St. John's University Undergraduate
Student Managed Investment Fund
Presents:
Apple Inc.: AAPL

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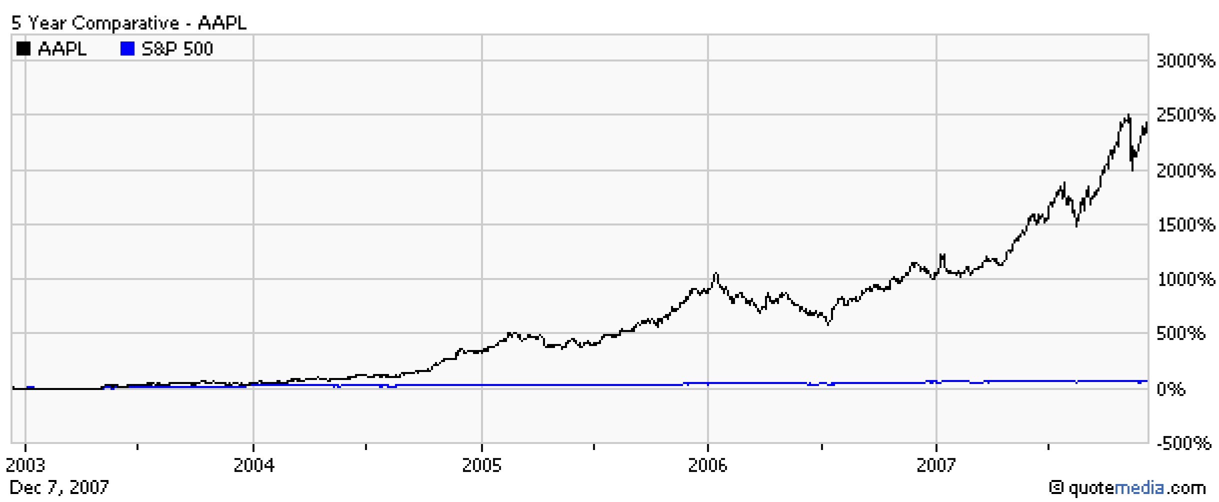
Share Data:
Price: 12/9/07 $194.30
Shares Outstanding: 875.54M
Market Cap: $170.12B
Beta: 1.442
52 Week High: $194.99
52 Week Low: $76.77

Fundamentals:
$P/E_{12/9/07}$: 49.44
Forward P/E: 41
EPS_{2007}: $3.93
$EPS(1)_{2008}$: $3.56
$EPS(2)_{2008}$: $4.98



I. EXECUTIVE SUMMARY

After analyzing Apple Inc.’s computer and consumer electronics industry, we are recommending the acquisition of 100 shares of stock at market price. Apple is well diversified within its industry and highly competitive. Our decision is based on the following criteria:

1.) Apple believes continual investment in research and development is critical to the development and enhancement of innovative products and technologies. Apple is continuously creating and refining innovations, such as the iPod, iPhone, iTunes Store, and Apple TV.

2.) Apple is the only company in the personal computer industry that controls the design and development of the entire personal computer-from the hardware and operating system to sophisticated applications which gives the advantage to adhere to many industry standards in order to provide an optimized user experience

3.) Apple recently debuted the iPhone in June 2007, and already has a 1% of the world market share for cellular phones.

4.) Our Absolute valuation suggests Apple is undervalued.

5.) Since 2002, around the launch of the iPod, Apple has largely outperformed the industry and its competitors. In areas were Apple had lagged relative to its competitors, Apple is now gaining ground. In 2002 Apple had the second lowest ROA relative to the industry and its competitors. Since then Apple’s ROA has grown faster than any of its competitors, and as of 2007 Apple has the second highest ROA. Apple’s strong performance in the ratio’s we analyzed, as well as its ability to grow rapidly in less successful areas, is just one of the reasons we recommend it as a buy.

II. COMPANY OVERVIEW

Company Overview

Apple Inc, formerly Apple Computer, Inc. was established April 1, 1976 in Cupertino California. Apple is an American multinational corporation that specializes in designing and manufacturing consumer electronics. The company also custom designs all platform software that is related or included in its personal computers, portable media players, and mobile phones. As of September 2007, the company operates 197 retail stores in five countries, and its online store where its hardware and software products are sold exclusively. Apple Inc. also operates worldwide by selling its different products through, third party wholesalers, resellers, and value-added resellers. The iTunes Store, an online store run by Apple, provides music, audio books, iPod games, music videos, episodes of television programs, and movies which can be downloaded using iTunes, Mac, or a PC. Recently Apple has made the iTunes store available to mobile users

of the iPod touch and the iPhone. The company's most popular hardware products include their personal computers, the iPod line of portable media players, and the iPhone. Apple's most popular software products include the Mac OS X operating system, the iLife suite, and Final Cut Studio (Professional video editing software)
Apple employs over 20,000 permanent and temporary workers worldwide and had worldwide annual sales in its fiscal year 2007 (ending September 29, 2007) of $24.01 billion dollars.

Apple has built a favorable reputation surrounding its company. The Company's products are generally believed to be more user-friendly than its Windows based competitors and featuring a more modern design.

> "The company introduced the Apple II microcomputer in 1977. A few years later, in 1983, it introduced the Lisa, the first commercial personal computer to employ a graphical user interface (GUI), which was influenced in part by the Xerox Alto. Lisa was also the first personal computer to have a mouse. In 1984, the Macintosh was introduced, which arguably advanced the concept of a new user-friendly graphical user interface. Apple's success with the Macintosh became a major influence in the development of graphical interfaces elsewhere, with major computer operating systems, such as the Commodore Amiga and Atari ST, appearing on the market within two years of the introduction of the Macintosh."

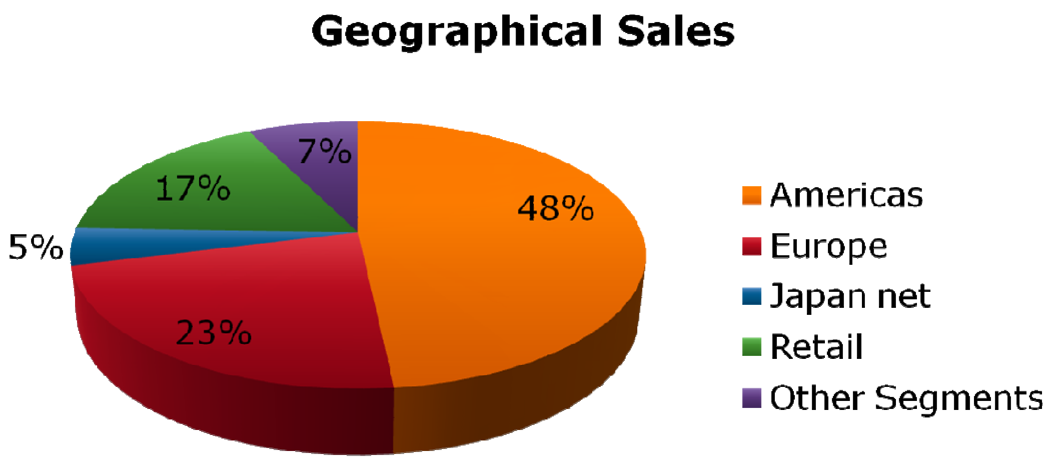
In 1991, Apple introduced the PowerBook line of portable computers. In the 1990s Apple's market share fell as competition from Microsoft Windows and the comparatively inexpensive IBM PC computers began to dominate the market. In effort to compete in the ever changing technology industry Apple shifted its focus to software. Apple's main software includes its MAC OSX operating system as well as professional and pro consumer video software, and both music and photo production Software. In 2001, Apple entered the consumer electronic market with the introduction of the iPod.

Business Segments

Apple's operations are managed on a geographical basis, which includes the Americas, Europe, Japan, Retail (Apple's operates retail stores in the U.S., Canada, Japan, the U.K., and Italy.). Americas, Europe, and Japan do not include activities related to retail in their sales percentages. The Americas include both North and South America. In 2007, Apple's net sales in the Americas segment increased by $2.2 billion, or 23% from 2006, which was mainly due to their popular products such as Mac portable products and the iPod. The Americas represented 48% of the Company's total net sales as compared to 49% in 2006. The European segment includes European countries and also the Middle East and Africa. Net sales for the European segment increased $1.4 billion or 33% compared to 2006. The primary drivers of growth were the Mac portable product, iMacs, iPods, and iTunes Store. Japan's net sales declined by $129 million or 11%, compared to 2006. Total Mac sales for Japan declined by 1% during 2007 which is partially attributable to Japan's declining consumer PC market. However, the decrease was slightly offset by revenue from Mac Books and third-party content from the iTunes.

The retail segments are Apple's operated retail stores in the U.S., Canada, Japan, the U.K., and Italy. As of September 2007, Apple has a total of 197 retail stores. Apple has opened 32 new retail stores during 2007, including a total of 4 international stores in the U.K. and Italy. The net sales increased by 27% or $4.1 billion compared to 2006.

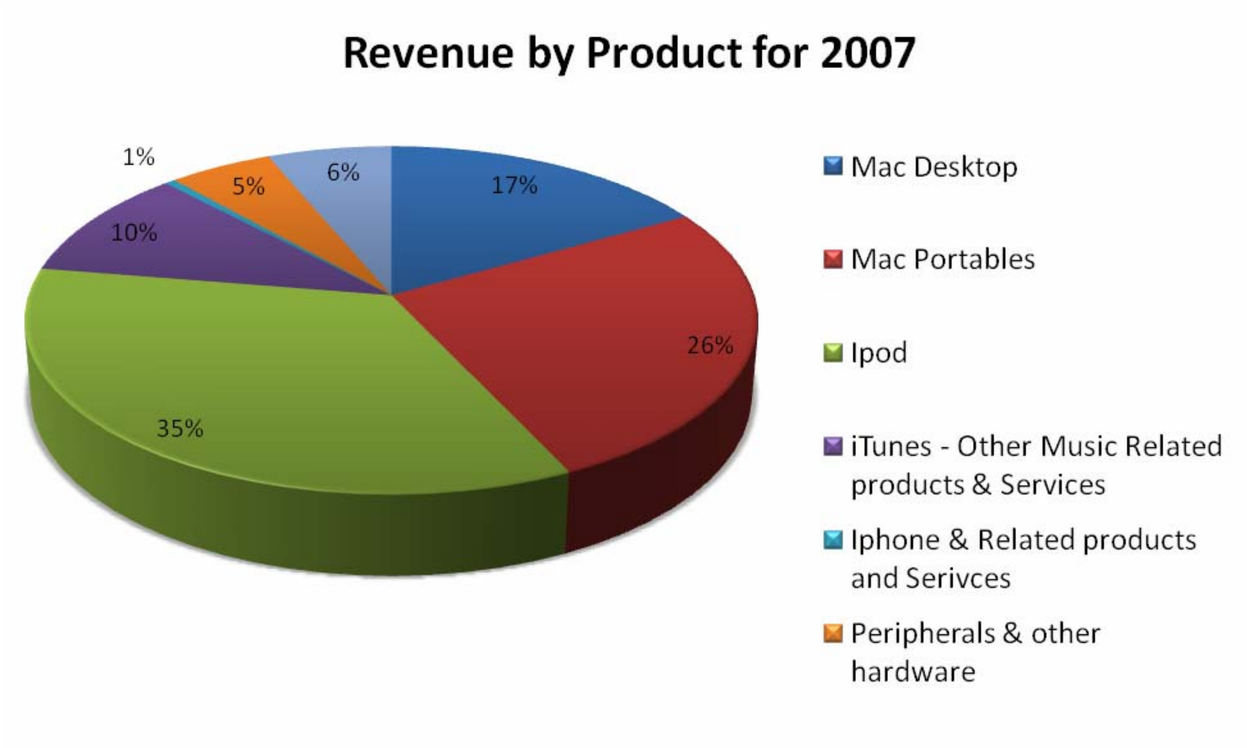
Apple's other segments consist of Asia Pacific region and FileMaker Inc. operations. FileMaker, Inc. is a wholly owned subsidiary of Apple Inc. that specializes in easy-to-use database software. Other Segment net sales increased $406 million, or 30%**,** during 2007 and are primarily related to increased sales of Mac portables and robust iPod sales.



