Motorola Mobility Holdings, Inc
Form 10-Q
May 01, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the period ended March 31, 2012

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number: 001-34805

MOTOROLA MOBILITY HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**27-2780868**
(State of Incorporation)	(I.R.S. Employer Identification No.)
600 N. U.S. Highway 45	**60048**
Libertyville, Illinois 60048	(Zip Code)
(Address of principal executive offices)	

Registrant s telephone number, including area code:

(847) 523-5000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares outstanding of each of the issuer s classes of common stock as of the close of business on March 31, 2012:

Class	Number of Shares
Common Stock; $.01 Par Value	303,676,580

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Part I Financial Information

Motorola Mobility Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended	
(In millions, except per share amounts)	***March 31, 2012***	*April 2, 2011*
Net revenues	**$3,078**	$3,032
Costs of sales	**2,324**	2,277
Gross margin	**754**	755
Selling, general and administrative expenses	**430**	417
Research and development expenditures	**366**	357
Other charges	**28**	17
Operating loss	**(70)**	(36)
Other income (expense):		
Interest income, net	**3**	2
Other, net	**(2)**	(17)
Total other income (expense)	**1**	(15)
Loss before income taxes	**(69)**	(51)
Income tax expense	**17**	30
Net loss	**$(86)**	$(81)
Loss per common share (Note 2):		
Basic	**$(0.28)**	$(0.27)
Diluted	**$(0.28)**	$(0.27)
Weighted average common shares outstanding:		
Basic	**302.4**	294.7
Diluted	**302.4**	294.7

See accompanying notes to condensed consolidated financial statements (unaudited).

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Motorola Mobility Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Loss)

(Unaudited)

	Three Months Ended	
(In millions)	***March 31, 2012***	*April 2, 2011*
Net loss	**$(86)**	$(81)
Other comprehensive income (loss):		
Net unrealized loss on securities (net of tax of $0)	**(1)**	(3)
Net loss on derivative instruments (net of tax of $1)	**(3)**	
Foreign currency translation adjustments	**23**	2
Total other comprehensive income (loss)	**19**	(1)
Comprehensive loss	**$(67)**	$(82)

See accompanying notes to condensed consolidated financial statements (unaudited).

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Motorola Mobility Holdings, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited)

(In millions)	***March 31, 2012***	*December 31, 2011*
ASSETS		
Cash and cash equivalents	**$3,065**	$3,451
Cash deposits	**267**	2
Accounts receivable, net	**1,711**	1,780
Inventories, net	**569**	701
Deferred income taxes	**92**	95
Other current assets	**595**	583
Total current assets	**6,299**	6,612
Cash deposits	**162**	155
Property, plant and equipment, net	**801**	805
Investments	**123**	119
Deferred income taxes	**93**	93
Goodwill	**1,434**	1,433
Other assets	**480**	513
Total assets	**$9,392**	$9,730
LIABILITIES AND STOCKHOLDERS EQUITY		
Accounts payable	**$1,530**	$1,666
Accrued liabilities	**2,224**	2,408
Total current liabilities	**3,754**	4,074
Other liabilities	**547**	568
Stockholders Equity		
Common stock: $.01 par value;	**3**	3
Authorized shares: 900.0		
Issued shares: 304.3		
Outstanding shares: 303.7		
Additional paid-in capital	**5,522**	5,452
Accumulated other comprehensive loss	**(99)**	(118)
Accumulated deficit	**(335)**	(249)
Total stockholders equity	**5,091**	5,088
Total liabilities and stockholders equity	**$9,392**	$9,730

See accompanying notes to condensed consolidated financial statements (unaudited).

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Motorola Mobility Holdings, Inc. and Subsidiaries

Condensed Consolidated Statement of Stockholders Equity

(Unaudited)

			Accumulated Other Comprehensive Income (Loss)				
(In millions)	*Shares*	*Common Stock and Additional Paid-in Capital*	*Fair Value Adjustment to Available for Sale Securities, Net of Tax*	*Foreign Currency Translation Adjustments, Net of Tax*	*Retirement Benefits Adjustments, Net of Tax*	*Other Items, Net of Tax*	*Accumulated Deficit*
Balances at December 31, 2011	**301.7**	**$5,455**	**$**	**$(111)**	**$(11)**	**$4**	**$(249)**
Net loss							(86)
Net unrealized loss on securities (net of tax of $0)			(1)				
Net loss on derivative instruments (net of tax of $1)						(3)	
Foreign currency translation adjustments				23			
Stock options exercised	2.0	22					
Share-based compensation expense		48					
Balances at March 31, 2012	**303.7**	**$5,525**	**$(1)**	**$(88)**	**$(11)**	**$1**	**$(335)**

See accompanying notes to condensed consolidated financial statements (unaudited).

Motorola Mobility Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In millions)	*Three Months Ended* ***March 31, 2012***	*April 2, 2011*
Operating		
Net loss	**$(86)**	$(81)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:		
Depreciation and amortization	**49**	54
Share-based compensation expense	**48**	40
Non-cash other charges (income)		(1)
Deferred income taxes	**(3)**	(11)
Changes in assets and liabilities, net of effects of acquisitions and dispositions:		
Accounts receivable	**74**	21
Inventories	**138**	(16)
Other current assets	**(8)**	22
Accounts payable and accrued liabilities	**(327)**	1
Other assets and liabilities	**17**	78
Net cash provided by (used for) operating activities	**(98)**	107
Investing		
Acquisitions and investments, net	**(20)**	(11)
Capital expenditures	**(33)**	(50)
Cash deposits	**(265)**	
Other, net	**(1)**	
Net cash used for investing activities	**(319)**	(61)
Financing		
Issuance of common stock	**22**	16
Capital contribution from Former Parent, net of cash deposits of $168		3,032
Other, net	**(1)**	15
Net cash provided by financing activities	**21**	3,063
Effect of exchange rate changes on cash and cash equivalents	**10**	7
Net increase (decrease) in cash and cash equivalents	**(386)**	3,116
Cash and cash equivalents, beginning of period	**3,451**	
Cash and cash equivalents, end of period	**$3,065**	$3,116
Cash Flow Information		
Cash paid during the period for:		
Interest, net	**$1**	$1
Income taxes, net of refunds	**6**	19

See accompanying notes to condensed consolidated financial statements (unaudited).

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Motorola Mobility Holdings, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Dollars in millions, except as noted)

(Unaudited)

1. Background and Basis of Presentation
Background

Motorola Mobility Holdings, Inc. (Motorola Mobility or the Company) is a provider of innovative technologies, products and services that enable a broad range of mobile and wireline, digital communication, information and entertainment experiences. The Company s integrated products and platforms deliver rich multimedia content, such as voice, video, messaging and Internet-based applications and services to multiple screens, such as mobile devices, televisions and personal computers (multi screens). Our product portfolio primarily includes mobile devices, wireless accessories, set-top boxes, video distribution systems and associated customer premises equipment. We are focused on developing differentiated, innovative products to meet the expanding needs of consumers to communicate, to collaborate and to discover, consume, create and share content at a time and place of their choosing on multiple devices.

On January 4, 2011 (the Distribution Date), the separation of Motorola Mobility from Motorola, Inc., which effective January 4, 2011 changed its name to Motorola Solutions, Inc. (hereinafter, the Former Parent) (the Separation), was completed. Motorola Mobility is now an independent public company trading under the symbol MMI on the New York Stock Exchange. On January 4, 2011, Former Parent stockholders of record as of the close of business on December 21, 2010 (the Record Date) received one (1) share of Motorola Mobility common stock for each eight (8) shares of Motorola, Inc. common stock held as of the Record Date (the Distribution). Motorola Mobility did not issue fractional shares of its common stock in the Distribution. Fractional shares that Former Parent stockholders would otherwise have been entitled to receive were aggregated and sold in the public market by the distribution agent and aggregate net cash proceeds of these sales were distributed ratably to those stockholders who would otherwise have been entitled to receive fractional shares.

