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Finance (Sample of writing)

Apple Inc AAPL [XNAS] | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
423.2 USD	600.00 USD	420.00 USD	810.00 USD	Medium	Narrow	Standard		Computer Systems

Samsung Galaxy S 4 Poised to Be Worthy IPhone Competitor

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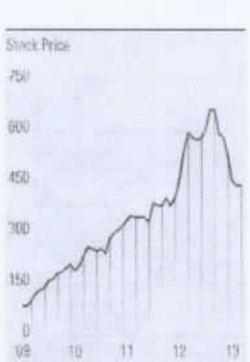
Analyst covering this company do not own its stock.

Pricing as of Apr 05, 2013.
Rating as of Apr 05, 2013.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.



Analyst Note Mar. 15, 2013

Samsung announced its long-awaited Galaxy S 4 smartphone Thursday, and at first glance, we're impressed by some of the new and innovative services associated with the device and expect it to be a worthy challenger to Apple's AAPL iPhone in the premium smartphone market. Initial reviews from a variety of tech websites have been mixed thus far, but we anticipate that if nothing else, Samsung's brand and marketing muscle will probably make the GS4 the premier Android-based phone in the market. Samsung intends to launch the phone in 155 countries, beginning at the end of April.

We have two key takeaways from the announcement. First, Samsung didn't focus much on hardware, but rather a host of innovative services that differentiate the device from not only the iPhone but also other Android handsets. This is indicative of our long-term thesis that software, not hardware, will be the more important differentiator in the smartphone market. Some examples include S Translator, S Voice Drive for navigation, Story Album for photo sharing, and Samsung Hub, which allows for syncing of content among devices. Second, the GS4 launch did not mention Google GOOG or highlight its Android operating system, and no third-party apps partners were highlighted, as they took a back seat to more gadgetlike product features built internally by Samsung.

Our initial take is that the GS4 will continue to make the premium smartphone market a two-horse race between Samsung and Apple. We certainly see the GS4 as a compelling device for new smartphone adopters and current Android users, and it may crush the efforts of HTC, Blackberry BBRY, and Nokia NOK to regain share in the premium smartphone market. Since the iPhone 5 will be more than seven months old by the time the GS4 arrives, Samsung may again do a great job of capitalizing on a window of opportunity between iPhone cycles and raising the bar that Apple must hurdle with its new product launches. That said, we believe a slowdown in iPhone 5 sales over the next few months, as well as the competitive threat from Samsung, is already baked into Apple's stock price today, and we think the shares remain attractively valued. We maintain our fair value estimate for Apple.

Thesis Jan. 24, 2013

We believe Apple's strength lies in its experience and expertise in integrating hardware, software, services, and third-party applications into differentiated, premium devices that provide superior functionality and ease of use for the end customer. Although Apple has a robust product pipeline and ample opportunity to gain share in its various end markets, short product life cycles and intense competition will prevent the firm from resting on its laurels or carving out a wide economic moat, in our opinion.

Although Apple originated as an innovator in the PC market and rose from the ashes in the mid-2000s on the heels of its wildly popular iPods, its fortunes are likely to remain tied to the iPhone and, to a lesser extent, the iPad for quite some time. We believe the key to Apple's success has been the firm's ability to seamlessly integrate hardware and software into easy-to-use devices. Its multiyear head start in this integration gives the firm an advantage over software providers (like Google GOOG and Microsoft MSFT) and hardware providers (such as Samsung and Hewlett-Packard HPQ) alike. Although Apple didn't invent the handset, or even the smartphone, its elegant iPhone design revolutionized the industry. Handset makers caught up with their own touchscreen smartphones, and certain devices have at times outperformed Apple's hardware in terms of screen size and data speed, but we see Apple remaining at or ahead the rest of the pack on the hardware front as it continues to add innovative, differentiated features (like retina display and a devout focus on battery technology) into its devices.

We believe Apple's bigger battles are in software and services today. The early iPhone success was driven by easy portability of iTunes media (leveraged from its dominant

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Close Competitors	Currency (Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Google, Inc.	USD	258,143	50,175	12,760	10,737
Microsoft Corporation	USD	240,398	72,930	19,645	15,459
Hewlett-Packard Co	USD	42,710	118,680	-11,347	-12,886
Dell Inc	USD	24,845	56,940	3,012	2,372