Products

The company offers a range of hardware products: Mac desktop, notebook, server and storage products, related devices and peripherals, and third party hardware, MacBook Pro, MacBook, Mac Pro, iMac, Mac mini, Xserver, Xserver RAID, Storage System, Music Products and Services, iPod shuffle, iPod nano, iPod classic, iPod touch, iTunes 7, iPhone, Peripheral Products, Displays, Apple TV, Software Products and Computer Technologies, Application Software, Internet and Software Services, and AppleCare; different Care Services to support customers.

iPods sales account for the majority of Apple's revenue, currently at 34.6%. Sales are down from last year which was 39.74%. This decrease in iPod revenue may not be due to decreasing sales of iPods, but rather price decreases in the iPods. Portable computers represent the second largest source of revenue. In 2007 portable computer sales made up 26.22% of Apple's revenue, up from 21% in 2006. Desktop sales were down from 17.18% in 2006 to 16.75% in 2007. The decrease proportional decrease in desktop computer sales can be attributed to the considerable rise in portable computer sales. Other music related sales made up 3.36% of Apple's revenue in 2004, when the iTunes store debuted. Those sales have grown to 10.4% in 2007. Peripherals & other hardware sales were 5.25% in 2007, down slightly from 2006 in which peripherals & other hardware made up 5.7% of revenue. Software made up 6.28% of Apple's revenue in 2007, also down slightly from its 2006 revenue percentage of 6.62%. Apple's iPhone, which was released mid-2007**,** made up .51% of revenue; this number is expected to grow as Apple develops the iPhone into a staple of their product line. The following chart represents Apple's Revenue based on products for 2007.



Recent News

Apple reported their highest ever quarter revenue and earnings for the 4th quarter of 2007 with revenue increase over 6.22 billion or 29% of prior year quarter. This revenue was driven largely by the record Mac Sales and strong demand for iPod. In the 4th quarter 2007, Apple sold over 2.16 million Macs, an increase of 34% from same period last year and over 10.2 million iPods an increase of 17%. For the fiscal year Apple sold an estimated 52 million iPod and over 7 million Macs. Since inception the iPod has sold over 120 million units. Net Income for the 4th quarter was up 67% or 905 million from last year's quarter, which translates to an EPS of $1.01. Revenue from iTunes has also experienced robust growth with other music revenue growing 33% from last year and accounts for over 85% of music purchased and downloaded in the US.[1] For the entire fiscal year, Apple reported $3.93 earnings per share, up 73% from last year.

The introduction of the iPhone has been met with high anticipation. Apple has sold over 1.1 million iPhones over the last quarter. They have also begun selling the iPhone in Europe in November 2007. They have forecast that sales of iPhone will reach 10 million units by 2008 and are expected to introduce a second-generation iPhone by mid 2008.

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[1] FactSet: Call Street – Apple 3rd Quarter Earnings

Apple has announced that they will unveil a new sub-portable MacBook at MacWorld in January. The ultra-portable laptop is expected to be 50% thinner than the existing MacBook, and will contain flash-based memory instead of a disc drive.

Competitive Strategy

Apple is committed to bringing the best personal computing, portable digital music and cellular phones to students, educators, consumer, creative professionals (one of the most important markets for Apple), business, and government sectors through its innovative hardware, software, peripherals, services, and Internet offerings.

Apple’s Business strategy leverages its unique ability to design and develop its own operating system, hardware, application software, and services to provide its customers new products and solutions with superior ease-of-use seamless integration, and innovative industrial design. They also believe continual investment in research and development is critical to the development and enhancement of innovative products and technologies. Apple is continuously creating and refining innovations, such as the iPod, iPhone, iTunes Store, and Apple TV.
Finally, Apple believes a high quality buying experience with a knowledgeable salesperson who can convey the value of the Company’s products and services greatly increase its ability for customer attraction and retention. Apple Inc. sells many of its products and resells certain third-party products in most of its major markets directly to consumers. The Apple has also engaged in programs to increase resellers’ sales, including Apple Sales Consultant Program, which places Apple employees and contractors at selected resellers’ locations.

At the end of fiscal year 2007 the company has opened a total of 197 retail stores of its own, 174 in the U.S. and 23 in Canada, Japan, U.K. and Italy. These stores are typically placed at strategic locations, such as; upscale shopping malls and urban shopping districts. By operating in chosen locations the company is able to control the buying experience and attract new customers. These stores are intended to simplify and enhance the presentation and marketing of the products and retail solutions. Apple stores have developed into various sizes to meet market-specific demands. One of the retail goals is to expand out through sales to individuals who currently do not own the company’s products. [2]

Key Executives and Members of the Board

Senior Vice President and Chief Financial Officer
Peter Oppenheimer
Chief Executive Officer and Director
Steven P. Jobs
Senior Managing Directors

[2] (www.apple.com 10K release)

William V. Campbell
Millard S. Drexler
Albert Gore JR.
Arthur D. Levinson
Eric E Shmidt
Jerome B. York

III. INDUSTRY ANALYSIS

Overview

Apple is the only company in the personal computer industry that controls the design and development of the entire personal computer -- from the hardware and operating system to sophisticated applications which gives the advantage to adhere to many industry standards in order to provide an optimized user experience. Apple Inc. operates worldwide by selling its different products through its online stores, retail stores, its direct sales force, and third party wholesalers, resellers and value-added resellers.

***Analysis of Competitive Forces** - Michael Porters 5 Forces*

Rivalry

The Company is confronted by aggressive competition in all areas of its business. These markets are highly competitive and characterized by rapid technological advances in both hardware and software with competitive price, features and performance characteristics.
Over the past several years, price competition in these markets has been intense, the company’s competitors who sell personal computers have cut prices and lowered their margins to gain or maintain market share based on other operating systems. The Company financial and operating results can be affected these downward pressures on gross margins. The main competitive factors include price, product features, relative price/performance, product quality and reliability, design innovation, availability of software and peripherals, marketing and distribution capability, service and support, and corporation reputation; further, As the personal computer industry and its customers place more reliance on the internet, an increasing number of internet devices that are smaller, simpler and less expensive than traditional personal computers may compete for market share with Apple’s products. Competition among the firms is becoming more aggressive, they are each targeting different and new markets and also customers. Below these facts are further explained.

Threat of New Entrants

The technology sector is constantly developing and changing. Apple must constantly revise their products in order to stay current. The company will always be subject to new patted technology, but by being innovators themselves, the risk is greatly reduced. Apple’s has engendered products that are preferred by consumers because they are “Apple” products. Other companies may be able to enter and compete with similar quality products, but because Apple has such a preferred customer following, Apple is at less risk than its competitors. In order for Apple to stay above new companies entering the technology market, Apple must continue to deliver the same quality product that it did originally to develop its consumer following and established brand name.

Threat of Substitute Products

Apple has a dominating market share on its iPod, with a current 76% market share. . Several competitors have entered the market, most notably Microsoft, with its mp3 player, the “Zune”. Despite the variety of the choices, the consumer has picked the Apple’s iPod 76% of the time. This is due to Apple’s patent design, and the continuous software updates and year –to-year improvements. Apple also hosts the iTunes store, hosting media that is most compatible with the iPod mp3 player. The success of the iPod has opened an over 1 billion dollar third party accessories market exclusively for the iPod. With all the advantages to being an iPod owner it will be hard for any company, including Microsoft, to pose a serious threat to Apple’s iPod sales.

The other Main part of Apple’s revenue is generated from computer software and hardware. The threat of new entrants does not affect apple as much as it would its competitors; mainly, Microsoft, Dell, Hewlett Packard, and IBM. This is due to Apple’s unique aesthetics an operating system. While many competitors have tried to capitalize on the cosmetic appeal of Apple’s computers, their success has been limited. This is because they missed the key component, the MAC OSX Operating System. Apple’s operating system is unique, and available only on Apple manufactured computers. Since Apple’s Competitors cannot physically or legally run MAC OSX on their computers, Apple faces very minimal risk from new or existing competitors. Further decreasing the threat of new entrance, Apple computers are now capable of running the Windows operating system. This removes the need for an Apple user to switch to a PC.

