Apple

Ticker: AAPL (NASDAQ)

Recommendation:

Short-Term (<1 week): SELL. Apple is currently overvalued and will likely see a drop in its share price as consumer activity continues to be interrupted by COVID lockdowns.

Medium-Term: HOLD. Apple is a company that has consistently outperformed the US technology sector and the wider market, across a 5-year to 30-day period. This reflects its strong adaptability to changing consumer preferences and their widespread adoption of innovative features, that help to retain a large global customer base. Considering Apple's strong position and FCF, it is reasonable to assume Apple will recover quickly from the COVID pandemic. This recovery may even surpass investor expectations, bringing up the share price.

Performance: While the iPhone consumer market is renowned for its brand loyalty and engagement with phone applications are at an all-time high during the lockdown, Apple's short-term revenue and earnings will be directly dependent on new devices sold in 2020. With all macroeconomic data pointing towards a global recession resulting from the COVID-19 pandemic, Apple's premium-priced products across its product ranges will likely see a drop in demand, with first-quarter results indicating a partial collapse in consumer discretionary spending between February and April. This will likely further be realised in second-quarter earnings. With lockdown measures in place, it will also be difficult for Apple to compete in its additional services, such as streaming, which will struggle to compete against Netflix and Disney +.

Description

Apple Inc. design, manufacture and market smartphones, personal computers, tablets, wearables, and accessories worldwide.

Net sales break down by family of products and services as follows:

- Telephone products (54.7%): iPhone brand
- Computers (9.9%): laptops (MacBook, MacBook Air and MacBook Pro brands) and PCs (iMac, Mac mini, Mac Pro and Xserve)
- Peripheral devices (9.4%): screens, storage systems, printers, video camera, memory cards, server, switches, etc.
- Music support (8.2%): music readers iPod and iPad and accessories
- Other (17.8%): software, maintenance service and Internet access service, etc

Net sales are distributed geographically as follows:

- The United States (39.3%)
- The Americas (5.6%)
- China (16.8%)
- Japan (8.3%)
- Asia/Pacific (6.8%)
- Europe (23.2%)

Quality **Rating**

AAPL stock has an IBD Relative Strength Rating of 91 out of 99. That puts it in the top 9% of stocks over the past 12 months. At the same time, Apple's relative strength line has moved slightly lower lately (Source).

Apple Rating: AA1.

"The Aa1 rating incorporates Moody's expectation that Apple's gross debt and leverage will decline over the next 12 to 24 months. Apple's credit profile reflects a large and global installed base of active devices, strong customer loyalty, and a track record of product innovation. While Apple plans to transition to a net cash neutral position, Moody's expects Apple to maintain a robust financial profile with credit metrics that compare favourably with other highly rated companies, including Moody's estimates for [Apple's] free cash flow of about $46 billion in FY '20. Strong momentum in Services revenues will continue to improve Apple's revenue diversification but Apple's growth and profitability will remain highly dependent upon iPhone sales. Apple's iPhone products face intense competition, mature growth and lengthening replacement cycles." (Source)

Porter Competition Analysis

Competitive Rivalry

Apple faces a high degree of competition among major multinational companies that compete directly in the technology sector. They are in direct competition with companies such as Google, Samsung Electronics, Hewlett-

Packard, Huawei, Lenovo and Microsoft. All these companies have a strong focus on R&D spending and have large global marketing campaigns. Apple, therefore, faces a strongly competitive industry.

Threat of New Entrants

There is a relatively low threat of entry to the mobile phone marketplace. A variety of small firms already produce popular mobile phones, and significant efforts towards consolidation have meant that the 3-firm global market share of the computing market is 39.6 and the 3-firm global market share of the mobile phones market is 40.4. (Euromonitor). Despite the high R&D and manufacturing costs, the highest barrier is brand recognition, where companies like Apple, Samsung, Huawei and Xiaomi dominate.

Threat of Substitution

There is a very low threat of substitution for Apple. As defined by Porter, substitute products are not direct-competing goods. Such services, such as using desktop applications to telephone calls or using devices other than mobile phones - are yet at a nascent stage and do not pose a threat to Apple.

