Altman Vilandrie & Company In The News

Palm "Pre" Launch Costs May Prove a Financial Burden

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By Roger Cheng
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NEW YORK (Dow Jones)--Palm Inc.'s (PALM) much ballyhooed smartphone, the Pre, may end up being a costly affair for the embattled company.

With an aging product portfolio and nothing else in the pipeline, Palm is betting it all on the success of the Pre. A lot of capital goes into production and marketing to ensure a successful launch, which some peg as high as $100 million. As a result, Monday's announced financing move may not be its last.

"Palm's ability to recover from a shortfall in launch volume could be problematic," said Daniel Hays, a consultant at PRTM. "Having extra working capital to build up inventory seems prudent."

The Sunnyvale, Calif., company said on Monday that it plans to remarket shares representing the stake Elevation Partners bought in January. The firm gets to recoup $49 million of its investment, which it plans to buy stock with, and Palm gets any net proceeds beyond that amount.

Palm has no estimates for how much it plans to receive from the financing, said spokeswoman Lynn Fox, adding the company had sufficient funds.

"Raising additional capital is not at this point an operational necessity," Fox said. Palm shares recently gained 1.6% to $6.25.

Any proceeds from the offering will be used to bolster the resources devoted to the launch of the Pre. It's believed that the higher-than-expected demand has forced the company to increase the production of the device.

The need to build inventory is necessary for a smooth launch. But it's also a costly gamble, as Palm will have to spend $50 million to $75 million ahead of the launch to get enough phones ready, according to Michael Grossi, director for consulting firm Altman Vilandrie & Co. Marketing costs could go as high as $50 million depending on how aggressive Palm wants to get, and how much support it receives from carrier partner Sprint Nextel Corp. (S).

That's a squeeze for a company that ended last quarter with between $215 million and $220 million in cash, cash equivalents and short-term investments.

Costly Start

The handset business is a capital-intensive one that can strain even the largest companies, which is why even a giant like Motorola Inc. (MOT) can struggle.

One of the biggest variables for manufacturing costs is whether a company is working off of an existing platform. Because the Pre is based off a brand new operating system and sports a novel design, Palm is essentially starting from scratch.

Palm will have to build up its inventory ahead of the launch, spending money that won't immediately be reimbursed. Carriers often won't pay a handset maker back until the phone is sold to a customer, meaning there could be a lag between when Palm pays to make the phone, and when it gets paid for it.

Advertising, meanwhile, could also get more expensive than normal. A company like Research in Motion Ltd. (RIMM) may enjoy a $50 million marketing blitz, borne by both the company and its carrier partners. Palm will get marketing support from Sprint, but how much remains a question.

The Palm Pre could see a marketing budget of roughly $50 million, with Sprint likely making most of the contribution.

Given the stakes, Palm could earmark some of its capital into bolstering the marketing campaign, said Richard Nespola, chief executive of telecom consulting firm Management Network Group Inc. (TMNG).

"I would say they're hedging their bets," he said. "It'll require more than carrier advertising."

Industry observers point to the lukewarm launch of Samsung Electronics Co. Ltd.'s (005930.SE) Instinct by Sprint. The marketing campaign wasn't strong, and aside from an initial pop, the phone failed to live up to its billing as the "next iPhone."

The proceeds from the offering will give Palm additional headroom. But given its cash position, more financing may be needed once the launch gets underway. Hays said the typical "recovery time" from a big launch is two-and-a-half months. Analysts peg the 1 million unit sale mark as the break-even point.

If the phone's demand persists, Palm will need to get additional financing anyway. But the success of the Pre could allow them to obtain financing at a better rate, given the stability of a return.

"It's a virtuous cycle," Hays said.