Bargaining Power of Suppliers

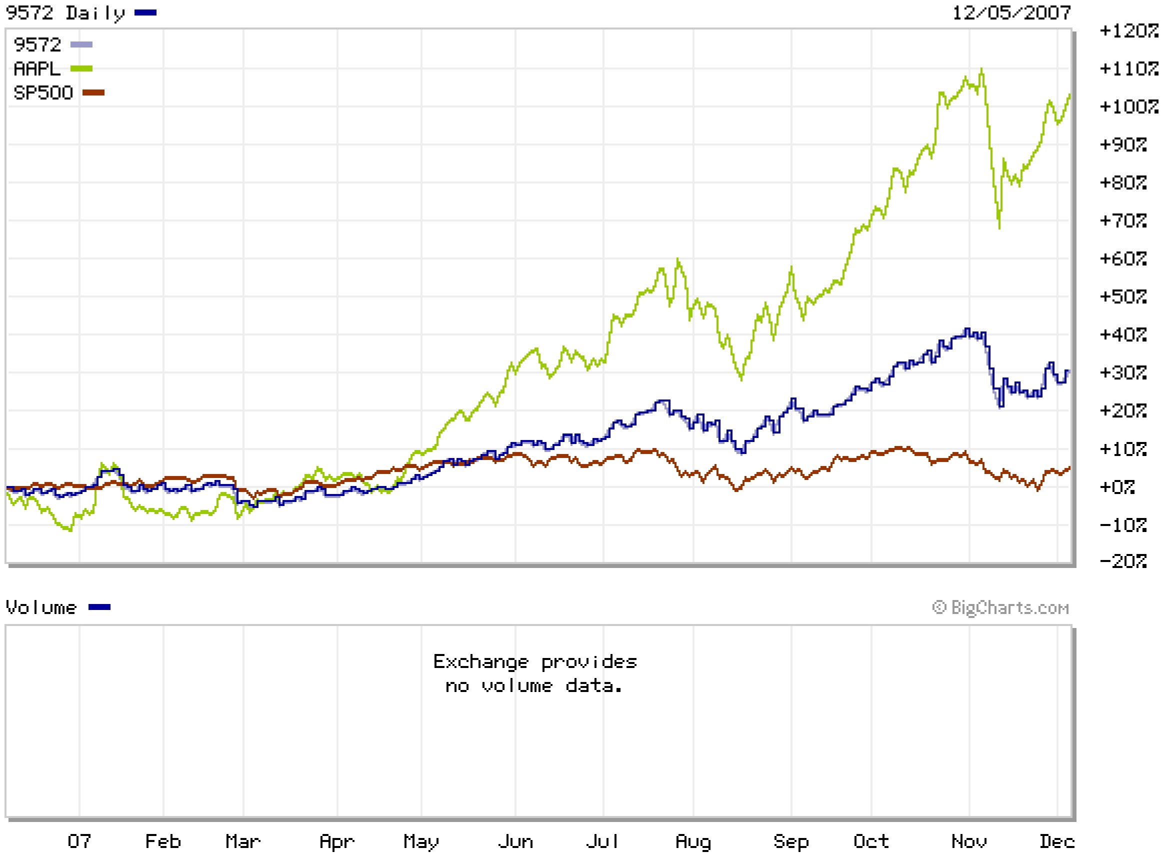
The main factors that threaten Apple’s market share are Intel chips and NAND drives. The most palpable risk is the Intel chips that are used in Apple’s computers. Apple must be able to purchase and maintain Intel chips at stable and standard prices. Apples second concern would be NAND flash drives used in its iPod nano. There is currently no substitute that apple could use, if it wanted to maintain the same dimensions of this iPod. Apple is subject to supplier risk should it not find a suitable alternative in the near future.

Bargaining Power of Buyer Forces

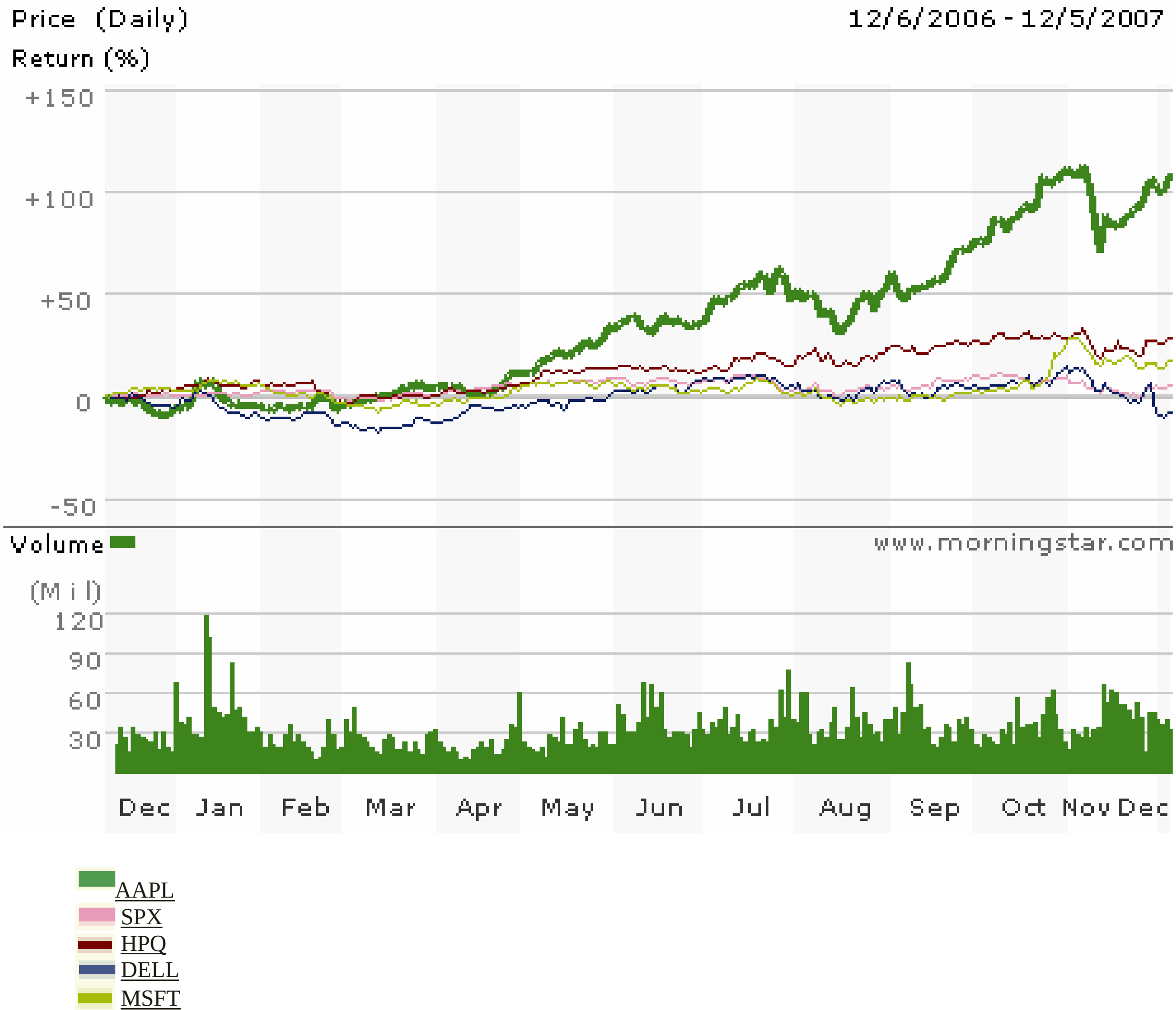
Apple is a company that always strives to be ahead of the Buyer. Apple strives to know consumers wants needs, even before the consumer does. The company is continuously refining innovations, such as the iPod, iPhone, iTunes Store, and Apple TV. Apple listens to its customers needs and adjusts its product lines accordingly.

Apple has been caught in situations where the buyer felt their products were not priced aggressively enough. Apple quickly adjusts itself to handle these situations. When consumers spoke out about the iPhone being too expensive, Apple lowered the price buy $200 dollars, and offered current owners a $100 dollar rebate.

Relative Industry Valuation



The Chart above compares the S&P500 Computers Hardware Industry (blue line), the S&P (brown line) and Apple Inc (green line) for a 1 year period on a daily basis. The chart indicates that the Computers Hardware industry is currently outperforming the market and Apple is outperforming both the industry and the market by a considerable margin.



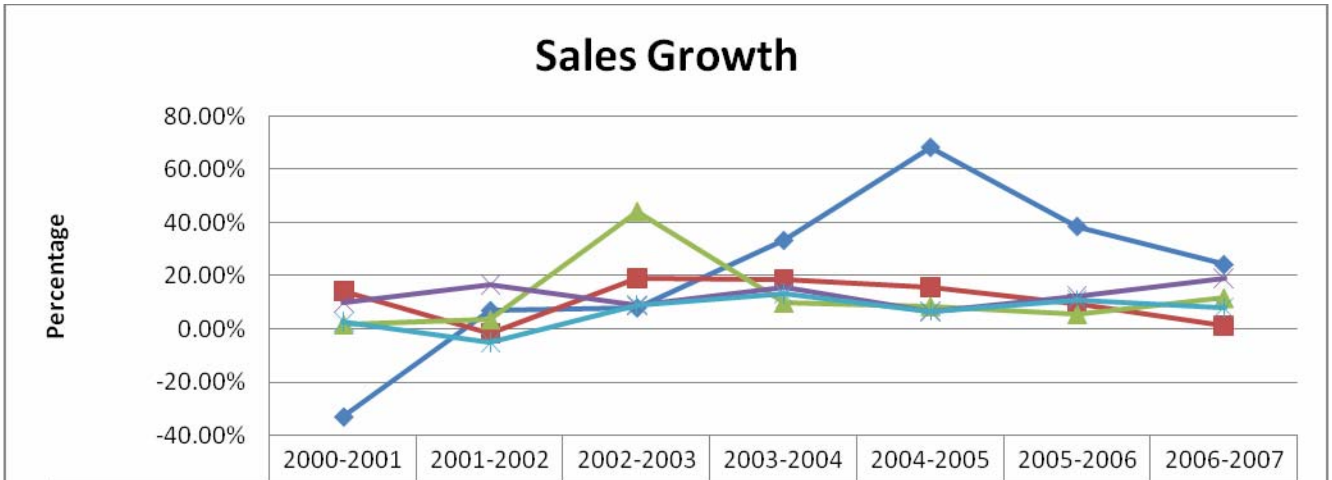
The chart above compares Apple to its main competitors: HPQ, Microsoft, Dell as well as the S&P 500 over the trailing one year period. As the chart reflects Apple has been trending above the industry and its main competitors since the end of April.

IV. FUNDAMENTAL ANALYSIS

1. Growth Rate Comparisons (Year over Year)

<u>*Sales Growth*</u>

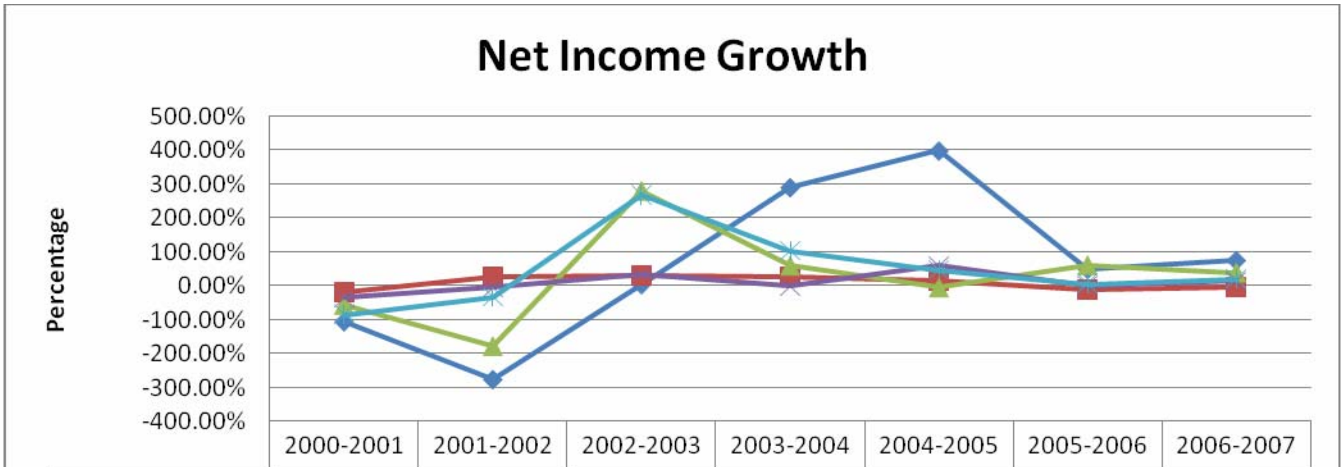
Apple’s sales started to pick up around the middle of 2002, growing 70% from 2003 to 2004. In 2004 growth began to decline, but has remained above the industry, therefore Apple’s sales are favorable compared to those of its competitors.



