

PALM FIGHTS BACK (AGAINST APPLE)

The beleaguered handset maker says its new smartphone, the Pre, is an iPhone killer. Apple isn't laughing.

BY
ADAM LASHINSKY

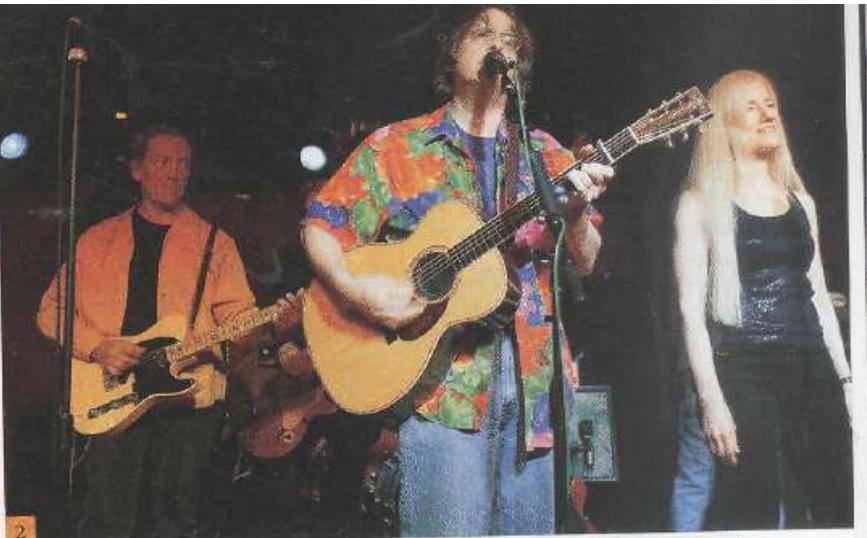
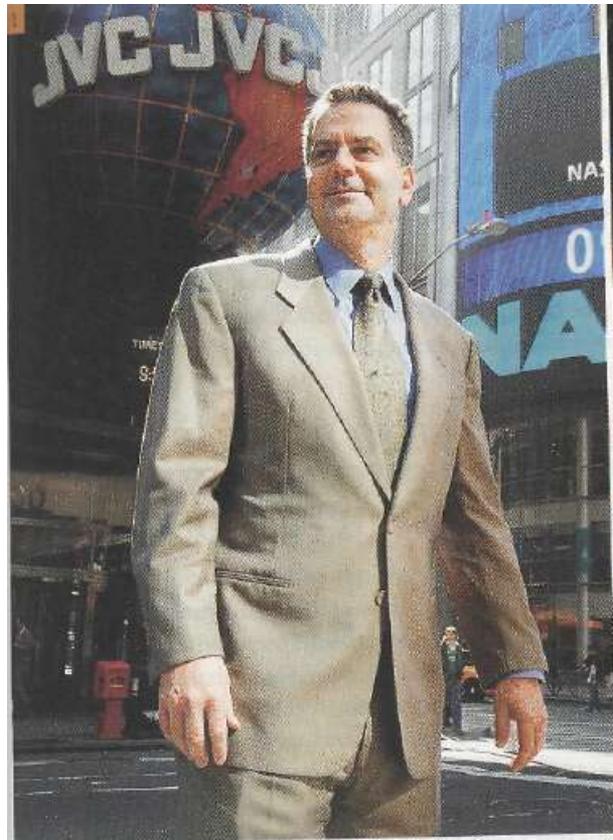
NOTMUCH RATTLES APPLE. DISCIPLINED and focused, the company lavishes attention on its own elegant products and rarely deigns to discuss rivals. Yet here was Tim Cook, Apple's chief operating officer and designated stand-in for ailing CEO Steve Jobs, erupting during an earnings call in late January at the mere mention of a pip-squeak competitor. The pest in question was Palm, the fallen pioneer of handheld digital organizers, which two weeks earlier had unveiled a new smartphone, the Palm Pre, to rave reviews. Not only did the Pre have features the iPhone couldn't match—snazzy multitasking, universal search, a

drop-down keyboard—but it also showed the kind of multitouch screen technology that Apple popularized with the iPhone. Cook didn't try to hide his annoyance. "We're going to go after anybody" who rips off Apple's technology, he said. "We'll use whatever weapons we have at our disposal."

