

# APPLE SHORT-SELL PITCH

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Apple, Inc. (NASDAQ: AAPL)

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# COMPANY & INDUSTRY OVERVIEW

Apple Inc. manufactures, and markets mobile communication and media devices, personal computers, and portable digital music players. Its products and services include iPhone, iPad, Mac, iPod, Apple TV, the iOS and Mac OS X operating systems, iCloud, and various accessory and support offerings, as well as a range of consumer and professional software applications.

**Current Price: 595.32**  
**Target Price: ?**



Ticker	WBMD
Current Price	595.32
Market Cap	559B
52-Week Range	363.32-705.07
Avg Daily Volume	18.38M
Dividend	--

**Industry:** Personal Computers

**Competitors:**

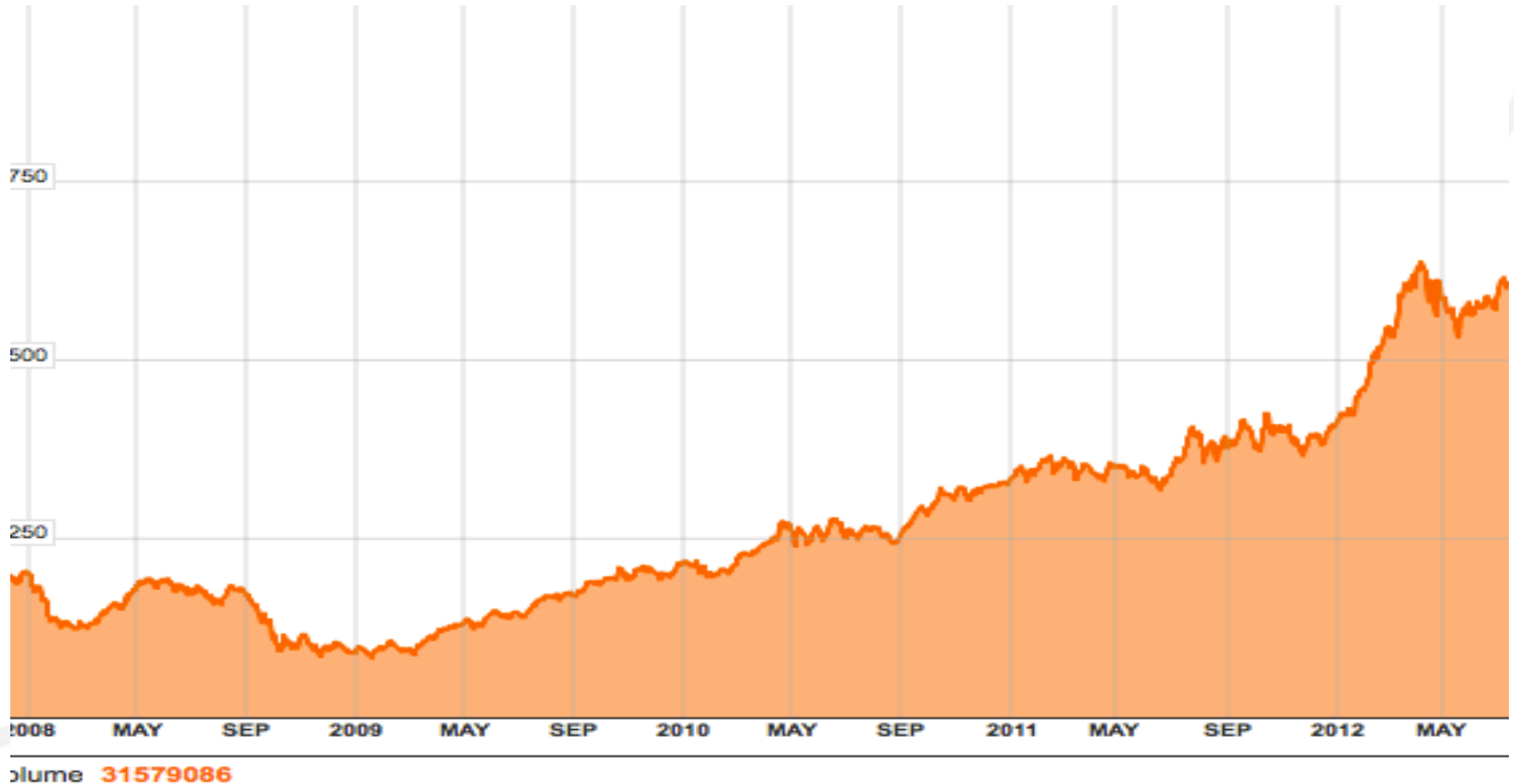
Personal Computers: IBM, Dell, HP

Smartphones: Google, Microsoft, Samsung

Software: Microsoft

Tablets: Amazon, Microsoft, Google