	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
AAPL	-32.82%	7.07%	8.10%	33.38%	68.27%	38.65%	24.29%
DELL	14.16%	-1.61%	19.14%	18.83%	15.82%	9.67%	1.30%
HPQ	1.75%	3.60%	44.20%	9.98%	8.68%	5.69%	11.70%
MSFT	9.93%	16.87%	8.91%	15.78%	6.69%	12.42%	19.23%
Industry Avg	+0.0	-5.04%	9.35%	13.57%	6.82%	11.25%	8.14%

<u>*Net Income*</u>

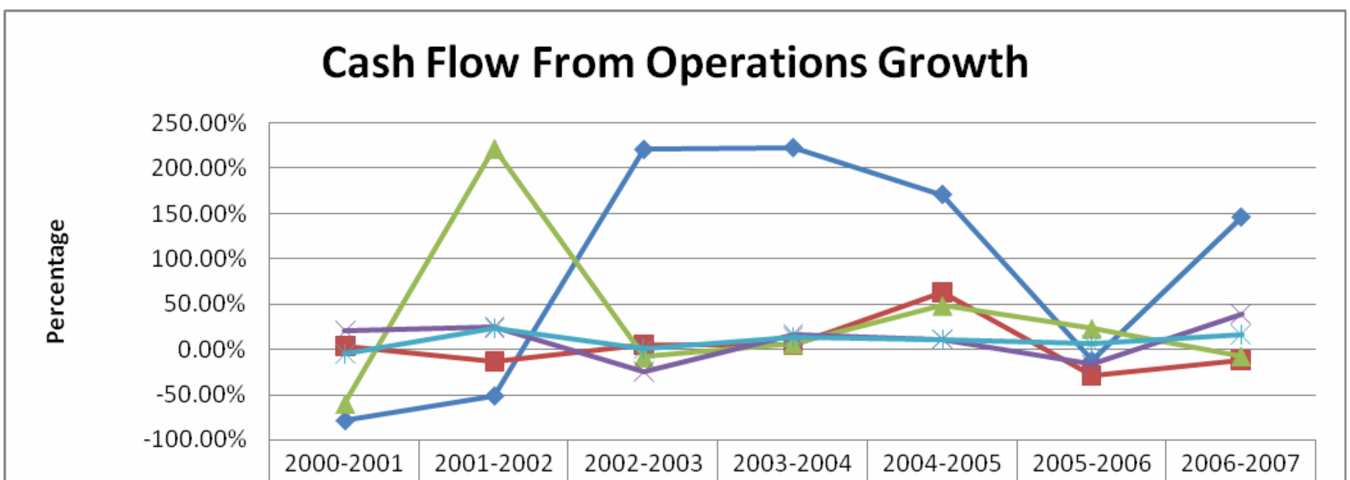
Apple’s Net income started to increase since 2002 and its annual growth rates have above that of its competitors since around 2003. Apple growth rate slowed in 2004, ultimately falling on par with HPQ in 2005. It has begun a small stable rally since the 2005 mark.



	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
AAPL	-104.71%	-275.68%	4.62%	291.18%	399.25%	49.77%	75.77%
DELL	-20.72%	25.46%	29.30%	24.05%	14.28%	-12.14%	-4.68%
HPQ	-56.99%	-178.86%	279.27%	58.10%	-5.97%	60.01%	38.23%
MSFT	-34.53%	-4.83%	32.57%	-0.27%	59.21%	0.54%	15.00%
Industry Avg	-85.74%	-33.33%	269.05%	103.87%	46.94%	6.25%	20.00%

<u>Cash Flow from Operations</u>

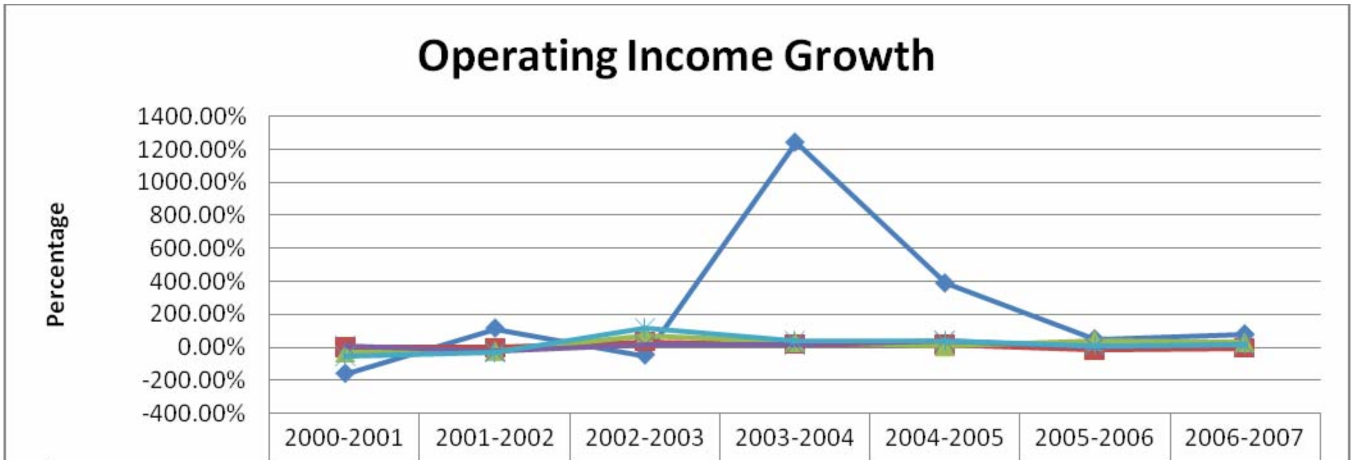
Apple’s cash flow from operations increased from 2000 to 2002, experiencing a heavy decline from 2003-2005 where it reached its lowest level before entering a sharp incline eventually reaching back to its 2004 high. Apple’s cash flow from operations has been generally better than those of its competitors and the relative industry.



	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
AAPL	-78.69%	-51.35%	221.11%	223.18%	171.41%	-12.43%	146.40%
DELL	3.58%	-13.59%	4.96%	4.94%	63.51%	-29.16%	-11.68%
HPQ	-60.10%	222.08%	-8.54%	5.95%	48.23%	22.95%	-7.45%
MSFT	20.14%	24.84%	-24.54%	16.55%	11.30%	-16.49%	38.75%
Industry Avg	-5.34%	23.26%	0.51%	12.82%	10.96%	5.52%	16.00%

<u>Operating income growth</u>

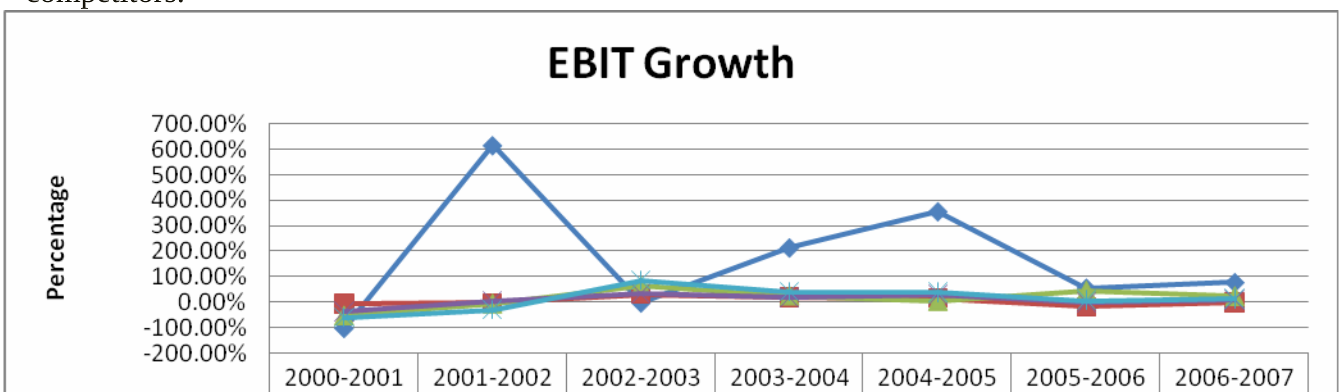
Apple's operating income has been better relative to the industry and its competitors since 2002. 2000 Apple demonstrated major growth from its 2002 low to its 2003 high. Since 2005, Apple has performed only marginally better than the industry and its competitors.



	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
AAPL	-158.87%	115.89%	-47.92%	1244.00%	388.99%	49.30%	79.74%
DELL	0.63%	-5.31%	34.22%	19.73%	16.02%	-18.80%	-6.73%
HPQ	-34.26%	-23.20%	69.74%	29.16%	4.07%	40.40%	27.86%
MSFT	6.06%	-23.45%	17.74%	16.59%	39.35%	3.01%	14.41%
Industry Avg	-56.21%	-31.31%	115.19%	37.83%	37.92%	9.53%	14.07%

<u>EBIT Growth</u>

Earnings before interest and taxes reflect that Apple's performance has been predominantly better than its competitors since 2000. Apple demonstrated major growth from its 2002 low to its 2004 high. Since 2005 Apple has performed only marginally better than the industry and its competitors.

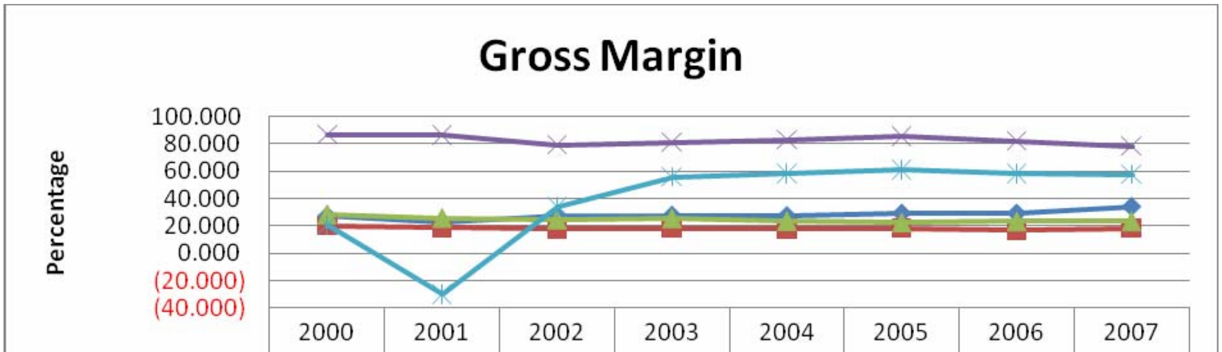


	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007
AAPL	-102.23%	616.00%	-2.33%	214.29%	356.57%	55.86%	77.71%
DELL	-6.63%	-3.57%	30.47%	18.80%	16.29%	-18.01%	-2.30%
HPQ	-50.18%	-3.58%	65.10%	27.51%	6.65%	46.55%	24.76%
MSFT	-36.17%	1.41%	33.20%	17.15%	29.75%	0.40%	10.30%
Industry Avg	-59.75%	-30.40%	86.67%	42.58%	39.22%	8.38%	13.63%