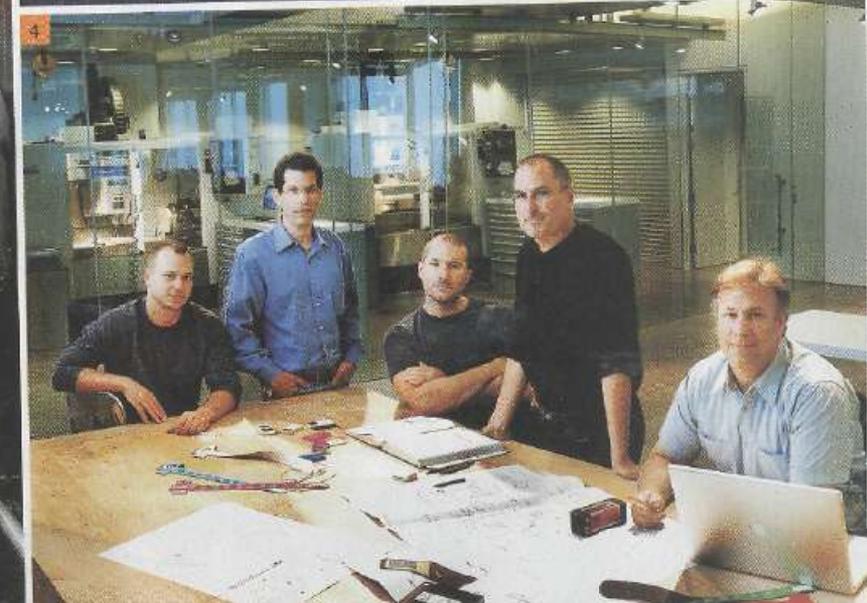
Open hostility from the world's hottest tech company cuts two ways for Palm, which says its years in the mobile business have produced plenty of patents of its own. On the plus side, Apple's obsession with the Pre makes it look as though the little company may have a winner on its hands. (Apple is 25 times the size of Palm, which had \$1.3 billion in 2008 revenue.) Then again, for an outfit betting its future on one product, few prospects are more daunting than a potential Apple lawsuit. And litigation is not Apple's



Sprint Palm Pre



CLASH OF THE TECH TITANS
 HERE'S A ROSTER OF THE SILICON VALLEY WARRIORS GIRDING THEMSELVES FOR THE UPCOMING BATTLE BETWEEN PALM AND APPLE. 1. PALM CEO ED COLLIGAN RAIDED APPLE FOR TALENT. 2. ROGER MCNAMEE, WEEKEND ROCKER AND CO-FOUNDER OF ELEVATION PARTNERS, TOOK A MAJOR STAKE IN PALM. 3. APPLE COO TIM COOK HAS SUGGESTED THAT PALM IS COPYING THE IPHONE'S TECHNOLOGY. 4. JONATHAN RUBINSTEIN (SECOND FROM LEFT) HAS BEEN ACCLAIMED AS THE SAVIOR OF THE MACINTOSH AS WELL AS THE FATHER OF THE IPOD. 5. MCNAMEE (LEFT) AND AN ELEVATION PARTNERS CO-FOUNDER, BOND (THE INVESTMENT FIRM WAS NAMED FOR A U2 SONG).



only ammunition. Palm's financially shaky partner, Sprint Nextel, will begin selling the Pre in the U. S. on June 6 for \$200 with a two-year service contract. A few days later the world will hear Apple's response when it releases software upgrades and possibly new iPhones at lowered prices, which could inflict pain on Palm. It could also keep the upstart from becoming a major player along with Apple and Research in Motion, maker of the BlackBerry, in the fast-growing smartphone market, where 139 million of the devices were sold worldwide last year, up 14% from 2007, according to Gartner.

