ailment that has caused him to have "lost his voice," hasn't helped buoy investor confidence as the company faces a critical juncture.

Shares in Google are down roughly 14 percent from their 52-week high of \$670.25.

Google is an "an execution story, which is why it's so unnerving that Larry now has an illness that's not defined," said BGC's Gillis. "He set the company down this path and now there's no undoing it ... If he becomes sick in the middle of it and can't put as much energy into it as he'd like to, that's a risk."

Page, 39, a co-founder of Google, returned to the CEO role in April 2011 and quickly reset many of the company's priorities, shutting down underperforming products, launching the Google+ social network to challenge Facebook Inc and buying Motorola, the largest acquisition in Google's history.

### **HIT-DRIVEN BUSINESS**

Investors have a wide range of questions about Google's expansion into the hardware business, where margins are low and competition with the likes of Apple Inc and Samsung is fierce. In addition to acquiring Motorola, Google recently launched the Nexus 7 tablet in partnership with Taiwan's Asustek and released the first Google-designed and manufactured consumer electronics device, dubbed the Nexus Q.

"We need to hear from management about not only the strategy for the hardware business but also how much they're planning to invest in the business," said Colin

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Sebastian, an analyst with Robert W. Baird & Co, referring to the Motorola business.

Google's hardware push comes at a time when its core Web search advertising business is under pressure from consumers' increasing use of smartphones to surf mobile versions of the Web - where ad rates are lower - and as Europe's struggling economies raise fears of a broader advertising-spending slowdown.

When Google first announced plans to acquire Motorola in August 2011, Google's chief financial officer, Patrick Pichette, told investors the deal would be "mildly accretive."

But Baird & Co's Sebastian says that a lot has changed in the smartphone market since then and he estimates that the deal may actually be dilutive to [earnings](#) [1] at this point.

Google has said very little about its plans for Motorola since the deal closed.

Many investors recognize the benefit of Motorola's vast portfolio of patents amid the technology sector's increasing legal battles.

But Motorola's hardware business, which includes factories in China, Taiwan and [Brazil](#) [2] for building phones and television set-top boxes, is a less obvious fit with Google's high-profit-margin Internet business. In the first quarter of the year, Motorola reported a net loss of \$86 million.

Some analysts say that entering the hit-driven mobile phone business, where a company's fortunes can quickly change with one successful or unsuccessful product, will inject a lot more volatility into the financials and stock of Google, which has until now enjoyed the relative stability that comes from controlling two-thirds of the world's online search market.

"The search business is a competitive industry, but Google has won that one. This is a whole new ball game and they're certainly not the leaders," said Needham & Co analyst Kerry Rice.

"You've got a lot of fixed costs to absorb. So if you don't have a hit all of a sudden all of that positive leverage becomes negative leverage," said Rice, noting that part of Google's business could look more like a semiconductor company.

### EUROPEAN CLOUDS

Analysts, on average, estimate that Google's traditional business generated net revenue - which excludes fees paid to partner websites - of \$8.44 billion in the second quarter, according to Thomson Reuters I/B/E/S, up 22 percent year-on-year. But some analysts caution that there is a possibility that figure has been inflated by the inclusion of Motorola revenues.

"Current consensus estimates are all over the map, between analysts that include a month and a half of Motorola results and analysts that say 'Let's focus on core

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Google," said ThinkEquity analyst Ronald Josey.

That's likely to cause confusion when investors try to assess Google's results by measuring them against Wall Street targets on Thursday.

Analysts expect Google to post adjusted earnings per share of \$10.12 for the second quarter. Google does not provide public forecasts for revenue or earnings.

Google will you a new method for reporting results, and the potential inconsistency in analyst estimates, means that consensus numbers will be a "little less of a guidepost" in the second quarter, said ThinkEquity's Josey.

Besides reporting consolidated results for the second quarter, Google will break out results for its traditional business, Motorola's mobile business and Motorola's set-top box business.

In a note to investors earlier this month, Sanford Bernstein & Co analyst Carlos Kirjner estimated that Google's second-quarter net revenue could be as low as \$7.83 billion due to the impact of foreign-exchange rates and a rise in the traffic acquisition costs that Google pays to partner websites.

Ben Schachter, an analyst with Macquarie Research, said that on a relative basis, Google and other Internet companies perform better than other types of businesses during economic downturns.

But, he noted, "Google is large enough that no matter how well they're doing or how well the Internet industry is doing, the company will be impacted by the overall slowdown in the economy."

The options market is implying around a 6 percent move for shares post earnings in either direction as of Monday morning based on Google's July options expiring this Friday, said Philip Saunders, equity derivatives strategist at broker-dealer Topeka Capital Markets in New York

That is lower than the average absolute earnings day move of 7.5 percent over the past eight quarters. (Additional reporting by [Doris Frankel](#) [3]; Editing by Steve Orlofsky)

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