Supplier Power

Apple has long term contracts with most of its suppliers and has a diversified global production network. With multiple suppliers seeking to undercut each other to service Apple, Apple is an attractive customer and thus has greater bargaining power with its suppliers.

Buyer Power

On a micro-scale, the bargaining power of an individual Apple customer is very low. On a macro-scale, large demographics within Apple's target market have significant bargaining power, and their move to an alternative, such as to Samsung or Huawei, represents an active threat to Apple. To mitigate this threat, Apple builds brand loyalty through its unique OS system and continued R&D expenditure, which allows Apple to develop new complementary products such as Air pods and thus build a loyal customer base.

Key Risk Assessment

Key risks and implications:

Economic Risks

The uncertainty of the current global economic environment poses a risk to the company through consumers and business aspects. The post-COVID pandemic global economic conditions could decrease the demand of company`s products and services, because of the decreased income and lack of confidence, such as tighter credit policy, an increase of unemployment, negative financial news and depreciation of asset values.

Geopolitical Risks

Apple faces Geopolitical Risks in China and Greater China region. State-backed competitors are increasing their market share year-on-year, and this poses a potential threat to Apple’s consumer base in those regions. Apple's international operations are also widely spread across the world. This means they are exposed to local economic, labour, political and exchange rate fluctuations and such macro changes can affect Apple's capacity to maintain its operating margins in those countries. Apple is most significantly at risk of increased risk of US tariff revivals, in response to the COVID-19 pandemic.

Raw Materials Risk

Recently commodity pricing fluctuations pose a potentially negative effect on the company's performance.

Competition Risk

Apple faces a high degree of competition among major multinational companies that compete directly in the technology sector. Across computers and peripherals, music players, mobile communication devices, video players and related services, Apple faces strong competition globally.

Credit risk

Apple faces a credit risk through the widespread use of credit purchases for Apple services. These credit risks, such as artificially or randomly failed credit payments, could negatively affect Apple's financial performance.

Inventory Risk

With purchasing manufacturing indexes falling significantly in China and multiple distribution outlets being shut down globally, Apple is facing a products shortage - largely driven by the decreased manufacturing capacity but also by the inventory ability due to COVID-induced supply issues. Despite the strong demand for Apple products, the immediate short-term products shortage will likely negatively impact on Apple's sales.

Charts & Data

Relevant information:

Current and Past Performance

Shareholder Returns:

Stock Performance by Group (last 7 days)		
Apple (AAPL)	US Technology Sector Average	US Market Average
3.9%	5.0%	5.4%

Apple has rebounded slower than the wider US Technology sector and the wider US market. This is partially explained by Apple's stronger performance despite the COVID outbreak than several competitors in the smartphone market.

Stock Performance by Group (last 1 year)		
Apple (AAPL)	US Technology Sector Average	US Market Average
38.8%	32.4%	-0.9%

AAPL has performed well over the TTM, exceeding the US Tech industry, which returned 32.4% over the past year. AAPL has concurrently performed considerably better than the US market, which fell 0.9% over the past year due to COVID.

Stock Performance by Group (last 5 year)		
Apple (AAPL)	US Technology Sector Average	US Market Average
130.3%	110.0%	35.0%
Stock Performance by Group (last 5 year) including Dividend Returns		
Apple (AAPL)	US Technology Sector Average	US Market Average
149.2%	130.3%	51.8%
Stock Performance by Group (last 3 year) including Dividend Returns		
Apple (AAPL)	US Technology Sector Average	US Market Average
106.2%	91.0%	28.5%
Stock Performance by Group (last 90 days)		
Apple (AAPL)	US Technology Sector Average	US Market Average
-5.0%	-8.0%	-9.3%

Apple has been a strong investment in the medium to long term and has consistently outperformed the wider US market and the fast-growing tech industry at the 5-year, 3-year, 1-year, 90-day and 30-day level. Despite below-average-industry dividend levels, total stock returns are high and offer an attractive opportunity for capital gains. Meanwhile, the fact that the stock only fell 5% during the sharp downturn of the entire market during the COVID pandemic's early stage, suggests that investors believe the company is better able to weather the crisis than its industry or wider market peers.

