The Genesis

On August 15, Google (GOOG) announced an agreement to acquire Motorola Mobility (MMI), based in Libertyville, Illinois, for $40 per share or a total of about $12.5 billion, a premium of 63% to the closing price of Motorola Mobility shares on Friday, August 12, 2011. The transaction was unanimously approved by the boards of directors of both companies. The deal was not easy. It took Google significant effort to obtain regulatory approvals without conditions. This is a Vertical Merger (which companies at different places in a chain of products join together). Here, Hardware Client (Motorola) is acquired by the Software Client (Google).

Google's Android operating system has recently come under fire in an industry-wide patent battle, in which Android manufacturers HTC, Motorola, and Samsung have been sued for alleged patent infringement, by Microsoft, Oracle and Apple. The Motorola Mobility acquisition is considered a means of protecting the viability of Android. Google has stated that it will run Motorola as an independent company. On November 17, 2011, Motorola announced that its shareholders voted in favor of the company's acquisition by Google Inc. for $12.5 billion, receiving approval from the United States Department of Justice and the EU on February 13, 2012. The deal received subsequent approval from Chinese authorities and was completed on May 22, 2012.

Why eye Motorola Mobility?

Investors are wondering how an internet giant like Google can integrate with and run a hardware company that has been bleeding cash over the last few quarters. A quick answer is that Google can manufacture hardware in large quantities. Motorola was once a major mobile manufacturer. Its Motorola Razr model sold more than 100 million units. Looking at OEM market share data, Motorola holds a market share of 13.7%. This is down from the previous year’s share of 20%. The company later decided to manufacture phones on the Android platform, which saw strong market reception based on its reviews. Therefore, Motorola has a fighting chance to move up the ranks in the smartphone space.

The Motorola acquisition equates to a third of Google's cash balance. Motorola recently reported an $86 million net loss for the first quarter, slightly higher than its loss for the same period last year. Total handset shipments declined from 9.3 million units to 8.9 million units. The silver lining is that smartphone shipments increased to 5.1 million from last year's 4.1 million units. Clearly, Google sees continued high potential in the smartphone market.

Patent is just one of those investment merits of Motorola's acquisition. The acquisition of Motorola solidifies Google's position in the midst of its intellectual property battles. Google added 24,500 patents to its growing portfolio.

Motorola Mobility has a long history of innovation in communications technology and the development of intellectual property.

Its many industry milestones include the introduction of the world's first portable cell phone nearly 30 years ago, and the StarTAC—the smallest and lightest phone in the world when it was launched.

On the other side, this also strengthens the position of Android as a mobile platform. The platform was in 56.1% of all smartphones sold in the first quarter this year. It beats Apple's iOS, which represents 36.4% of the worldwide smartphone market. Nokia's (NOK) Symbian operating system has a market share of 27%. Meanwhile, Research In Motion's (RIMM) market share has declined to a mere 13%.

The laggard is Microsoft, which corners only 2.6% of the worldwide smartphone market. This trend will likely continue in the near future as Android holds a strong competitive position in the Asia Pacific phone market.

Motorola Mobility's full commitment to the Android operating system means there is a natural fit between both the companies.

Motorola Mobility was a founding member of the Open Handset Alliance, a consortium of 84...
firms to develop open standards for mobile devices

Motorola Mobility in 2008 made a big bet on Android as the sole operating system for all its smartphone devices.

The Competition perspective

Mobile computing is highly competitive. Google, Apple, Microsoft, Research in Motion and Nokia all make smartphone operating systems. Apple, RIM and Nokia also make their own devices, in addition to a number of other large manufacturers. Microsoft and Nokia also have a very tight and highly-integrated partnership.

- Android currently is the most popular open-source option for mobile computing. Faster innovation and strong patent protection are good for the whole Android ecosystem.
- Since the first Android phone launched in October 2008, Android devices have injected competition into mobile computing, giving consumers, applications developers and mobile carriers high-quality alternatives to products like Apple's iPhone and iPad and RIM's BlackBerry.
- Diversity and choice are key to a healthy industry. With competition, consumers get better mobile devices at lower prices.
- Google wants to encourage as many handset makers as possible to use Android because Android helps mobile users get online. And online advertising is Google's core business.
  - Google has no incentive to close off Android to other hardware manufacturers, limiting itself the way Apple and Research in Motion have.
  - The Android ecosystem depends on a range of manufacturers and software developers adding their innovations to Android. Cutting that off would be bad for Android.

