Palm, Inc., Leveraged Recapitalizations and Business Value

Palm, Inc. (PALM) announced a “strategic relationship with the private-equity firm of Elevation Partners (“Elevation”) and a recapitalization plan” designed to “position Palm to lead the next phase of the smartphone and mobile-computing markets” on June 4th, 2007. At the time of the announcement (immediately before), Palm’s stock traded at $16.27 per share, the company had no debt, and more than a half billion dollars in cash. And Palm was seen by the markets as lagging, not leading in the development of its key markets.

Leading up to the announcement, Palm’s board considered a number of “strategic alternatives,” including the outright sale of the business. Rather than a sale, the board agreed to the announced leveraged recapitalization with Elevation. As part of the deal, Jon Rubenstein, former SVP of hardware engineering and head of the iPod division at Apple, Inc., will join Palm as executive chairman of the board. Two principles of Elevation will also join Palm’s board, and there will be one resignation.

The leveraged recapitalization. Given Palm’s debt-free, cash-rich balance sheet, the potential for a leveraged recapitalization and the creation of New Palm existed, and one will occur, with the following features:

1. Existing Palm shareholders will receive a dividend of some $9.00 per share (or about $940 million for the 102.6 million pre-transaction shares).
2. Elevation will invest $325 million in exchange for a convertible preferred series with a conversion price of $8.50 per share. This was represented as about a 16% premium to the “implied post-distribution price over the 10 trading days ended June 1, 2007, excluding the $9 per share distribution,” or $7.33 per share. This investment will convert into 25% of the equity of New Palm (fully diluted to give effect to certain existing and new options).
3. The $940 million distribution will be financed with Elevation’s $325 million investment, some $215 million of New Palm’s cash, and about $400 million in new long-term debt.
4. In addition, New Palm will have a $40 million revolving credit facility, which can be used for working capital purposes.
5. New Palm has a pro forma current ratio of 1.46x and a long-term debt to equity ratio of 97%.

So what do the shareholders have? Palm’s pre-announcement price was $16.27 per share. If we subtract the $9.00 expected distribution, shareholders would be left with implied value of $7.27 per share.
However, existing shareholders get the benefit of the 16% premium paid by Elevation, and the implied value is close to $7.50 per share when this is taken into account.

Palm shares were trading at $17.62 per share at the close of business June 5th, 2007. If we subtract the anticipated dividend of $9.00 per share from that price, we are left with an implied value of $8.62 per share. One day after the announcement, then, the market was saying that Palm shares were worth a slight premium to the implied Elevation price of $8.50 per share, plus the $9.00 per share expected distribution.

At the close of business on June 19th, Palm shares traded at $17.29 per share, implying a per share pro forma price of New Palm of $8.29 per share, or still fairly close to the Elevation price of $8.50 per share. The market’s assessment of New Palm’s business value is pretty close to that which business valuation principles would have suggested.

So what’s the deal? Based on our review of the transaction, there are several positive factors that suggest that the recap transaction was favorable for Palm shareholders. These factors include:

1. Palm shareholders receive a return of $9.00 per share, or about 55% of the market value of their shares prior to the announcement.
2. The remaining company appears to be reasonably capitalized, i.e., not excessively leveraged.
3. Pro forma return on equity rises to 11.2% relative to a pre-transaction ROE of 6.6%.
4. The board avoided selling the entire company for what likely would have been a low premium in pricing.
5. The company gains a new, experienced executive chairman, who comes with an excellent reputation.
6. Management is incented to perform, positively, with options and ownership, and negatively, with debt.
7. Existing Palm shareholders will receive 73% of any future premium should the company later be sold.
8. Earnings per share, because of leverage, are poised for more rapid growth than before the transaction.

There are a couple of negatives to the transaction. First, there is more leverage. However, that is also a positive. The biggest negative is that in a severe downturn of the company’s fortunes, Elevation’s convertible preferred stock has superior rights to the remaining common stock. So the transaction is not without some expected risks. However, Palm is a publicly traded stock, and shareholders have the opportunity to liquidate their positions at the current market price if they are not happy with the outlook or desire full liquidity for any reason.

What does this mean for private companies? If Palm, Inc. can engage in a leveraged recapitalization to create liquidity and future opportunity for its shareholders, so can, perhaps, your company. A private company recapitalization could have all the bells and whistles of the Palm transaction or more (or less), depending on your objectives and your company’s particular situation. Give us a call (901-685-2120) or email mercerc@mercercapital.com if you’d like to talk about the possibilities for a leveraged recapitalization for your company.