There's far more at play here, though, than a simple David vs. Goliath yarn, Silicon Valley-style. True, Palm could be trans-

Yet it was right around the time of his settlement that Anderson had the bright idea of recruiting Jonathan Rubinstein to Palm. Rubinstein was an acolyte of Steve Jobs' for nearly two decades and was the executive acclaimed as the savior of the Macintosh and the father of the iPod. But wait, there's more. Palm has been raiding Apple's ranks of engineers and executives, just as Apple has done to Palm for years. And a rock star also figures in the mix. It's Bono, a co-founder of Elevation (named for a U2 song), is a friend of Jobs' and helped smooth the way with record companies before the launch of the iTunes Music Store in 2003.

Even without the personalities involved, Palm's Pre against

“WE’RE GOING TO GO AFTER ANYBODY” WHO RIPS OFF OUR INTELLECTUAL PROPERTY, SAYS APPLE’S COOK. “WE’LL USE WHATEVER WEAPONS WE HAVE AT OUR DISPOSAL.”

formed if the Pre is a hit—the company's stock ran from \$3 before the Pre's January unveiling to about \$32 recently—or wiped out if it flops. But success is just as critical for Palm's largest investor, the quirky, high-profile private equity firm Elevation Partners, whose portfolio has suffered some setbacks. Indeed, this spat goes way beyond competing companies and gadgets: It's deeply personal. One of Elevation's founding partners, Fred Anderson, was chief financial officer of Apple before retiring in 2004. He became embroiled in a scandal over backdated stock options at Apple and reached a settlement in 2007 with the SEC in which he admitted no wrongdoing. Anderson publicly pointed the finger at Steve Jobs. Apple's board said Jobs did nothing wrong.

Apple's iPhone would be a decent tale of corporate rivalry. Layer in the animosities, hurt feelings, and potential for retribution, and it's a story of unusually high drama in the land of pocket protectors. Oh, and there's an undeniably cool product in the picture, which, if it's as good as its previews suggest, has the potential to shake up an already crowded and fast-growing industry.

IN ITS HEYDAY PALM SOLD THE IPHONE OF ITS TIME, THE PALM Pilot, which It introduced in 1996. That device was revolutionary, succeeding where Apple had failed with the Newton. By merging with Handspring in 2003, Palm became a leader in smartphones with its Treo, a combination cellphone/organizer/e-mail device. Yet by 2007,

the year Apple launched the iPhone, Palm's products had lost their way. Its newest idea, a slimmed-down portable computer called the Foleo, fizzled even before being launched, despite being a prescient precursor to the latest all-the-range product: the netbook computer.

By necessity, Palm began to think about its next act. It started to develop a new operating system for smartphones, but knew the process would take up to two years. CEO Ed Colligan, a marketing exec who had moved from Handspring to Palm, had the idea of taking Palm private, a better environment for a company with declining revenues trying to nurture a new product. With private-equity fever sweeping the market, Colligan called his buddy Roger McNamee, a co-founder of Elevation Partners, beginning a conversation that by June 2007 had led to Elevation's announcement that it would invest \$325 million for a 25% stake in Palm.



PALM'S A-TEAM
(FROM LEFT)
RUBINSTEIN,
MCNAMEE,
ANDERSON, AND
COLLIGAN

As a financier, McNamee had been at the center of the tech industry for nearly three decades. First as a mutual fund manager for T. Rowe Price and then as a founder of the VC/hedge fund Integral Capital Partners, McNamee was a cheerleader for technology companies—and an unusual one. Not only does McNamee play in his own rock band, but he also used to keep a life-size doll of Grateful Dead leader Jerry Garcia in his office. He left Integral in 1999 to form one of the first buyout shops dedicated to tech deals, Silver Lake, which scored big by taking private and then flipping Seagate, the disk-drive maker.

A mercurial sort, McNamee got booted by his Silver Lake partners in 2003. Soon after, he hooked up with Bono to form Elevation. They recruited an eclectic team comprising Anderson, Electronic Arts executive John Riccitiello, and two younger partners with experience in private equity. The idea was to apply tech-industry smarts to media and entertainment companies on the theory that the looming digital remake of those businesses would produce unique investment opportunities.

