Microsoft shares drop on $7.2B Nokia phone deal

September 3 2013, by Matti Huuhtanen

Microsoft CEO Steve Ballmer speaks during a press conference on the company's deal with Finnish mobile manufacturer Nokia in Espoo, Finland on Tuesday, Sept. 3, 2013. Microsoft Corp. is buying Nokia Corp.'s line-up of smartphones and a portfolio of patents and services in an attempt to mount a more formidable challenge to Apple Inc. and Google Inc. as more technological tasks get done on mobile devices instead of personal computers. (AP Photo/Lehtikuva, Markku Ulander)

Microsoft is wagering $7.2 billion on the idea that owning Nokia's phone business will help the software giant grab a bigger slice of the mobile computing market from Apple and Google.

The Windows maker is buying Nokia Corp.'s line-up of smartphones and a portfolio of patents and services. The 5.44 billion euros ($7.2 billion) deal, announced late Monday, marks a major step in the company's push to transform itself from a software maker focused on desktop and laptop computers into a more versatile and nimble company that delivers services on any kind of Internet-connected gadget.

But some analysts questioned whether buying up the mobile business of Nokia, the fading star of the cellphone world, would aid Microsoft.

"Until there are signs that (Microsoft) can innovate and successfully execute in the post-PC era, we expect the stock to languish at current levels," said Janney analysts Yun Kim and Alice Hur. "We do not believe the planned acquisition of (Nokia's) mobile business changes (Microsoft's) strategic positioning in the smartphone market."

Microsoft's shares fell $2.05, or 6.1 percent, to $31.35 in midday trading in the U.S.

Microsoft, based in Redmond, Wash., has been racing to catch up with customers who are increasingly pursuing their digital lives on smartphones and tablet computers rather than traditional PCs. The shift is weakening Microsoft, which has dominated the PC software market for the past 30 years, and empowering Apple Inc., the maker of the trend-setting iPhone and iPad, and Google Inc., which gives away the world's most popular mobile operating system, Android.

Microsoft is now betting it will have a better chance of narrowing the gap with its rivals if it seizes complete control over how mobile devices work with its Windows software.

"It's a bold step into the future—a win-win for employees, shareholders and consumers of both companies," Microsoft CEO Steven Ballmer told reporters at Nokia's headquarters in Finland Tuesday. "It's a signature event."

But speaking to investors and analysts later Tuesday, Ballmer admitted that the company still has to play catch-up with the likes of Apple and Android.

"We know we need to accelerate. We're not confused about that," he said.

Standing together are from left to right, Nokia's new CEO Timo Ihamuotila, Chairman of the Board Risto Siilasmaa and former Nokia CEO Stephen Elop, during the press conference of the Finnish mobile manufacturer Nokia in Espoo, Finland on Tuesday, Sept. 3, 2013. Microsoft has announced a takeover of the Finnish mobile phone company Nokia in a deal reported to be worth some 5.44 billion euros (US dlrs 7.2 billion). (AP Photo / LEHTIKUVA, Markku Ulander)

"We need to be a company that provides a family of devices."

Nokia, based in Espoo, near the Finnish capital, and Microsoft have been trying to make inroads in the smartphone market as part of a partnership forged in 2011. Under the alliance, Nokia's Lumia smartphones have run on Microsoft's Windows software, but those devices haven't managed to compete with iPhone or the array of Android-powered devices spearheaded by Samsung Electronics' smartphones and tablets

Terry Myerson, Microsoft Executive Vice-President of Operating Systems, admitted on a call to investors Tuesday that the message about company's products hasn't been getting through to consumers and that "marketing approaches we've used in the past have been inefficient."

The acquisition is being made at the same time that Microsoft is looking for a new leader. Just 10 days ago, Ballmer, 57, announced he will step down as CEO within the next year.

Stephen Elop, who left Microsoft in 2010 to become Nokia CEO, will step down as president and CEO of the company to become executive vice president of Nokia devices and services and will rejoin Microsoft once the acquisition closes.

The deal has fueled speculation that Elop, a former Microsoft executive, will emerge as a top candidate to succeed Ballmer.

Nokia board chairman Risto Siilasmaa told reporters that they had been preparing the deal since February. "It's been an extremely pragmatic and deeply analytical process where we have left no stone unturned to understand all the possible alternatives for the company going forward," said Siilasmaa, who will be Nokia's interim CEO.

Investors in Nokia welcomed the deal, sending shares in the company up 34 percent to 3.97 euros in Helsinki.

Microsoft hopes to complete the deal early next year. If that timetable pans out, about 32,000 Nokia employees will transfer to Microsoft, which currently has about 99,000 workers.

The proposed price consists of 3.79 billion euros ($5 billion) for the Nokia unit that makes mobile phones, including its line of Lumia smartphones that run Windows Phone software. Another 1.65 billion euros ($2.2 billion) will be paid for a 10-year license to use Nokia's patents, with the option to extend it indefinitely. Ballmer said that Microsoft will invest more than $250 million in a new data center to serve European consumers.

Nokia CFO Timo Ihamuotila said the company's future will center on its mobile networks business and two smaller units—HERE mapping services and the advanced technologies unit including Nokia's licensing business.

"Our aim is clearly to grow the networks business in a profitable way," he said in a call to investors. "It is a cash-generating business where we can invest into the future growth."

Nokia will continue to own the rights to its brand, but the deal between the two companies prevents it from venturing into a separate smartphone business until the end of 2015.

Neil Mawston from Strategy Analytics said the move was good for Nokia's shareholders but did not change much for the ailing Finnish firm, which has lost significant market share.

"Nokia is still heavily dependent on Microsoft's software capabilities and Microsoft continues to lag the market like it has done in the last few years," Mawston said. "Not much will change whether Nokia is inside or outside the Microsoft portfolio."

The deal with Nokia represents the second most expensive acquisition in Microsoft's 38-year history, ranking behind an $8.5 billion purchase of Internet calling and video conferencing service Skype. Tony Bates, who ran Skype, is also regarded as a potential successor to Ballmer.

The money to buy Nokia's smartphones and patents will be drawn from the nearly $70 billion that Microsoft held in overseas accounts as of June 30.