

CEO Script –Sept. 21, 2006

Slide : Palm Q1 FY07 Conference Call/ Titles

Good afternoon, everyone.

I would like to take a few minutes to update you on the quarter, give you a summary of our financial performance and talk to you about how we're positioned in the marketplace. I'll also cover our strategies to differentiate our solutions and to expand globally. I'll wrap up with the four objectives I set out for the team this year.

Slide: financial bullets

Starting with the quarter:

- We delivered overall revenue of 355 million dollars, up 4% vs. Q1 of fiscal year 2006.
- Smartphone revenue totaled 269 million dollars in the quarter, up 18% from the comparable period a year ago.
- Smartphone sell through totaled 569 thousand units, up 21% year over year and up 8% sequentially.
- Our profits were strong. Operating income rose 28% on a GAAP basis and 44% on a non-GAAP basis, year over year. EPS was 21 cents per diluted share.

- And, our balance sheet remains very strong. We're in excellent shape to make short- and long-term investments to benefit our business. Today we believe our stock is an excellent value and so, as we announced earlier this afternoon, our board has authorized a stock repurchase program under which we will buy back up to 250 million dollars of Palm common stock.

We delivered profitable year-over-year revenue growth this quarter, as we have for the previous 11 consecutive quarters. But the top line was below our original guidance and below what we expected of ourselves. While our business to business sales grew, sales in carrier retail stores did not keep pace with our expectations.

It's a fact that the smartphone market is becoming more competitive. We've been saying for some time that we expected the market to heat up, and it has done that in the last couple of quarters. This is a growth market, and there are many players that will pursue a share of that growth. Competition will create pricing pressure and fragment the market, making differentiation more important to communicate.

Clearly, our differentiation is understood in the business-to-business market, where sales were strong. The shortfall occurred in carrier retail stores, where customers are more easily influenced by price, fashion or aggressive marketing.

Businesses weigh the comparative merits of smartphones. They ask themselves if a purchase will answer a real need, if a product will deliver a full day's work and if people and businesses will be more competitive as a result of a purchase. When those questions are asked, people choose Treo. Ultimately, people and businesses are willing to pay for products that work.

To address the retail market, we made some pricing adjustments and saw an immediate rebound in sell-through. We will address the retail environment further with the introduction of a lower-priced product targeted at retail demographics in the very near future.

To further build our competitive position, we expanded our product portfolio with a new smartphone for Europe. And, we have diversified our carrier base by signing up another world-leading carrier.

Let's not lose sight of the fact that despite an unprecedented competitive onslaught, Treo sell-through matched the highest in company history, and we delivered very strong margins and operating profits.

(pause)

We continue to believe that our product portfolio is strong and grew more compelling in recent quarters with its choice of operating system, network technologies, email partners and carriers. The next step is expanding our

addressable market around the world, and we made excellent progress in that regard, too.

Slide: Treo 750v

Case in point is our launch last week of the Treo 750v. This is a product made from the ground up to captivate the European smartphone market, a market comparable to that of the United States. The 750v is distinguished first by a slimmer form factor – with antenna integrated into the body – and operates on the Vodafone 3G/UMTS network. So it's sleek, and it's fast.

We're thrilled to have collaborated with Vodafone Group and nine Vodafone operating companies across Europe. Vodafone is Europe's largest carrier, and between its retail stores, business stores and dedicated business-sales teams, we couldn't ask for a better partner.

They're also putting significant marketing muscle behind this product. Travelers in Europe are going to see our new Treo featured just about everywhere – in airports across Europe and in key transit hubs, in traditional and in new media. Vodafone's marketing support extends to pricing, too. The various Vodafone operating companies in Europe generally have set the subsidized price of the Treo 750v to the equivalent of 299 US dollars at the high end, all the way down to **free** in some countries, depending on contract terms.

