TECHNOLOGY

As Its Phones Flop, Palm Shares the Blame

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Palm Inc. bet its survival on a pair of new smart phones. Now, that wager is unraveling, and the company is partly blaming one of its wireless partners.

The struggling handset maker said Thursday its flagship Pre and Pixi devices, which were launched last year, aren't selling as well as it hoped and warned revenue for the year ending in May will be "well below" its forecasts.

Palm's shares plunged 19% to $6.53 on the disclosure, which renewed questions as to whether the company can compete in a market it helped pioneer.

In an email to employees obtained by The Wall Street Journal, Palm Chief Executive Jon Rubinstein suggested part of the fault lay largely with Verizon Wireless, which began selling the new phones in January.

Mr. Rubinstein wrote that "[Verizon Wireless] acknowledged that their execution of our launch was below expectations and recommitted to working with us to improve sales."

Palm declined to make Mr. Rubinstein available, but spokeswoman Lynn Fox said his email shows a recognition that Palm also takes responsibility for its performance, saying that "the entire executive team has been working extremely hard to improve product performance."

Sales of Palm's new phones, unveiled last year with much fanfare, have stalled amid tough competition, heavy marketing by carriers for rival devices and a dearth of "apps," the programs and games that have driven much of the appetite for smart phones.

Wireless carriers are ordering fewer phones than expected and putting future orders on hold as "consumer adoption of Palm products is taking longer than we anticipated," the company said its press release Thursday.

Palm's warning highlights the tough position it's in as a small company in an increasingly crowded market that has attracted bigger and better-funded rivals such as Apple Inc. and Google Inc., which have larger communities of developers creating programs for their devices.

Palm's newest phones until recently were only available through Sprint Nextel Corp. , a carrier that has been battling subscriber defections. The addition of Verizon Wireless, which has nearly twice as many customers, was expected to give Palm a boost.

In his memo, Mr. Rubinstein said Palm

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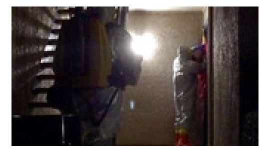

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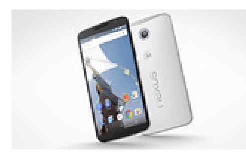

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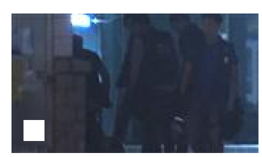

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has implemented "a number of initiatives to increase awareness and drive sales." Those include more advertisements and the deployment of nearly 200 staffers to train Verizon sales representatives.

People familiar with the situation said Palm is preparing to launch the Pre and Pixi through AT&T Inc., the No. 2 U.S. wireless carrier, in the next few months. One of those people said the company was also developing a brand new phone for later this year.

"I wouldn't say [Palm is] done, but they're pretty close," said Ed Snyder, an analyst at Charter Equity Research, speaking of Palm's ability to be a major player in the smart phone industry.

Palm is particularly at a disadvantage in negotiating with carriers, which typically pay greater attention and spend more marketing dollars on phones they carry exclusively. For example, Verizon recently spent $100 million on the marketing campaign behind Motorola Inc. 's Droid, which helped catapult the Google-based phone to one of its best-selling phones in the fourth quarter.

Even Sprint, which advertised the Pre widely when it had it exclusively, has cut back on the promotion it gives to Palm devices, analysts say. That means Palm has to burn its own cash on marketing and in-store training for salespeople, analysts say. Sprint declined to comment on how well the Palm devices are selling or its marketing.

Private-equity firm Elevation Partners invested in Palm several years ago and brought in new leadership-including former Apple executive Mr. Rubinstein-to turn the company around. Since then, Palm has developed a new operating system and launched the Pre and Pixi.

Concerns are rising as to whether Palm can remain a standalone company. Palm said Thursday it has about $500 million in cash, but Kaufman Bros. analyst Shaw Wu estimated the company spent about $90 million since its last quarter ended in November.

In addition, Palm's smartphone market share has been dwarfed by competitors. While its U.S. smart-phone market share rose slightly to 5.2% in the fourth quarter from 4% a year earlier, according to research firm IDC, that's still less than half of its position two years ago. Meanwhile, Apple's iPhone holds 18.2% of the U.S. smart-phone market, and Research In Motion Ltd. 's BlackBerry holds 43%, according to IDC.

The device also had the backing of Google Inc. because it runs on its Android operating system.Palm's troubles selling its new phones became evident in December. At the time, the company said in its quarterly report that while it shipped more phones to carriers than expected, the number of those phones that carriers were able to sell to consumers fell sharply from the prior quarter.

Sachin Agarwal of Somerville, Mass., recently returned his Palm phone. While he eagerly scooped up a Palm Pre Plus in January from Verizon, he returned less than a month later, fed up with what he said was its sluggish responsiveness and lack of apps. "The Pre just wasn't good enough," the 29-year-old said.

For its fiscal third quarter, which it will report March 18, Palm now expects revenue of $285 million to $310 million, compared with the $425 million analysts predicted, as polled by Thomson Reuters. Palm also said its revenue for the full fiscal 2010 year will be "well below" the $1.6 billion to $1.8 billion it had forecast.

—Roger Cheng contributed to this article.

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