# HISTORICAL STOCK PERFORMANCE



- After a marked decline in September 2008, Apple's stock gradually rose until a sharp increase in 2012.
- Apple stock has fallen from its 2012 peak.

# RECENT COMPANY HISTORY

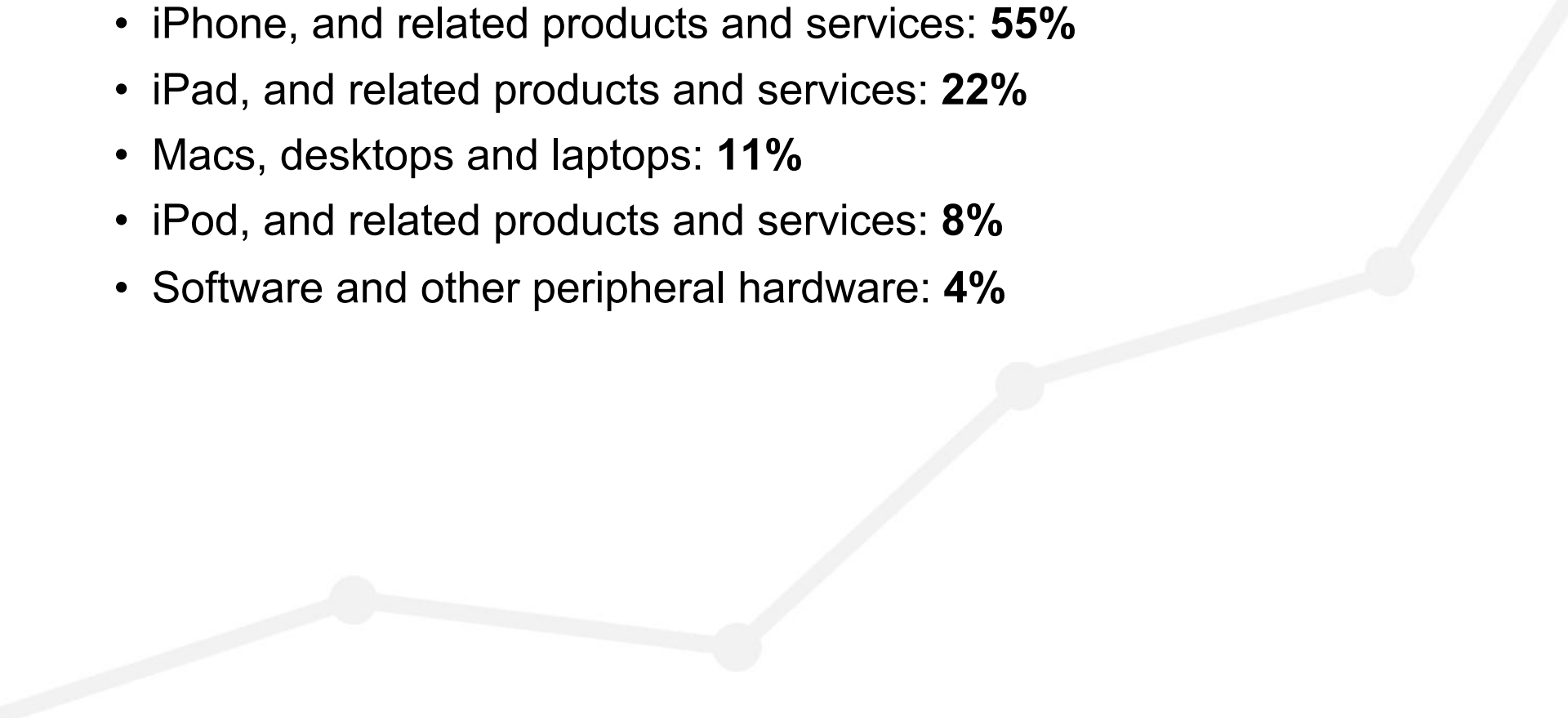
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- October 18, 2011: Q<sub>1</sub> 2012 Guidance above Analysts' Estimates
- January 24, 2012: Q<sub>2</sub> 2012 Guidance Above Analysts Estimates
- February 29, 2012: Market Cap tops \$500 Billion
- March 7, 2012: Apple unveils new HD iPad
- March 15, 2012: Apple Stock tops \$600
- April 24, 2012: Q<sub>3</sub> 2012 Guidance Below Analysts' Estimates
- July 11, 2012: Apple not green enough to suit San Francisco city policy
- July 24, 2012: Q<sub>4</sub> 2012 Guidance Below Analysts' Estimates
- August 9, 2012: Apple Pays first dividend
- September 12, 2012: iPhone 5 introduced
- October 23, 2012: iPad mini, new iPad, iMac refresh
- October 29, 2012: John Browett and Scott Forstall fired

