Apple Inc.

NASD: AAPL - Telecommunications Equipment

MarketGrader currently has a BUY rating on Apple Inc. (AAPL), based on a final overall grade of 75.9 scored by the company's fundamental analysis. Apple Inc. scores at the 99th percentile among all 5824 North American equities currently followed by MarketGrader. Our present rating dates to July 12, 2005, when it was upgraded from 'HOLD'. Relative to the Telecommunications Equipment sub-industry, which is comprised of 69 companies, Apple Inc.'s grade of 75.9 ranks second. The industry grade leader is Lumentum Holdings, Inc. (LITE) with an overall grade of 78.5. The stock, up 28.8% in the last six months, has outperformed both the Telecommunications Equipment group, up 0.51% and the S&P 500 Index, which has returned 5.93% in the same period. Please go to pages two and three of this report for a complete breakdown of AAPL's fundamental analysis.

Overview

Company Scores Very Good Fundamental Grades

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Price, Rating and Sentiment History - 2 Years
Apple Inc.

NASDAQ: AAPL - Telecommunications Equipment

The Company's Recent Reports Reflect Solid Top and Bottom Line Growth

According to its latest earnings report, Apple booked $53.43 billion in total revenue last quarter, a 18.04% rise from the year earlier period's $45.26 billion, which is not only a healthy increase but an improvement from its long term sales growth. Also including the latest quarter the company had $255.70 billion in 12-month trailing revenue, only 14.89% higher than the $222.56 billion booked during the equivalent period ended three years ago, a modest increase in such timeframe. The next couple of quarters will help investors determine if the recent increase in top line growth is sustainable and whether it will lead to higher profits. It also reported very strong year-over-year profit growth, but not so when measuring full year profits against results from three years ago, showing very weak growth from a long term perspective despite the latest short term jump. It posted a Second quarter profit increase of 32.14% to $11.52 billion from $8.72 billion (excluding extraordinary items) a year earlier, compared to a 10.61% full year profit increase to $56.12 billion in the 12 months ended last quarter from $50.74 billion three years earlier. The company has shown an improvement in margin growth during its last three quarters, including a modest 1.30% average increase in EBITDA, operating and net margins during its latest quarter compared to the year ago period.

After reporting earnings on August 01, 2018 that beat analysts' consensus estimates by 8.33%, the company's stock jumped 8.99% as investors welcomed the report. Apple's latest earnings report extended its excellent earnings surprise record as it has beaten the consensus estimate by an average of 5.31% over its last six announcements.

Assuming the Company's Fundamentals Don't Deteriorate in Coming Quarters, the Stock's Valuation is Acceptable at this Level

Apple's stock, currently priced at 16.65 times 12-month' earnings per share, trades 15.49% higher than our "optimum" P/E ratio of 14.42. This ratio, calculated by MarketGrader, is determined by the growth in the company's earnings in the last five years, measured over 12-month rolling periods. Based on this formula Apple has grown earnings per share at a 14.03% annualized rate during the last five years. Based on this strong growth rate and its healthy overall Profitability grade, the company may be gaining market share. In order to make these gains sustainable without adversely impacting its financial performance its margin growth needs to continue. The stock's forward P/E of 16.65, based on its earnings estimate for the next four quarters, represents a premium to the S&P 500 index's forward P/E of 15.20 but is lower than its trailing P/E of 20.14. Therefore value could apparently be found in the company's future earnings growth even though relative to the market the stock might not seem cheap (the fundamentals may already be factored into the price). But assuming the company remains fundamentally strong, the stock might have further room to run, or at least be a relatively safe place to be if earnings estimates materialize into actual reported results.

