Microsoft Buys Nokia’s Phone Business; Signals the Start of its Mobile Expansion

Summary: Just two weeks after announcing that Steve Ballmer would step down, Microsoft announced that it would purchase Nokia’s Devices & Services business, license Nokia’s patents and use Nokia’s mapping services.

Event: On September 3rd, Microsoft and Nokia jointly announced that Microsoft will purchase Nokia’s Devices & Services business for $3.79 billion euros, and that it would license Nokia’s patents for $1.65 billion euros.

Analysis

While Microsoft is living up to its recently stated goal of becoming a devices and services company, it has a spotty record of making money in hardware. It is buying the Nokia Devices & Services business for less than what it spent on Skype just two years ago.

Microsoft’s reorganization, announced in July 2013, was designed to make Microsoft into a devices and services company. Even though Steve Ballmer will soon step down as CEO, he is wasting no time in executing the newly announced strategy.

One aspect of this transaction is that Microsoft expects approximately 32,000 new employees to transfer from Nokia to Microsoft. One of them is Nokia President and CEO Stephen Elop, who returns to Microsoft as Executive Vice President of Devices. Mr. Elop is also rumored to be a potential replacement candidate for Steve Ballmer.

Strategic Value is the IP

Microsoft gets the Nokia Mobile Division at an attractive price (0.35 times revenue). However, Nokia’s crown jewels are its patents. There are many patents with different terms, but for many of them Microsoft only gets a ten-year license. The strategic value of Nokia’s business rests in its patent portfolio, so the winner in this part of the deal appears to be Nokia.

Microsoft and Hardware: A Challenging Future

Microsoft is trying to remake itself into a tighter provider of a complete ecosystem – similar to what Apple does and what Google is in the process of doing. The problem is that Apple has years of a head start.

Nokia was a leader in cell phones for years, and has proven to be a cost-effective manufacturer, but it takes a lot of innovating to keep up in the fast-paced world of the mobile ecosystem, which demands yearly software updates and new phones that deliver those features. It is a much more brutal game than just doing the software.

In the tablet era, where the lines between a phone and a tablet are blurred, Nokia has struggled to keep up. The R&D and design teams that Microsoft is getting as part of the deal face some high hurdles on the innovation front.

To make money in hardware, critical investments are needed, often years in advance. Microsoft has the cash to make those investments. The question is: does Microsoft need to make additional acquisitions to challenge Apple and Google? We believe that
they do, and that one of those acquisitions may be RIM.

**Planning Assumption:** By YE 2013, Microsoft will acquire at least one additional mobile firm.

**Innovating in Mobile**

With the Nokia acquisition, Microsoft now competes with Apple, Google and Samsung, among others. The consumer mobile business is brutal, but success there often leads to success in the enterprise. Microsoft has some very tough competition, and will have to act quickly to increase demand for Windows Phone devices.

**Questions for Microsoft Partners**

Microsoft is now clearly in the hardware business, and this raises questions about others who make phones that run Windows Phone 8. We expect current partners HTC and Samsung to keep marketing Windows phones. The question is: can Microsoft be successful in phones, tablets and PCs? So far the answer is “no.”

**Never Count Microsoft Out**

Microsoft has proven over the years that it can never be counted out of a market. Its challenge right now is getting its OS story right across its ecosystem. Windows 8.1 is trying to fix Windows 8 and the hybrid PC/tablet approach is what led to Mr. Ballmer’s early announcement he is stepping down.

If Microsoft can harmonize its operating systems across its mobile and PC platforms, it has the potential to challenge Apple and Google. However, time is not slowing down in mobile. Even as we write this, the new iPhone has just been rolled out.

**Aragon Advisory**

- Enterprises need to ask Microsoft for clear product roadmaps that go beyond Windows Phone 8 OS.
- Enterprises need to understand what Microsoft’s plans are for mobile devices.
- Enterprises using older Nokia devices that do not run Windows Phone software should develop exit strategies.

**Bottom Line**

Microsoft got Nokia’s Devices & Services business at an attractive price, but faces hurdles to compete with established mobile players. Given how high the stakes are, we think Microsoft will feel compelled to spend more of its cash to buy additional mobile firms.

**Related Research**

- [Nokia and Microsoft: Partnership Bears First Fruit in Mobile Ecosystem Battle](https://www.aragonresearch.com/research/nokia-and-microsoft-partnership-bears-first-fruits-in-mobile-ecosystem-battle/)
- [Nokia Contingency Plan: RIM vs Google](https://www.aragonresearch.com/research/nokia-contingency-plan-rim-vs-google/)
- [Mobile Upgrades – Apple iOS and Microsoft Windows Phone Trump Android](https://www.aragonresearch.com/research/mobile-upgrades-apple-ios-and-microsoft-windows-phone-trump-android/)
- [Stephen Elop as the next CEO of Microsoft?](https://www.aragonresearch.com/research/stephen-elop-as-the-next-ceo-of-microsoft/)
- [Patent Wars are not new, the Battle for Mobile is](https://www.aragonresearch.com/research/patent-wars-are-not-new-the-battle-for-mobile-is/)

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