Price to Earnings Ratios:

Data Point	**Source**	**Value**
Earnings Per Share*	Company Filings (28/12/2019) in USD	$12.68
NasdaqGS: AAPL Share Price**	NasdaqGS (30/04/2020) in USD	$293.95
United States of America Tech Industry PE Ratio	Median Figure of 15 Publicly Listed Tech Companies	13.93x
United States of America Market PE Ratio	Median Figure of 2901 Publicly Listed Companies	14.89x

Source: NasdaqGS: AAPL PE (Price to Earnings) Ratio Data Sources

*Trailing twelve months (TTM) annual GAAP earnings per share excluding extraordinary items.

AAPL is of poor value based on its PE Ratio (23.2x) compared to the Tech industry average (13.9x), reflecting above-average confidence in Apple among investors.

AAPL is of poor value based on its PE Ratio (23.2x) compared to the US market (14.9x). The significant discrepancy suggests a potential overvalued stock position.

Price to Earnings Growth:

Data Point	Source	Value
PE Ratio	Company Filings (28/12/2019) in USD	23.19x
Net Income Annual Growth Rate	Consensus Estimate Earnings of Analysts from Etoro and SimplyWallSt	9.5% per year
United States of America Tech Industry PEG Ratio	Median Figure of 9 Publicly Listed Tech Companies	0.47x
United States of America Market PEG Ratio	Median Figure of 1984 Publicly Listed Companies	0.99x

NasdaqGS: AAPL PE (Price to Earnings) Ratio Data Sources

AAPL is poor value based on its price to earnings growth ratio which is at 2.44x. Such a high PEG suggests the stock's price rises above a justifiable reaction to its earnings growth, further suggesting the stock is growing on sentiment and is currently overvalued.

Liabilities and Debt Profile:

Short Term Liabilities: AAPL's short term assets, convertible into liquid cash within a 1-year period ($163.2B) exceed their short-term liabilities ($102.2B).

Long Term Liabilities: AAPL's short term assets ($163.2B) exceed its long-term liabilities ($148.9B).

Interest Coverage: AAPL earns more interest than it pays, so coverage of interest payments is not a concern. Apple's interest income, earned on cash temporarily held in savings accounts, certificates of deposits, or other investments, was $4.7bn for the TTM.

Cash Flow to Debt Ratio: AAPL's high cash flow to debt ratio (67.6%) indicates that the business is in a strong financial position and can accelerate its debt repayments if necessary.

Capital Structure Latest: Apple's Capital Structure has changed dramatically, with its Debt to equity ratio rising from 0.3x in 2014 to 1.2x in 2019. One of the reasons is that Apple's total outlay for dividends and share repurchases has increased from $47 billion in 2015 to $81 billion in 2019. While Apple's Debt has increased from $35 billion to $108 billion, its shareholder' equity has declined from $112 billion to $90 billion, as the company has been reducing its cash position via its capital return program.

Valuation Considerations

Valuation metrics and considerations

Using a DCF and discounting with a weighted average cost of capital (WACC) calculation, I used a terminal growth rate assumption of 2%.

Sum of Present Values	**1,113,847,893,634**
Minus Debt	118,761,000,000
Add Cash	100,557,000,000
Value of Company	**1,095,643,893,634**
Number of Shares	**4,375,500,000**
Valuation	**250.4**
Actual Valuation	**289.1**