Apple's market value is 11.84 times the company's tangible book value, which excludes intangible assets such as goodwill; such a premium suggests investors have high expectations for the company's future earnings potential. Intangible assets make up a moderate 19.61% of the company's total stockholders' equity. Relative to the $14.93 in cash flow per share generated by the company in the last twelve months, the stock is attractively priced at 14.87 times cash flow per share considering its strengths across our fundamental indicators. Its shares also trade at 4.21 times trailing 12-month sales, a 113.00% premium to its industry average of 1.98. Our final value indicator looks at the relationship between the company's current market capitalization and its operating profits after deducting taxes. According to this indicator Apple's $1072.78 billion valuation is reasonable at 16.07 times its most recent quarterly net income plus depreciation.
Apple Inc.

Company’s Profitability Is Remarkable, Reflective of Excellent Operating Conditions and Strong Management

Apple is a very profitable company with strong overall indicators in this section of our analysis. The company’s different measures of return to shareholders and margins are typically above those of its peers. In the last four quarters Apple earned a profit of $56.12 billion, equivalent to 21.95% of its sales in the period. Operating income during that same period accounted for 26.79% of sales, 126.68% higher than the average operating margin for the Telecommunications Equipment industry, which was 11.26%. Apple’s return on equity, based on trailing 12-month earnings, is not only outstanding at 48.82%, but it’s higher than the 35.23% return on equity from the year earlier period. This is an important metric of management efficiency in our grading system, as it measures the amount earned on an investment in the company’s common stock.

The company’s capital structure is pretty conservative relative to its recent performance, with a debt to equity ratio of just 1.00. Its long term debt accounts for 45.80% of total capital, a very manageable level. Apple’s core earnings in the last twelve months grew moderately from the twelve months ended a year earlier. The company’s EBITDA for the most recent period was $84.07 billion, or 12.56% above the $74.69 billion earned from its core operations in the prior period. EBITDA is used by MarketGrader to measure the company’s true earnings power since it includes interest expenses, income taxes, depreciation and amortization, all non-operating expenses, which are nevertheless accounted for in other parts of our analysis that look at EPS gains and net income.

Company’s Cash Flow Is Very Well Managed as Our Analysis Reflects a Very Healthy Operation

Apple’s cash flow grew considerably in its latest quarter to $14.49 billion, a 73.24% increase from $8.36 billion reported in the year earlier period. This growth seems to be accelerating considering that in the last twelve months the company’s cash flow was 14.83% higher than the twelve months ended a year ago, a nice increase but quite lower than the current pace. This upward trend should boost its margins and overall profitability in the next few quarters. The company has a moderate net debt to EBITDA ratio of 2.60, even though it jumped 17.34% from last year’s 2.21. The latest number is based on $43.63 billion in net debt, calculated as total debt minus cash on hand, and EBITDA of $16.80 billion, suggesting the company could pay off its debt with the cash flow it generates from operations with relative ease. Of further concern is not only the fact that as a percentage of total capital Apple’s total debt has climbed to 49.92%, 10.95% higher than a year earlier when it represented 45.00% of total capital but also that its cash on hand has fallen by 7.54% during the same period. It therefore seems clear the company is using leverage to curb a deterioration in its core business, at least temporarily, perhaps at the expense of future profitable growth.

An important indicator of management efficiency used by MarketGrader is Economic Value Added, or EVA, which measures each company’s true return to shareholders after accounting not only for the cost of running the business (operating costs) but also the cost of the capital it employs. By measuring the real cost of capital, both equity and debt, EVA measures the creation of true economic profit. In this case Apple had $212.08 billion in invested capital in its most recent quarter, a combination of both equity and long term debt. However, the company’s weighted cost of equity of 4.29% is much larger than the weighted cost of debt, which is 0.92%. When combined, the two result in a total cost of capital of 5.21%, quite low compared to the company’s total return on invested capital of 32.30% based on 12-month trailing operating income. The result is an excellent economic value added of 27.10%, a very high return to investors after all capital costs are covered. The company increased its quarterly common dividend on June 30, 2018 by 15.87%, to $0.730 cents a share from $0.630 cents. It has paid a dividend for at least 31 years and, based on this latest payout, the stock is currently yielding 1.22%. The company’s capital structure is pretty conservative relative to its recent performance, with a debt to equity ratio of just 1.00. Its long term debt accounts for 45.80% of total capital, a very manageable level. Apple’s core earnings in the last twelve months grew moderately from the twelve months ended a year earlier. The company’s EBITDA for the most recent period was $84.07 billion, or 12.56% above the $74.69 billion earned from its core operations in the prior period. EBITDA is used by MarketGrader to measure the company’s true earnings power since it includes interest expenses, income taxes, depreciation and amortization, all non-operating expenses, which are nevertheless accounted for in other parts of our analysis that look at EPS gains and net income.