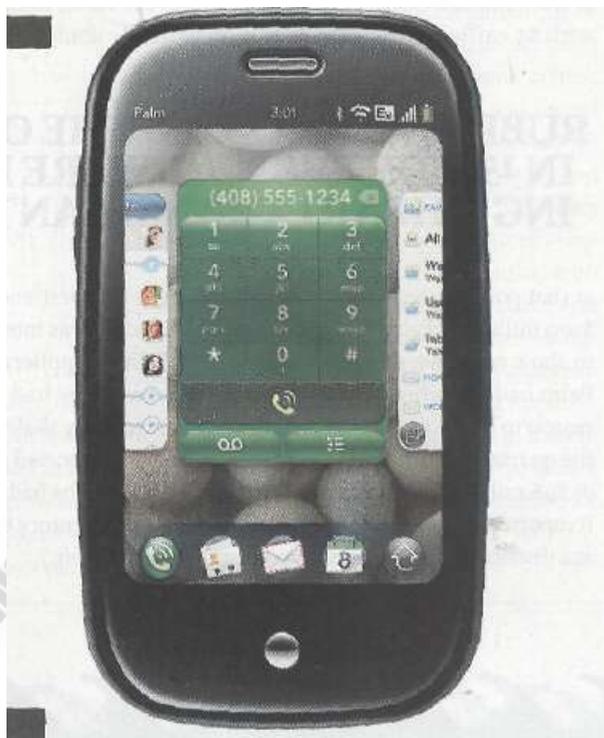
Unfortunately for Elevation, which raised \$1.9 billion, its timing was poor and its investment selection worse. Two of its first three investments were stinkers. Homestore.com (since renamed Move.com) was a scandal-plagued operator of real estate sites. Elevation invested in 2005, shortly before the bottom fell out of the real estate market. In 2006, Elevation bought a 40% stake in business publisher Forbes Media. Elevation hoped to win by investing heavily in the company's websites, but online ads have slowed along with those for print. McNamee, who recently resigned from the Forbes board, says, "The recent deterioration in web advertising poses a new challenge I am confident Forbes will overcome." (Fortune, of course, competes with Forbes.) Elevation did have one modest hit. It consolidated two videogame companies, BioWare and Pandemic Studios, and sold the resulting company in 2007 to gaming giant Electronic Arts. Funny thing about that success, though: Co-founder Riccitiello had left Elevation to rejoin EA as chief executive when his company bought BioWare/Pandemic, making him both a buyer and a seller in the transaction. EA disclosed the situation to its shareholders at the time.

Meanwhile, Elevation was busy hatching its plan for Palm. At first it tried to buy Palm outright. Unable to raise enough money, it eventually settled on a minority investment contingent on landing Rubinstein, portrayed by Elevation as the key to remaking Palm. Anderson and McNamee contacted Rubinstein (who had retired) in April 2007, when the former Apple hardware chief's noncompete agreement with Apple expired. Rubinstein, a rail-thin 52-year-old who commutes by train to Palm's Sunnyvale office from his home in San Francisco, spent his formative years as a computer engineer at Hewlett-Packard and in 1990 joined Next, the company Jobs founded when he was kicked out of Apple. Rubinstein moved to Apple just ahead of Jobs' return and had a key role in the rejuvenation of the Macintosh and the creation of the iPod.

Rubinstein started, in his words, "hanging out" with Palm people in late June. He didn't like what he saw. The hardware for the Pre needed to be scrapped and rebooted. For one thing, prototypes were using old "resistive" touchscreen technology that responds to a

A SMARTER PHONE?

The BlackBerry and iPhone dominate the U.S. market. *Palm*, however, believes its new Pre has cool features that will make consumers switch.



{ Sprint Palm Pre }

This smartphone retails for \$200 with a two-year Sprint contract. It works on a 3G network and has a color touchscreen and a drop-down keyboard. Features include:

1. New brains

Pre's webOS operating system allows you to work with multiple applications open on your screen. No more switching in and out of apps.

2. Better contacts

You can automatically pull friends' contact details from different applications, such as Outlook, Google, and Facebook, and see the info on your phone as one listing.

3. Time tracker

The Pre allows you to view your calendars on their own or layered together as a single view—combining work, family, friends, and sports team schedules.

4. Messaging center

You can see all your conversations with a person in chat-style view, even if she started in IM and you want to reply in, say, text messaging.

user physically pushing the screen, not the newer "capacitive" technology manipulated by the electricity in the user's body. Rubinstein tossed out the old phone's hardware and built a new one in about 15 months. "We were basically running a marathon and doing a heart transplant in the middle of it," says Rubinstein.