position in iPod music players), as well as a first-mover advantage in the development of its iOS operating system and third-party app store. Ongoing enhancements, such as FaceTime and iMessage, help to differentiate Apple from Google's Android and other operating systems even further. Apple's current goal is to heighten the switching costs of its products, and we see iCloud, which allows for online storage and synchronization across iOS devices, as a key facet of this plan. Customers who own an iPhone and other iOS products (perhaps an iPad, Mac, iPod, or current and future Apple TV products) may become more reluctant to buy a new device that doesn't sync with iCloud and the rest of the ecosystem. Although iCloud and iOS won't provide Apple users with insurmountable switching costs, especially if the company's products are perceived to be stale or boring, the firm has done a much better job than predecessors (Motorola and Research in Motion RIMM come to mind) that failed to lock in customers when they were king of the hill. Finally, we view Apple's integration of third-party apps into iOS 6, including Siri, as an interesting, increasingly important part of its strategy. A Siri search that provides a restaurant review from Yelp YELP may enhance the iPhone's ease of use today and, given the complexity of voice recognition software, may emerge as a clear differentiator that other OS platforms may be unable to match for years to come.

Ultimately, Apple will have to continually develop superior products on all fronts (hardware, software, services and third-party apps) while fending off many strong rivals in end markets highlighted by short product life cycles and intense competition. We expect Apple to remain a premium supplier of devices, even though rivals will clearly compete on price; Amazon AMZN is essentially selling its hardware at cost in order to profit from higher online media sales, and Google gives the Android OS to handset makers for free in order to drive search traffic. Apple may do a better job than any other phone or tablet maker in raising the switching costs associated with its devices, but as rivals like Samsung develop products with similar functionality and others offer serviceable products at much lower prices, a few missteps from Apple could drive customers to leave iOS altogether, especially as consumers replace phones every couple of years. In hardware, Samsung is the clear leader in smartphones and "phablets" (phone/tablets) with larger screen sizes today, and Apple may need to retaliate with a larger iPhone if more and more consumers prefer these larger devices. In software, Apple's decision to part ways with Google Maps and offer an inferior in-house mapping solution may have been one such misstep and may persist as an iOS weakness if Siri and other apps will not allow iOS users to select the mapping software of their choice and instead point all users toward Apple Maps. In our opinion, the maps issue highlights that, despite Apple's size and software expertise, the firm will still have to develop and maintain partnerships with third parties like Facebook FB and others in order to provide a favorable experience to end users.

Valuation, Growth and Profitability

We are lowering our fair value estimate for Apple to $600 from $770, based on more conservative iPhone, iPad, and Mac unit growth assumptions, modestly lower gross margin projections, and a lower terminal EPS growth beyond our five-year forecast horizon. This fair value estimate implies fiscal 2013 (ending September 2013) price/earnings of 13 times and 10 times after excluding $145 per share of cash on hand as of December 2012. We project solid revenue growth of 19% in fiscal 2013, thanks to the success of the iPhone 5, iPad and iPad Mini, and a variety of Mac computers. However, our new fair value estimate incorporates slower revenue growth in 2014 and beyond, as iPhone and iPad unit sales increases are mostly offset by pricing declines and an unfavorable mix toward lower priced models. We currently model 9% revenue growth in fiscal 2014 and 6% in fiscal 2015, down from our prior projections of 14% and 9%, respectively.

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We still see several avenues for long-term iPhone growth. We don't believe that smartphone adoption, as a percentage of total handsets, has peaked in developed markets like the U.S., and deals with new carriers like China Mobile CHL could bring the iPhone to entirely new sets of users. However, the next wave of growth in the smartphone market will likely come from low end phones sold in emerging markets, which we project will cause Apple's smartphone market share to decline from the low 20% range today down to the mid-to-high teens. We project 17% revenue growth for the iPhone in fiscal 2013.

We also anticipate robust long-term iPad revenue growth, as this device both displaces PCs and is purchased as a third device alongside of PCs and phones. However, a mix shift toward lower-priced iPad Minis will partially offset this strong unit sales growth. We assume that Apple's line of Mac PCs will see minimal revenue growth, as Macs gain share in the large but slow-growth (at best) PC market.

We project that a negative product mix shift, and perhaps more competitive pricing, will weigh on Apple's gross margins. We view Apple's fiscal 2012 gross margin of 44% as a peak, falling to 38% in fiscal 2013 and down to the 32% range by fiscal 2017. In turn, operating margins of 35% in fiscal 2012 would also be a peak, as we project that operating margins dip to the low 20% range in the long-term.

Risk

We believe a large, well-diversified company like Apple faces several risks. Despite its intentions to control as much of the user experience as possible for its products, the firm still relies on a robust app developer base and strong partnerships with third parties. Its decision (and subsequent apology) to use an in-house mapping solution may have diminished Apple's reputation and its customers' user experience, at least in the near term, and switching costs around other iOS products might not be enough to retain unsatisfied customers. We think it is unlikely that a further split from Google involving search is next, as we believe Apple's and Google's map differences pertained to specific creative user interface differences around mapping features, whereas search has a much simpler user interface (i.e., typing in the search bar). We also view Facebook as a key third-party apps provider. Although Apple is on the record as stating that Facebook is a friend and not a foe, a Facebook-centric phone could lure customers away from iOS in the unlikely event that the two firms were to end their relationship.