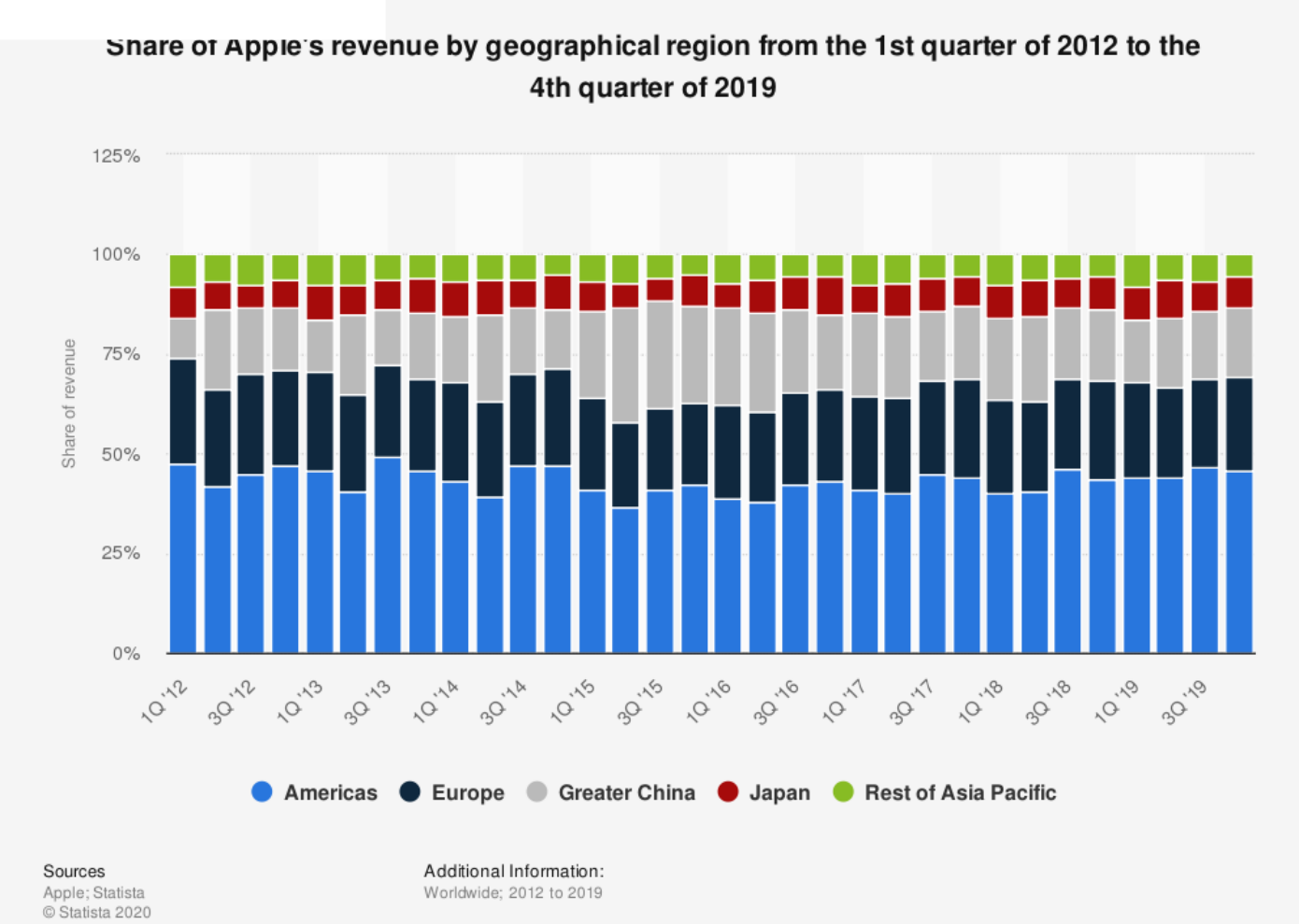
Status	**15.4%**	**OVERVALUED**
Action	**SELL**	

Using Apple's Annual reports and data from the provided balance sheet and financial statement, a DCF valuation suggests that Apple is significantly overvalued.