At the time of the Distribution, the Former Parent contributed $3.2 billion in cash, cash equivalents and cash deposits to the Company (the Distribution Date Contribution). The Former Parent agreed to contribute to the Company an additional $300 million in cash if and when the Former Parent receives cash distributions as a result of the reduction in registered capital of an overseas subsidiary (the Deferred Contribution). Since Separation, the Company has received $297 million of the Deferred Contribution from the Former Parent including $72 million received on April 24, 2012.

Merger Agreement with Google Inc.

On August 15, 2011, Motorola Mobility Holdings, Inc. entered into an Agreement and Plan of Merger (the Merger Agreement) with Google Inc. (Google) and RB98 Inc., a wholly owned subsidiary of Google (Merger Sub). The Merger Agreement provides for the merger of Merger Sub with and into the Company (the Merger), with the Company surviving the Merger as a wholly owned subsidiary of Google. In the Merger, each outstanding share of common stock, par value $0.01 per share, of the Company, other than any dissenting shares, shares held by Google, Merger Sub, the Company or any of their respective subsidiaries and treasury shares, will be cancelled and converted into the right to receive $40 in cash, without interest.

The closing of the Merger is subject to customary closing conditions, including adoption of the Merger Agreement by the Company s stockholders and regulatory approvals. On November 17, 2011, Motorola Mobility stockholders approved the proposed merger with Google at the Company s Special Meeting of Stockholders. Antitrust clearances have been received in the U.S., European Commission, Canada, Israel, Russia, Taiwan and Turkey. Under the merger agreement, antitrust clearances, or waiting period expirations, are also required in

China. Requisite filings have been submitted to the appropriate regulatory body in China. In March 2012, the Chinese Ministry of Commerce extended the second phase of its investigation and the investigation is pending.

Pursuant to the Merger Agreement, stock options and restricted stock units (RSUs) granted by the Company as a substitute for Motorola, Inc. stock options and RSUs granted prior to 2011 will fully vest upon the closing of the transaction and be paid out at $40 for each RSU and $40 minus the exercise price for each stock option, in each case less applicable tax withholdings. Vested stock options and vested RSUs granted under Motorola Mobility s 2011 Incentive Compensation Plan in 2011 will be paid out at $40 for each RSU and $40 minus the exercise price for each stock option, in each case less applicable tax withholdings. Unvested stock options and unvested restricted stock (RS) and RSUs granted under Motorola Mobility s 2011 Incentive Compensation Plan in 2011 and 2012 will be converted to an award of equivalent value in Google stock options, RS and RSUs, respectively.

Basis of Presentation

The condensed consolidated financial statements include the accounts of the Company and all controlled subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. The condensed consolidated financial statements as of March 31, 2012 and December 31, 2011 and for the three months ended March 31, 2012 and April 2, 2011 include, in the opinion of management, all adjustments (consisting of normal recurring adjustments and reclassifications) necessary to present fairly the Company s consolidated financial position, results of operations and cash flows for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Form 10-K for the year ended December 31, 2011. The results of operations for the three months ended March 31, 2012 are not necessarily indicative of the operating results to be expected for the full year. Certain amounts in prior period financial statements and related notes have been reclassified to conform to the 2012 presentation.

The preparation of financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

2. Other Financial Data
Statement of Operations Information

Other Charges

Other charges included in Operating loss consist of the following:

Three Months Ended	***March 31, 2012***	*April 2, 2011*
Other charges:		
Merger-related transaction costs	**$17**	$
Intangible asset amortization	**11**	16
Intangible asset impairment		4
Reorganization of businesses		(3)
	$ 28	$ 17

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In August 2011, the Company retained investment banking firms to, among other things, advise us in connection with a potential transaction such as the merger and to evaluate whether the consideration to be received by the holders of our common stock pursuant to the Merger agreement was fair, from a financial point of view, to such holders. In the first quarter of 2012, the Company has incurred non-refundable fees of approximately $1 million, which have been recorded as a component of Other charges (income) in the Company s condensed consolidated statements of operations for the three months ended March 31, 2012. At the effective time of the Merger, the Company will incur additional aggregate fees of approximately $39 million to the investment banking firms. Additionally, the Company incurred $16 million in legal fees and other incremental costs in the first quarter of 2012 relating to the Merger, which has also been recorded as a component of Other charges (income) in the Company s condensed consolidated statements of operations for the three months ended March 31, 2012.

Other Income (Expense)

Interest income (expense), net, and Other, net, both included in Other income (expense), consist of the following:

Three Months Ended	***March 31, 2012***	*April 2, 2011*
Interest income (expense), net:		
Interest income	**$5**	$4
Interest expense	**(2)**	(2)
	$3	$2
Other, net:		
Foreign currency costs	**$(1)**	$(12)
Investment impairments	**(3)**	
Other	**2**	(5)
	$(2)	$(17)

Loss Per Common Share

The computation of basic and diluted loss per common share is as follows:

Three Months Ended	***March 31, 2012***	*April 2, 2011*
Basic loss per common share:		
Net loss	**$(86)**	$(81)
Weighted average common shares outstanding	**302.4**	294.7
Per share amount	**$(0.28)**	$(0.27)
Diluted loss per common share:		
Net loss	**$(86)**	$(81)
Weighted average common shares outstanding	**302.4**	294.7
Add effect of dilutive securities:		
Share-based awards and other		
Diluted weighted average common shares outstanding	**302.4**	294.7

Per share amount	**$(0.28)**	$(0.27)

For the three months ended March 31, 2012 and April 2, 2011, the Company was in a net loss position and, accordingly, the assumed exercise of 2.5 million stock options and the assumed vesting of 4.0 million restricted stock units for the three months ended March 31, 2012 and the assumed exercise of 1.3 million stock options and the assumed vesting of 2.7 million restricted stock units for the three months ended April 2, 2011, were excluded from diluted weighted average shares outstanding because their inclusion would have been antidilutive.

Balance Sheet Information

Cash and Cash Equivalents and Cash Deposits

The Company s cash and cash equivalents (which are highly-liquid investments with an original maturity of three months or less) were $3.1 billion at March 31, 2012. In addition, the Company had $429 million of cash deposits, primarily related to various legal disputes, at March 31, 2012. At March 31, 2012, $267 million of this amount was current and $162 million of this amount was non-current.

Accounts Receivable

Accounts receivable, net, consists of the following:

	March 31, 2012	*December 31, 2011*
Accounts receivable	**$1,730**	$1,803
Less allowance for doubtful accounts	**(19)**	(23)
	$1,711	$1,780

Inventories

Inventories, net, consists of the following:

	March 31, 2012	*December 31, 2011*
Finished goods	**$387**	$474
Work-in-process and production materials	**401**	455
	788	929
Less inventory reserves	**(219)**	(228)
	$569	$701

Other Current Assets

Other current assets consists of the following:

	March 31, 2012	*December 31, 2011*
Contractor receivables	**$234**	$264
Tax refunds receivable	**141**	101

Deferred costs	**97**	97
Royalty license arrangements	**55**	47
Other	**68**	74
	$595	$583

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Property, Plant and Equipment

Property, plant and equipment, net, consists of the following:

	March 31, 2012	*December 31, 2011*
Land	**$43**	$43
Buildings	**719**	696
Machinery and equipment	**1,671**	1,685
	2,433	2,424
Less accumulated depreciation	**(1,632)**	(1,619)
	$801	$805

Depreciation expense for the three months ended March 31, 2012 and April 2, 2011 was $38 million for each period.