Apple also faces several well-branded, well-capitalized rivals in software and hardware. It must continually deliver premium products in order to stave off these hungry competitors. If Apple were to falter and its exceptional brand be diminished as customers departed iOS in droves, we don't think its cash cushion could help the firm buy its way out of any problem. As a premium phone supplier, Apple also runs the risk that wireless carriers could reduce or eliminate the subsidies that they provide their customers on the iPhone, in turn raising customers' up-front costs and perhaps making other smartphones appear to be better alternatives. Finally, Apple lost cofounder and visionary Steve Jobs in October 2011, and while we believe that CEO Tim Cook is a more-than-capable leader, Apple runs the risk that its unique culture and sense of innovation may diminish over time.

Bulls Say

- Gartner expects the smartphone market to essentially double from 2011 to 2014, so Apple could see tremendous revenue growth even if it only grew at the market rate.
- The iPad has been Apple's fastest-growing product line

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ever, which is a tremendous achievement given previous hits like the iPod and iPhone.

- For each iOS device purchased, customers may be less likely to switch to another provider and more likely to buy another Apple product, which could be a good sign for Mac sales, even in a soft PC environment.
- Apple's retail stores provide a platform for exposing new consumers to the breadth of the company's expanding product lines.

Bears Say

- Few firms have been able to maintain Apple's strong position in the handset market, as short product cycles and intense competition typically lead to new, innovative products that have historically prevented any single firm from dominating the marketplace.
- Apple will probably need to cut iPhone prices in order to grow in emerging markets, which in turn will weigh on gross margins.
- Apple may have lost much of its vision and creativity with the passing of cofounder Steve Jobs in October 2011.
- Apple is reliant on partnerships with third-party software providers like Google and Facebook, and it may struggle to sell premium products if it were to sever ties with these partners or offer inferior substitutes to these apps.

Financial Overview

Financial Health:As of December, Apple held about $43 billion in cash and investments in the U.S. that can be used for dividend payments, stock repurchases, and domestic acquisitions. Apple held another $94 billion in overseas cash and investments that it cannot repatriate to the U.S. without paying additional taxes. The company has no debt. We are not concerned about Apple's financial health.

Company Overview

Profile: Apple designs consumer electronic devices, including PCs (Mac), tablets (iPad), phones (iPhone), and portable music players (iPod). Its iTunes online store is the largest music distributor in the world; it sells and rents TV shows and movies and sells applications for the iPhone and iPad. In early 2011, Apple launched the Mac App Store, an online store that sells first- and third-party applications for Mac desktop and notebook computers. Apple's products are distributed online as well as through company-owned stores and third-party retailers.

Management: We view Apple as a good steward of shareholder capital. Arthur Levinson, former chairman and CEO of Genentech, is chairman of Apple's board of directors. Tim Cook became CEO in August 2011 after cofounder, longtime CEO, and visionary Steve Jobs stepped down from the CEO role before passing away in October 2011. Cook was considered to be Jobs' right-hand man and served in various operations roles with Apple before becoming COO in 2005. We believe Jobs' passing was a blow to the firm, as he was a one-of-a-kind leader and creative mind.

Although Tim Cook was a highly effective COO, one could question his leadership in the top spot thus far. Apple's formal apology after parting ways with Google Maps in iOS 6 and launching Apple Maps with a variety of bugs and errors may have put management in the spotlight. Given Cook's reputation as an operations guru, we're also modestly concerned with Apple's inability to build enough supply of a host of new products, such as iPad Minis and iMacs in the December 2012 quarter, potentially leaving revenue on the table. Finally, Apple recently hinted that a 4" screen is an adequate screen size for a smartphone, yet Samsung has done quite well in recent quarters with its much larger Galaxy S III (4.8" screen) and Note II (5.5") products, and we fear that Apple may miss out on part of the premium smartphone market that seeks larger screen sizes. Apple continues to generate operating margins and cash flow well above its peers in various hardware industries. Although Apple may have frustrated investors under Jobs by holding a titanic cash cushion ($117 billion as of June), we applaud the company's recent dividend initiation and buyback plan under Cook, although we recognize that many investors may believe that such steps are not nearly enough to adequately reward shareholders. That said, we also appreciate Apple's frugality by making smaller strategic acquisitions and developing products in-house, rather than splashy but questionable deals like Microsoft's purchase of Skype or Google's foray into hardware by acquiring Motorola Mobility.