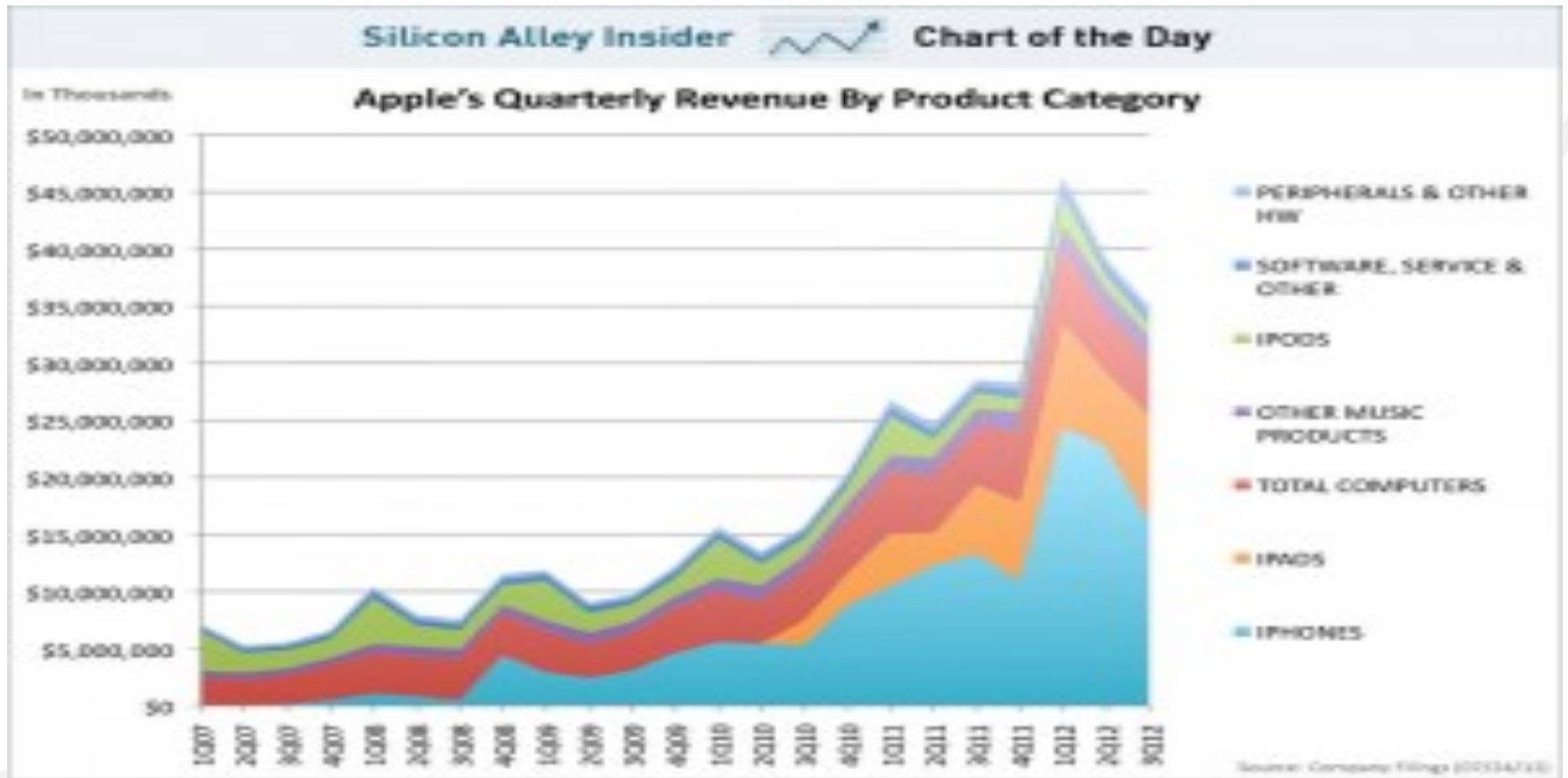
# APPLE REVENUE BREAKDOWN

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- iPhone, and related products and services: **55%**
- iPad, and related products and services: **22%**
- Macs, desktops and laptops: **11%**
- iPod, and related products and services: **8%**
- Software and other peripheral hardware: **4%**

