Issue 349: Wednesday, December 24, 2008

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Telecom Overview: Mixed Results and a Holiday Surprise

Effective next week, The Telecom Connection *will cease publication, making the Wednesday, Dec. 31, newsletter the final issue you will receive. After that time, the remainder of your subscription will automatically be transferred to RealMoney Silver. Please watch for an email you will receive from* TheStreet.com *Customer Service Team for more details, or call 1-866-321-8726, Monday through Friday 8:00 a.m. - 6:00 p.m. ET, with any questions.*

In this week's Christmas edition of *The Telecom Connection*, there are earnings results from model portfolio names **Research In Motion** (RIMM) and **Micron** (MU). While Research In Motion may have preannounced, it was apparent that the shortfall had as much to do with execution as foreign exchange. Despite the lowered numbers, the outlook was a pleasant surprise. Now all the company has to do is deliver.

Going into the Micron call Tuesday, I don't think investors were focused on the results. The stock had spiked up nearly 60% in the prior week on expectations that **Qimonda** (QI:NYSE) may be allowed to "go under," along with a number of other cutbacks in memory production capacity. Qimonda has since been rescued, so the stock has pulled back. But investors remain focused on capacity -- and rightly so.

Emerging market wireless subscriber data were reported this past week in China (we're still waiting on India) and it doesn't look particularly good. Just one more data point supporting the market deterioration scenario in the wireless "growth markets."

Last, whether you celebrate Christmas, Hanukkah, something else or nothing at all, let me extend all the best wishes of the season to you and your families.

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Research In Motion Earnings Results

Research In Motion became a pleasant surprise last week. Granted, the numbers were only in line with the preannouncement, but the guidance was strong and the commentary had a definite positive spin on it.

As I'm certain you are aware by now, revenue came in at $2.78 billion (up 66% year over year; up 8% quarter over quarter) with GAAP earnings per share (EPS) of 69 cents (pro forma EPS came in at 83 cents). Gross margin was actually a little lower than expected because of the strength of the company's new products, the BlackBerry Bold and the BlackBerry Storm. Most products start out with lower margins, and when you have underestimated demand, attempting to ramp up production can frequently involve expedite fees.

Management had told us the previous two quarters that there would be slower operating expense growth in the second half of the fiscal year, and we finally saw that despite the weaker-than-expected revenue level. Operating expenses grew only 3% sequentially vs. 8% sequential revenue growth.

The company experienced a tax anomaly in the period related to foreign exchange rates that pushed the tax rate up to 41% vs. an expectation of 29%-30%. Management indicated that a new law in Canada will prevent this issue from recurring in calendar 2009. The unusual tax hit was partially offset by a one-time investment gain of $13 million. Cash from operations was a very strong $560 million, enabling Research In Motion to add about $100 million to its cash position. Accounts receivable (A/R) increased about $70 million, but days sales outstanding (DSO) declined three days to 59 days. Inventory increased about $70 million, but days of inventory (DOI) remained unchanged at 36 days.

Generally speaking, sales were in line with the preannouncement, but not from a mix perspective. Unit demand was good with 6.7 million units having shipped in the quarter, but more than half of the demand was from the newly introduced Storm and Bold smartphones. Average selling prices (ASPs) were $337 million, which was below expectations due to the foreign exchange impact. The Storm remains capacity constrained, a situation that will not be resolved for several more weeks. Management believes that anticipation for the new products led to the relatively weak level of new activations in the quarter of only 2.6 million vs. 3.1 million in the prior year.

The big surprise from my perspective was guidance for the fiscal fourth quarter. I had anticipated that anything even close to what was then the current consensus estimate would be viewed positively. The company's guidance was actually above consensus. Revenue is anticipated to be $3.3 billion to $3.5 billion, or up 19%-26% sequentially. New units are expected to be 7.5 million to 8.0 million, with ASPs of the units up to $370. However, the strong new product demand will continue to weigh on gross margins with the expectation that it drops further, to 40%-41%. Operating expenses should be up 11%-13% sequentially and the tax rate is anticipated to be at a more normalized 29%-30%. Pro forma EPS are expected to be 83 cents to 91 cents. Street consensus at the time of the call was for revenue of $3 billion and pro forma EPS of 83 cents.

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At the time of the preannouncement, Research In Motion noted that about one-third of the shortfall was related to foreign exchange. During the conference call, management indicated that most of the remainder of the shortfall could be attributed to the late shipment of the Bold and Storm products. And as of last Thursday, the company continues to see very strong demand for the new devices.

Management did its best to downplay their enthusiasm on the call. Despite the margin issues, which will resolve themselves over time, the Storm and Bold appear to be off to a great start. There was no mention of any "return rates," but if that were an issue the products wouldn't still be capacity constrained. When questioned a number of times about guidance in light of the economy, management suggested that they have factored in some conservatism to the numbers. If that's conservative, I say give me more.

