

Palm Inc. (PALM) – Under Perform

PALM: Pre on Target in Q1

Palm reported a non-GAAP loss of \$0.10 in the August quarter on non-GAAP sales of \$360 million. Forced to move to non-GAAP, we're estimating a loss of \$0.35 in 2010 vs. a loss of \$0.25 previously and earnings of \$1.00 in 2011. We continued with an underperform rating chiefly because the company's guidance of a sequential decline in revenues in the second quarter implies that Pre sales are not off to the races.

- Palm reported a non-GAAP loss of \$0.10 on non-GAAP sales (excluding subscription accounting) of \$360 million. With non-recurring costs thrown in, which recur with great regularity, Palm's non-GAAP loss was \$0.43.
- Although Palm did not say what Pre sales were in the quarter, they appear to have been around 600,000 units, about 100,000 above our estimate.
- Palm indicated that revenues could fall to \$240 million to \$270 million in the second quarter, a number that implies that Pre sales could fall to 500,000 units vs. our previous estimate of 750,000 units. For the fiscal year, Palm is guiding to revenues of \$1.6 to \$1.8 billion, in line with our previous estimate.
- We are continuing with our underperform rating for now chiefly because of the disappointing guidance. We are now publishing non-GAAP estimates, which are reflected in the table below.
- The Pre and its siblings running on Palm's WebOS software platform appear to be a serious contender in the smartphone market. But it would be premature at this point to declare it a winner in view of the fact that the smartphone market will shortly be overrun with new phones from Motorola (N/R) and others running on the Android platform as well as new BlackBerry models in time for the holiday selling season.
- However, if Palm's WebOS platform can hold its own in this increasingly competitive environment and possibly gain share, an upgrade would clearly be warranted.

EPS Change

Market Data	
Price (09/17/09)	\$14.44
12-Month Price Target	N/A
52-Week range	\$16.58-1.42
Shares Out. (MM)	141.0
Market cap (MM)	\$2,036.1
Avg. daily volume (000)	12,098.0
Financial Data	
Total Debt/Cap.	(596.9%)
Price/LTM Rev.	
Tangible BVPS	(\$6.75)
Net Cash Per Share	(\$1.26)

Palm Inc. is a provider of mobile computing solutions worldwide. The company offers Palm Treo smartphones, Palm LifeDrive mobile managers, Palm handheld computers, as well as software, services, and accessories.

	FY	FY		FY	
	05/30/09 A	05/30/10 E		05/30/11 E	
		Old	New	Old	New
Rev. (MM)			\$1,604.4		\$3,562.5
Growth	0.0%		0.0%		122.0%
Op. Mar.			(1.8%)		9.0%
EPS: 1Q			(0.43)A		0.14
EPS: 2Q			(0.24)		0.21
EPS: 3Q			(0.04)		0.28
EPS: 4Q			0.08		0.36
EPS: Year			(0.35)		1.00
Growth	0.0%		0.0%		nm
P/E Ratio	0.0x		nm		14.7x



Note: Pro forma earnings estimates displayed above do not include one-time items or any stock compensation expenses.

Disclosures applicable to this security: B, E, G.
Disclosure explanation on the inside back cover of this report.

Palm Non-GAAP Financial Forecast

(\$ in millions)

	Aug '09	Nov '09	Feb '10	May '10		Aug '10	Nov '10	Feb '11	May '11	
	2010/1	2010/2	2010/3	2010/4	2010	2011/1	2011/2	2011/3	2011/4	2011
Sales										
Organizers										
Smartphones										
Total	\$361.2	\$265.5	\$374.8	\$603.0	\$1,604.4	\$712.5	\$831.3	\$950.0	\$1,068.8	\$3,562.5
Cost of sales	\$260.5	\$187.3	\$262.7	\$422.3	\$1,132.8	\$498.8	\$581.9	\$665.0	\$748.1	\$2,493.8
Gross profits	\$100.6	\$78.3	\$112.0	\$180.7	\$471.6	\$213.8	\$249.4	\$285.0	\$320.6	\$1,068.8
Operating expenses										
Sales and marketing	56.0	55.8	52.5	78.4	242.6	89.1	99.8	109.3	117.6	415.6
Research & development	43.7	45.1	45.0	48.2	182.1	53.4	58.2	61.8	64.1	237.5
General & administrative	16.3	15.9	14.1	21.1	67.4	21.4	22.9	23.8	26.7	94.7
Amortization of intangibles	8.7									
Total	\$124.7	\$116.8	\$111.5	\$147.7	\$492.1	\$163.9	\$180.8	\$194.8	\$208.4	\$747.8
Non-GAAP operating earnings	(\$24.0)	(\$38.6)	\$0.5	\$33.0	(\$29.1)	\$49.9	\$68.6	\$90.3	\$112.2	\$320.9
Impairment of auction rate securities	(2.0)									
Interest & other income (expense)	(4.2)	(4.2)	(4.2)	(4.2)	(16.8)	(4.2)	(4.2)	(4.2)	(4.2)	(16.8)
Gain on series C derivative	(27.4)									
Non-GAAP pretax income	(\$57.6)	(\$42.8)	(\$3.7)	\$28.8	(\$45.9)	\$45.7	\$64.4	\$86.0	\$108.0	\$304.1
less: income taxes	0.1	(12.8)	(1.1)	8.6	(5.2)	13.7	19.3	25.8	32.4	91.2
Tax rate		30.0%	30.0%	30.0%		30.0%	30.0%	30.0%	30.0%	
Non-GAAP net income	(\$57.7)	(\$29.9)	(\$2.6)	\$20.1	(\$40.7)	\$32.0	\$45.1	\$60.2	\$75.6	\$212.9
Preferred dividends	\$3.4	\$3.4	\$3.4	\$3.4	\$13.5	\$3.4	\$3.4	\$3.4	\$3.4	\$13.5
Non-GAAP applicable to shareholders	(\$61.0)	(\$33.3)	(\$5.9)	\$16.8	(\$54.2)	\$28.6	\$41.7	\$56.9	\$72.2	\$199.4
Non-GAAP earnings per share	(\$0.43)	(\$0.24)	(\$0.04)	\$0.08	(\$0.35)	\$0.14	\$0.21	\$0.28	\$0.36	\$1.00
Shares outstanding	141.0	141.0	141.0	200.0	155.8	200.0	200.0	200.0	200.0	200.0
Year-over-year sales growth	NA	NA	NA	NA	NA	97%	213%	154%	77%	NA
% organizer revenues	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
% smartphone revenues	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Percent of sales										
Gross profits	27.9%	29.5%	29.9%	30.0%	29.4%	30.0%	30.0%	30.0%	30.0%	30.0%
Sales and marketing	15.5%	21.0%	14.0%	13.0%	15.1%	12.5%	12.0%	11.5%	11.0%	11.7%
Research & development	12.1%	17.0%	12.0%	8.0%	11.3%	7.5%	7.0%	6.5%	6.0%	6.7%
General & administrative	4.5%	6.0%	3.8%	3.5%	4.2%	3.0%	2.8%	2.5%	2.5%	2.7%
Operating expenses	34.5%	44.0%	29.8%	24.5%	30.7%	23.0%	21.8%	20.5%	19.5%	21.0%
Non-GAAP operating income	-6.7%	-14.5%	0.1%	5.5%	-1.8%	7.0%	8.3%	9.5%	10.5%	9.0%
Interest and other income	-1.2%	-1.6%	-1.1%	-0.7%	-1.0%	-0.6%	-0.5%	-0.4%	-0.4%	-0.5%
Pretax income	-15.9%	-16.1%	-1.0%	4.8%	-3.4%	6.4%	7.7%	9.1%	10.1%	5.6%