Slide: Nine Voda countries

Customers in nine countries – Austria, France, Germany, Ireland, Italy, the Netherlands, Spain, Switzerland and the UK – will be able to buy the 750v starting in October. We plan to announce the 750's availability in other regions of the world by the end of the calendar year as well.

The Treo 750v is built upon the Microsoft Windows Mobile operating system – specifically the Pocket PC Edition, so it's extremely capable as an enterprise solution with the added benefit of the Palm experience. That's much of why Microsoft will accord the Treo 750v "hero status" in extensive advertising efforts across Europe, where Windows is clearly the favored platform.

Microsoft is marketing the new Treo to their Exchange Server 2003 customers, about 80 percent of which, we understand, have deployed Service Pack 2. A Treo in those business environments means free, secure, real-time push email without the need for additional middleware.

Although we expect the Microsoft solution will appeal generally to the European market, a key attribute of Palm solutions is that we offer customers choice. With the Treo 750v, customers can deploy Microsoft's push email, use Vodafone's Visto email, or take advantage of RIM's BlackBerry Connect.

Together, Vodafone, Microsoft and Palm will spend nearly 30 million dollars to market the Treo 750v. We believe these and other marketing activities will build brand awareness, smartphone awareness and preference for “Palm” and “Treo” in Europe, similar to what we enjoy today in the U.S.

SLIDE: Europe oppty

Our strategic partnership with Vodafone and Microsoft for this European product represents the latest salvo in our drive for European market share. We started this initiative by appointing new worldwide leadership and regional management for Europe, Middle East and Africa. We followed with a realignment of our marketing and distribution partners to favor carriers and to focus on smartphones. We opened a European engineering center in Dublin to collaborate closely with European carriers, and we worked to build and expand relationships with the biggest of those carriers.

The culmination of our work leading to the launch with Vodafone and Microsoft of the Treo 750v represents a major milestone for this company. And we will have additional significant news later this year. The fourth new smartphone is coming soon for worldwide distribution and aimed at a broader demographic. We will target people who want to get more out of their business and personal time but who may be more price-sensitive than our original target market. This customer

may today own a feature phone with basic text-messaging capabilities or perhaps a phone whose email capabilities are limited or disappointing. We're collaborating with a new China-based ODM, or outsourced design partner, that is helping us lower costs to end-user customers. You'll hear more from us about this product in coming weeks.

Slide: Objectives:

Now I'll say a few words about the four objectives I set for the last quarter. **The first and foremost objective is our commitment to profitable growth.** We were very profitable in the quarter, and will continue to vigorously pursue a number of initiatives that will allow us to reduce the cost of our Treos to end-user customers, build further product differentiation, and expand and deepen our market reach globally.

- As we've discussed before, we have gone from having one ODM smartphone partner in 2005, to two in 2006, and there will be three in calendar 2007. We plan soon to open an R&D center and operations hub in Shanghai to better integrate the ODMs.
- We are reducing component and manufacturing costs. Part of this initiative has been to analyze our supply base, benchmark against our competitors, and partner with Tier 1 component suppliers to deliver industry-leading solutions at lower costs.

- In addition, we continue to advance and scale our design practices. This includes developing products for a wider array of price points, creating reference designs that are easy to customize, and reducing the component count and complexity.
- And, to spur topline growth, we will invest further in marketing and carrier relations to drive sell-through on an ongoing basis. This fall, we will launch a U.S.-based marketing campaign to demonstrate in a very tangible way how a Palm smartphone can benefit the personal and business lives of our customers. We expect the campaign, which will be the largest we've funded in the last 5 years, to stimulate smartphone adoption by users new to the category and to bring new awareness to our brand.

The second major objective is **to execute a roadmap of high-quality, category-defining mobile-computing solutions**. We continue to earn the best reviews in the industry, and our Treo 700p and 700w products are the gold standards for smartphones. The accolades we've earned reflect our deep commitment to a proven design that works, delights and that delivers a whole day through.

