

Stock Market Review



Edward Rizzo

Mr Rizzo is a director at Rizzo, Farrugia & Co. (Stockbrokers) Ltd.

Apple's financial performance below estimates despite phenomenal growth

For many years, Apple Inc has been dominating the headlines across the IT sector and the financial markets. This technology company revolutionised the industry and its financial performance consistently exceeded everyone's expectations on a regular basis.

The market was particularly eager to know this year's September full-year financial results following the demise of the company's co-founder Steve Jobs on October 5. Apple released its earnings report on October 18 with CEO Tim Cook presenting the figures to analysts and the media for the first time without Steve Jobs.

Apple reported that it generated total revenue of \$28.3 billion (+39 per cent) during the final three months of their financial year with profits surging by 53 per cent to \$6.6 billion. However, despite the phenomenal rate of growth registered once again and also despite the fact that these were the best Q4 results ever reported, the performance was below market expectations.

The immediate reaction on the stock market was negative and within the first hour after the release of the numbers, Apple's share price had dropped by 6.4 per cent wiping off \$24 billion from the overall value of the company.

The major disappointment of various financial analysts was the lower-than-expected sales of the iPhone. During the three month period from July to September 2011, a total of 17.07 million iPhones were sold compared to their estimate of 20 million. Apple's chief financial officer attributed the shortfall to people postponing their purchases ahead of the new model which was launched only 24 hours before the passing away of Steve Jobs. Although sales of iPad's were at a record level of 11.12 million over the past three months (amounting to an average of circa 123,500 units per day), this level was also below some estimates in the marketplace.

During past 12 months, sales of iPhones totaled 72.3 million (+81 per cent), with iPad sales volumes climbing to over 32 million from under 7.5 million in the previous 12-month period. On the other hand the sales of iPods decreased by 15 per cent to 42.6 million reflecting customer migration towards the iPad and iPhone. In the 2010/2011 financial year, which came to a close four weeks ago, Apple generated total revenue of \$108 billion, representing an extraordinary growth rate of 66 per

Apple Inc	2008	2009	2010	2011
	USDmillion	USDmillion	USDmillion	USDmillion
Revenue	37,491	42,905	65,225	108,249
EBITDA	8,823	12,474	19,412	35,604
Profit after tax	6,119	8,235	14,013	25,922
Cash flow from operations	9,596	10,159	18,595	37,529
Dividends	0	0	0	0
Shareholders' Funds	22,297	31,640	47,791	76,615
iPhones (no. of units)	11.6 mln	20.8 mln	39.9 mln	72.3 mln
iPad (no. of units)	NIL	NIL	7.5 mln	32.4 mln
MAC (no. of units)	9.7 mln	10.39 mln	13.7 mln	16.7 mln
iPod (no. of units)	54.8 mln	54.1 mln	50.3 mln	42.6 mln

cent and overall profits after tax of \$26 billion (+73 per cent).

Ever since the health problems of Steve Jobs first emerged in 2004 and more so following his recent demise, many critics have questioned whether Apple can continue to innovate and continue to grow at this pace especially without the input of their leader and mentor at the helm of the company. An increasingly competitive landscape is also another threat especially in the market for smartphones from companies such as Samsung Electronics and HTC which both released new handsets running on the Android operating system of Google.

However, CEO Tim Cook continued to refer to the strength of the company's future product lineup as well as the growth potential from existing products especially in the tablet market and also expansion into new territories. Apple's CEO claimed last week that the tablet market, in which Apple has a sizeable lead through the iPad, would overtake the market for Personal Computers representing "a huge opportunity for Apple".

The CEO also singled out the expansion in Asia, with particular reference to China as a major driver for future growth. China has become Apple's largest market after the US accounting for 16 per cent of revenue generated during the past three months, equivalent to \$4.5 billion, representing an increase of almost four times the level last year. Apple's CEO confirmed that the company would replicate its US strategy in China and commented: "I've never seen

a country with so many people rising into the middle class that aspire to buy Apple products". China is the world's largest mobile phone market in terms of subscriber numbers with over 940 million users. Apple is also targeting continued expansion in Brazil, China and the Middle East where the iPhone is helping further proliferation of Apple products.

Apple already provided estimates for the first quarter of their 2011/12 financial year. During the upcoming months of October, November and December this year, Apple expects to generate total revenue of \$37 billion and profits in excess of \$8.5 billion. Apple is heading towards its best ever quarter boosted by the inclusion of the initial sales of the new iPhone 4s.

Surprisingly, despite the surge in profitability and cash generation in recent years, Apple last distributed a cash dividend to its shareholders in 1995. However, despite the lack of a dividend return, Apple was very much loved by numerous investors as it represented a typical growth story with revolutionary products leading to strong sales and profitability growth. Last week, Apple reported that its total amount of cash and similar investments amounted to an extraordinary \$81.6 billion.

The CEO was naturally questioned again on the company's lack of a dividend policy and when it was likely to start handing out some of this sizeable cash pile to shareholders. While not committing himself on such a delicate matter, Tim Cook provided a clear signal that Apple may be consid-

ering a dividend as he stated that "I am not religious about holding cash or not holding it. It's the topic for the board on an ongoing basis".

Although Apple's share price dropped following the publication of the financial results, few may realise the extraordinary level of capital growth registered by this equity in the past few years. Apple's share price touched a record level of \$425 per share last week when the company announced that during the first few days following the launch of the iPhone 4S, a total of four million smartphones were sold.

Only five years ago in September 2006, the share price was at a level of \$68. Despite the exceptional surge of over 525 per cent in only five years, few investors may be aware that the equity which is currently priced at around \$400 per share is "cheaper" from a fundamental perspective compared to the lower level of \$68 per share in 2006.

One of the most commonly used valuation multiples is the price to earnings ratio comparing the current share price to the profitability generated by the company for every share in issue. Despite the phenomenal increase in the share price to over \$400 per share, due to the substantial growth in profitability from \$2 billion in 2006 to \$26 billion during the last 12-month period, the p/e ratio of circa 12 times at the moment indicates it is cheaper today at a price of \$400 per share than when it was priced at \$68 per share in 2006 with a ratio of almost 30 times earnings. This is an important consideration which very often goes unnoticed.

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