Palm Inc.

(\$ in MM, except per share data)

Fiscal Year Ending May 31	Annual		Quarterly			
	FY 5/30/2008	FY 5/31/2009	Ending 11/30/2008	Ending 2/28/2009	Ending 5/31/2009	Ending 8/31/2009
BALANCE SHEET						
ASSETS						
Cash & Short-term Investments	258.7	255.1	224.0	219.4	255.1	211.8
Receivables	116.4	66.5	98.2	52.7	66.5	76.6
Inventory	67.5	19.7	28.5	15.3	19.7	27.8
Other Current Assets	97.4	12.3	20.8	85.7	12.3	117.4
Current Assets	540.1	353.6	371.6	373.2	353.6	433.7
Property and Equipment	39.6	31.2	33.2	32.5	31.2	31.0
Goodwill and Intangibles	229.0	215.2	220.4	217.8	215.2	212.7
Long-term Marketable Securities	0.0	0.0	0.0	0.0	0.0	0.0
Other Assets	371.5	43.3	35.7	32.9	43.3	116.6
Total Assets	1,180.3	643.2	660.9	656.4	643.2	794.0
LIABILITIES AND SHAREHOLDERS' EQUITY						
Current Liabilities	411.3	342.4	411.6	342.4	342.4	703.1
Short-term Debt	0.0	0.0	0.0	0.0	0.0	0.0
Long-term Debt	394.0	390.0	392.0	391.0	390.0	389.0
Shareholders' Equity	111.0	(413.9)	(411.1)	(425.7)	(413.9)	(738.9)
Total Liabilities + Shareholders' Equity	1,180.3	643.2	660.9	656.4	643.2	794.0
INCOME STATEMENT						
Revenue						361.2
Gross Profit						100.6
Operating Income						(24.0)
Pretax Income						(57.6)
Net Income						(57.7)
Shares Outstanding						141.0
CASH FLOW STATEMENT						
Depreciation and Amortization						
Cash Flow from Operations						
Capital Expenditures						
CASH MANAGEMENT*						
DSOs						17.8
Inventory Turns						8.2
Inventory Days						34.2
Days Payable						(8.2)
Cash Conversion Cycle						
PROFITABILITY						
Gross Margin						27.9%
Operating Margin						(6.7%)
Net Margin						(16.0%)
Return on Assets*						(32.1%)
Return on Equity*						40.0%
Total Debt/Capital	51.8%	138.3%	162.4%	127.5%	138.3%	(596.9%)
PER SHARE DATA						
Tangible Book Value						(6.75)
Cash						1.50
Net Cash						(1.26)
EPS (Pro Forma)						(0.43)
EPS (Pro Forma Including Option Expenses)						(0.43)
EPS (GAAP)						

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Price, Rating, and Price Target History: Google, Inc. (GOOG/NASDAQ) as of 9-17-09



Source: Factset (Prices) / Needham (ratings and target price)

Disclosures applicable to this security: B, G.

Price, Rating, and Price Target History: Research in Motion (RIMM/NASDAQ) as of 9-17-09



Source: Factset (Prices) / Needham (ratings)

Disclosures applicable to this security: B, G.

	% of companies under coverage with this rating	% for which investment banking services have been provided for in the past 12 months
Strong Buy	4	0
Buy	49	5
Hold	39	4
Under Perform	1	0
Rating Suspended	5	6
Restricted	<1	33
Under Review	<1	0

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