2. ***Operating Ratios**: Operating ratios show the efficiency witch income dollars are generated from revenue.*

<u>Gross Margin</u>

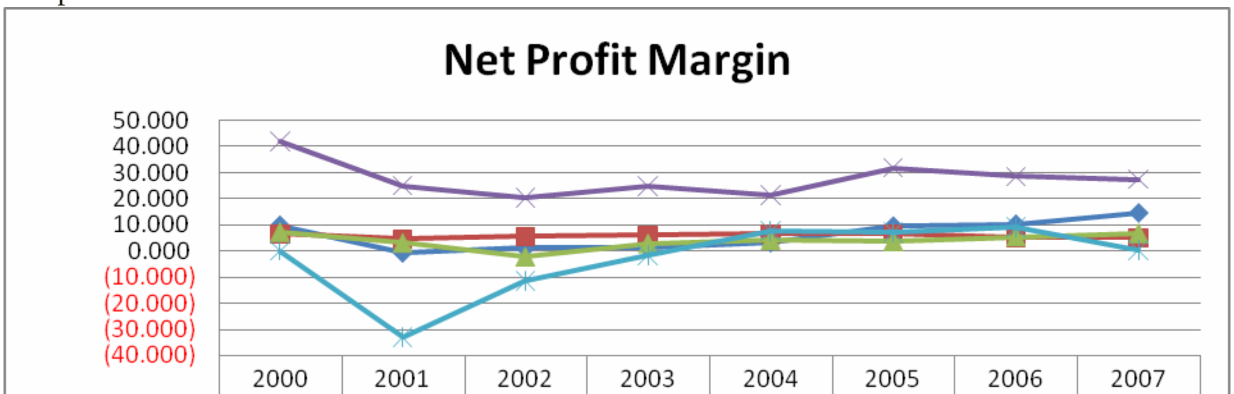
Gross Margin represents the amount of money the company generated over the cost of producing its goods or services. Apple's Gross margin has been out performed by the industry and by Microsoft, one of its main competitors for the greater part of 5 years.



	2000	2001	2002	2003	2004	2005	2006	2007
AAPL	27.133	23.028	27.917	27.517	27.262	29.014	28.983	33.967
DELL	20.325	18.710	17.580	18.249	18.142	18.445	16.750	18.256
HPQ	28.497	25.901	24.885	25.612	23.690	22.566	23.399	23.494
MSFT	86.653	86.303	79.460	81.030	82.753	85.426	82.155	78.414
Industry Avg	20.900	(29.600)	34.300	56.100	58.900	61.600	58.800	58.300

Net Profit Margin

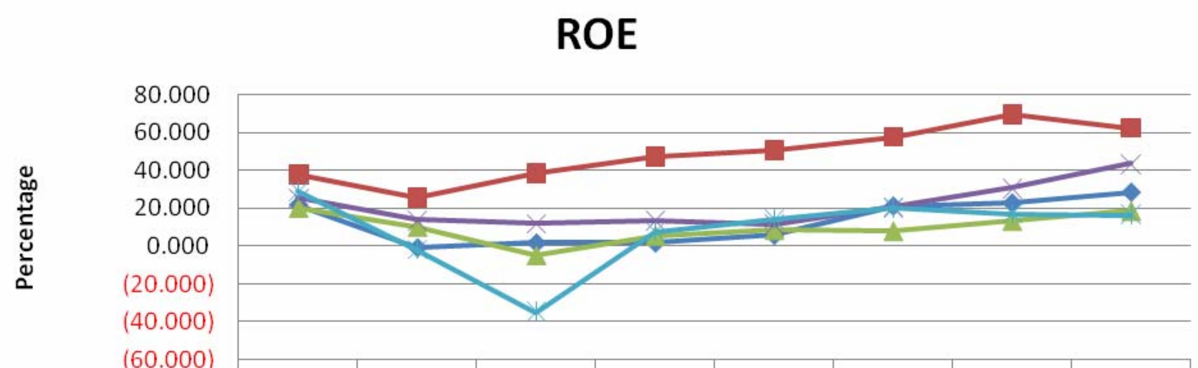
A higher profit margin indicates a more profitable company that has better control over its costs compared to its competitors. Apple has shown a modest increase in profit margin since 2002, this is well in line with the industry and its competitors. Apple currently has a 15% profit margin, which means the company has a net income of $0.15 for each dollar of sales whit only one main competitor: MSFT with 28%.



	2000	2001	2002	2003	2004	2005	2006	2007
AAPL	9.846	-0.690	1.132	1.096	3.213	9.533	10.298	14.563
DELL	6.494	4.509	5.750	6.240	6.514	6.427	5.149	4.845
HPQ	7.250	3.065	(2.33)	2.901	4.170	3.608	5.462	6.760
MSFT	42.039	25.035	20.387	24.816	21.376	31.896	28.524	27.511
S&P500	0.000	(33.00)	(11.50)	(1.60)	7.600	7.100	9.100	0.089

ROE

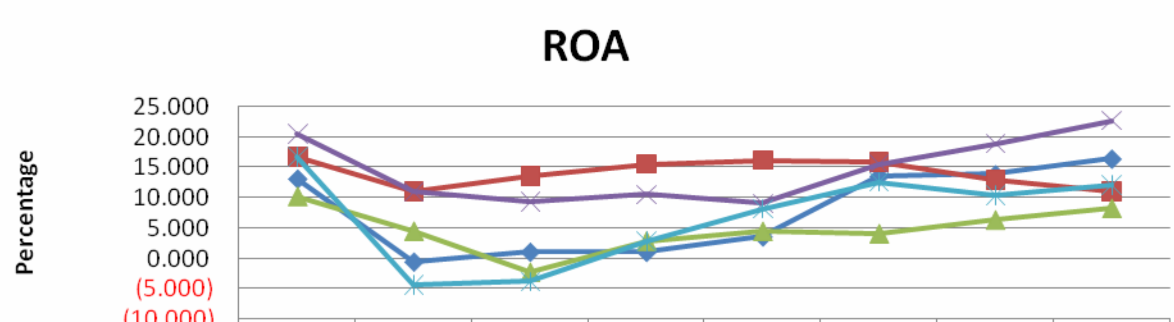
Return on equity measures how much profit a company generates with the money shareholders invested. Apple's Return on Equity is behind that of MSFT and DELL; however, Apple's ROE is above the industry and therefore Apple's profitability is above average.



	2000	2001	2002	2003	2004	2005	2006	2007
AAPL	21.800	(0.922)	1.622	1.635	5.721	21.241	22.846	28.520
DELL	37.693	25.745	38.735	47.319	50.474	57.665	69.435	62.285
HPQ	20.220	10.267	(4.593)	5.647	8.648	8.077	13.337	18.549
MSFT	25.588	13.688	11.984	13.485	11.333	20.708	30.644	43.602
Industry Avg	29.100	(1.800)	(34.900)	7.700	14.000	20.100	17.100	16.600

ROA

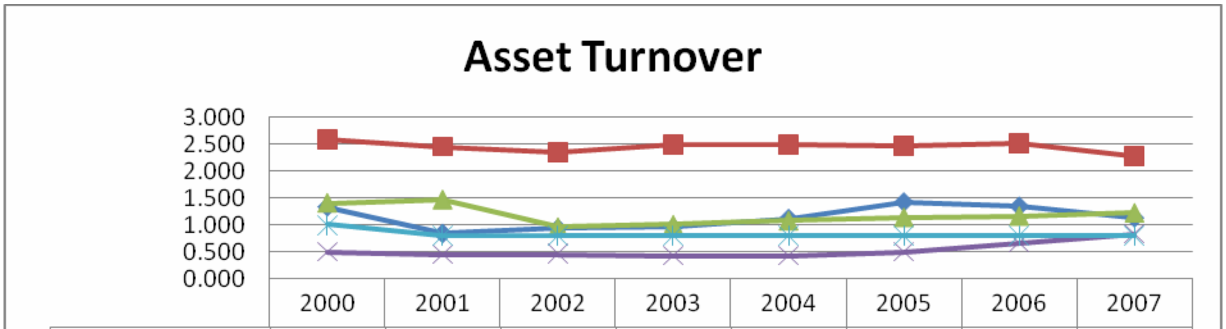
ROA gives an idea as to how efficient management is using its assets to generate earnings. Apple's ability to generate profit from its assets has not been very favorable compared to its competitors but has started to improve since 2004.



	2000	2001	2002	2003	2004	2005	2006	2007
AAPL	13.139	(0.577)	1.055	1.037	3.579	13.575	13.850	16.432
DELL	16.756	11.051	13.533	15.574	16.210	15.880	12.929	11.017
HPQ	10.218	4.510	(2.233)	2.902	4.479	4.103	6.361	8.272
MSFT	20.491	10.937	9.290	10.490	9.053	15.528	18.910	22.712
Industry Avg	16.800	(4.400)	(3.800)	2.800	8.200	12.600	10.400	12.100

Asset Turnover

Asset turnover measures a firm's efficiency at using its assets in generating sales or revenue. It also indicates pricing strategy; since Apple has a relatively high profit margin its asset turnover is relatively low. Apple has maintained itself above industry since around 2004.

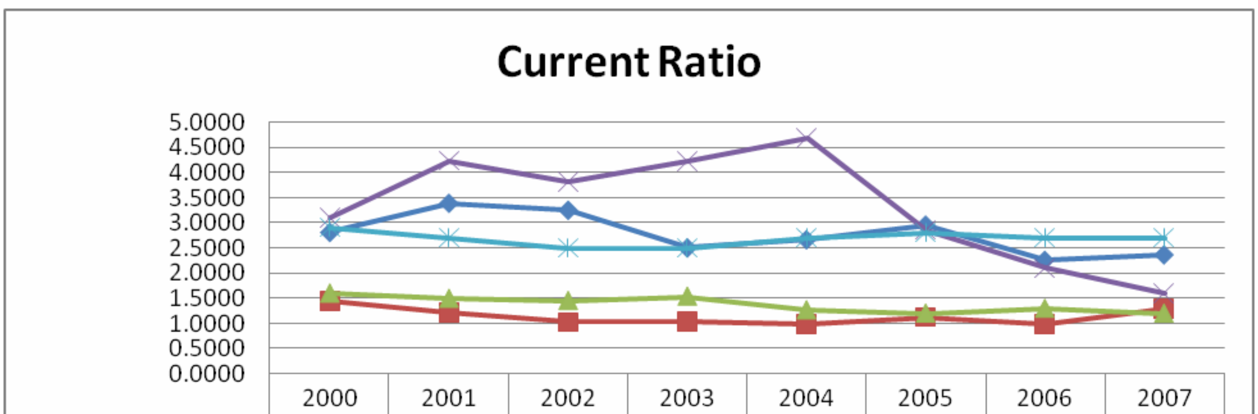


	2000	2001	2002	2003	2004	2005	2006	2007
AAPL	1.335	0.836	0.932	0.947	1.114	1.424	1.345	1.128
DELL	2.580	2.451	2.354	2.496	2.488	2.471	2.511	2.274
HPQ	1.409	1.472	0.957	1.000	1.074	1.137	1.164	1.224
MSFT	0.487	0.437	0.456	0.423	0.424	0.487	0.663	0.826
Industry Avg	1.000	0.800	0.800	0.800	0.800	0.800	0.800	0.800