Z. Christopher Mercer, ASA, CFA
mercerc@mercercapital.com
# MERCER CAPITAL’S E-BOOK LIBRARY

<table>
<thead>
<tr>
<th>TITLE</th>
<th>DESCRIPTION</th>
<th>INVESTMENT</th>
<th>RELEASE DATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valuing Shareholder Cash Flows: Quantifying Marketability Discounts</td>
<td>Quantifying Marketability Discounts has been updated and is now offered as an e-book. Titled Valuing Shareholder Cash Flows: Quantifying Marketability Discounts - 2005 E-Book, this edition provides a brand new chapter which discusses each of the five assumptions of the QMDM in depth. As a bonus, when you purchase the e-book, you will also receive the QMDM Companion, the latest edition of the Quantitative Marketability Discount Model, in spreadsheet format.</td>
<td>$95.00</td>
<td>Currently Available</td>
</tr>
<tr>
<td>Valuing Financial Institutions</td>
<td>We are responding to requests to put this 1992 book back into print and we are doing so as an E-Book</td>
<td>$65.00</td>
<td>Currently Available</td>
</tr>
<tr>
<td>Are S Corporations Worth More Than C Corporations?</td>
<td>An e-booklet that adds to the S Corp vs. C Corp debate</td>
<td>$19.95</td>
<td>Currently Available</td>
</tr>
<tr>
<td>Embedded Capital Gains</td>
<td>A closer look at the Embedded Capital Gains issue.</td>
<td>$19.95</td>
<td>Currently Available</td>
</tr>
<tr>
<td>Rate &amp; Flow: An Alternative Approach to Determining Active/Passive Appreciation in Marital Dissolutions</td>
<td>In this e-book, we present an alternative model for determining active / passive appreciation in a marital dissolution. In states where an owner/spouse’s active management of a business does not preclude the consideration of passive appreciation, we offer a fresh approach based on rate and flow analysis.</td>
<td>Complimentary</td>
<td>Currently Available</td>
</tr>
</tbody>
</table>

**NEW SERIES: “UNDERSTAND THE VALUE OF YOUR ...”**

<table>
<thead>
<tr>
<th>TITLE</th>
<th>DESCRIPTION</th>
<th>INVESTMENT</th>
<th>RELEASE DATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Understand the Value of Your Insurance Brokerage</td>
<td>For the past several years, insurance brokerages have been in a period of consolidation, and the current soft market is expected to persist for at least the near term. As such, it is an opportune time for business owners to have an idea of what their brokerage business is worth.</td>
<td>Complimentary</td>
<td>Currently Available</td>
</tr>
<tr>
<td>Understand the Value of Your Physician Practice</td>
<td>The ownership of every practice will change hands. The event that triggers the transfer can be categorized as either voluntary or involuntary. It is important for physicians to consider the universe of ownership transfer possibilities, because sooner or later, you will be involved.</td>
<td>Complimentary</td>
<td>Currently Available</td>
</tr>
<tr>
<td>Understand the Value of Your Auto Dealership</td>
<td>Because your business will change hands, it is important for you to understand the key concepts of business value and how value is determined for your business.</td>
<td>Complimentary</td>
<td>Currently Available</td>
</tr>
<tr>
<td>Understand the Value of Your Wholesale Distributorship of Malt Beverage Products</td>
<td>The financial landscape is littered with rules of thumb pertaining to the value of privately owned businesses. Perhaps in no other industry is the rule of thumb concept more prevalent than in beer distribution. It is critical that value be determined and articulated in a credible fashion.</td>
<td>Complimentary</td>
<td>Currently Available</td>
</tr>
</tbody>
</table>

Visit our website at www.mercercapital.com for more information or to download an e-book.
The professionals of Mercer Capital have a great deal of experience speaking to industry and professional groups across the nation on topics such as:

- Buy-Sell Agreements
- The Integrated Theory of Business Valuation
- Is Your Business Ready for Sale?™
- Purchase Price Allocation
- Valuation of Employee Stock Options
- Litigation Support and Expert Testimony
- Valuation of Privately Held Businesses, Partnerships, or LLCs
- Financial Institution Valuation
- ESOP Valuation

To book a Mercer Capital professional as a speaker at your next conference or CLE/CPE meeting, please contact Barbara Walters Price at priceb@mercercapital.com.
A GENTLE PLUG FOR OUR FIRM

MERCER CAPITAL is a business valuation and investment banking firm serving a national and international clientele. Our reputation for excellence is based on an ability to solve complex financial problems expeditiously. We convert over 20 years of experience, including thousands of assignments, into solutions for the issues of today.