Google has stated in a press release that Motorola will stand as a separate business. This addresses concerns that it will no longer remain as an open source mobile platform. Motorola will remain a licensee of the Android platform and Google will be spending more time developing better Motorola models to suit the changing Android ecosystem. According to Google, it is about innovation, rather than a defensive move on their part to acquire Motorola.

The Inorganic Growth Scenario

- Margins decline for the sake of future growth

The move to buy Motorola will have an impact on the margins. Major phone manufacturers have slim margins. The cost to produce a smartphone ranges from $150 to $200 per unit. Conversely, for market leaders like Apple and Samsung, they could easily maintain a margin of 40% to 50%. The challengers are forced to subsidize a portion of the cost to attract new clients to switch to their phones. The expectations are margins will be slim for Motorola going forward.

This is not a point to be overly concerned about, however. Google has maintained net profit margins of 25% over the last five years. A conservative assumption would be a 100 to 150 basis point impact on profitability. This appears to be insignificant relative to the benefit it will give Google over the long run.

Valuations Perspective

At present, Google is trading at 13 times 2012 earnings. This is lower than its five-year average earnings multiple of 19 times. The stock trades at 10 times earnings. These valuations do not justify the economic prospects of Google and its dominance in the market it operates. In fact, the market is discounting slight earnings growth in the future.

In contrast, Apple trades at 12 times earnings. It is in a position similar to that of Google. The market is discounting slower growth in the coming years. Other peers like Baidu (BIDU), trade at 36 times earnings. Yahoo! (YHOO) trades at 17 times earnings. These companies trail to Google, yet the market has valued them higher.

It is too early to say that this acquisition will produce handsome returns for Google. Google's track record on acquisitions has been relatively good. The Motorola acquisition will have a big impact in the coming years. It is safe to assume that Google has gone all in on this deal.

1. The Real Need of this deal:

Motorola pioneered the 'flip phone' with the MicroTAC and the 'clam phone' with the StarTACIn
The RAZR model gave it humongous success, but with the emergence of other players, it lost significant market share in the mid-2000s.

Though the company earned $100 million during the fourth quarter of 2007, its handset division lost $1.2 billion at the same time. Numerous key executives went on to join the rivals and the website Trusted Reviews called its products repetitive. Further, 3500 employees were made to leave the company in January 2008, followed by 4000 in June.

Finally, a setback for it was the resignation of huge number of executives only to join Apple Inc's iPhone.

Motorola struggled and the once no. 2 cellphone maker now ranked 8th.

Motorola's handset division then had to be put on sale.

The company's global market share declined from 18.4% in 2007 to 6.0% in the first quarter of 2009.

To its rescue came Google- which had earlier bought Android Inc. - the developer of the highly demanded Android operating system, used by half of the smart phones in the United States of America.

In a statement, Google said the deal was aimed at acquiring Motorola's patent portfolio, which it said, would help it defend Android against legal threats from competitors armed with their own patents. 

Google's urge to expand into hardware business led to the most expensive and riskiest acquisition in its 14-year history. It will enable Google to have more control over how Android is being used on portable or mobile handsets. Also it plans to be a tough competitor for Apple's iPad and Amazon.com's Kindle Fire.

This deal gave Google access to a whole base of 17000 cellphone patents and now, further it is bringing in more ambitious plans for the newly acquired business.

2. The impact of this Deal

Google and Motorola Mobility together will accelerate innovation and choice in mobile computing. Consumers will get better phones at lower prices because: Google is great at software; Motorola Mobility is great at devices. 

Last year, the online advertising at Google's American region accounted for $17.5 billion of Google's revenues. In totality, 96 percent of revenues of Google come from ads, which amounted to $38 billion last year.

This deal with Motorola has proved to be the icing on the cake as Motorola Mobility Holdings booked $13.1 billion in revenue during its final year as an independent company.

Other byproduct benefits are:

- Delivery of extra services, for example, advertising to living rooms through Motorola's cable TV boxes
- Develop the next generation device for mobile computing
- Compete with Microsoft's upcoming Window's phone.
- Smartphone designs to fulfill government's and companies' needs.

With an increase from 46.9% of the World Market for Smartphones in Q1 2012 to about 68.1%, it seems the Google Motorola deal is doing more good than bad. However it is also of importance that Samsung contributed to 44% of that success.

Arguably, the Google Motorola deal was entered to give a tough competition to both Samsung and Apple in the hardware business and one of the prime reasons of getting into the deal was the strong foothold of Apple. It is well known that Steve Jobs thought the folks over at Android were just a bunch of thieves.