3. Short Term Solvency

Current Ratio

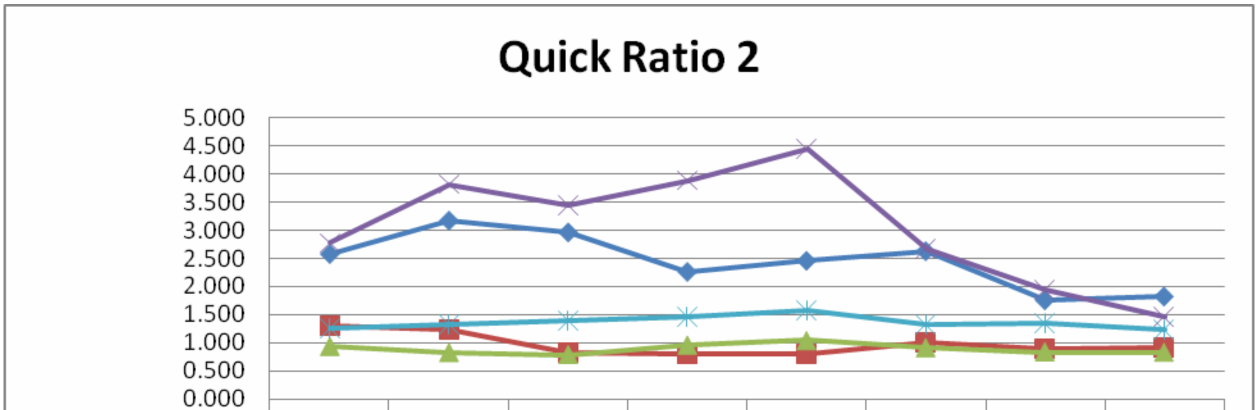
Current ratio measures the company's ability to pay back its short-term liabilities with its short-term assets. The higher the current ratio, the more capable the company is at paying its obligations. Apple currently ranks higher than all of its competitors and has a better ability to repay its short term debt than most of its competitors.



	2000	2001	2002	2003	2004	2005	2006	2007
AAPL	2.8076	3.3880	3.2497	2.4977	2.6613	2.9538	2.25	2.36
DELL	1.4512	1.2261	1.0296	1.0370	0.9905	1.1295	1.00	1.30
HPQ	1.6105	1.5027	1.4595	1.5458	1.2685	1.2016	1.30	1.20
MSFT	3.1069	4.2371	3.8117	4.2202	4.6860	2.8587	2.10	1.60
Industry Avg	2.9000	2.7000	2.5000	2.5000	2.7000	2.8000	2.70	2.70

Quick ratio 2

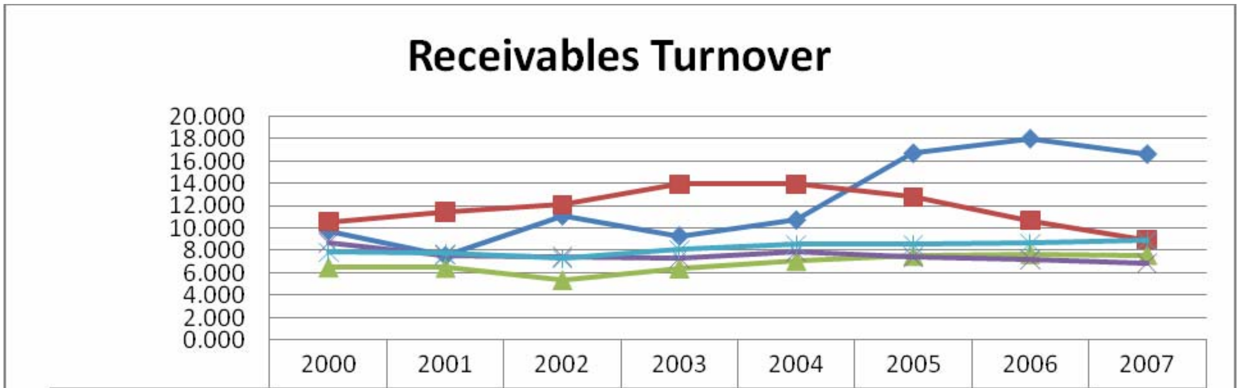
Quick ratio 2 measures a company's ability to meet its short-term obligations with its most liquid assets and is calculated by dividing the sum of cash, accounts receivable, and short-term marketable security by current liability. Apple had the second highest quick ratio from 200-2006. From 2006 Apple has maintained a quick ratio substantially higher than its competitors.



	2000	2001	2002	2003	2004	2005	2006	2007
AAPL	2.576	3.163	2.96	2.262	2.457	2.626	1.76	1.83
DELL	1.298	1.229	0.822	0.809	0.806	1.015	0.898	0.925
HPQ	0.938	0.827	0.788	0.960	1.042	0.915	0.839	0.829
MSFT	2.773	3.811	3.435	3.882	4.441	2.662	1.937	1.463
Industry Avg	1.256	1.327	1.390	1.458	1.570	1.323	1.345	1.231

Receivables Turnover

An accounting measure used to quantify a firm's effectiveness in extending credit as well as collecting debts. Apple has been above the industry average and most of the competitors since 2000 despite a decline in 2001. From 2001, Apple increased and currently remains well ahead of both its competitors and the industry.

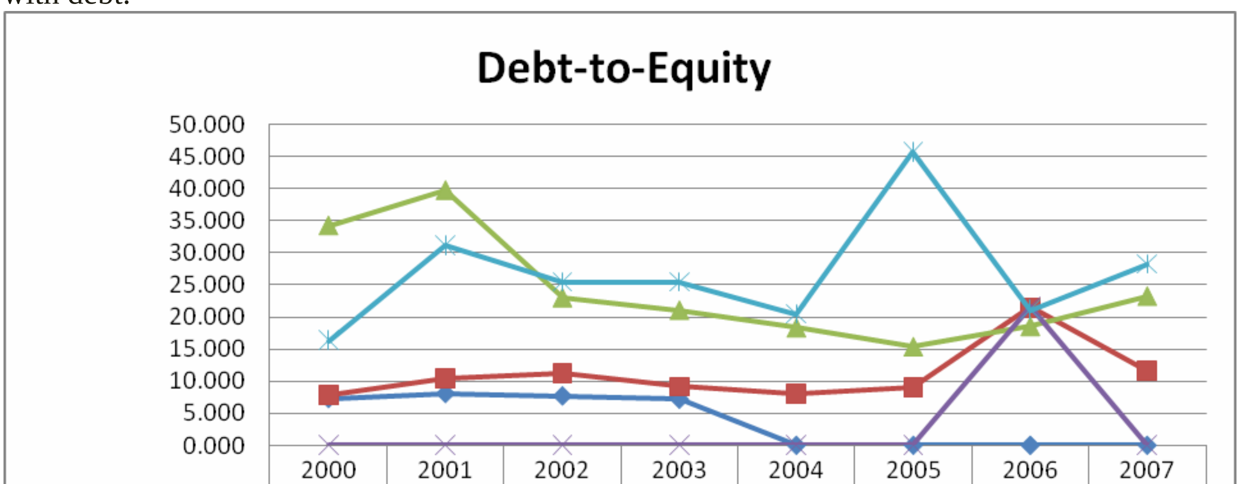


	2000	2001	2002	2003	2004	2005	2006	2007
AAPL	9.771	7.559	11.139	9.327	10.752	16.694	17.993	16.619
DELL	10.590	11.483	12.098	13.955	13.946	12.775	10.688	8.976
HPQ	6.454	6.440	5.343	6.392	7.047	7.494	7.650	7.585
MSFT	8.677	7.560	7.436	7.271	7.845	7.398	7.154	6.818
Industry Avg	7.900	7.700	7.300	8.100	8.600	8.600	8.700	8.900

4. Long Term Solvency

<u>*Debt-to-Equity*</u>

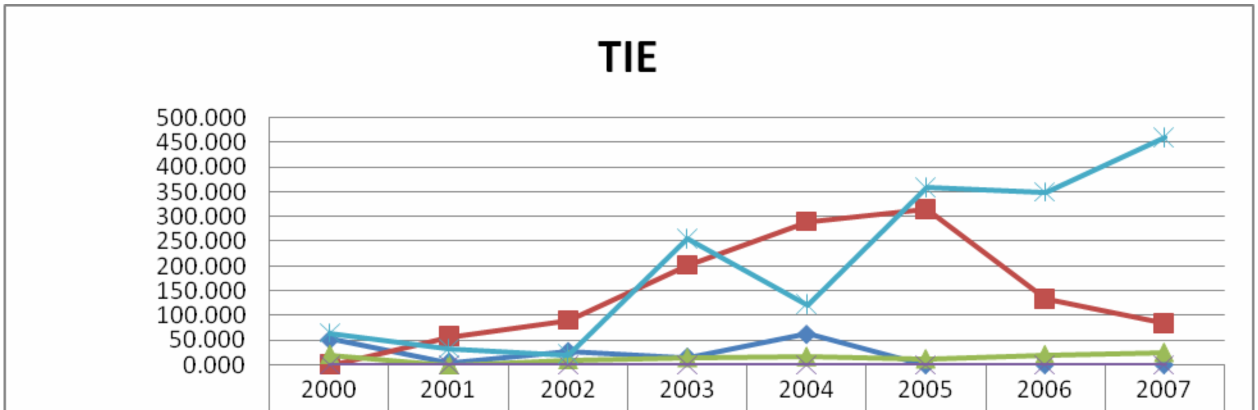
Debt-to-Equity indicates what proportion of equity and debt the company is using to finance its assets. Apple D/E ratio shows that the company is not very aggressive in financing its growth with debt.