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Apple Inc. designs, manufactures, and markets mobile communication and media devices, personal computers, portable digital music players, and sells a variety of related software, services, peripherals, networking solutions, and third-party digital content and applications. Its products and services include iPhone, iPad, iPod, Mac, iPod, Apple TV, a portfolio of consumer and professional software applications, the iOS and OS X operating systems, iCloud, and accessories, service and support offerings. The company also sells and delivers digital content and applications through the iTunes Store, App Store, iBooks Store, and Mac App Store. It sells its products worldwide through its retail stores, online stores, and direct sales force and third-party cellular network carriers, wholesalers, retailers, and value-added resellers to the consumer and also sells third-party iPhone, iPad, Mac and iPod compatible products, including application software, and accessories, through its online and retail stores. The company was founded by Steven Paul Jobs, Steve Wozniak and Ronald Gerald Wayne on April 1, 1976 and is headquartered in Cupertino, CA.

Key Facts:
One Apple Park Way
Cupertino, CA 95014-2083
Phone: www.apple.com

Biggest Company in Sub-Industry
Apple Inc. (AAPL)
Grade 82.2
Market Cap: $1,072.78 billion

Smallest Company in Sub-Industry
Novra Technologies Inc.
Grade 4.2
Market Cap: $5.05 million

MarketGrader Dilution Analysis

Income Statement
Last Qtr (06/2018) 12 Mo. Trailing
Revenue $53.4B $255.7B
Op. Income $13.0B $68.5B
Net Income $11.5B $56.1B
*EPS $2.34 0

*Earnings per share are based on fully diluted net income per share excluding extraordinary items. This number may not match the headline number reported by the company.

Balance Sheet
Latest
Total Assets $349.2B
Total Debt $114.6B
Stockholders Eq. $114.9B
All numbers in millions except EPS

Ratios
Price/Earnings (12 mo. trailing) 20.14
Price/Tangible Book 11.84
Price/Cash Flow 14.87
Price/Sales 4.21
Debt/Cash Flow 155.78
Return on Equity 48.82%
Gross Margin (12 mo. trailing) 38.91%
Operating Margin (12 mo. trailing) 26.79%
Net Profit Margin (12 mo. trailing) 21.95%
# Top Down Analysis

## Technology

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<thead>
<tr>
<th>#</th>
<th>Ticker</th>
<th>Grade</th>
<th>Sentiment</th>
<th>Name</th>
<th>Price</th>
<th>Next EPS</th>
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<td>Momo Inc Sponsored ADR Class A</td>
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<td>MU</td>
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<td>NANO</td>
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<td>7</td>
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<td>9</td>
<td>FB</td>
<td>81.93</td>
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<td>Facebook, Inc. Class A</td>
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<td>10</td>
<td>ATHM</td>
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<td>Autohome, Inc. Sponsored ADR Class A</td>
<td>$68.92</td>
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## Telecommunications Equipment

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<th>Ticker</th>
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<th>Next EPS</th>
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<td>1</td>
<td>LITE</td>
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<td>Lumentum Holdings, Inc.</td>
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<td>Vecima Networks Inc.</td>
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## Sentiment