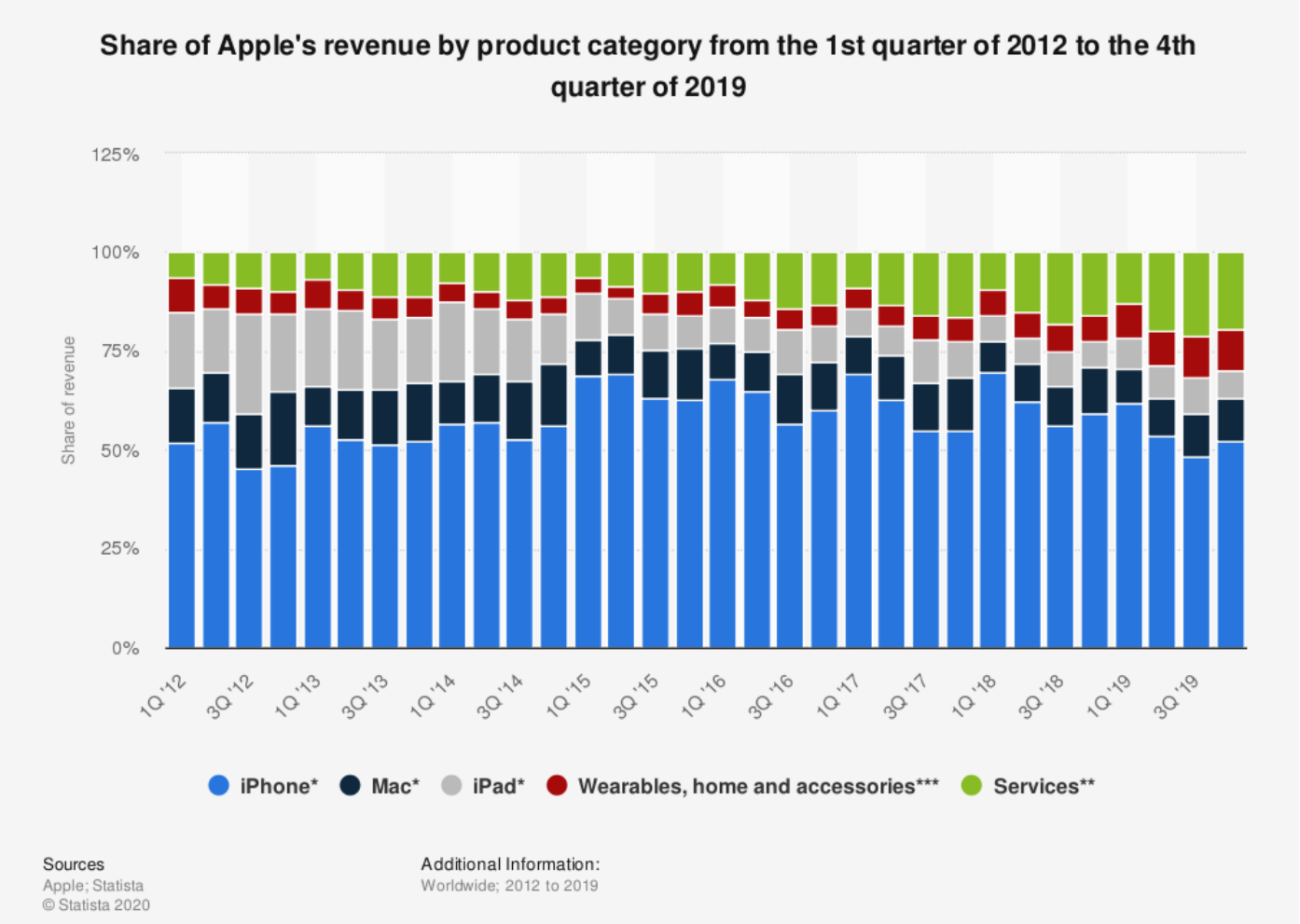
Estimate Values of Apple	
Average Comparables Valuation of Apple	$1,235,548,734,667
Current Valuation of Apple	$1,265,000,000,000
Per Share Average Comparable Valuation	$282.38
Per Share Actual Valuation	$289.11
Status:	**OVERVALUED**
Action Recommendation:	SELL

Using Apple's Annual reports and drawing on S&P CapitalIQ data for 11 comparable companies in the mobile or digital technology space, a comps analysis likewise suggests Apple is overvalued, by approximately 2.4%

Recommendation: SELL



Greater China accounts for a 10%+ share of Apple revenue. Geopolitical exposure to increased tensions between China and Taiwan and greater competition risks in China pose a risk to Apple's business operations there.



The iPhone accounts for approximately 50% of Apple Sales. A large part of the Apple customer journey involves physical advertising and exposure in Apple stores globally. As these are closed, iPhone sales will likely decrease during the COVID pandemic.