



# Apple Inc. (AAPL)

Updated October 31<sup>st</sup>, 2019 by Eli Inkrot

## Key Metrics

<b>Current Price:</b>	\$248	<b>5 Year CAGR Estimate:</b>	1.8%	<b>Volatility Percentile:</b>	73.2%
<b>Fair Value Price:</b>	\$188	<b>5 Year Growth Estimate:</b>	6.0%	<b>Momentum Percentile:</b>	54.4%
<b>% Fair Value:</b>	133%	<b>5 Year Valuation Multiple Estimate:</b>	-5.5%	<b>Growth Percentile:</b>	57.6%
<b>Dividend Yield:</b>	1.2%	<b>5 Year Price Target</b>	\$25	<b>Valuation Percentile:</b>	20.3%
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	D	<b>Total Return Percentile:</b>	13.9%

## Overview & Current Events

Apple is a technology company that designs, manufactures and sells products such as smartphones, personal computers and portable digital music players. Apple also has a thriving services business that sells music, apps, and subscriptions. The company was founded in 1976, is headquartered in Cupertino, CA and is valued at \$1.1 trillion.

On October 30<sup>th</sup>, 2019 Apple reported Q4 and fiscal year 2019 results for the period ending September 28<sup>th</sup>, 2019. For the quarter Apple recorded revenue of \$64.0 billion (at the high end of prior guidance), which was up 1.8% compared to Q4 2018. Respective revenue gains of 18.0%, 54.4% and 16.9% in Services (which hit a record \$12.5 billion), Wearables and iPad, were offset to a degree by a -9.3% and -4.8% decline in iPhones and Mac's. Net income equaled \$13.7 billion, a -3.1% decline, while earnings-per-share equaled \$3.03 compared to \$2.91 previously, aided by a significantly lower share count. During the quarter over \$21 billion was returned to shareholders via dividends and share repurchases.

For the year Apple generated \$260.2 billion in sales, a -2.0% decline, as a 16.5% gain in Services was more than offset by a -5.3% decline in the much larger Products portion of the business. Net income for fiscal 2019 equaled \$55.3 billion, a -7.2% decline; however, earnings-per-share of \$11.89 were only down slightly as a result of the lower share count.

Apple also provided guidance for Q1 2020. The company anticipates revenue of between \$85.5 billion and \$89.5 billion, with a 37.5% to 38.5% gross margin and \$9.6 billion to \$9.8 billion in operating expenses.

## Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
<b>EPS</b>	\$2.16	\$3.95	\$6.31	\$5.68	\$6.45	\$9.22	\$8.31	\$9.21	\$11.91	\$11.89	<b>\$12.50</b>	<b>\$16.73</b>
<b>DPS</b>	---	---	\$0.38	\$1.63	\$1.81	\$1.98	\$2.18	\$2.40	\$2.72	\$3.00	<b>\$3.08</b>	<b>\$4.74</b>
<b>Shares<sup>1</sup></b>	6,412	6,505	6,575	6,295	5,866	5,579	5,336	5,126	4,755	4,649	<b>4,550</b>	<b>4,000</b>

Apple is among the largest publicly traded corporations in the world. Since 2012 Apple's earnings-per-share have grown by 11.2% annually, which is an attractive growth rate, although it is substantially lower than the growth rates Apple produced in the years prior to 2012. The bigger the bottom line gets, the harder it becomes to grow at a very high pace.

Going forward Apple's earnings growth will be driven by several factors. One of these is the ongoing cycle of iPhone releases, which saw a significant decline 2019. However, in the long run Apple should be able to grow its iPhone sales again, albeit in an irregular fashion. Moreover, in emerging countries where consumers have rising disposable incomes, Apple should be able to increase the amount of smartphones it is selling over the coming years. Apple also has been increasing the selling prices of its phones over the last couple of years, which is a tailwind for revenues.

Another avenue for growth is Apple's services segment. This business unit, which consists of iTunes, Apple Music, the App Store, iCloud, Apple Pay, etc., has recorded a significant revenue growth rate during the last couple of quarters. Services revenues grow substantially faster than other segments, and produce high-margin recurring revenues.

Another factor that has played a role in the past is the shrinking share count. Due to its immense cash flows Apple is able to repurchase hundreds of millions of shares. The resulting lower share count means that each remaining share's

<sup>1</sup> In millions.

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portion of profits rises. Apple should continue to lower its share count further through 2020 and beyond. Taking these items collectively – a strong “cash cow” legacy business, growing Services revenue and a shrinking share count – we are forecasting 6% annual growth over the intermediate-term.

## Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	15.2	12.4	12.0	12.3	13.0	12.8	12.6	14.9	15.3	15.5	19.9	15.0
Avg. Yld.	---	---	0.5%	2.3%	2.2%	1.7%	2.1%	1.8%	1.5%	1.6%	1.2%	1.9%

Absent the last recession, shares of Apple have routinely traded with an average price-to-earnings multiple between 13 and 14 times earnings. We believe a multiple closer to 15 times earnings is a fair starting point, considering the growth possibilities of the firm to go along with an exceptional balance sheet. Still, given the current valuation of nearly 20 times expected earnings, this could imply the potential for a moderate valuation headwind in the years to come.

While the dividend yield is not spectacular, it is very well covered with the propensity to grow over time.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	6%	29%	28%	22%	26%	26%	23%	25%	25%	28%

Apple started paying a dividend in 2012. Since then, the dividend has been increased regularly, but more or less in-line with the company’s earnings-per-share growth, which is why the dividend payout ratio has remained in the 20% range. This, coupled with the company’s enviable balance sheet, makes Apple’s dividend look quite safe.