Investments

Investments consists of the following:

March 31, 2012	*Recorded Value*	*Unrealized Gains*	*Less Unrealized Losses*	*Cost Basis*
Available-for-sale securities:				
Common stock and equivalents	$4	$	$(1)	$5
Other securities, at cost	90			90
Equity method investments	29			29
	$123	$	$(1)	$124

December 31, 2011	*Recorded Value*	*Unrealized Gains*	*Less Unrealized Losses*	*Cost Basis*
Available-for-sale securities:				
Common stock and equivalents	$	$	$	$
Other securities, at cost	90			90
Equity method investments	29			29
	$119	$	$	$119

During the three months ended March 31, 2012, the Company recorded investment impairment charges of $3 million, representing other-than-temporary declines in the value of the Company s investment portfolio, primarily related to other securities recorded at cost. During the three months ended April 2, 2011 the investment impairment charges recorded by the Company were *de minimis*. Investment impairment charges are included in Other within Other income (expense) in the Company s condensed consolidated statements of operations.

Other Assets

Other assets consists of the following:

	March 31, 2012	*December 31, 2011*
Royalty license arrangements	**$202**	$210
Intangible assets, net of accumulated amortization of $684 and $673	**137**	147
Deferred costs	**94**	111
Value-added tax refunds receivable	**8**	6
Other	**39**	39
	$480	$513

Accrued Liabilities

Accrued liabilities consists of the following:

	March 31, 2012	*December 31, 2011*
Customer reserves	**$338**	$382
Deferred revenue	**315**	307
Warranty reserves	**289**	277
Royalty license arrangements	**249**	269
Contractor payables	**194**	217
Compensation	**168**	302
Tax liabilities	**102**	106
Other	**569**	548
	$2,224	$2,408

Other Liabilities

Other liabilities consists of the following:

	March 31, 2012	*December 31, 2011*
Deferred revenue	**$144**	$162
Defined benefit pension plans	**98**	95
Facility financing obligation	**97**	97
Deferred income taxes	**64**	70
Other	**144**	144
	$547	$568

3. Risk Management

Derivative Financial Instruments

Foreign Currency Risk

The Company uses financial instruments to reduce its overall exposure to the effects of currency fluctuations on cash flows. The Company s policy prohibits speculation in financial instruments for profit on exchange rate price fluctuations, trading in currencies for which there are no underlying exposures, or entering into transactions for any currency to intentionally increase the underlying exposure. Instruments that are designated as part of a hedging relationship must be effective at reducing the risk associated with the exposure

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being hedged and are designated as part of a hedging relationship at the inception of the contract. Accordingly, changes in the market values of hedge instruments must be highly correlated with changes in market values of the underlying hedged items both at the inception of the hedge and over the life of the hedge contract.

The Company s strategy related to foreign exchange exposure management is to offset the gains or losses on the financial instruments against losses or gains on the underlying operational cash flows or investments based on the operating business units assessment of risk. The Company enters into derivative contracts for some of the Company s non-functional currency receivables and payables, which are primarily denominated in major currencies that can be traded on open markets. The Company typically uses forward contracts and options to hedge these currency exposures. In addition, the Company enters into derivative contracts for some firm commitments and some forecasted transactions, which are designated as part of a hedging relationship if it is determined that the transaction qualifies for hedge accounting under the provisions of the authoritative accounting guidance for derivative instruments and hedging activities. A portion of the Company s exposure is from currencies that are not traded in liquid markets and these are addressed, to the extent reasonably possible, by managing net asset positions, product pricing and component sourcing.

As of March 31, 2012 and December 31, 2011, the Company had outstanding foreign exchange contracts with notional values totaling $564 million and $546 million, respectively. Management believes that these financial instruments should not subject the Company to undue risk due to foreign exchange movements because gains and losses on these contracts should generally offset losses and gains on the underlying assets, liabilities and transactions, except for the ineffective portion of the instruments, which are charged to Other within Other income (expense) in the Company s condensed consolidated statements of operations.

The following table shows the five largest net notional amounts of the positions to buy or sell foreign currency as of March 31, 2012 and the corresponding positions as of December 31, 2011:

	Notional Amount	
Net Buy (Sell) by Currency	***March 31, 2012***	*December 31, 2011*
Euro	**$(343)**	$(154)
British Pound	**(27)**	(10)
Chinese Yuan	**31**	191
Brazilian Real	**41**	37
Canadian Dollar	**46**	47

Counterparty Risk

The use of derivative financial instruments exposes the Company to counterparty credit risk in the event of nonperformance by counterparties. However, the risk is limited to the fair value of the instruments when the derivative is in an asset position. At the present time, all of the counterparties have investment grade credit ratings. The Company is not exposed to material credit risk with any single counterparty.

The following table summarizes the effect of derivative instruments in our condensed consolidated statements of operations:

Three Months Ended March 31, 2012	*Loss on Derivative Instruments*	*Statement of Operations Location*
Derivatives designated as hedging instruments:		
Foreign exchange contracts Fair value hedges	$	Foreign currency income (expense)
Derivatives not designated as hedging instruments:		
Foreign exchange contracts	(4)	Other income (expense)
Total derivatives not designated as hedging instruments	$(4)	

Three Months Ended April 2, 2011	*Loss on Derivative Instruments*	*Statement of Operations Location*
Derivatives designated as hedging instruments:		
Foreign exchange contracts Fair value hedges	$	Foreign currency income (expense)
Derivatives not designated as hedging instruments:		
Foreign exchange contracts	(25)	Other income (expense)
Total derivatives not designated as hedging instruments	$(25)	

Fair Value of Financial Instruments

The Company s financial instruments include cash equivalents, accounts receivable, accounts payable, accrued liabilities, derivative financial instruments and other financing commitments. The Company s available-for-sale investment portfolios and derivative financial instruments are recorded in the Company s condensed consolidated balance sheets at fair value. All other financial instruments are carried at cost, which is not materially different than the instruments fair values.

4. Income Taxes

Income Tax Expense

For the three months ended March 31, 2012 and April 2, 2011, the Company recorded income tax expense of $17 million and $30 million, respectively, comprised of taxes on foreign earnings and foreign withholding taxes on royalty and other income. The Company has not recorded a tax benefit on its U.S. losses due to its recent history of cumulative U.S. losses.

Deferred Income Taxes

As of March 31, 2012 and December 31, 2011, the Company s net deferred tax assets, exclusive of valuation allowances, were $2.6 billion. As of March 31, 2012 and December 31, 2011, the valuation allowance against the net deferred tax assets was $2.5 billion.

Included in the net deferred tax assets of $2.6 billion as of March 31, 2012 are: (i) approximately $900 million of deferred tax assets related to capitalized R&D costs that may be amortized for tax purposes through 2019; (ii) approximately $900 million of deferred tax assets related to U.S. and foreign tax loss and credit carry forwards; and (iii) approximately $800 million of deferred taxes related to other temporary differences.

Unrecognized Tax Benefits

The Company had unrecognized tax benefits of $16 million and $23 million, at March 31, 2012 and December 31, 2011, respectively. During the three months ended March 31, 2012, the Company reduced its unrecognized tax benefits by $7 million primarily for facts that indicate the extent to which certain tax positions are more-likely-than-not of being sustained. The reduction resulted in the recording of no net income tax benefit due to offsetting valuation allowances.