Corporate Valuation. Mercer Capital provides a broad range of independent valuation and financial advisory services, including:

» Dispute Analysis Services and Expert Testimony
» Valuation for Corporate Tax Matters
» Valuation for Corporate Income Tax Issues
» Valuation for ESOPs
» Purchase Price Allocations

» Valuation of Employee Options
» Goodwill Impairment Testing
» Valuation of Intangible Assets
» Fairness Opinions

Investment Banking. Mercer Capital’s investment banking division and specializes in providing merger and acquisition services to sellers or buyers of private businesses or public companies divesting divisions and subsidiaries. In addition, we assist clients in industry consolidations, roll ups, and refinancings.

INTERNET COMMERCE: OBTAIN PROPOSALS TO VALUE YOUR COMPANY, BANK, FLP OR LLC VIA OUR WEBSITE

The cost of your time and delays in obtaining proposals has just gone down. Use one of the PROPOSAL REQUEST FORMS on our website.

Many of your colleagues have already used our PROPOSAL REQUEST FORMS and are impressed by the decrease in transactional overhead and the increased ease in obtaining actionable proposals for their clients. We are pleased to be doing business with them. Try it yourself! Visit our website and provide us with the pertinent information via this form, and we’ll prepare a proposal and deliver it to you via e-mail, fax or USPS. Complete confidentiality is assured.

UNSUBSCRIBE

We will continue to send the newsletter as published at no cost unless you notify us that you wish to be removed from the distribution list. To REMOVE yourself from this list, send an e-mail to: newsletters@mercercapital.com and type the words “Unsubscribe – Value Matters” in the subject line (without the quotation marks).

Business Valuation » Investment Banking

HEADQUARTERS:
5860 Ridgeway Center Parkway, Suite 400
Memphis, Tennessee  38120
901.685.2120 » Fax 901.685.2199

LOUISVILLE OFFICE:
511 South 5th Street, Suite 206
Louisville, Kentucky  40202
502.585.6340 » Fax 502.585.6345

www.mercercapital.com

DISCLAIMER. This publication does not constitute legal, valuation, tax, or financial consulting advice. It is offered as an information service to our clients and friends. Those interested in specific guidance for legal and accounting matters should seek competent professional advice. Inquiries to discuss specific valuation or corporate finance matters are welcomed. Permission is specifically granted to send copies of this Value Matters™ to others who might have an interest in its contents. Permission is also granted to quote portions of this newsletter with proper attribution.

Copyright © 2007 by Mercer Capital Management, Inc., all rights reserved. Text, graphics, and HTML code are protected by US and International Copyright Laws, and may not be copied, reprinted, published, translated, hosted, or otherwise distributed by any means without explicit permission.
To summarize *Buy-Sell Agreements* in one word, that word would be "methodical." Mercer focuses like a laser beam on virtually all of the possible permutations of the pricing and valuation provisions of buy-sell agreements, together with the advantages and disadvantages of each... *Buy-Sell Agreements* offers a comprehensive buy-sell audit checklist that alone makes it worthy of purchase, serious use and study... If you are looking for a book that has a comprehensive discussion of the pricing and valuation aspects of buy-sell agreements (which I’ve really not ever seen before), this is it... *Buy-Sell Agreements* is a no-brainer addition to the library of every one who works with or who drafts buy-sell agreements.

L. PAUL HOOD, ESQ.
Courtesy: Leimberg Information Services, Inc. (LISI) at www.leimbergservices.com

In this eminently well-written, concise, and non-technical book, Chris lays out the fundamental parameters and processes that must be considered to minimize problems... Appraisers who read this book and apply its lessons will be able to position themselves in the marketplace as not just valuation specialists but in the wider role of facilitators of business valuation dispute resolutions, a much more productive role for us.

RAND M. CURTISS, FIBA, MCBA, ASA, ASA
President, Loveman-Curtiss, Inc.
Chair of the American Business Appraisers National Network
Published on IBA Discussions Blog at www.go-iba.org/blog

In the teacher’s manual to our Business Associations case book, my friend, colleague and coauthor Bill Klein poits that “any lawyer who advises people entering into a business venture who fails to urge the adoption of a buy-sell agreement is guilty of malpractice.” Z. Christopher Mercer’s new book *Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions* offers a tremendously useful guide to these remarkably important contracts. In it, he provides guidance for business people and their financial advisors to use in assessing the need for a buy-sell agreement and, if one is appropriate, deciding on key terms. It will also be very useful to counsel drafting buy-sell provisions, as it offers drafting checklists and samples of how various issues can be treated. I recommend it very highly.