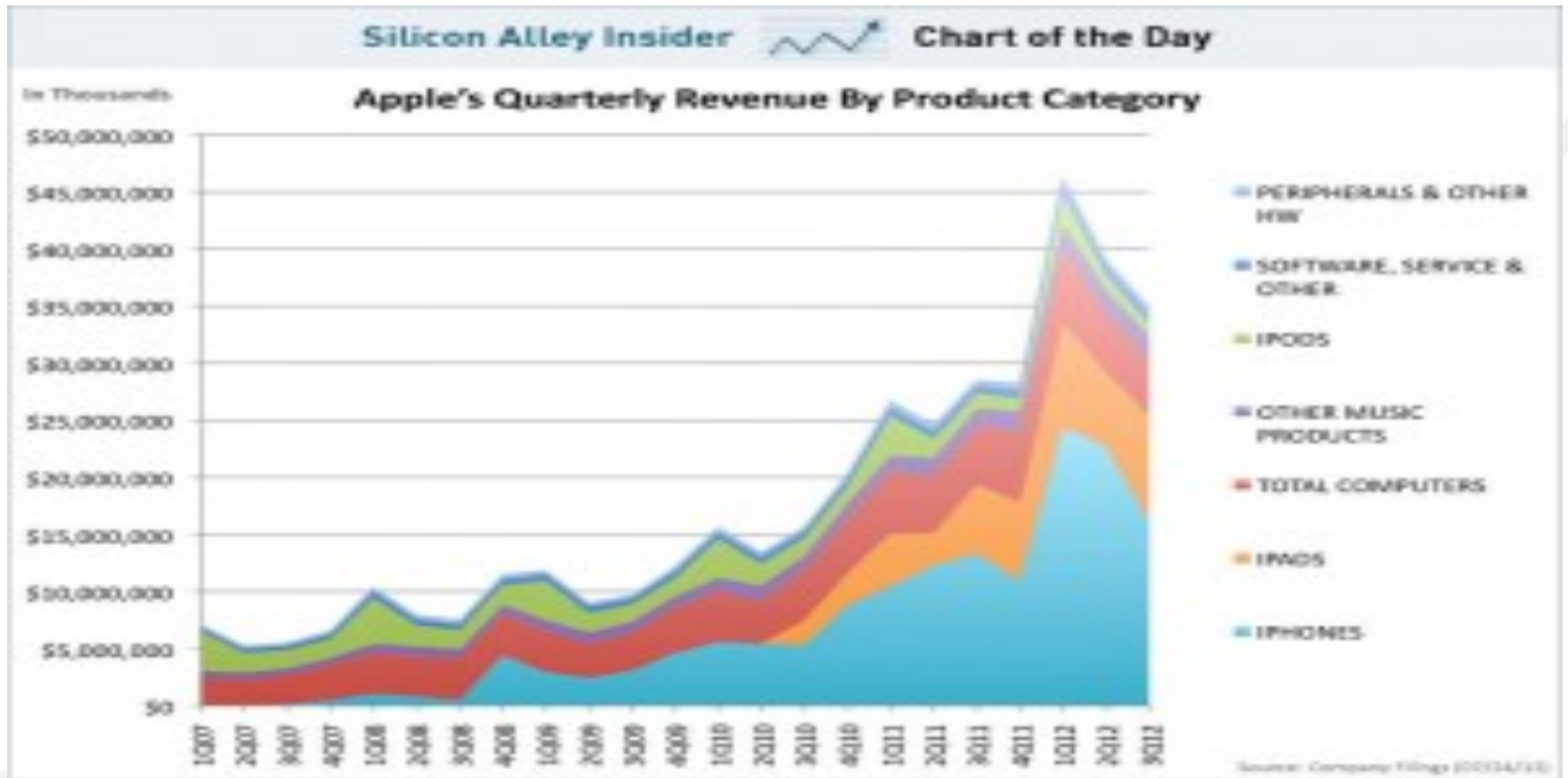


# QUARTERLY REVENUE SEGMENTATION



-Note that iPhone has been making up a larger segment of Apple Revenues since release, as has iPad (to a lesser extent)

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# MANAGEMENT TEAM

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- **Timothy Cook, CEO**
  - Former COO, excellent operations
  - Not a proven leader whom can make hard product decisions
- **Peter Oppenheimer, CFO**
  - Long-time tenured employee of Apple
- **Jonathan Ive, Senior VP of Industrial Design**
  - Design sense is heavily embedded in Apple's DNA
- **Eddy Cue, Senior VP of Internet Software**
  - Recently assigned responsibility over Siri and Maps
- **Craig Federighi, Senior VP of Mac Software**
  - Recently assigned responsibility over iOS
- **Bob Mansfield, Senior VP of Hardware**
  - Recently assigned leadership of Technologies group which will combine all of Apple's wireless and semiconductor teams

# PRODUCT OUTLOOK

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- iPod

- No significant innovations since the introduction of the iPod Touch
- People are jumping ship from iPhone Samsung.
  - Usually would mean increase in amount of iPods sold.
    - BUT reviews for music platforms on competitors' devices have been positive.

- iPhone

- Last major update was Siri (10/2011)
- Not innovating at same rate as Android based phones; no first mover advantage
- Consumer loyalty is down in EU
- Apple is premium brand and focuses on consumers that are willing to pay top-dollar
  - Market is being saturated and Samsung is gaining market-share, while maintaining market share for sub-premium phones as well.
- Microsoft will have top 46/50 apps for their phones, may begin to pose legitimate threat
