

Potentially Poor Priv Sales Likely To End BlackBerry Hardware

About: BlackBerry Ltd. (BBRY)

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Summary

- About 1.25 million smartphones sales are required for BlackBerry to break even in hardware.
- Reasons such as poor carrier support, distribution, and marketing point to poor sales.
- Chen likely to persuade investors to hold on for another quarter.
- The Priv may be BlackBerry's last smartphone and the hardware business may be dismantled.

It has been over a month now since BlackBerry (NASDAQ:BBRY) released their new smartphone, the Priv, and although sales figures haven't been released yet the verdict may be out already. This latest release was supposed to reverse the quarterly decline in hardware sales and stabilize that business segment, but the initial signs don't look too good.

CEO John Chen's most recent target for break-even in the hardware business is 5 million handsets. This goal came down from a 10-million target not too long ago. To achieve 5 million in sales, about 1.25 million handsets would need to be sold each quarter and with only about 800,000 sold last quarter, this goal seems highly unachievable.

The Priv had a lot of potential to be a big hit and some investors believe sales have been great. Those investors would point out the Priv's stellar reviews, modern specs, physical keyboard, and security. I would, however, attribute weak US carrier support, poor manufacturing/distribution, and a non-effective marketing strategy to the failed Priv launch. Even with these reasons, I believe Chen may continue to persuade investors to hold on with promises for better results next quarter.

In this article, I lay out a few reasons why I believe sales have been poor and why Q3 hardware revenue could be another disaster.

Weak carrier support in the US

Rumors initially pegged the Priv to come to all four major carriers in the US. Since its November 6th launch, and to the present day, AT&T (NYSE:T) is the only carrier in America selling the Priv. It is also very likely that AT&T will continue to be the only US carrier with the Priv for the remainder of the year. In terms of missed potential,

this is huge, not only for the impact to FY16Q3 results but also missed potential of holiday sales.

Poor manufacturing/distribution

Previously, I wrote an article making the case that several aspects of BlackBerry's hardware business had improved over the years. What we saw from the last three weeks in November was that these aspects clearly had not improved enough. The Priv was available for purchase from the ShopBlackBerry.com website in three markets: US, Canada, and the UK. Supplies of the phone were only available for purchase that opening weekend and after that they were only available for pre-order. What is worse is eventually the ShopBB site had shipments expected to start on November 30 (the end of Q3). BlackBerry counts smartphones sales on a sell-through basis. For this reason, the majority of pre-orders through the ShopBB website would not contribute towards Q3 revenue.

Still no effective marketing strategy

BlackBerry has continued to focus on online marketing for the Priv. This includes using its blogs.blackberry.com portal and its YouTube channel to advertise its products. In terms of getting the most bang for its buck, John Chen believes this is the way to go. To my surprise, a few of the Priv videos actually gained over a million views. This appears to be significantly better than the reception for the Passport device. However, it is difficult to determine how this will actually convert to sales. Furthermore, this online material continues to target the consumers that actively seek out BlackBerry material.

A series of obscure black and white images have also been used to promote the Priv using different types of people. They have been showing up in ads across several websites. However, users with some sort of ad-blocking software would most likely not see these. I feel that by not going for more traditional forms of advertising, the Priv awareness continues to be relatively low. Therefore, I cannot see this marketing translating into a great amount of sales.

Priv release dampens BB10 device sales even further

Older BB10 models like the Passport and Classic continue to further fade into irrelevance and the Priv only accelerates this. The company has shown it prefers to support Android development now and with no BB10 phones scheduled to be released, it should be apparent that the BB10 operating system is reaching its end of life. For this reason, it makes it even less likely that a consumer would purchase a BB10 device.

Still some bright points

To be honest, I'm actually a fan of the Priv. No, I haven't purchased one yet as the CAD\$900 price seems a bit too steep. After using a touchscreen phone for over

three years now, I still constantly make spelling mistakes. Fully punctuated sentences tend to result in numerous errors and just seem so tedious. After all this time, I still miss the physical keyboard. With the keyboard, the adoption of the Android OS, a large battery and modern specs, I would personally consider the Priv a great phone. So the Priv does have a few things going for it. For one, numerous consumer reviews would confirm that it is a good phone. BlackBerry has made a high quality product here.

Moreover, there are two markets that are showing great carrier support: Canada and Hong Kong. In Canada, most of the major carriers have carried the Priv since launch day. These include Bell (NYSE:BCE), Rogers (NYSE:RCI), SaskTel, TELUS (NYSE:TU), and WIND. Hong Kong came to the game a week later and launched on November 12. Since then, the Priv has been available for purchase through China Mobile (NYSE:CHL), csl, 1010, SmarTone, 3 Hong Kong, Fortress, Hong Kong Suning, Broadway Photo Supply, Chung Yuen Electrical Co, Nuance-Watson Ltd., and Wilson Communications. This is a level of carrier support in Hong Kong that has not been seen in recent years. Carrier relations are significant and strong support could even facilitate sales for BlackBerry in the EMM area.

John "Next quarter" Chen

With the reasons I listed above, I believe BlackBerry has the recipe for disastrous sales of the Priv. We will get to find out on December 18 when BlackBerry releases FY2016Q3 earnings. If sales are as bad as I expect, I would anticipate Chen to spin this negative news and get investors to continue to hold on.

Investors can prepare for these remarks in advance:

A) More supply

As I mentioned, the Priv was not even available through ShopBlackBerry.com for the majority of Q3. Chen will most likely state that revenue will be recognized next quarter as he did with sales of the Passport. Hopefully, investors have not forgotten that fiasco.

B) More carriers

Eventually more carriers will have the Priv. It is likely that US carriers like Verizon (NYSE:VZ), T-Mobile (NASDAQ:TMUS), and Sprint (NYSE:S) will carry the Priv in the New Year. This, unfortunately, won't help sales as the buzz around the device will have cooled off and the holiday season would have passed. Furthermore, new devices from competitors with even better specs will be released.

C) More markets

The Priv did not yet receive a global rollout; very far from it actually. BlackBerry focused on three major markets (USA, Canada, UK) but executed horribly. Chen will

likely say sales should be stable as the device is rolled out to more markets in Europe and Asia. We have heard this before with the Leap/Passport/Classic and clearly sales did not improve or remain stable.

D) More devices

Only about a week after the Priv launched, rumors surfaced for BlackBerry's next Android device. This potentially cheaper phone does not contain a slide-out keyboard but rather has one that is always present. This rumor may fool investors into believing the company is committed to releasing phones as Chen believes he can still make the business profitable.

Conclusion

As of last quarter, hardware still accounted for 41% of BlackBerry's revenue. Although the average selling price may increase due to the Priv's premium price tag, I don't feel confident that smartphone sales will increase to the 1.25 million figure. To achieve that target, I estimate at least a half million Priv sales would be required. For the reasons I outlined above, I simply don't see that happening.

Chen has already done a decent job at cutting hardware expenses. If sales volumes are not up to par, then the hardware business will need to be shutdown. If history has taught us anything it is that Chen's estimates with respect to BlackBerry don't seem to come true. With that being said, it is highly possible that the Priv will be the last smartphone by BlackBerry.

Although I don't believe the stock price reflects optimistic sales of the Priv, I think if the sales are as bad as I expect, then the poor revenue/earnings figures will drive the stock even lower. Chen stated during last quarter's conference call that hardware is expected to remain stable. If this estimate is shown to be wrong then what can be said about the other estimates like for software revenue.

Cautious investors should stay away from this stock until a more certain direction is shown. I am trading the stock in the \$6.50-\$8.00 range.