5. Share-Based Compensation Plans

Upon Separation, all outstanding Former Parent stock options, stock appreciation rights and restricted stock units for the Company s employees were replaced with awards in the Company using a formula designed to preserve the intrinsic value and fair value of the award immediately prior to Separation. There was no incremental compensation expense to the Company related to the replacement of the Former Parent share-based compensation awards. Any unrecognized compensation expense related to the replaced awards will be recognized by the Company over the remaining vesting period of the awards.

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Stock Options

During the three months ended March 31, 2012, the Company did not grant any stock options. As of March 31, 2012, the Company had 18.6 million stock options and stock appreciation rights outstanding.

Restricted Stock and Restricted Stock Units

During the three months ended March 31, 2012, the Company granted 6.1 million RS and RSUs with a weighted-average fair market value of $38.88 per RS and RSU. As of March 31, 2012, the Company had 14.2 million RS and RSUs outstanding.

Compensation expense related to the Company s employee stock option, stock appreciation rights, employee stock purchase, restricted stock and restricted stock unit plans was as follows:

Three Months Ended	***March 31, 2012***	*April 2, 2011*
Share-based compensation expense included in:		
Costs of sales	**$5**	$4
Selling, general and administrative expenses	**25**	21
Research and development expenditures	**18**	15
Share-based compensation expense included in Operating loss	**48**	40
Tax benefit		
Share-based compensation expense, net of tax	**$48**	$40

6. Fair Value Measurements

The Company had no non-financial assets or liabilities that are required to be measured at fair value on a recurring basis as of March 31, 2012.

Applicable accounting standards specify a hierarchy of valuation techniques based on whether the inputs to each measurement are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company s assumptions about current market conditions. The prescribed fair value hierarchy and related valuation methodologies are as follows:

Level 1 Quoted prices for identical instruments in active markets.

Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations, in which all significant inputs are observable in active markets.

Level 3 Valuations derived from valuation techniques, in which one or more significant inputs are unobservable.

The fair values of the Company s financial assets and liabilities by level in the fair value hierarchy as of March 31, 2012 were as follows:

March 31, 2012	*Level 1*	*Level 2*	*Level 3*	*Total*
Assets:				
Cash equivalents				
Money market funds	$2,345	$	$	$2,345
Time deposits and bank drafts		423		423

Common stock and equivalents	4		4
Foreign exchange derivative contracts		1	1

7. Sales of Receivables

For the three months ended March 31, 2012 and April 2, 2011, total accounts receivable sold by the Company were $3 million and $31 million, respectively. As of March 31, 2012 and December 31, 2011, there were no accounts receivable outstanding for which the Company retained servicing obligations.

8. Credit Facilities

On January 4, 2011, the Company entered into a $500 million unsecured three-year credit agreement (the Credit Agreement) with a syndicate of lenders. The Credit Agreement provides for a revolving credit facility and a letter of credit facility, is guaranteed by certain of the Company s subsidiaries, and contains restrictive covenants. The Company may use any borrowings under the Credit Agreement for general corporate purposes. No obligations are outstanding under the Credit Agreement as of March 31, 2012.

9. Commitments and Contingencies

Legal

The Company is involved in various lawsuits, claims and investigations arising in the normal course of business and relating to the Company s business. The Company is currently engaged in significant patent litigation with Microsoft Corporation (Microsoft) and Apple Inc. (Apple) in many different forums within and outside the U.S., including in the U.S. International Trade Commission (ITC). The Company expects final ITC determinations on the Microsoft patent infringement matter against the Company in May 2012 with a sixty-day presidential review period subject to any applicable bonding requirements. An ultimate loss for the Company in an ITC action could result in a prohibition on importing infringing products or products incorporating infringing components into the U.S. The Company s manufacturing is conducted outside the U.S. and the Company imports all of its products into the U.S. An ultimate loss in the ITC also could necessitate workarounds to shift to non-infringing products or limit certain features of our products, increasing costs. Such patent litigation also could result in increased costs for the Company associated with damages, development of non-infringing products, and licenses under the subject intellectual property.

In the opinion of management, the ultimate disposition of these various matters is not expected to have a material adverse effect on the Company s consolidated financial position, liquidity or results of operations. However, an unfavorable resolution could have a material adverse effect on the Company s consolidated financial position, liquidity or results of operations in the periods in which the matters are ultimately resolved. If the Company is prohibited from importing infringing products into the U.S. and the scope of the prohibition impacts a meaningful portion of the Company s products, disposition of such an ITC matter could have a material impact on the Company s consolidated financial position, liquidity or results of operations.

Tax and Regulatory Proceedings in Brazil

In connection with the Company s operations in Brazil, Brazilian tax authorities have proposed assessments against the Company s Brazilian subsidiary relating to various technology transfer taxes, duties, value added taxes and certain other taxes related to the subsidiary s operations for calendar years 1997 through

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2010. As of March 31, 2012, these assessments collectively represent reasonably possible loss contingencies under the applicable accounting standards of up to approximately $449 million, based on the exchange rate in effect at March 31, 2012, including interest and penalties. However, the Company is vigorously disputing these matters, believes it has valid defenses that are supported by the law, and believes that this amount is not a meaningful indicator of liability. These matters are progressing through the multiple levels of administrative and judicial review available in Brazil. Due to the complexities and uncertainty surrounding the administrative and judicial process in Brazil and the nature of the claims asserted, the Company does not expect a final resolution of these matters for several years.

The Company routinely assesses the probability of ultimately incurring a loss in each of these matters and records the Company s best estimate of the ultimate loss in situations where the Company assesses the likelihood of an ultimate loss as probable. Based on the Company s assessment of these matters, the Company has recorded accruals on only a small portion of the total exposure. It is, however very difficult to predict the outcome of legal disputes and controversies, including litigation, in Brazil and our ultimate loss may be significantly greater than our current assessments and related accruals.

As of March 31, 2012, the Company had approximately $157 million of cash deposits, including accrued interest, for these matters, which are included in non-current Cash deposits in the Company s condensed consolidated balance sheet as of March 31, 2012.

Indemnifications

The Company may provide indemnifications for losses associated with indemnification and/or warranty provisions contained in certain commercial and intellectual property agreements. Historically, the Company has not made significant payments under these indemnifications. However, there is an increasing risk in relation to intellectual property indemnities given the current legal climate. In particular, two customers of the Company have made indemnification demands of the Company related to patent infringement claims by TiVo, Inc. against our products.

Furthermore, pursuant to the Master Separation and Distribution Agreement and certain other agreements with the Former Parent, Motorola Mobility agreed to indemnify the Former Parent for certain liabilities, and the Former Parent agreed to indemnify Motorola Mobility for certain liabilities, in each case for uncapped amounts.

Generally, in indemnification cases, payment by the Company is conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the Company to challenge the other party s claims. Further, the Company s obligations under these agreements for indemnification are generally limited in terms of duration and are for amounts not in excess of the contract value, except with respect to certain intellectual property infringement claims. In some instances, the Company may have recourse against third-parties for certain payments made by the Company.

10. Segment Information

The Company reports financial results for the following business segments:

The Mobile Devices segment designs, manufactures, sells and services wireless mobile devices, including smartphones and media tablets, with integrated software and accessory products, and licenses intellectual property.