We will alter the design and form factor of our award-winning smartphones, but only when the tradeoffs preserve the overall user experience, or enhance it. We will use batteries that last. We will offer a keyboard that makes email and web

browsing easy. We will make products with touch screens so you can speed through your tasks with a tap.

And we will continue to deliver category-defining solutions using our dual-OS strategy -- Palm OS and Windows Mobile – and we will continue to bring innovation to the marketplace.

**The third objective is to increase our smartphone market penetration outside the United States.** Case in point: the Vodafone and Microsoft relationship we just executed in Europe. As I mentioned earlier, this product will be sold in nine countries across Europe. And we intend to offer it in five additional regions in the coming months.

Another way we'll expand our presence worldwide is with our fourth smartphone, due out soon. We expect to see it offered by more than 20 carrier partners worldwide by the end of our fiscal year.

The Treo 700wx, which we announced earlier this month on the Sprint EvDO network, also is bound for international markets where CDMA networks are deployed.

**The fourth objective is to raise awareness of the Palm brand and its hallmark attributes.** We absolutely believe that brand is a key driver of long-

term profitability. I've already mentioned the large and collaborative campaigns planned for Europe for the Treo 750v smartphone and the soon-to-be launched US campaign. We aim to replicate the awareness we have built in the United States in Europe and elsewhere.

Part of our brand campaign, too, is to continue to bring products to market that deliver on our brand promise: Simple, fast and easy mobile computing.

In summary, I believe we executed well on a number of fronts in Q1, including delivering strong profitability in spite of a much more competitive market. And since concluding Q1, we expanded our product offerings with the Treo 700wx with Sprint and the Treo 750v with Vodafone.

Despite very positive announcements and trends, we are not satisfied. We will work to be more predictable about our business. There is no question it is difficult to foretell the competitive front, and product deliveries in this category are subject to change given development timeframes and carrier certification trials. But we have to do better.

In addition, we must and we **have** embraced a relentless focus on costs. We are hammering away on multiple programs to reduce them. We are confident that as we continue to drive down our costs, we can deliver a better product than those of other vendors and be price competitive while sustaining healthy margins.

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Last, we need to be sure we communicate our compelling product differentiation more effectively to end users, and we will continue to build that differentiation through both organic development and strategic investment.

I'll close by thanking our team. They are committed to Palm and its vision and have worked very hard. Together, we will continue to do what it takes to succeed. I'll now turn the call over to Andy and come back later to answer your questions..... Andy. . .

ADD CLOSE for after the Q&A to leave folks with the message we want:

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## **Andy's Q1 2007 Script FINAL**

**September 21, 2006 – 11:30 AM**

### **SLIDE 1**

Thanks, Ed, and good afternoon, everyone. Before I start, I would like to note that my commentary today will be based on non-GAAP financial measures except where specifically identified as GAAP. I encourage you to refer to the reconciliation of GAAP to non-GAAP financial results that we have posted to the Palm website and included with the press release.

Net revenue for the first quarter of fiscal year 2007 was 355.8 million dollars, in line with our updated guidance given on September 6<sup>th</sup>, compared to 342.2 million dollars in the first quarter of fiscal year 2006. The slower than expected growth rate during the quarter was primarily due to lower Treo sales volumes in carrier retail channels.

Gross margin of 37.1% for the first quarter was higher than our guidance. However, this included a one-time benefit of 2.6 million dollars as a result of improved licensing terms for certain standards-based technology. Gross margin would have been 36.3% without this benefit, compared with the year-ago gross margin of 30.5%. We continue to see a healthy increase in gross margin as revenue mix shifts toward smartphones, and we benefit from reduced warranty costs.

Operating expenses for the quarter were 101.5 million dollars, a total lower than our previous guidance. A couple of factors helped us manage to the lower spending rate. First, we slowed our hiring ramp, and second, revenue-related expenses such as MDF, commissions and bonuses were lower than planned due to the lower revenue attainment.