- Is there any way to go up?

- iPad

- Last innovations have all been size, screen, and computing power
- iPad mini
- Is there major innovation in the future? Is the release schedule sustainable?

# PRODUCT OUTLOOK

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- **Macs**

- The lineup of desktops and laptops has been gaining share as demand wanes for competing personal computers, according to research firm Gartner Inc. Microsoft this week releases its own tablet, the Surface. – Giles (Bloomberg)
- Touch screen?

- **Other (iTunes + Apple TV):**

- Competition has significantly grown in the radio space
  - Spotify
  - Pandora
    - Serious competition mitigates potential for Apple radio

# WHY EXPECTATIONS ARE SO HIGH

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- **It's Apple**
  - Largest company by market cap, meteoric rise
  - Successfully broken through top after top
  - Legacy of releasing high-margin, high-quality, game-changing products that have driven incredibly strong performance
- **Jobs's Legacy**
  - Laser focus on product and customers
  - Spearheaded the constant reinvention of the company that enabled it to create lucrative new markets for itself
- **Mutual Funds and Value Investors Love Apple**
  - Large-cap, dividend, equity-growth showing stock -- institutional investors love it
- **Established History of Beating Earnings**
  - Apple is known for conservatively guiding so it can produce strong beats; has beaten 27 out of the past 30 quarters
  - Because of this, every miss is particularly significant
- **iPhone 5 has exceeded selling estimates**
  - Historically, Apple's best quarter is the holiday season (so the fourth calendar quarter)