The Home segment designs, manufactures, sells, installs and services set-top boxes for digital video, Internet Protocol (IP) video, satellite and terrestrial broadcast networks, end-to-end digital video and Internet Protocol Television (IPTV) distribution systems, broadband access network infrastructure platforms, and associated data and voice customer premises equipment and associated software solutions to cable television (TV) and telecommunication service providers.

Summarized below are the Company s net revenues and operating earnings (loss) by segment for the three months ended March 31, 2012 and April 2, 2011:

	Net Revenues		*Operating Earnings (Loss)*	
Three Months Ended	***March 31, 2012***	*April 2, 2011*	***March 31, 2012***	*April 2, 2011*
Mobile Devices	**$2,194**	$2,128	**$(121)**	$(89)
Home	**884**	904	**68**	53
	$3,078	$3,032		
Merger-related transaction costs			**(17)**	
Operating loss			**(70)**	(36)
Total other income (expense)			**1**	(15)
Loss before income taxes			**$(69)**	$(51)

11. Reorganization of Businesses

The Company maintains a formal Involuntary Severance Plan (the Severance Plan), which permits the Company to offer eligible employees severance benefits based on years of service and employment grade level in the event that employment is involuntarily terminated as a result of a reduction-in-force or restructuring. Prior to Separation, the Company participated in the Former Parent s Severance Plan. The Company recognizes termination benefits based on formulas per the Severance Plan at the point in time that future settlement is probable and can be reasonably estimated based on estimates prepared at the time a restructuring plan is approved by management. Exit costs consist of future minimum lease payments on vacated facilities and other contractual terminations. At each reporting date, the Company evaluates its accruals for employee separation and exit costs to ensure the accruals are still appropriate. In certain circumstances, accruals are no longer needed because of efficiencies in carrying out the plans or because employees previously identified for separation resigned from the Company and did not receive severance or were redeployed due to circumstances not foreseen when the original plans were initiated. In these cases, the Company reverses accruals through the condensed consolidated statements of operations where the original charges were recorded when it is determined they are no longer needed.

2012 Activity

During the three months ended March 31, 2012, the Company recorded no additional charges related to restructuring actions under Other charges in the Company s condensed consolidated statements of operations, and *de minimis* reversals of reorganization of business charges for accruals no longer needed.

The following table displays a rollforward of the reorganization of businesses accruals established for exit costs and employee separation costs from January 1, 2012 to March 31, 2012:

	Accruals at January 1, 2012	*Additional Charges*	*Adjustments*	*Amount Used*	*Accruals at March 31, 2012*
Exit costs	$5	$	$	$(1)	$4

Employee separation costs	21			(14)	7
	$26	$	$	$(15)	$11

Adjustments include foreign currency translation adjustments.

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Exit Costs

At January 1, 2012, the Company had an accrual of $5 million for exit costs attributable to lease terminations. The $1 million used reflects cash payments. The remaining accrual of $4 million, which is included in Accrued liabilities in the Company s condensed consolidated balance sheet at March 31, 2012, represents future cash payments, primarily for lease termination obligations that are expected to be paid over a number of years.

Employee Separation Costs

At January 1, 2012, the Company had an accrual of $21 million for employee separation costs, representing the severance costs for approximately 700 employees. During the three months ended March 31, 2012, approximately 300 employees, of which 100 were direct employees and 200 were indirect employees, were separated from the Company. The $14 million used reflects cash payments to these separated employees. The remaining accrual of $7 million, relating to employee separation costs that are expected to be paid in 2012, is included in Accrued liabilities in the Company s condensed consolidated balance sheet at March 31, 2012.

2011 Activity

During the three months ended April 2, 2011, the Company recorded $6 million of reversals of reorganization of business charges for accruals no longer needed, including $3 million of Separation-related adjustments for employees that remained with the Former Parent and $3 million under Other charges in the Company s condensed consolidated statements of operations.

The following table displays the net charges (reversals of accruals) incurred by business segment:

Three Months Ended	*April 2, 2011*
Mobile Devices	$(3)
Home	
	$(3)

The following table displays a rollforward of the reorganization of businesses accruals established for exit costs and employee separation costs from January 1, 2011 to April 2, 2011:

	Accruals at January 1, 2011	*Additional Charges*	*Adjustments*	*Amount Used*	*Accruals at April 2, 2011*
Exit costs	$12	$	$	$(1)	$11
Employee separation costs	32		(6)	(18)	8
	$44	$	$(6)	$(19)	$19

Adjustments include foreign currency translation adjustments.

Exit Costs

At January 1, 2011, the Company had an accrual of $12 million for exit costs attributable to lease terminations. The $1 million used reflects cash payments. The remaining accrual of $11 million, which is included in Accrued liabilities in the Company s condensed consolidated balance sheet at April 2, 2011, represents future cash payments, primarily for lease termination obligations that are expected to be paid over a number of years.

Employee Separation Costs

At January 1, 2011, the Company had an accrual of $32 million for employee separation costs, representing the severance costs for approximately 1,100 employees. The adjustments of $6 million reflect reversals of accruals no longer needed. During the three months ended April 2, 2011, approximately 500 employees, of which 100 were direct employees and 400 were indirect employees, were separated from the Company. The $18 million used reflects cash payments to these separated employees. The remaining accrual of $8 million is included in Accrued liabilities in the Company s condensed consolidated balance sheet at April 2, 2011.

12. Intangible Assets and Goodwill

Intangible Assets

Amortized intangible assets were comprised of the following:

	March 31, 2012		*December 31, 2011*	
	Gross Carrying Amount	*Accumulated Amortization*	*Gross Carrying Amount*	*Accumulated Amortization*
Completed technology	**$516**	**$466**	$515	$459
Licensed technology	**106**	**106**	106	106
Patents	**97**	**26**	97	24
Customer-related	**64**	**48**	64	46
Other intangibles	**38**	**38**	38	38
	$821	**$684**	$820	$673

Amortization expense on intangible assets, which is included within Other charges, was $11 million and $16 million for the three months ended March 31, 2012 and April 2, 2011, respectively. As of March 31, 2012, annual amortization expense is estimated to be $42 million in 2012, $36 million in 2013, $16 million in 2014, $12 million in 2015 and $9 million in 2016.

Amortized intangible assets, excluding goodwill, by business segment were as follows:

	March 31, 2012		*December 31, 2011*	
	Gross Carrying Amount	*Accumulated Amortization*	*Gross Carrying Amount*	*Accumulated Amortization*
Mobile Devices	**$149**	**$67**	$148	$64
Home	**672**	**617**	672	609
	$821	**$684**	$820	$673

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Goodwill

The following table displays a rollforward of the carrying amount of goodwill by reportable segment from January 1, 2012 to March 31, 2012:

	Mobile Devices	*Home*	*Total*
Balances as of January 1, 2012:			
Aggregate goodwill acquired	$142	$1,419	$1,561
Accumulated impairment losses	(55)	(73)	(128)
Goodwill, net of impairment losses	87	1,346	1,433
Goodwill acquired			
Impairment losses			
Adjustments	1		1
Balances as of March 31, 2012:			
Aggregate goodwill acquired	143	1,419	1,562
Accumulated impairment losses	(55)	(73)	(128)
Goodwill, net of impairment losses	$88	$1,346	$1,434

MANAGEMENT S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This commentary should be read in conjunction with Motorola Mobility Holdings, Inc. s (the Company s) condensed consolidated financial statements for the three months ended March 31, 2012 and April 2, 2011, as well as the Company s consolidated financial statements and related notes thereto and management s discussion and analysis of financial condition and results of operations in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

Introduction

Management s discussion and analysis of financial condition and results of operations (MD&A) is a supplement to the accompanying condensed consolidated financial statements and provides additional information on Motorola Mobility s business, recent developments, financial condition, liquidity and capital resources, cash flows and results of operations. MD&A is organized as follows:

Separation from Motorola, Inc. This section provides a general discussion of our separation from Motorola, Inc., which changed its name to Motorola Solutions, Inc. (hereinafter, our Former Parent) effective January 4, 2011.

