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Is time short for Zander?

Three consecutive quarters of lackluster results, including back-to-back losses, put Motorola's CEO in a tough spot. Board members publicly support him, but analysts wonder how long that will continue.

By Mike Hughlett | Tribune staff reporter
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Consecutive quarter of grim tidings unveiled Thursday and little significant improvement in sight, Motorola Inc. Chief Executive Edward Zander's hold on his job seems increasingly tenuous.

BusinessWeek, citing unnamed sources, reported Thursday that three directors, including Zander, recently met with a well-known tech executive, Michael Capellas, to discuss "leadership roles at the company."

A Motorola director denied the board met with Capellas for the CEO post, saying the board isn't looking for a CEO and fully supports Zander. "The board is of the opinion that we have the right strategy and the right leadership," Thomas Meredith, director and acting chief financial officer, said in an interview with the Tribune.

Capellas, who recently agreed to become head of First Data Corp., declined to comment.

Still, some corporate governance observers say Motorola's directors are likely at the point where they are at least talking about a successor to Zander.

At any company that's posted three straight miserable quarters, board members should be discussing a potential leadership change, said Peter Crist, a Chicago executive recruiter and director at Wintrust Financial Corp. "I'm compelled to have the discussion, but I may not be compelled to act," he said.

Zander is scheduled to preside over Motorola's annual meeting for stock analysts in September, which will be watched particularly closely this year. The company's board is scheduled to meet before then, and could choose to boot Zander then and there.

But several stock analysts said they think Zander will get a least one more full quarter to show some progress.

"This business can't be turned around on the dime," said Morningstar Inc. stock analyst John Slack.

And Motorola's board knows that, he said. "They're realistic about what's going on."

Motorola recorded a net loss of \$28 million and a loss from continuing operations of \$38 million, or 2 cents a share. The company had charges of 4 cents a share, mainly for workforce cuts. It

was Motorola's second consecutive quarterly loss and the third straight quarter in which it significantly missed Wall Street forecasts.

Revenue fell from \$10.8 billion a year ago to \$8.7 billion during the second quarter, a decline sparked by a 40 percent drop in mobile phone sales. The results were in line with Motorola's warning to Wall Street last week, and its stock rose 22 cents Thursday to close at \$18.22 on the New York Stock Exchange.

Analysts said some big institutional investors see Motorola as a good value, assuming it can turn around its phone business. And if it can't, the market knows that activist shareholders such as Carl Icahn, who controls a nearly 3 percent stake in Motorola, will push for big changes, including Zander's exit.

Zander is increasingly facing the scenario that haunted his predecessor, Christopher Galvin. Grandson of Motorola's founder, Galvin abruptly exited in late 2003 after a sustained poor performance and a barrage of criticism from Wall Street.

Zander, after being widely hailed for turning around Motorola in 2005, has now presided over a sustained period of weakness. Granted, Zander's malaise can be measured in quarters, not years like Galvin's.

But times have changed in recent years, as shareholders have ratcheted up pressure on corporate boards, said Charles Elson, director of the University of Delaware's Weinberg Center for Corporate Governance. "It could be a couple of quarters instead of a couple of years."

Once the board loses confidence in a CEO, "it's only a matter of time," Elson said.

Meredith said the board has every bit as much confidence in Zander as it did this spring when Zander and Icahn were in a showdown. Icahn ran for a seat on Motorola's board, a quest that Zander and the board successfully opposed. Icahn publicly questioned Zander's fitness for the CEO post if Motorola's phone business didn't improve. So far, it hasn't.

The mobile phone division posted an operating loss of \$264 million during the second quarter, \$31 million more than in the first quarter. Meanwhile, phone sales dropped so much that Motorola anticipates its global phone market share sank to about 13.5 percent from more than 17 percent during the first quarter. That share was about 22 percent during the second quarter of 2006.

Motorola, long the world's second-largest cell phone-maker, behind Nokia, will drop to No. 3 for the second quarter, just below South Korea-based Samsung Electronics.

Motorola said earlier this year that it wouldn't pursue market share at the expense of profits. "We chose to lose share to stabilize our pricing," Meredith told analysts Thursday.

But in a way, Motorola got the worst of both worlds during the second quarter. "They sold a lot fewer phones, but they lost a lot more money," said Ed Snyder, a stock analyst at Charter Equity Research.

Meredith and Zander told analysts that they expect the company's financial results to improve in the second half of the year, but other than saying the third quarter will be flat to slightly better, they offered no specifics.

Motorola's problems remain the same: It lacks compelling follow-up devices to the smash hit Razr, and has fallen short on phones that work on "3G" networks, which are more technologically sophisticated. It recently began rolling out new high-end phones, including the Razr 2 in Asia. Motorola executives noted Thursday that the Razr 2 is due out in Europe and North America this quarter.

"The encouraging thing, if you want to pull anything encouraging out of it, is that they are starting to get some new products out there," Morningstar's Slack said.

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