



## Is BlackBerry a Buy?

### Description

Many investors have abandoned **BlackBerry** ([NYSE: BB](#)) over the past decade as the early king of smartphones lost its crown (and then virtually its entire kingdom) to **Apple**'s iPhones and a host of devices using's **Alphabet**'s Android operating system. BlackBerry has tried to stage a comeback over the past six years under CEO John Chen through such efforts as halting first-party production of smartphones, expanding its enterprise software business, and squeezing out licensing fees from its patents.

Those efforts finally began paying off [earlier this year](#) as BlackBerry's reported that in fiscal 2019's fourth quarter (which ended Feb. 28) revenue grew for the first time in years. That report also showed improved margins and the return of profits. The stock hit a 52-week high of about \$10 in late March after the Q4 numbers were released, but investor interest has since waned. Then, it plunged to a 52-week low of about \$5 a share after a mixed [fiscal second-quarter report](#) in late September.

Let's discuss what happened and whether or not BlackBerry's turnaround remains intact.

## BlackBerry's core growth engine is slowing down

Chen's main strategy was to phase out BlackBerry's hardware and non-core businesses and boost its higher-margin software and services revenues with new products and acquisitions. On the surface, that strategy paid off over the past year:

Metric	Fiscal Q2 2019	Fiscal Q3 2019	Fiscal Q4 2019	Fiscal Q1 2020	Fiscal
Software and Services revenue* growth (YOY)	1%	10%	14%	35%	30%

Software and Services percentage of total revenue*	92%	96%	96%	97%	98%
Total revenue growth (YOY)	(14%)	(3%)	8%	23%	22%

YOY = Year-over-year. \*[Non-GAAP](#). Source: BlackBerry quarterly results.

However, it generated more of that growth by acquiring companies — including Good Technology, Encription, and Cylance — than it did organically.

If we exclude the gains from Cylance (its latest purchase) from BlackBerry's fiscal Q1 2020 numbers, its software and services revenues only rose 8% annually on a non-GAAP basis — marking a deceleration from its 14% growth in the prior quarter. That deceleration continued in fiscal Q2, as its combined revenues rose just 30%. BlackBerry's non-GAAP software and services revenue also declined nearly 2% sequentially in the second quarter, indicating that its core business is losing steam.

Within that total, [Internet of Things](#) revenues fell 2% sequentially to \$134 million, licensing revenues dipped 1% to \$71 million as its patent lawsuits against **Facebook** and **Snap** [ran into problems](#), and its BlackBerry Cylance revenues remained flat at \$51 million. Moreover, BlackBerry's current deferred revenue — a key indicator of forward demand — rose just 1% sequentially.



Image source: Getty Images.

BlackBerry claims that its total non-GAAP revenues will rise by 23% to 25% for the full year, which indicates that it expects sequential growth to even out in the second half. However, analysts expect its revenue to rise just 8% next year as it laps the Cylance acquisition.

## Unstable margins and rising competition

BlackBerry's gross and operating margins improved throughout most of fiscal 2019, but both figures declined annually in the second quarter:

Metric	Fiscal Q2 2019	Fiscal Q1 2020	Fiscal Q2 2020
Gross margin	78%	74.5%	74.7%

Operating margin	7.9%	1.9%	0.8%
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Non-GAAP. Source: BlackBerry quarterly reports.

Those declining margins, along with the “retooling” of its sales strategy, suggest that BlackBerry and Cylance might be struggling against competitors in the enterprise software market.

Cylance rival OptiV belongs to investment giant **KKR** — which can afford to run the cybersecurity unit at a loss to gain ground in a crowded market. **Broadcom**, which recently agreed to buy **Symantec**’s enterprise security unit, represents a similar long-term threat.

BlackBerry believes that the Cylance deal will be accretive to its earnings within the first year, that the growth of its licensing revenues will offset its near-term declines, and that its automotive and Internet of Things services can drive its long-term growth.

That’s an optimistic outlook, but analysts still expect BlackBerry’s adjusted earnings to plunge 79% this year before rebounding 180% next year. The bulls believe the company will hit those targets, but the bears think that its core business will run out of steam amid fierce competition.

## So is BlackBerry a buy?

BlackBerry is no longer dying, but it hasn’t demonstrated the ability to move forward without the crutches of acquisitions and significant exclusions (like stock-based compensation expenses) from its non-GAAP numbers. It also remains unprofitable on a GAAP basis.

While I don’t think shareholders should panic and sell BlackBerry yet, I also think investors shouldn’t buy it until its growth accelerates sequentially and its margins improve.

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1. NYSE:BB (BlackBerry)

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