Merger Agreement with Google Inc. This section provides a general discussion of our proposed Merger with Google Inc.

Executive Overview This section provides a general description of our business, as well as recent developments we believe are important in understanding our results of operations and financial condition or in understanding anticipated future trends.

Looking Forward This section provides a discussion of management s general outlook about market demand, competition and product development.

Results of Operations This section provides an analysis of our results of operations for the three months ended March 31, 2012 and April 2, 2011.

Liquidity and Capital Resources This section provides a discussion of our current financial condition and an analysis of our cash flows for the three months ended March 31, 2012 and April 2, 2011.

Significant Accounting Policies This section identifies and summarizes those accounting policies that significantly impact our reported results of operations and financial condition and require significant judgment or estimates on the part of management in their application.

Separation from Motorola, Inc.

On January 4, 2011 (the Distribution Date), Motorola Mobility Holdings, Inc. became an independent, publicly traded company as a result of our Former Parent s distribution of its shares of Motorola Mobility to our Former Parent s stockholders. On the Distribution Date, Former Parent stockholders of record as of the close of business on December 21, 2010 (the Record Date) received one share of Motorola Mobility common stock for every eight shares of Motorola, Inc. common stock held as of the Record Date (the Distribution). Motorola Mobility is comprised of

Motorola, Inc. s former Mobile Devices and Home businesses. Our Former Parent s Board of Directors approved the distribution of its shares of Motorola Mobility Holdings, Inc. on November 30, 2010. Motorola Mobility Holdings, Inc. was incorporated on May 28, 2010 and is the parent of Motorola Mobility, Inc., our main U.S. wholly owned operating subsidiary through which we conduct substantially all of the business activities discussed in this Form 10-Q. Our Registration Statement on Form 10 was declared effective by the U.S. Securities and Exchange Commission on December 1, 2010. Our common stock began trading regular-way under the ticker symbol MMI on the New York Stock Exchange on January 4, 2011.

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Merger Agreement with Google Inc.

On August 15, 2011, Motorola Mobility Holdings, Inc. entered into an Agreement and Plan of Merger (the Merger Agreement) with Google Inc. (Google) and RB98 Inc., a wholly owned subsidiary of Google (Merger Sub). The Merger Agreement provides for the merger of Merger Sub with and into the Company (the Merger), with the Company surviving the Merger as a wholly owned subsidiary of Google. In the Merger, each outstanding share of common stock, par value $0.01 per share, of the Company, other than any dissenting shares, shares held by Google, Merger Sub, the Company or any of their respective subsidiaries and treasury shares, will be cancelled and converted into the right to receive $40 in cash, without interest.

The closing of the Merger is subject to customary closing conditions, including adoption of the Merger Agreement by the Company s stockholders and regulatory approvals. On November 17, 2011, Motorola Mobility stockholders approved the proposed merger with Google at the Company s Special Meeting of Stockholders. Antitrust clearances have been received in the U.S., European Commission, Canada, Israel, Russia, Taiwan and Turkey. Under the merger agreement, antitrust clearances, or waiting period expirations, are also required in China. Requisite filings have been submitted to the appropriate regulatory body in China. In March 2012, the Chinese Ministry of Commerce extended the second phase of its investigation and the investigation is pending. The Company currently expects the transaction to close during the first half of 2012.

Pursuant to the Merger Agreement, stock options and restricted stock units (RSUs) granted by the Company as a substitute for Motorola, Inc. stock options and RSUs granted prior to 2011 will fully vest upon the closing of the transaction and be paid out at $40 for each RSU and $40 minus the exercise price for each stock option, in each case less applicable tax withholdings. Vested stock options and vested RSUs granted under Motorola Mobility s 2011 Incentive Compensation Plan in 2011 will be paid out at $40 for each RSU and $40 minus the exercise price for each stock option, in each case less applicable tax withholdings. Unvested stock options and unvested restricted stock (RS) and RSUs granted under Motorola Mobility s 2011 Incentive Compensation Plan in 2011 and 2012 will be converted to an award of equivalent value in Google stock options, RS and RSUs, respectively.

Executive Overview

The Company

Motorola Mobility Holdings, Inc. is a provider of innovative technologies, products and services that enable a range of mobile and wireline digital communication, information and entertainment experiences. The Company s integrated products and platforms deliver rich multimedia content, such as voice, video, messaging and Internet-based applications and services to multiple screens, such as mobile devices, including smartphones and media tablets, televisions and personal computers. Our product portfolio primarily includes mobile devices, wireless accessories, set-top boxes, video distribution systems and associated customer premises equipment. We are focused on developing differentiated, innovative products to meet the expanding needs of consumers to communicate, to collaborate and to discover, consume, create and share content at a time and place of their choosing on multiple devices.

We operate our business in two segments. The Mobile Devices segment is focused on mobile wireless devices and related products and services. This segment s net revenues were $2.2 billion in the first quarter of 2012 and $2.1 billion in the first quarter of 2011, representing 71% and 70%, respectively, of Motorola Mobility s consolidated net revenues. The Home segment is focused on technologies and devices that provide video entertainment services to consumers by enabling subscribers to access a variety of interactive digital television services. This segment s net revenues were $884 million in the first quarter of 2012 and $904 million in the first quarter of 2011, representing 29% and 30%, respectively, of Motorola Mobility s consolidated net revenues.

Motorola Mobility s Financial Results for the First Quarter of 2012

Net Revenues of $3.1 Billion: Our net revenues were $3.1 billion in the first quarter of 2012, up 2% compared to net revenues of $3.0 billion in the first quarter of 2011. Net revenues increased 3% in the Mobile Devices segment and decreased 2% in the Home segment.

Operating Loss of $70 Million: We incurred an operating loss of $70 million in the first quarter of 2012, compared to an operating loss of $36 million in the first quarter of 2011.

Net Loss of $86 Million: We incurred a net loss of $86 million in the first quarter of 2012, compared to a net loss of $81 million in the first quarter of 2011.

Cash used for Operating Activities of $98 Million: We used $98 million of net cash from operating activities in the first quarter of 2012, compared to generating $107 million of net cash from operating activities in the first quarter of 2011.

Financial results for our two business segments for the quarter ended March 31, 2012

In Our Mobile Devices Business: Net revenues were $2.2 billion in the first quarter of 2012, an increase of 3% compared to net revenues of $2.1 billion in the first quarter of 2011. The increase in net revenues was primarily driven by an 11% increase in average selling price (ASP), partially offset by a 3% decrease in handset unit shipments. We shipped 8.9 million mobile devices in the first quarter of 2012, a 4% decrease compared to shipments of 9.3 million mobile devices in the first quarter of 2011, and a 15% decrease sequentially compared to shipments of 10.5 million mobile devices in the fourth quarter of 2011. We shipped 5.1 million Android-based smartphones in the first quarter of 2012, a 24% increase compared to shipments of 4.1 million in the first quarter of 2011, and a 5% decrease sequentially compared to shipments of 5.4 million in the fourth quarter of 2011. On a geographic basis, net revenues increased in the Europe, Middle East and Africa region (EMEA) and Latin America, partially offset by decreased net revenues in Asia and North America.