Micron Earnings Results

Micron's results for its fiscal first quarter were mixed to say the least, courtesy of a huge inventory writedown. The writedown sent the loss per share well below the Street consensus, but revenue was actually above expectations.

Revenue in the quarter was $1.40 billion (down 9% year over year; down 3% quarter over quarter) with a loss per share of 91 cents. Gross margin was negative once again, after a $369 million inventory writedown and a gain of $157 million after the sale of previously written-down inventory. The net after these two events was 28 cents to reported loss per share. The operating margin was negative for the seventh consecutive quarter. Cash from operations was quite strong at $359 million. The company's cash accounts declined another $330 million, to about $1 billion after acquisitions. A/R was essentially unchanged, but DSO was up two days to 66 days. Inventory declined $400 million largely due to the writedown, but gigabits of inventory were down 15%. DOI now stands at 43 days.

Despite the weak results, demand was actually strong. Gigabits shipped increased 35% sequentially and 40% sequentially for DRAM and NAND flash, respectively. Unfortunately, ASP declines were just as strong, with DRAM down 34% from the fiscal fourth quarter and NAND flash prices down 24% from the prior period. The strong shipment levels did not go into anyone's inventory, as evidenced by the spike up in spot prices over the past week.

On the production side, DRAM gigabit output at Micron increased 14% sequentially vs. the expectation of high teens from the prior call. On the NAND flash side, output increased only 8% vs. the fiscal fourth quarter and vs. a target of mid-teens in the original guidance.

As I've noted in the past, Micron doesn't give guidance, so the Street estimates are largely guesstimates and frequently miss by quite a bit. However, unlike in the past, the company is not giving any specifics regarding its own bit-growth rates for the fiscal second quarter. The expectation for DRAM bits is that they will be "down," with no real changes in the cost of goods for the product line. NAND flash bit-growth will also be down, but cost savings are expected to increase again.

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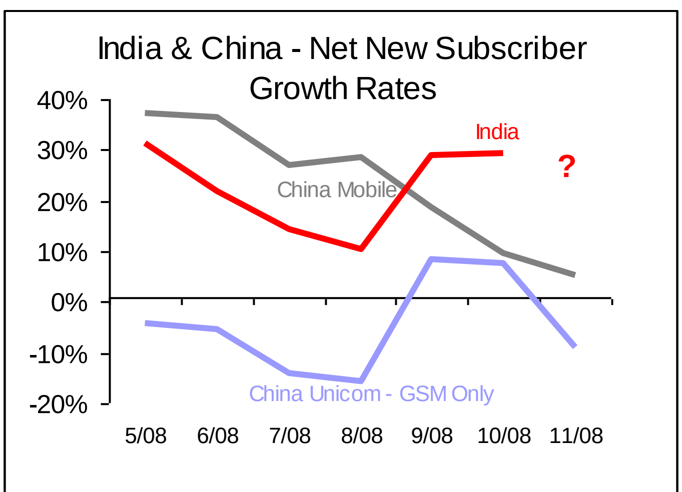
Like every company, Micron is cutting back wherever possible. The company also reduced its capex guidance for full-year 2009 again. The new range is expected to be in the $650 million to $750 million neighborhood vs. the prior expectation of $1.0 billion to $1.3 billion. CEO Steven Appleton also noted that many of the capex spending expectations he's seen for the industry from the Street remain too high.

Operating expenses were also down 5% from the fiscal fourth quarter on a weekly basis. The fiscal first quarter was a 14-week quarter vs. a normal 13-week quarter.

Business remains tough, but Micron is among the leanest companies in the industry. It produces the lowest-geometry DRAM and NAND flash in an industry where size matters. Many of the marginal competitors are in serious financial trouble. Despite the press releases on loans and bailouts, those monies are simply staving off bankruptcy. Consolidation is inevitable because the majority of the troubled firms are not competitive from a technology perspective. It's only a matter of time, and Micron will be a prime beneficiary.

Emerging Market Subscriber Growth

The data are in from China for new wireless subscribers in November, but unfortunately the Telecom Regulatory Authority of India (TRAI) has yet to publish its figures. As you can see in the first graph below, both China Mobile and China Unicom have continued to deteriorate. New subscriber growth at China Mobile fell to 5.4% year over year, the lowest level in my data set that goes back to 2006. China Unicom's GSM-only subscriber growth turned negative, down 9.0% from last year. However, that's the fifth negative number over the past seven months, which may say more about China Unicom than the overall market for wireless in China.