# WHY APPLE WON'T MEET EXPECTATIONS

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- **Product pipeline has significantly weakened**
  - Apple has historically been all about the products
  - Recent product launches have been incremental at best, no game-changer that would satisfy the expectations
  - Cook highly focused on pipeline and product timelines, not on making the revolutionary products that have been Apple's bread and butter; low-risk, x's and o's executive
- **Incremental Products Won't Make Wall Street Happy**
  - Without big product launches, it's unclear how Apple will gain market share, particularly with the stiff competition and the loss of first-to-market advantage
  - Apple has been a company that has been able to continue to support the meteoric rise because it has constantly reinvented itself, from the mac, to the iPod, to the iPhone and iPad
    - When one wave runs out, Apple has been able to maintain the momentum by launching a product that triggers a new wave
  - The iPhone and iPad wave is running out: incremental upgrades suggests market saturation and complacency
  - It has to find a new product to ride the wave and blow away estimates: **but can it?**

# WHY APPLE WON'T MEET EXPECTATIONS

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- A Multitude of Problems Are Slowly Creeping Up That May Prevent Apple From A Big Hit
  - Less Jobsian
  - Less product-focused and not as adamant about perfection in product line
  - Instability in management team
  - Incredible competition in the mobile and pc space
    - First-mover advantage is gone; nothing Apple has announced recently has been something completely new and not already established by some competing company
    - First-mover is gone on the software side too; Android Market now has 700,000 apps, matches the offerings of the App Store
  - Supply concerns

# CATALYSTS FOR AN APPLE FALTER

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- **Less Jobsian**
  - Apple became the most valuable company in the world because of a high level focus on perfectionism in product
    - Cook is not so focused on product; has openly admitted he doesn't spend much time on the product side of the business
  - Missteps like Siri and Maps are examples of what an Apple without a Jobs-like focus on product development may be like
- **No opportunity for market share growth in iPhone**
  - Apple has failed to address the lower price segment of the smart phone market
- **Management Shakeup**
  - Forstall, a Jobs favorite and head of the iOS team, axed
- **Missing Earnings**
  - Apple has only missed earnings 5 times in the past 30 quarters; 3 of the 5 have occurred in the last 5 quarters
    - This really illustrates how high expectations are for the company

# CATALYSTS FOR AN APPLE FALTER

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- **Intensifying Competition**

- Microsoft, Google, and Samsung will pose a big fight in the smartphone and tablet segment
- Apple no longer has the first-to-market advantage
- Android Market rivals iOS App Store; this has historically been a big selling point for the iPhone, which should fade

- **Supply Concerns**

- Given how many suppliers are involved in Apple's production process, its almost impossible to maintain secrecy regarding major product launches
- A number of products in Apple's supply chain are obtained from one supplier or a limited number of sources and this means Apple will face significant supply and pricing risks
  - Components are subject to industry-wide shortages as well as significant pricing fluctuations

# SCOTT FORSTALL RAMIFICATIONS

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- “A Major Blow” – Trip Chowdhry, Global Equities Research
  - Forstall was responsible for the spearheading of iOS, a Jobs-like decision maker and visionary
- Apple was organized entirely around Steve Jobs
  - Forstall was Jobs’ friend from NeXT days but didn’t gel with other senior execs
  - Apple promoted people who worked well with Steve Jobs, not who worked well with each other
- Apple needed Jobs et al to serve as “glue”
  - There’s no real corporate culture beyond Jobs’ charisma and vision
  - Sans Jobs, schisms within senior management are becoming more apparent
  - Apple expert Horace Dediu: “Apple’s biggest threat is corrosive politics and the entropy that follows”
- Apple, by nature, has depend ended on several, high-conviction product visionaries
  - Other than Ive, Forstall was the man
  - Cook has openly admitted he doesn’t spend much time on product and is more in favor of a bottom-up approach, giving each division much more autonomy than they had under Jobs
  - Analysts and insiders say that iOS product guys don’t respect Cook and will have difficulty warming to Ive
    - People respected Forstall’s decision making