The segment incurred an operating loss of $121 million in the first quarter of 2012, compared to an operating loss of $89 million in the first quarter of 2011. The increase in the operating loss was primarily due to (i) higher selling, general and administrative (SG&A) expenses to support the growth in smartphone volumes and (ii) a decrease in gross margin, partially offset by a 3% increase in net revenues.

In Our Home Business: Net revenues were $884 million in the first quarter of 2012, a decrease of 2% compared to net revenues of $904 million in the first quarter of 2011. The decrease in net revenues in the Home segment was primarily driven by a 4% decrease in net revenues of set-top boxes, reflecting a 10% decrease in shipments of set-top boxes, partially offset by a higher ASP due to a favorable product mix. Net revenues of video and access infrastructure equipment declined slightly. On a geographic basis, net revenues decreased in North America, Latin America and Asia, partially offset by increased net revenues in EMEA.

The segment had operating earnings of $68 million in the first quarter of 2012, compared to operating earnings of $53 million in the first quarter of 2011. The increase in operating earnings was primarily due to (i) an increase in gross margin primarily driven by operational efficiencies and a favorable product mix and (ii) a decrease in SG&A expenditures, primarily due to a non-recurring charge to settle a legal matter during the first quarter of 2011, partially offset by higher research and development (R&D) expenditures.

Looking Forward

In August 2011, Motorola Mobility and Google entered into the Merger Agreement pursuant to which Google will acquire the Company. The Merger is subject to various closing conditions, including antitrust clearances in various jurisdictions and other conditions described in the Company s definitive proxy statement on Schedule 14A filed with the Securities and Exchange Commission on October 14, 2011. We currently expect the Merger to be completed during the first half of 2012 following antitrust regulatory approval from China. In all other jurisdictions with pre-closing requirements, the transaction has been investigated and cleared without conditions. It is possible that the failure to timely meet the closing conditions or other factors outside of our control could require us to complete the Merger at a later time or prevent us from completing the Merger altogether.

We expect continued growth, as well as convergence, of industries like wireless, media, computing and the Internet. This is expected to create continued consumer demand for new mobile devices, applications and services. We believe we are well positioned to deliver innovative experiences, both in the home and on the go, and across multiple types of devices, to address these opportunities.

In our Mobile Devices business, we expect continued annual growth in total industry demand over the next several years, particularly in the smartphone and media tablet segments of the market. We expect the overall global mobile device market to remain intensely competitive, particularly in smartphones and media tablets. The largest competitors in the industry, particularly Apple, are expected to continue to be very successful in the marketplace. We also expect certain competitors to significantly expand their smartphone portfolios in 2012 in the markets in which we compete, including several China-based manufacturers. Our strategy is focused on developing and marketing a competitive mobile device portfolio and strengthening our position in priority markets. Our product portfolio priorities include the following: (i) providing a more focused portfolio of mobile devices distributed through carriers, distributors and retailers globally, (ii) software applications, services and accessories for consumers, including cloud based, interactive experiences and a portfolio of accessories that enhance user experiences, and (iii) enterprise-ready devices for business as well as personal use. The balance of our portfolio, including feature phones, iDEN devices, and voice-centric devices will be more limited given the declining opportunity for profitable growth in these segments of the handset industry. Mobile Devices market priorities continue to be primarily North America, China and Latin America, followed by Western Europe and other strategic markets. With the growth in industry demand for mobile devices, and by providing compelling consumer experiences and leveraging our brand, we expect to continue to improve the financial performance in our Mobile Devices business.

In our Home business, we expect industry conditions in 2012 to be comparable to 2011, including overall demand levels, competitiveness and pricing pressures. We will leverage our market leadership position and intellectual property to enhance our device portfolio, including advanced high definition and DVR set-top boxes and voice and data gateways. We are focusing our development efforts on innovation that enables our customers to provide converged media experiences through next generation whole-home IP video gateways and multi-screen service enablement. Increasing adoption of IP connected devices, such as smartphones, tablets, PCs and TVs, is enabling new services and increasing broadband demand. These trends are leading service providers to invest in IP networks driving the need for video and broadband infrastructure equipment to optimize their network, increase bandwidth and provide new services. We are focused on balancing our investment in growth market segments, management of our cost structure in the mature market segments and the profitability of the business.

The Company has an industry leading patent portfolio encompassing many wireless, video, and other innovative technologies. We are involved in significant patent litigation with industry competitors and other relevant patent holders. Several of these matters could be resolved during 2012. The outcome of these disputes could have a significant impact on our business and such matters are discussed in *Part II. Item 1. Legal Proceedings* of the Company s Form 10-Q and *Part I. Item 3. Legal Proceedings* of the Company s 2011 Form 10-K.

We conduct our business in highly competitive markets, facing both new and established competitors. The markets for many of our products are characterized by rapidly changing technologies, frequent new product introductions, changing consumer trends, short product life cycles, consumer loyalty and evolving industry standards. Market disruptions caused by new technologies, the entry of new competitors, consolidations among our customers and competitors, changes in regulatory requirements, changes in economic conditions, supply interruptions or other factors, can introduce volatility into our businesses. Meeting all of these challenges requires consistent operational planning and execution and investment in technology, resulting in innovative products that meet the needs of our customers around the world. As we execute on meeting these objectives, we remain focused on taking the necessary action to design and deliver differentiated and innovative products, services and experiences that simplify, connect, and enrich people s lives.

Results of Operations

(Dollars in millions)	***March 31, 2012***	***% of Revenue***	*April 2, 2011*	*% of Revenue*
	Three Months Ended			
Net revenues	**$3,078**		$3,032	
Costs of sales	**2,324**	**75.5%**	2,277	75.1%
Gross margin	**754**	**24.5%**	755	24.9%
Selling, general and administrative expenses	**430**	**14.0%**	417	13.8%
Research and development expenditures	**366**	**11.9%**	357	11.8%
Other charges	**28**	**0.9%**	17	0.5%
Operating loss	**(70)**	**(2.3)%**	(36)	(1.2)%
Other income (expense):				
Interest income (expense), net	**3**	**0.1%**	2	0.0%
Other, net	**(2)**	**%**	(17)	(0.5)%
Total other income (expense)	**1**	**0.1%**	(15)	(0.5)%
Loss before income taxes	**(69)**	**(2.2)%**	(51)	(1.7)%
Income tax expense	**17**	**0.6%**	30	1.0%
Net loss	**$(86)**	**(2.8)%**	$(81)	(2.7)%

Three months ended March 31, 2012 compared to three months ended April 2, 2011

Net Revenues

Net revenues were $3.1 billion in the first quarter of 2012, up 2% compared to net revenues of $3.0 billion in the first quarter of 2011. The increase in net revenues reflects a $66 million, or 3%, increase in net revenues in the Mobile Devices segment, partially offset by a $20 million, or 2%, decrease in net revenues in the Home segment. The 3% increase in net revenues in the Mobile Devices segment was primarily driven by an 11% increase in ASP, partially offset by a 3% decrease in unit shipments. The 2% decrease in net revenues in the Home segment was primarily driven by a 4% decrease in net revenues of set-top boxes, reflecting a 10% decrease in shipments of set-top boxes, partially offset by a higher ASP due to favorable product mix. Net revenues of video and access infrastructure equipment declined slightly.