While the company was working furiously to ready its new product it had another dilemma: It was running out of money. As the overall market melted down, Palm's shares fell even further, at one point in December nearly touching \$1 per share, compared with \$5 earlier in the year. Elevation basically doubled down

All the while, of course, Apple was having a banner year. It was on its way to selling 21 million iPhones. In July it opened the Apple App Store, an online bazaar for applications downloadable to iPhones and iPod Touch devices. Users would soon download a billion programs from the App Store, a new revenue generator for the company that also is making more and more Apple enthusiasts out of non-Mac users.

Finally, though, in early 2009, Palm's luck began to turn. Apple flip-flopped on the health status of Steve Jobs, who then pulled out altogether from the annual Macworld trade show in January

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at that point, agreeing just before Christmas to invest another \$100 million in Palm. Colligan says the fresh cash was intended to show customers, investors, and—critically—suppliers that Palm had the wherewithal to launch the Pre. They had good reason to doubt it: Palm's finances were increasingly shaky. For the quarter that included Christmas sales, Palm reported a loss of \$98 million. The company even seemed plagued by bad luck. It reported a \$5 million charge for a "warehouse inventory theft" at a distributor. (Palm says it was insured for the theft.)

and announced a six-month medical leave of absence. With a grim economy, few sexy new products, and an atypically ruffled Apple, the stage was set at January's Consumer Electronics Show in Las Vegas for Palm to show off its Pre. The product was the surprise hit of the trade show, setting the company's stock price on its gallop northward. Palm took advantage of the run-up to raise another \$103 million from public investors. It's in this context that one begins to understand why Apple's Cook was so hot about Palm. The mouse was beginning to roar.



**IN THE NEW ENERGY FUTURE
WE'LL NEED TO THINK AROUND CORNERS.**

As the global population grows and energy demand increases we need to get at some of the 'difficult oil' trapped in sand, rock and in the deepest seas.

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AS PALM READIES ITS LAUNCH OF THE Pre, there's most definitely a glimmer of hope, but the company still faces some tall obstacles. The Pre clearly offers features that neither the iPhone nor RIM's BlackBerry does. Palm, however, wouldn't make a review copy of the phone available to Fortune—typically a sign that not all glitches have been worked out. (In an April earnings call, COO Cook took another swipe at Palm, saying, "It is difficult to comment on products that aren't shipping," leaving him, he said, with nothing intelligent to say about the Pre.)

As for the choice of carriers, it's no surprise that Palm went with Sprint. AT&T and Verizon each had its megabit product already in the iPhone and the BlackBerry Storm, respectively. What's more, Palm had become increasingly reliant on Sprint. For Palm's year that ended last May, 41% of all its sales, smartphone and otherwise, came from Sprint. With both companies losing money and customers, the pair have increasingly come to look like perennially last-place baseball teams that can't seem to catch a break. Each thinks the new gizmo will change that. "The Palm Pre will be in a category by itself," says Kevin Packingham, a top Sprint executive responsible

A BIG BOUNCE

After Palm unveiled its Pre smartphone in January, the company's stock price shot up from \$3 to about \$12 a share.



for devices. Another knock on Palm is that it's a local player in a global business. Some 80% of its sales are in the U.S., and even assuming the Pre is a success, Palm doesn't currently plan to market it in Asia, where it has no presence.

Then there is the looming battle with Apple. In early March, McNamee caused a stir by telling a wire-service reporter that he thought the Pre was so good that customers would give up their iPhones as soon as their AT&T contracts expired. Palm was forced to file a statement with the SEC calling his comments "premature" and "an exaggerated prediction of consumer behavior." Since then McNamee has toned down his rhetoric—but just a bit. He now calls the relationship with Apple "asymmetric," implying that Palm should have no bearing whatsoever on Apple's plans or performance. Adds Rubinstein: "This is about Palm. It's not about Apple."

Palm and its investors may indeed face a daunting task in launching the Pre and competing with limited resources against the likes of Apple. Yet one thing seems to weigh in Palm's favor: Its confidence and determination don't appear to be in short supply. □

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