Source: Telecom Regulatory Authority of India, China Mobile & China Unicom

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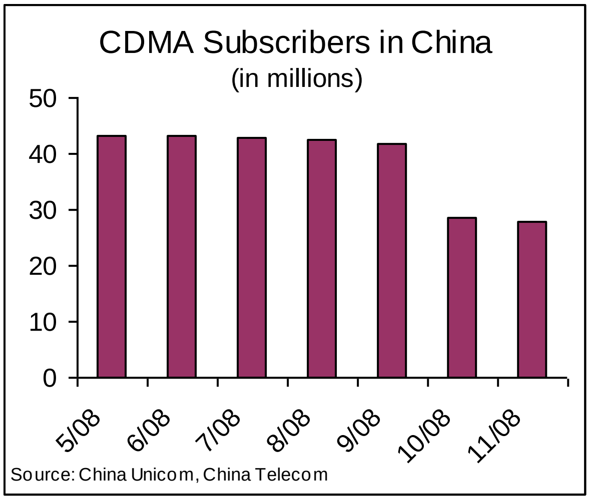
A quick look at China Telecom (see the chart below) shows that there has been a bit more deterioration in the subscriber base. The company lost about 430,000 subscribers during the month vs. losing 680,000 in the prior period. China Telecom's marketing "push" with its newly acquired wireless network is not expected to commence until the start of the new year.



The Telecom Connection Portfolio

Company Name	Date Initiated	Cost Basis per Share	No. of Shares	Amount Invested	Current Price	% Gain/Loss	IXTC at Buy Date	IXTC Return
Apple AAPL	2/15/06	$100.56	300	$30,168.00	85.04	-15.43%	235.36	-39.19%
Alvarion ALVR	2/22/07	$8.98	2,510	$22,538.00	3.27	-63.58%	244.90	-41.56%
Clearwire CLWRD	11/12/07	$13.50	500	$6,750.00	4.01	-70.30%	257.91	-44.50%
Cisco Systems CSCO	3/30/05	$22.51	800	$18,009.00	16.35	-27.37%	223.36	-35.92%
Cypress Semiconductor CY	7/10/08	$5.36	2,000	$10,720.00	4.01	-25.19%	230.96	-38.03%
Dell (call options) DLYAD – 20 contracts	12/6/07	$6.80	2,000	$13,600.00	0.01	-99.85%	259.97	-44.94%
First Solar FSLR	8/28/08	$263.55	150	$39,533.00	133.73	-49.26%	239.62	-40.27%
Google GOOG	2/9/06	$494.76	75	$37,106.70	302.95	-38.77%	243.87	-41.31%
Level 3 LVLT	6/19/08	$3.76	3,000	$11,280.00	0.67	-82.18%	263.91	-45.77%
Netlist NLST	2/14/08	$1.46	3,500	$5,095.00	0.29	-80.08%	232.75	-38.50%
Qualcomm QCOM	8/14/08	$55.02	500	$27,510.00	34.16	-37.91%	256.15	-44.12%
Research In Motion RIMM	11/19/07	$113.82	200	$22,763.75	41.02	-63.96%	247.44	-42.15%
Riverbed Technology RVBD	7/26/07	$32.56	450	$14,654.25	11.37	-65.09%	244.32	-41.42%
SunPower SPWRA	2/14/08	$89.70	300	$26,910.00	34.31	-61.75%	239.54	-40.25%
SunPower SPWRB	9/29/08	$70.95	548	$38,880.60	28.51	-59.82%	190.17	-24.74%

(The model portfolio continues on the next page)

Microtune TUNE	2/8/07	$5.23	2,500	$13,075.00	2.16	-58.70%	244.96	-41.57%
Micron (call options) WGYAZ – 125 contracts	8/28/08	$2.26	12,500	$28,250.00	1.13	-50.00%	251.83	-43.16%

The Telecom Connection Portfolio – Performance

Total Average Return	- 53.06%
2008 YTD Return	- 60.49%

Performance results listed here reflect values of stocks as of the close of the most recently completed trading day, and do NOT take into account dividends paid, interest earned or commissions. Results are updated overnight and posted prior to the market open the following business day. Sales are taken from the most recent purchase of that stock unless otherwise stated. The 2008 YTD Return figures reflect changes since the beginning of 2008. The Total Average Return figures reflect changes since inception on 8/14/2001.

Nasdaq Telecom Index Performance

	Portfolio Inception	Open Level	Current Level	% Gain/Loss Since Portfolio Inception	2008 YTD Return
Nasdaq Telecom Index (IXTC)	8/14/2001	262.84	143.13	- 45.54%	- 44.34%

At the time of publication, Mr. Faulkner was long CLWR, CY, MU, NLST, TUNE, TUNE calls.

To see the full Telecom Connection model portfolio, including closed positions, visit **http://www.thestreet.com/k/tc/portfolio.html**

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