Gross Margin

Gross margin was $754 million, or 24.5% of net revenues, in the first quarter of 2012, compared to $755 million, or 24.9% of net revenues, in the first quarter of 2011. The decrease in gross margin as a percentage of net sales in the first quarter of 2012 compared to the first quarter of 2011 reflects a decrease in gross margin percentage in the Mobile Devices segment, partially offset by an increase in the Home segment. The Company s overall gross margin as a percentage of net revenues can be impacted by the proportion of overall net revenues generated by its various businesses.

Selling, General and Administrative Expenses

SG&A expenses increased 3% to $430 million, or 14.0% of net revenues, in the first quarter of 2012, compared to $417 million, or 13.8% of net revenues, in the first quarter of 2011. The increase in SG&A expenses reflects higher SG&A expenses in the Mobile Devices segment, partially offset by lower SG&A expenses in the Home segment, primarily due to the absence in the first quarter of 2012 of a comparable non-recurring charge to settle a legal matter. The increase in the Mobile Devices segment was to support the growth in smartphone volumes. SG&A expenses as a percentage of net revenues increased in the Mobile Devices segment and decreased in the Home segment.

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Research and Development Expenditures

R&D expenditures increased 3% to $366 million, or 11.9% of net revenues, in the first quarter of 2012, compared to $357 million, or 11.8% of net revenues, in the first quarter of 2011. The increase in R&D expenditures reflects higher R&D expenditures in the Home segment, partially offset by a slight decrease in R&D in the Mobile Devices segment. R&D expenses as a percentage of net revenues increased in the Home segment and decreased in the Mobile Devices segment. The Company participates in very competitive industries with constant changes in technology and, accordingly, the Company continues to believe that a strong commitment to R&D is required to drive long-term growth.

Other Charges

The Company recorded net charges of $28 million in Other charges in the first quarter of 2012, compared to net charges of $17 million in the first quarter of 2011. The charges in the first quarter of 2012 were primarily comprised of $17 million of charges related to the proposed Merger with Google and $11 million of charges relating to the amortization of intangibles. The charges in the first quarter of 2011 were primarily comprised of $16 million of charges relating to the amortization of intangibles.

Interest Income (Expense), Net

Net interest income was $3 million in the first quarter of 2012, compared to net interest income of $2 million in the first quarter of 2011. Net interest income in the first quarter of 2012 includes interest income of $5 million, partially offset by interest expense of $2 million. Net interest income in the first quarter of 2011 includes interest income of $4 million, partially offset by interest expense of $2 million.

Other, Net

Net expense classified as Other, as presented in Other income (expense), was $2 million in the first quarter of 2012, compared to $17 million in the first quarter of 2011. The net expense in the first quarter of 2012 was primarily comprised of $3 million of investment impairment costs. The net expense in the first quarter of 2011 was primarily comprised of $12 million of foreign currency costs.

Income Tax Expense

The Company recorded income tax expense of $17 million in the first quarter of 2012 as compared to $30 million in the first quarter of 2011. The expense for both the first quarters of 2012 and 2011 was comprised of taxes on foreign earnings and foreign withholding taxes on royalty and other income. The Company has not recorded a tax benefit on its U.S. losses due to its recent history of cumulative U.S. losses.

The Company s tax provision may change from period to period based on non-recurring events, such as the settlement of tax audits, changes in valuation allowances and the tax impact of significant unusual or extraordinary items. The Company s tax provision will also change due to the level of pre-tax income or loss and its geographic mix.

Net Loss

The Company incurred a loss before income taxes of $69 million in the first quarter of 2012, compared with a loss before income taxes of $51 million in the first quarter of 2011. After taxes, the Company incurred a net loss of $86 million in the first quarter of 2012, compared to a net loss of $81 million in the first quarter of 2011.

The increase in the loss before income taxes in the first quarter of 2012 compared to the first quarter of 2011 was primarily attributable to a $11 million increase in Other charges and a $13 million increase in SG&A expenses, partially offset by a $15 million decrease in Other, as presented in Other income (expense).

Segment Results

The following commentary should be read in conjunction with the financial results of each operating business segment as detailed in Note 10, *Segment Information*, to the Company s condensed consolidated financial statements as of and for the three months ended March 31, 2012. Net revenues and operating results for the Company s two operating business segments for the three months ended March 31, 2012 and April 2, 2011 are presented below.

Mobile Devices Segment

The **Mobile Devices** segment designs, manufactures, sells and services wireless mobile devices, including smartphones and media tablets, with integrated software and accessory products, and licenses intellectual property. For the first quarter of 2012, the segment s net revenues represented 71% of the Company s consolidated net revenues, compared to 70% for the first quarter of 2011.

	Three Months Ended		
(Dollars in millions)	***March 31, 2012***	*April 2, 2011*	*% Change*
Segment net revenues	**$2,194**	$2,128	**3 %**
Operating loss	**(121)**	(89)	**36%**

Three months ended March 31, 2012 compared to three months ended April 2, 2011

In the first quarter of 2012, the segment s net revenues were $2.2 billion, an increase of 3% compared to net revenues of $2.1 billion in the first quarter of 2011. The increase in net revenues was primarily driven by an 11% increase in average selling price, partially offset by a 3% decrease in unit shipments. On a geographic basis, net revenues increased in the Europe, Middle East and Africa region and Latin America, partially offset by decreased net revenues in Asia and North America.

The segment incurred an operating loss of $121 million in the first quarter of 2012, compared to an operating loss of $89 million in the first quarter of 2011. The increase in the operating loss was primarily due to (i) higher selling, general and administrative expenses to support the growth in smartphone volumes and (ii) a decrease in gross margin, partially offset by a 3% increase in net revenues. As a percentage of net revenues in the first quarter of 2012 as compared to the first quarter of 2011, gross margin and R&D expenditures decreased and SG&A expenses increased.

The segment s industry typically experiences short life cycles for new products. Therefore, it is vital to the segment s success that new, compelling products are continually introduced. Accordingly, a strong commitment to R&D is required and, even amidst challenging global economic conditions, the segment expects to continue to make the appropriate investments to develop a differentiated product portfolio and fuel long-term growth.

Handset unit shipments in the first quarter of 2012 were 8.8 million units, a 3% decrease compared to shipments of 9.0 million units in the first quarter of 2011 and a 14% decrease sequentially compared to shipments of 10.3 million units in the fourth quarter of 2011. Smartphone shipments in the first quarter of 2012 were 5.1 million, a 24% increase compared to shipments of 4.1 million smartphones in the first quarter of 2011 and a 5% decrease sequentially compared to shipments of 5.4 million smartphones in the fourth quarter of 2011. In addition to handsets, we also shipped over 100 thousand media tablet units in the first quarter of 2012.

In the first quarter of 2012, segment ASP increased approximately 11% compared to the first quarter of 2011 and increased approximately 3% compared to the fourth quarter of 2011. The increase in ASP in the first quarter of 2012 as compared to the fourth quarter of 2011 was driven by favorable product mix in the first quarter of 2012. ASP is impacted by numerous factors, including product mix, market conditions and competitive product offerings, and ASP trends often vary over time.

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Home Segment

The **Home** segment designs, manufactures, sells, installs and services set-top boxes for digital video, Internet protocol (IP) video, satellite and terrestrial broadcast networks, end-to-end digital video and Internet protocol television (IPTV) distribution systems, broadband access network infrastructure platforms, and associated data and voice customer premises equipment and associated software solutions to cable TV and telecommunication service providers. For the first quarter of 2012, the segment s net revenues represented 29% of the Company s consolidated net revenues, compared to 30% for the first quarter of 2011.

	Three Months Ended
	March 31,
(Dollars in millions)	***2012***