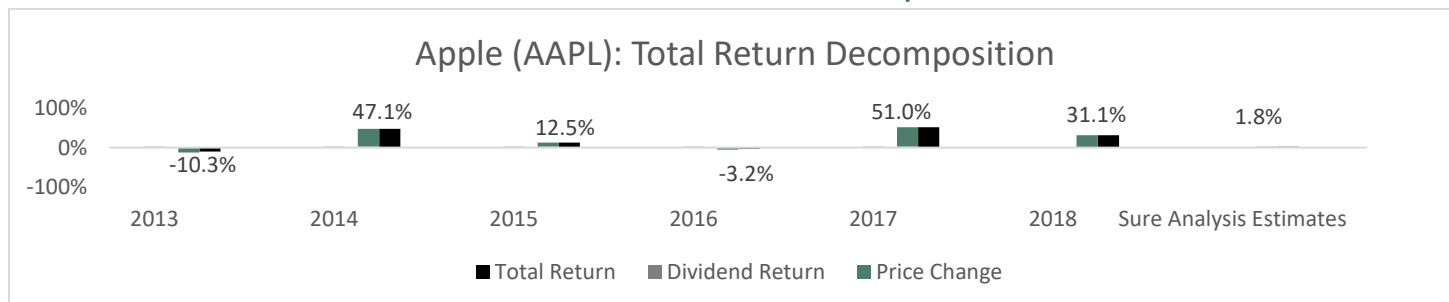
Apple’s brand is admired around the globe, and together with Samsung the company basically earns all the profits in the top end smartphone market. In addition, Apple’s Services will bring in an increasing stream of recurring revenues. During the last financial crisis Apple’s profits rose, but that was during the hyper-growth phase. Since Apple is still highly dependent on sales of relatively high-cost smartphones, a major economic crisis could hurt its profits considerably.

As of the most recent report Apple held \$100.6 billion in cash and securities, \$162.8 billion in current assets and \$338.5 billion in total assets (of which an additional \$105.3 billion are non-current marketable securities) against \$105.7 billion in current liabilities and \$248.0 billion in total liabilities.

## Final Thoughts & Recommendation

Shares are up 13% since our last report and over 60% in the last nine months. We are enthused on a number of fronts, including a business with an extraordinary story, a Services segment that is picking up steam and a balance sheet that provides significant safety in good times or bad. However, in our view, the current valuation leaves something to be desired. We are forecasting 1.8% annual total return potential, stemming from 6% growth and a 1.2% starting yield, offset by a moderate valuation headwind as a result of the much higher share price. We are reiterating our hold rating.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue (\$B)	42.91	65.23	108.2	156.51	170.91	182.8	233.72	215.64	229.2	265.60
Gross Profit	17222	25684	43818	68662	64304	70537	93626	84263	88186	102B
Gross Margin	40.1%	39.4%	40.5%	43.9%	37.6%	38.6%	40.1%	39.1%	38.5%	38.3%
SG&A Exp.	4149	5517	7599	10040	10830	11993	14329	14194	15261	16705
D&A Exp.	734	1027	1814	3277	6757	7946	11257	10505	10157	10903
Operating Profit	11740	18385	33790	55241	48999	52503	71230	60024	61344	70898
Op. Margin	27.4%	28.2%	31.2%	35.3%	28.7%	28.7%	30.5%	27.8%	26.8%	26.7%
Net Profit	8235	14013	25922	41733	37037	39510	53394	45687	48351	59531
Net Margin	19.2%	21.5%	23.9%	26.7%	21.7%	21.6%	22.8%	21.2%	21.1%	22.4%
Free Cash Flow	8946	16474	30077	41454	44590	49900	69778	52276	50803	64121
Income Tax	3831	4527	8283	14030	13118	13973	19121	15685	15738	13372

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets (\$B)	47.50	75.18	116.37	176.06	207.00	231.84	290.35	321.69	375.32	365.73
Cash & Equivalents	5263	11261	9815	10746	14259	13844	21120	20484	20289	25913
Accounts Receivable	3361	5510	5369	10930	13102	17460	16849	15754	17874	23186
Inventories	455	1051	776	791	1764	2111	2349	2132	4855	3956
Goodwill & Int. Ass.	453	1083	4432	5359	5756	8758	9009	8620	8015	N/A
Total Liab. (\$B)	15.86	27.39	39.76	57.85	83.45	120.29	170.99	193.44	241.27	258.58
Accounts Payable	5601	12015	14632	21175	22367	30196	35490	37294	49049	55888
Long-Term Debt (\$B)	0	0	0	0	16.96	35.30	64.33	87.03	115.68	114.48
Total Equity (\$B)	31.64	47.79	76.62	118.21	123.55	111.55	119.36	128.25	134.05	107.15
D/E Ratio	0	0	0	0	0.1373	0.3164	0.539	0.6786	0.863	1.0685

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	19.7%	22.8%	27.1%	28.5%	19.3%	18.0%	20.5%	14.9%	13.9%	16.1%
Return on Equity	30.5%	35.3%	41.7%	42.8%	30.6%	33.6%	46.2%	36.9%	36.9%	49.4%
ROIC	30.5%	35.3%	41.7%	42.8%	28.6%	27.5%	32.3%	22.9%	20.8%	25.3%
Shares Out.	6300	6410	6500	6570	6290	5870	5580	5340	5130	4850
Revenue/Share	6.76	10.08	16.51	23.65	26.21	29.86	40.34	39.21	43.65	53.12
FCF/Share	1.41	2.55	4.59	6.26	6.84	8.15	12.05	9.50	9.67	12.82

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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