	2000	2001	2002	2003	2004	2005	2006	2007
AAPL	7.305	8.087	7.717	7.199	0.000	0.000	0.000	0.000
DELL	7.892	10.505	11.301	9.190	8.136	9.149	21.546	11.681
HPQ	34.323	39.823	23.090	21.120	18.390	15.439	18.617	23.315
MSFT	0.000	0.000	0.000	0.000	0.000	0.000	21.617	0.000
Industry Avg	16.300	31.100	25.400	25.400	20.400	45.700	21.100	28.200

<u>TIE</u>

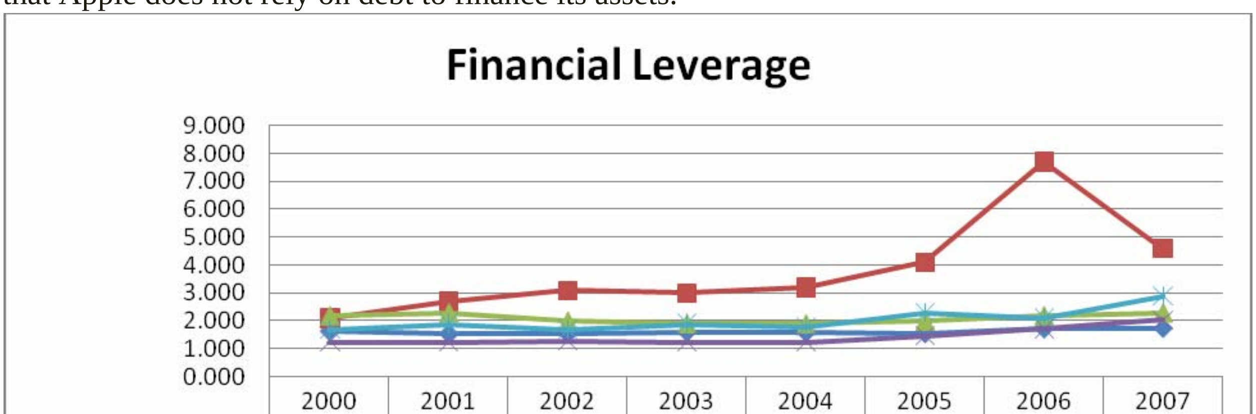
A metric used to measure a company's ability to meet its debt obligations. TIE is calculated by taking a company's earnings before interest and taxes, and dividing it by the total interest payable on bonds and other contractual debt. . Since Apple has no bonds this ratio are currently zero, and a non applicable measurement.



	2000	2001	2002	2003	2004	2005	2006	2007
AAPL	51.700	5.700	27.500	15.750	62.800	0.000	0.00	0.00
DELL	0	57.9	90.4	201.2	290.3	315.1	133.60	84.10
HPQ	21.1	0	10.5	14.5	17	12.2	20.70	25.20
MSFT	0	0	0	0	0	0	0.00	0.00
Industry Avg	64.6	33.4	20.7	255.9	122.8	359.3	349.90	461.20

<u>Financial Leverage</u>

Identifies the degree to which a company is utilizing borrowed money. This ratio again confirms that Apple does not rely on debt to finance its assets.



	2000	2001	2002	2003	2004	2005	2006	2007
AAPL	1.656	1.536	1.538	1.614	1.586	1.550	1.723	1.744
DELL	2.100	2.700	3.100	3.000	3.200	4.100	7.700	4.600
HPQ	2.200	2.300	2.000	1.900	1.900	2.000	2.200	2.300
MSFT	1.261	1.244	1.296	1.259	1.261	1.472	1.735	2.031
Industry Avg	1.700	1.900	1.700	1.900	1.800	2.300	2.100	2.900

DUPONT ANALYSIS

The DuPont Analysis model decomposes Return on Equity into three main components: Asset Turnover, Net Profit Margin, and Financial Leverage. The purpose of DuPont analysis is to analyze the driving factors behind ROE. Asset turnover is calculating by dividing Sales (or Total Revenue) by Average Asset and measures the company's asset management by showing how much revenue is produced per $1 of assets. The Net Profit Margin is calculated by dividing Net Income by Sales or (Total Revenue) and measures the company's efficiency at operating management by showing how much Apple is retaining per $1 of sales. Financial Leverage is calculated by dividing Total Assets by Total Shareholder's Equity and measures how well the company is utilizing its borrowed money. It is important to note that Apple's main source of financial capital is derived from Common Shareholder's Equity since they do not issue any debt. Based on the DuPont Analysis, Apple's main driving factor has been its asset management. Asset Turnover has steadily increased from 2003 thus causing their Return on Equity to increase.

DuPont Analysis	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Asset Turnover	9.846	-0.690	1.132	1.096	3.213	9.533	10.298	14.563
Net Profit Margin	1.335	0.836	0.932	0.947	1.114	1.424	1.345	1.128
Financial Leverage	1.656	1.598	1.537	1.576	1.599	1.565	1.649	1.736
ROE %	21.76466	(0.88632)	1.622993	1.673715	5.67572	21.04533	23.86796	28.66042

RELATIVE VALUATION

Using relative valuation allows us to show Apple's position relative to that of its competitors Dell, Hewlett Packard, Microsoft, the industry, and the consumer discretionary/ technology sectors of the S&P. The charts presented shows Apple's P/E position relative to its comparables, five price estimates that are derived from using the P/E ratios from 2000-2007, along with expected price multiples for 2008. These price estimates are based on the estimated earnings per share (EPS) for Apple for 2008 multiplied by the historical relative proportion between the firm and benchmark P/E multiplied by the benchmark P/E for 2008.

P/E's	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**P/E 2008**
AAPL	12.80	101.00	28.00	N/A	69.30	45.50	35.90	43.40	41
DELL	47.8	23.5	51	38.8	33.5	25.5	15.8	24.3	19.8
HPQ	32.9	13.8	22.8	N/A	19.5	28	29.3	21.7	17.3
MSFT	35.5	36.9	45.4	40.2	36.9	22.9	22.9	20.7	17
Industry Avg.	132.8	178.3	131.7	74.3	81.1	45.7	36.7	65.1	29.4
S&P 500.	106.9	86	56.4	44.5	39.1	38.1	26.7	34.4	22.7

Price to earnings is measured by dividing the price paid for a share by the earnings per share and shows the amount people are willing to pay for $1 of the firm's earnings. This can be an indicator of the company's implied expected growth. Apple's P/E is currently higher than most of their comparables. Comparing Apple's P/Es to its comparables and the industry average shows that the technology sector is a high growth field where investors generally expect more growth from in the company's earnings.

The follow charts are Apple's P/E relative to competitors, Industry, and the consumer discretionary/ technology sectors of the S&P 500.

PE Comparable	2000	2001	2002	2003	2004	2005	2006	2007	P/E 2008
AAPL	12.80	101.00	28.00		69.30	45.50	35.90	43.40	41
DELL	47.8	23.5	51	38.8	33.5	25.5	15.8	24.3	19.8
	0.2678	4.2979	0.5490		2.0687	1.7843	2.2722	1.7860	2.0707

PE Comparable	2000	2001	2002	2003	2004	2005	2006	2007	P/E 2008
AAPL	12.80	101.00	28.00		69.30	45.50	35.90	43.40	41
HPQ	32.9	13.8	22.8		19.5	28	29.3	21.7	17.3
	0.3891	7.3188	1.2281		3.5538	1.6250	1.2253	2.0000	2.3699

PE Comparable	2000	2001	2002	2003	2004	2005	2006	2007	P/E 2008
AAPL	12.80	101.00	28.00		69.30	45.50	35.90	43.40	41
MSFT	35.5	36.9	45.4	40.2	36.9	22.9	22.9	20.7	17
	0.3606	2.7371	0.6167		1.8780	1.9869	1.5677	2.0966	2.4118

PE Comparable	2000	2001	2002	2003	2004	2005	2006	2007	P/E 2008
AAPL	12.80	101.00	28.00		69.30	45.50	35.90	43.40	41
Industry Average	132.8	178.3	131.7	74.3	81.1	45.7	36.7	65.1	29.4
	0.0964	0.5665	0.2126		0.8545	0.9956	0.9782	0.6667	1.3946

PE Comparable	2000	2001	2002	2003	2004	2005	2006	2007	P/E 2008
AAPL	12.80	101.00	28.00		69.30	45.50	35.90	43.40	41
SP500	106.9	86	56.4	44.5	39.1	38.1	26.7	34.4	22.7
	0.1197	1.1744	0.4965		1.7724	1.1942	1.3446	1.2616	1.8062

	Average	Median
AAPL/DELL	1.860829	1.786008
AAPL/HPQ	2.477153	1.625
AAPL/MSFT	1.60624	1.878049
AAPL/Ind Avg.	0.624349	0.666667
AAPL/SP500	1.051916	1.194226

The arithmetic averages were attained by taking the relative P/E's in each, then taking that number and dividing it by the number of years. These numbers were used to determine the price estimates for 2008. We used the median, because the averages showed no visible pattern. In an effort to find a pattern it is more suitable to use the median since it is insensitive to any outliers.

EPS $(2008)_1$: \$3.56
EPS $(2008)_2$: \$4.98

Based on our Pro-Forma Income Statement we calculated a best case scenario and a worst case scenario. These EPS were affected by our estimated operating expenses for 2008. These EPS are used to calculate the Estimated Price for 2008. For more information on our estimated EPS see Figure 1 in the Appendices.

	E(price $_{2008}$) using EPS_1	E(price $_{2008}$) using EPS_2
AAPL / Dell Price	125.89	176.11
AAPL / HPQ Price	100.08	140.00
AAPL / MSFT Price	113.66	159.00
AAPL / Industry Price	69.78	97.61
AAPL / SP500 Price	96.51	135.00
Industry Avg. / Benchmark	87.07	87.07

Average Price Estimate	
Using EPS_1:	\$ 101.18
Using EPS_2:	\$ 141.54

Current Price as of 12/07/2007: \$194.30

The price estimates were calculated by multiplying the expected 2008 P/E's of each comparable, the $E(EPS_{2008})$ for both scenarios, and the median of the historical relationship with Apple and each of its comparables. While using relative valuations shows that Apple is overvalued, we believe the company is expected to continue to keep growing. This will be demonstrated in the absolute valuation.

ABSOLUTE VALUATION

Absolute value is used to determine the intrinsic value of Apple by calculating the present value of future cash flows. Future cash flow can take the form of dividends, capital gains, capital loss, earnings, and cash flows. Since Apple does not issue dividends, we used the Free Cash Flow to the Firm Model (FCFF Model).

In order to begin this valuation, we must establish the cost of capital. In our case we calculated two costs of capitals which are referenced as k_1 and k_2. The costs of capital are used to calculate the present value of the free cash flow for the firm. The table below shows how our costs of capital were calculated.

Costs of Capital			
CAPM		**Another K**	
10 yr T-Strip:	4.26%	HPQ Bond Outstanding:	5.16%
Beta:	1.442		
Risk Premium	6.50%	**K_2: Costs of Capital**	
CAPM=	4.26% + 1.442(6.5%)	**YTM:**	5.16%
		Equity Premium:	3%
k_1 =	**13.63%**	**k_2 =**	**8.16%**

Cost of Capital, k_1, is calculated by using the Capital Asset Pricing Method (CAPM). Our second costs of capital, k_2, was calculated by using the Utendahl method in which a 3% equity premium was added to the company's outstanding bond. Since Apple has no outstanding bond we decided to use a competitor's bond. We used Hewlett Packard's 10 year bond with a yield to maturity of 5.16%.

After establishing the costs of capital, we had to calculate the free cash flow for the firm (FCFF) from Cash Flow from Operating Activities for the last five years.