# APPLE POST-JOBS

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- **Company started apologizing for mistakes**
  - Forstall was fired, ostensibly, for not signing an apology for Apple Maps
  - Jobs always instilled confidence that he knew exactly what he was doing and that it was the consumers who were wrong; for instance, he didn't apologize for "Antenna-gate" in iPhone 4
  - This is reflective of a change in ethos
- **Loss of Focus**
  - Siri and Apple Maps were uncharacteristically sloppy
    - Cook simply doesn't have the same attention to product since he's so focused on the operational x's and o's
  - Chowdhry of Global Equities Research: Without Jobs, "one of the most innovative engineers in the software industry is having a series of missteps"
  - Jobs was the ultimate perfectionist—logos, UI, iPhone glass screens, etc.
    - This perfectionism in product and ultimate attention to the customer was key to Apple's success
- **Lack of assertive, visionary leadership like Jobs**
  - BMO Capital Markets describes Cook as "leader of leaders," emphasizing discussion and even dissent amongst senior execs over central control
    - Prefers bottom-up as opposed to top-down
  - Poses a difficult transition from having Jobs as an all-controlling executive to having more responsibility devolved to different sector heads

# WHAT'S NEXT FOR IOS?

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- Scott Forstall has managed iOS from inception
  - Even insiders are unsure what happens now
- Jonathan Ive, SVP of Industrial Design, taking over Forstall's responsibilities
  - Though brilliant, Ives is primarily a hardware guy and thus may struggle with UI
  - Will hardware genius translate to interface competency?
  - Wim Lewi, Apple analyst: "Nokia made the mistake to focus too much on the hardware and missed the App revolution entirely....The risk to the Apple margin is equally high if its software lead decreases."

# APPLE NO LONGER FIRST-MOVER

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- Historically, Apple has maintained a “first-mover advantage”
  - iPhone and iPad were incredibly innovative; both presented new and original value adds for customers
- Apple is rapidly losing that advantage: iPhone 5 introduced nothing that competing devices haven’t already offered
  - Same with the new iPad
  - Android and Samsung are particularly threatening; Galaxy SIII has all the new features that the iPhone 5 presented
  - Android Play store now has as many apps as App Store (> 700k)
  - Instead of defining a market with the iPad Mini, Apple was playing catch up to compete with Galaxy Note and Kindle
- Apple has been successful at disrupting and making new markets, and all of those markets (PCs, music players, smartphones, tablets) are maturing or are mature
- Only way for Apple to stay on top is to create radically new, innovative product, that could support the next wave of stock advancement
  - iTV?

# THE IMPORTANCE OF MARGINS

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- With only 19% smartphone market share (vs 64% for Android), Apple relies on high margins for profit
- Currently experiencing three straight quarters of falling margins—goes beyond the typical margin decline in anticipation of a new product release
- By expanding lower-margin products like the iPad Mini or the iPhone 5, Apple risks damaging its margins long term
- iTV (Apple's only shot at a major disruption) would worsen the problem of margins

# CHALLENGES FOR iTV

- TV Market Maturity

- To stand out, iTV needs to somehow attract content, and negotiating with content providers will be difficult
- Apple has to somehow unseat current giants (Samsung, LG, Sony) in a commoditized market

- Unprofitability of industry

- Apple's other products have high margins and typically get upgraded every two years
  - High margin products have supported Apple's awesome earnings
- TVs have low margins and long product lives, which doesn't fit Apple's established business model
  - You either have to way over price to sustain margins or price to compete and get terrible margins

TVs				Apple
Sony	Samsung	LG	Average	Overall Gross Margin
1.26%	3.71%	1.62%	2.20%	40.04%