STEPHEN BAINBRIDGE
William D. Warren Professor of Law, UCLA
Published on ProfessorBainbridge.com

Mr. Mercer has done a great job of addressing the reasons business owners might want to have a buy-sell agreement and the business factors these business owners should consider in the agreement... Overall, Mr. Mercer provides valuation practitioners, business consultants, and business owners with a very useful handbook for preparing, reviewing and interpreting buy-sell agreements.

DAVID A. ELLNER, CPA/ABV
The Financial Valuation Group
Published in the AICPA ABV e-Alert
Volume 9, Issue 2, February/March 2007

Released in January 2007, “Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?” has quickly become a valuable tool for attorneys, business advisors and business owners who recognize the importance of buy-sell agreements. Don’t take our word for it. Below are just some of the published reviews of “Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?.”

Mr. Mercer has done a great job of addressing the reasons business owners might want to have a buy-sell agreement and the business factors these business owners should consider in the agreement... Overall, Mr. Mercer provides valuation practitioners, business consultants, and business owners with a very useful handbook for preparing, reviewing and interpreting buy-sell agreements.
Buy-Sell Agreements
Ticking Time Bombs or Reasonable Resolutions?

Z. Christopher Mercer, ASA, CFA

Written for business owners, attorneys, CPAs, business appraisers, and other professional advisors to business, this book provides a roadmap for you (or your clients) to develop or improve your buy-sell agreement. The first book written from a valuation perspective which is important to note because business appraisers are usually consulted when there is a problem. Learn from our 25 years of experience working with well-constructed and terribly constructed buy-sell agreements (in almost every case no one realized there were problems until a trigger event occurred)!

HIGHLIGHT SECTIONS/CHAPTERS INCLUDE:

» Categories & Types of Buy-Sell Agreements
» Process & Single Appraiser Buy-Sell Agreements
» Process Timetables - Why it takes more time than you think
» The Six Defining Elements of Buy-Sell Agreements - Agreements must have all six but most do not!

» War Stories from our experience
» The Buy-Sell Audit Checklist - This alone is worth the price of the book
» In addition, the ASA BV Standards and USPAP Standards 3, 9 & 10 are reprinted in full for your convenience

"...is terrific - sophisticated, refreshingly thoughtful and the first really new ideas (to me, anyway) in this area I’ve heard or seen in a long time."

Putnam C. Smith, J.D., LLM, Partner, Lipscomb, Johnson, Sleister, Dailey & Smith, LLP, Cumming, Georgia

Order Your Copy Today
$79.00
(plus shipping)

To order, fax back to 901.685.2199, call us at 901.685.2120, or visit www.mercercapital.com

To make checks payable to:
Peabody Publishing, LP
5860 Ridgeway Center Parkway, Suite 400, Memphis, TN 38120

Categories & Types of Buy-Sell Agreements
Process & Single Appraiser Buy-Sell Agreements
Process Timetables - Why it takes more time than you think
The Six Defining Elements of Buy-Sell Agreements - Agreements must have all six but most do not!

HIGHLIGHT SECTIONS/CHAPTERS INCLUDE:

To order, fax back to 901.685.2199, call us at 901.685.2120, or visit www.mercercapital.com

<table>
<thead>
<tr>
<th>QTY</th>
<th>Regular Price</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Book</td>
<td>$79</td>
<td></td>
</tr>
<tr>
<td>2 or More</td>
<td>$12.00</td>
<td></td>
</tr>
<tr>
<td>FedEx Ground</td>
<td>$7.00</td>
<td></td>
</tr>
<tr>
<td>2-Day</td>
<td>$11.00</td>
<td></td>
</tr>
<tr>
<td>Overnight</td>
<td>$35.00</td>
<td></td>
</tr>
<tr>
<td>Sales Tax - TN Residents (9.25%)</td>
<td>$1.16</td>
<td></td>
</tr>
<tr>
<td>Shipping Charge</td>
<td>$0.00</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Visa  Mastercard  American Express  Check Enclosed

Card Number

Name on Card  Exp. Date

Signature

Make checks payable to
Peabody Publishing, LP
5860 Ridgeway Center Parkway, Suite 400, Memphis, TN 38120

Marketing & Sales:
Peabody Publishing, LP
3858 S.ahoma Street, Suite 400, Memphis, TN 38111
Toll-free: 800.466.2972
Local: 901.685.2120
Fax: 901.685.2199
E-mail: info@mercercapital.com

Peabody Publishing, LP
(c) 2008

www.mercercapital.com