This resulted in operating income of 8.6% of revenue and earnings per diluted share of 21 cents for the quarter, a healthy increase from the year-ago period when operating income was 6.2% of revenue and earnings per diluted share were 13 cents.

## SLIDE 2

Revenue mix for the quarter was 76% smartphones and 24% handholds. This compares to 67% smartphones and 33% handholds in the year-ago period.

Smartphone revenue for the first quarter was 268.8 million dollars -- an 18% year-over-year increase on shipments of 550,000 units. Smartphone ASP's declined relative to our expectations as we initiated new pricing through a rebate program on our 700 series products late in the quarter with one of our carriers. We expect continued ASP declines in Q2 as we implement these pricing actions more broadly.

## SLIDE 3

Smartphone sell-through for the first quarter was 569,000 units. While this represents an increase sequentially and year-over-year, it was not as robust as we had expected. This was the result of slower-than-expected retail sell-through to consumers as lower priced, competing products were introduced to the marketplace. Pricing actions we have recently implemented have increased retail sell-through, and we believe the future introduction of lower-priced products will continue that momentum.

Handheld revenue for the quarter was 87.0 million dollars, a 24% decline year-over-year, reflecting sales of 434,000 units. Handheld sell-through for the quarter was 490,000 units and weeks of inventory held by our channel partners was 7.6 weeks.

## SLIDE 4

Geographically, we generated 83% of our first quarter revenue in the US with 17% coming from outside the US. While this is a lower international contribution than we have seen in several years, we expect international business to pick up with the availability of our new Treo 750v smartphones in early October on the Vodafone network in Europe

## SLIDE 5

Looking at the balance sheet, we generated 20.9 million dollars in cash flow from operations and increased cash and short-term investments to 527.9 million dollars in Q1. During the quarter we made a one-time payment of 22.5 million dollars to Xerox as part of a legal settlement. You'll remember that we accrued for this payment in Q4 of fiscal year 2006.

Our future cash balance could be impacted by today's announcement that our board of directors has approved a repurchase of up to 250 million dollars of our common stock. We believe this is an appropriate use of our cash given the low valuation of our stock, and at current values, such a repurchase would be accretive. As structured, we believe the repurchase program leaves us with sufficient cash for strategic investments and acquisitions.

Accounts receivable decreased to 168.1 million dollars, and DSOs were at 43 days in Q1, in our expected range and down slightly from 46 days in Q4.

Inventory decreased to 51.9 million dollars at the end of Q1 with inventory turns slightly lower than we would like at 16 times during the quarter. We expect inventory turns to be in our preferred range of 20 to 25 times as we exit Q2.

## SLIDE 6

Looking to the future, we currently expect revenue for the second quarter of fiscal year 2007 to be in the range of 430 to 450 million dollars. This reflects the full impact of the pricing actions we implemented in late Q1, which we believe will strengthen our competitive position in the retail consumer portion of our business. In addition, we have two products currently in certification by a carrier partner, and although we are confident that these products will be launched during the quarter, a one or two week variance in the certification process could impact revenue for the quarter. As a result, we are providing a broader range than usual in our revenue projections for Q2.

We anticipate that gross margin for Q2 will be in the range of 33.5% to 34.0%, consistent with the recent changes to our product pricing.

Operating expenses are expected to be in the range of 115 million to 118 million dollars, driven by continued investment in R&D and an increase in advertising and promotional activity to support the upcoming product launches in the US and internationally.

The non-GAAP tax rate for Q2 is expected to be at 40%, resulting in earnings per diluted share of between 20 and 23 cents.

For the remainder of the year, we will balance on the side of top-line growth and market share over profitability. In view of dynamic market conditions, including our launch of new products and expansion into new geographies, we are not reaffirming previous annual guidance at this time, and are providing guidance only for the second quarter.

And now I'd like to turn the call back to the operator for your questions.