# COMPANY PERFORMANCE

In Millions of USD (except for per share items)	13 weeks ending 2012- 06-30	13 weeks ending 2012- 03-31	13 weeks ending 2011- 12-31	13 weeks ending 2011- 09-24	13 weeks ending 2011- 06-25
Revenue	35,023.00	39,186.00	46,333.00	28,270.00	28,571.00
Other Revenue, Total	-	-	-	-	-
Total Revenue	35,023.00	39,186.00	46,333.00	28,270.00	28,571.00
Cost of Revenue, Total	20,029.00	20,622.00	25,630.00	16,890.00	16,649.00
Gross Profit	14,994.00	18,564.00	20,703.00	11,380.00	11,922.00
Selling/General/Admin. Expenses, Total	2,545.00	2,339.00	2,605.00	2,025.00	1,915.00
Research & Development	876.00	841.00	758.00	645.00	628.00
Total Operating Expense	23,450.00	23,802.00	28,993.00	19,560.00	19,192.00
Operating Income	11,573.00	15,384.00	17,340.00	8,710.00	9,379.00

# EARNINGS

## Sales and Profit Figures in US Dollar (USD) Earnings and Dividend Figures in US Dollar (USD)

Estimates vs Actual	Estimate	Actual	Difference	Surprise %
<b>SALES (in millions)</b>				
Quarter Ending Sep-12	35,802.70	35,966.00	163.30	0.46
Quarter Ending Jun-12	37,215.90	35,023.00	2,192.88	5.89
Quarter Ending Mar-12	36,808.00	39,186.00	2,377.95	6.46
Quarter Ending Dec-11	39,062.50	46,333.00	7,270.46	18.61
Quarter Ending Sep-11	29,685.50	28,270.00	1,415.55	4.77
<b>Earnings (per share)</b>				
Quarter Ending Sep-12	8.75	8.67	0.08	0.91
Quarter Ending Jun-12	10.39	9.32	1.07	10.29
Quarter Ending Mar-12	10.04	12.30	2.26	22.55
Quarter Ending Dec-11	10.16	13.87	3.71	36.46
Quarter Ending Sep-11	7.39	7.05	0.34	4.54

# BALANCE SHEET

APPLE INC.		
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)		
(in millions, except number of shares which are reflected in thousands)		
	June 30, 2012	September 24, 2011
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 7,945	\$ 9,815
Short-term marketable securities	19,709	16,137
Accounts receivable, less allowances of \$94 and \$53, respectively	7,657	5,369
Inventories	1,122	776
Deferred tax assets	2,309	2,014
Vendor non-trade receivables	6,641	6,348
Other current assets	6,560	4,529
Total current assets	51,943	44,988
Long-term marketable securities	89,567	55,618
Property, plant and equipment, net	10,487	7,777
Goodwill	1,132	896
Acquired intangible assets, net	4,329	3,536
Other assets	5,438	3,556
Total assets	\$ 162,896	\$ 116,371

Total Assets: DOWN  
Stock Price: UP

# BALANCE SHEET II

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (USD \$) In Millions, except Share data in Thousands, unless otherwise specified	3 Months Ended		9 Months Ended	
	Jun. 30, 2012	Jun. 25, 2011	Jun. 30, 2012	Jun. 25, 2011
Net sales	\$ 35,023	\$ 28,571	\$ 120,542	\$ 79,979
Cost of sales	20,029	16,649	66,281	47,541
Gross margin	14,994	11,922	54,261	32,438
<b>Operating expenses:</b>				
Research and development	876	628	2,475	1,784
Selling, general and administrative	2,545	1,915	7,489	5,574
Total operating expenses	3,421	2,543	9,964	7,358
Operating income	11,573	9,379	44,297	25,080
Other income and expense	288	172	573	334
Income before provision for income taxes	11,861	9,551	44,870	25,414
Provision for income taxes	3,037	2,243	11,360	6,115
Net income	\$ 8,824	\$ 7,308	\$ 33,510	\$ 19,299
<b>Earnings per common share:</b>				
Basic	\$ 9.42	\$ 7.89	\$ 35.89	\$ 20.91
Diluted	\$ 9.32	\$ 7.79	\$ 35.48	\$ 20.63
<b>Shares used in computing earnings per share:</b>				
Basic	936,596	926,108	933,672	922,917
Diluted	947,059	937,810	944,440	935,688

Costs: Increased