Google always wanted to be where Apple is today. Hence the prime reason for this acquisition, besides the patent and tax benefits, was to take a bite off the Apple Market share. That is what we focus on in this section.

Did Google Motorola merger take a bite off the Apple?
Indeed Apple has come a long way since 1997 when its shares traded at $3.19 and it was nearing bankruptcy. Apple's market cap today is greater than the combined market caps of IBM (IBM), Microsoft (MSFT), Hewlett-Packard (HPQ) and Dell (DELL) with about $40 billion in market cap to spare.

From May 3, 2010 through August 1, 2012, Apple's cumulative EPS growth has outgrown the cumulative share price appreciation. This gap is expected to widen over the next twelve months. Apple is slowly transforming into a more conservative and a rather sure investment choice with shareholders seeking a mix of growth and income from their investment choices.

Since November 1, 2010, as shown in the graph below, Apple's share price appreciation on a quarterly basis has fallen behind the rate of growth in earnings per share. While generally speaking, a lagging share price performance relative to earnings growth is not usually a welcomed outcome. One would at least want the share price growth to be in accordance with the earnings growth indicating strong market presence. However with the Apple iPhone to be launched soon, it provides support for the share price as Apple's overall market cap continues to rise at a high rate.

Hence, the Apple loyalist are clearly not fazed by the Google Motorola merger and as pointed out earlier, with the launch of the iPhone 5 expected this quarter, Apple should regain whatever little ground it has lost in the Smartphone market and establish itself as one of the most valuable companies on Earth.

Impact on other Vendors

What this deal has eventually done is made sure a possibility of another takeover relatively soon. With both Nokia and Microsoft consistently losing market share and both holding on to a huge list of patents, Nokia is undoubtedly a strong candidate of a takeover in the years to come. Microsoft on the other hand might see itself being pushed out of the mobile vendor business unless it can remarkably turn around things and buy one of its hardware partners.

Other Android operators such as HTC, LG are relatively wary. They have realised that a lot of the innovative changes that happen in the Android Eco System might be first let out to Motorola. However Google maintains that it will in the future too continue to run Motorola as a separate entity.

Not much has changed for Samsung. It has a strong and solid foundation and good relationships with telecom operators around the world. However HTC, which is a relatively small company focussed on the Smartphone business is arguably the worst affected. HTC sales have already dropped down by about 27% in Q2 2012. If things continue to go this way, it seems the most likely
candidate to be taken over by Microsoft. It's share prices have already hit a 7 year low down by almost 80%.

http://wwwmpoweruser.com/

1. Financial Impact

With the collaboration of Google with Motorola, Google has experienced the best of its kind advantages from Motorola. The revenues rose from $10.8 billion to $17.5 billion.\[1\]

**Impact on Stock market for Google and Motorola**

15\textsuperscript{th} August 2011, when Google Inc. (NASDAQ:GOOG) announced its merger with Motorola Mobility Holdings (NYSE: MMI) the impact could be seen in the stocks of these companies. Google paying $40 per share of Motorola led to an almost 60% increase in the share price of Motorola Mobile Holdings with a value of around $38 that week rising from around $24 per share in the week before the announcement.

**Motorola's share price trend over the last year**

Google's stock, on the other hand, lost value very quickly following the announcement losing more than 10% in that week going from around $557 to $499. This is a common trend observed where the acquirer experiences a loss in the share price following such an announcement and the company which is acquired gains because of the market sentiment where there is substantial risk that is expected in each merger.

The week following the completion of the deal on 23\textsuperscript{rd} May 2012 also resulted in a decline in the share price for Google Inc from $608 to $565 because of apprehensions in the market about the deal with some questioning whether Google's deal is simply for patents or to control the end-to-end experience of consumers and others expecting the margins to decline for the sake of future growth of Google.

It is currently trading around $642.

**Google's share price trend over the last year**

**Share prices of other players in the market**

After the announcement of Google acquiring Motorola Mobility Holdings, the impact was also seen on other players of the market especially Apple and Microsoft.

It was believed that Google's announcement could shift some Android manufacturers over to Microsoft's Windows phone platform. Microsoft's stock rose by 1% following the news, whilst Nokia's rose by 11% – reflecting stock market opinion and speculation of Microsoft wanting to take over Nokia after the announcement.

Apple's shares also increased in the week following the announcement because there was a common belief in the...
market that Apple will remain unaffected by the deal and will still be a major player in the market.

1. Balance sheet of Google Liabilities and stockholder’s equity

Derived from financial statements

(source: internet)

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