FCFF Starting from CFO	2007	2006	2005	2004	2003
Operating Activities					
Net Income	**3,496.0**	**1,989.0**	**1,328.0**	**266.0**	**69.0**
Depreciation/Depletion	317.0	225.0	179.0	150.0	113.0
Depreciation	317.0	225.0	179.0	150.0	113.0
Depletion					
Amortization					
Amortization of Intangibles					
Amortization of Acquisition Costs					
Deferred Taxes	78.0	53.0	50.0	19.0	(11.0)
Non-Cash Items	254.0	174.0	486.0	131.0	(1.0)
Accounting Change					(1.0)
Discontinued Operations					
Extraordinary Item					
Unusual Items	12.0	11.0	437.0	85.0	(16.0)
Purchased R&D					0.0
Equity in Net Earnings (Loss)					
Other Non-Cash Items	242.0	163.0	49.0	46.0	16.0
Changes in Working Capital	1,325.0	(221.0)	492.0	368.0	119.0
Accounts Receivable	(385.0)	(357.0)	(121.0)	(8.0)	(201.0)
Inventories	(76.0)	(105.0)	(64.0)	(45.0)	(11.0)
Prepaid Expenses					(34.0)
Other Assets	(1,459.0)	(2,666.0)	(185.0)	(201.0)	(30.0)
Accounts Payable	1,494.0	1,611.0	328.0	297.0	243.0
Accrued Expenses					

Payable/Accrued					
Taxes Payable					
Other Liabilities	1,751.0	1,296.0	534.0	325.0	152.0
Other Changes, Net					
Other Assets & Liabilities, Net					
Other Operating, Net					
Net Cash from Operating Activities	**5,470.0**	**2,220.0**	**2,535.0**	**934.0**	**289.0**
Plus: Interest Expense X (1-Tax Rate)	0.0	0.0	0.0	2.2	5.9
Less Investment In Fixed Capital	986.0	657.0	260.0	176.0	174.0
Free Cash Flow to the Firm	**4,484.0**	**1,563.0**	**2,275.0**	**760.2**	**120.9**

Geometric Average **147%**

After calculating the free cash flow for the firm we had to estimate a growth rate to help calculate our estimated future free cash flow to the firms. As you can see, Apple’s FCFF has been growing at a geometric average of 147% from 2003 to 2007 We believe that a 147% growth rate is excessively bullish since this 147% is mainly driven by 2006 to 2007’s growth. Therefore we believe that a 30% growth rate is a more conservative and acceptable rate.

After establishing a growth rate we calculated the estimated cash flow for the next five years.

E(FCFF)	2008	2009	2010	2011	2012	2013
	5,829.20	7,577.96	9,851.35	12,806.75	16,648.78	21,643.41

Once the estimated FCFF for 2008 to 2013 was established, we calculated the present value. The following figures represent the 2007 present values.

PV(2007)	2008	2009	2010	2011	2012	2013	Sum
K1:	5,129.85	5,868.72	6,714.01	7,681.06	8,787.39	10,053.07	**44,234.11**
K2:	5,389.42	6,477.67	7,785.66	9,357.77	11,247.32	13,518.41	**53,776.26**

Calculating the Terminal Value

Once we figured out the estimated FCFF for 2013 we grew this number by eleven different growth rates to estimate 2014 FCFF. The following figures are the estimated $FCFF_{2014}$.

11 Estimates of 2014 FCFF

	FCFF2013	(1+G)	E(FCFFS2014)
0 Growth Rate--->	4,484.00	1.00	4,484.00
	21,643.41	1.01	21,859.85
	21,643.41	1.02	22,076.28
	21,643.41	1.03	22,292.71
	21,643.41	1.04	22,509.15
	21,643.41	1.05	22,725.58
	21,643.41	1.06	22,942.02

21,643.41	1.07	23,158.45
21,643.41	1.08	23,374.88
21,643.41	1.09	23,591.32
21,643.41	1.1	23,807.75

With these figures, we were now able to implement a Free Cash Flow Model to estimate the intrinsic value for all post-2013 FCFF using the formula of $E(FFCF_1)/(k-g)$.

<u>Terminal Values</u>

FCFF MODEL=E(FCFF1)/k-g
Using k1

	E(FCFF2014)	k1	g	est(IV2013)	est(IV2007)
est(IV2013)2	4484.000	0.1363	0.00	32,898.019	15283.10891
est(IV2013)3	21859.846	0.1363	0.01	173,078.746	80405.48963
est(IV2013)4	22076.280	0.1363	0.02	189,821.838	88183.663
est(IV2013)5	22292.714	0.1363	0.03	209,715.088	97425.27445
est(IV2013)6	22509.148	0.1363	0.04	233,739.855	108586.2237
est(IV2013)7	22725.582	0.1363	0.05	263,332.354	122333.7197
est(IV2013)8	22942.016	0.1363	0.06	300,681.733	139684.7533
est(IV2013)9	23158.450	0.1363	0.07	349,297.894	162269.8845
est(IV2013)10	23374.884	0.1363	0.08	415,184.449	192878.1529
est(IV2013)11	23591.319	0.1363	0.09	509,531.719	236708.1355
est(IV2013)12	23807.753	0.1363	0.1	655,860.956	304686.8689

Using K2

	E(FCFF2014)	k2	g	est(IV2013)	est(IV2007)
est(IV2013)2	4484.000	0.0816	0.00	54950.980	34322.22
est(IV2013)3	21859.846	0.0816	0.01	305305.107	190692.7
est(IV2013)4	22076.280	0.0816	0.02	358381.165	223843.8
est(IV2013)5	22292.714	0.0816	0.03	432029.339	269844.3
est(IV2013)6	22509.148	0.0816	0.04	541085.289	337960.3
est(IV2013)7	22725.582	0.0816	0.05	719163.992	449187.7
est(IV2013)8	22942.016	0.0816	0.06	1062130.382	663403.5
est(IV2013)9	23158.450	0.0816	0.07	1996418.135	1246957
est(IV2013)10	23374.884	0.0816	0.08	14609302.800	9124927
est(IV2013)11	23591.319	0.0816	0.09	-2808490.309	-1754175
est(IV2013)12	23807.753	0.0816	0.1	-1293899.604	-808166

In this chart, you can see the eleven different present values of 2013, using both costs of capital and how we calculated the present values using the different eleven different growth rates. The final columns represent the present value at 2007 of the terminal values.

The following figures represent the present value at 2007 at all our growth scenarios.

Scenario One: 0 Growth Rate

PV with 0 Growth Rate

PV(2007	2008	2009	2010	**2011**	**2012**	**2013**	**Sum**
K1:	3,946.04	3,472.62	3,055.99	2,689.35	2,366.70	2,082.76	$17,613.45
K2:	4,145.71	3,832.94	3,543.77	3,276.41	3,029.23	2,800.69	$20,628.76

Firm Value Using 0 Growth Rate

K1:	**E(Price 2007):**	$ 36.99
K2:	**E(Price 2007):**	$ 61.79

Scenario two: 1% Growth Rate

K1:	**E(Price 2007):**	$ 140.15
K2:	**E(Price 2007):**	$ 274.90

Scenario Three: 2% Growth Rate

K1:	**E(Price 2007):**	$ 148.90
K2:	**E(Price 2007):**	$ 312.18

Scenario Four: 3% Growth Rate

K1:	**E(Price 2007):**	$ 159.29
K2:	**E(Price 2007):**	$ 363.90

Scenario Five: 4% Growth Rate

K1:	**E(Price 2007):**	$ 171.84
K2:	**E(Price 2007):**	$ 440.50

Scenario Six: 5% Growth Rate

K1:	**E(Price 2007):**	$ 187.30
K2:	**E(Price 2007):**	$ 565.57

Scenario Seven: 6% Growth Rate

K1:	**E(Price 2007):**	$ 206.81
K2:	**E(Price 2007):**	$ 806.45

Scenario Eight: 7% Growth Rate

K1:	**E(Price 2007):**	$ 232.21
K2:	**E(Price 2007):**	$ 1,462.65

Scenario Nine: 8% Growth Rate

K1:	**E(Price 2007):**	$ 266.63
K2:	E(Price 2007):	$10,321.27

Scenario Ten: 9% Growth Rate

K1:	**E(Price 2007):**	$ 315.91
K2:	**E(Price 2007):**	$ (1,912.06)

Scenario Eleven: 10% Growth Rate

K1:	**E(Price 2007):**	$ 392.35
K2:	**E(Price 2007):**	$ (848.30)

Based on the valuation model, we believe Apple's growth will not slow down. If Apple grows at a growth rate of 6% then the current price of Apple is undervalued. Anything beyond 6% will only justify our reasoning that Apple is undervalued..

RISK FACTORS

The following risk factors were obtained from Apple’s 2007 10-K report.

Apple is subject to litigation risk.

The matters relating to the Company’s past stock option practices and the re-statement of the company’s consolidated financial statements may result in additional litigation and government enforcement actions.

Apple is subject to risks associated with laws, regulations, and industry-imposed standard related to mobile communication devices and other laws associated with health, safety and environmental protection.

Apple faces intense industry competition could negatively affect Apple’s sales.

Global markets for personal computers, digital music devices, mobile communication devices and related peripherals and services are highly competitive and subject to rapid technological change. If Apple Inc. is unable to compete effectively in these markets; its financial condition and operating results could be negatively affected.

Apple must be able to stay current.

To remain competitive and stimulate customer demand, Apple must successfully manage frequent product introductions and transitions.

Apple faces various business and operational risks.

The company faces substantial inventory and other asset risk.

Future operating results depend upon the Company’s ability to obtain key components, including microprocessors and NAND flash memory, at favorable prices and in sufficient quantities.

The Company products experience quality problems occasionally and can result in decreased sales and operating margin

Failure if information technology systems and breaches in data security could adversely affect Apple finances and operating results.

The Company's success depends largely to attract and retain key personnel.

The Company's retail initiative, new business strategies, and initiatives have required and will continue to required substantial investment and commitment of resources and is subject to risks and uncertainties and could also disrupt Apple's ongoing business.

Apple faces third party risks.

The Company depends on component and product manufacturing and logistics services provided by third parties, many of whom are located outside the U.S.

Apple relies on third-party digital content, which may not be available to the Company on commercially reasonable terms or at all.

The Company relies on access to third-party patents and intellectual property, and the Company's future results could be negatively affected if it is alleged or found to have infringed intellectual property rights.

The Company currently relies on a single cellular network carrier for iPhone in each of the U.S., U.K., Germany and France.

Third party software developers', resellers', distributors', etc, performance and maintenance is an important factor for apple performance.

Political Regulatory and Economic

Stock price may be Volatile and changes in taxes could affect results.

RECOMMENDATION

Based on our Absolute Valuation, Apples is currently undervalued. We recommend buying 100 shares of Apple Inc.'s stock. We believe Apple will continue show robust growth and continue to reinvest in their research and development. Apple continues to reinvent itself by consistently coming up with new innovative ideas that keeps them ahead of the competition.

Since 2001 apple has shown a rather high-quality performance relative to its industry and competitors in respect to its financials. The company has been one of the industry leaders in terms of Sales growth, EBIT growth, Net Income growth, Cash Flow from Operations, Operating growth, Gross Margin Percentage, Net Profit Growth, Receivables turnover, return on asset and current ratio. These Ratios evidently show a financially efficient company. These and our absolute valuation lead us to believe that Apple is a good candidate to invest in.

References

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