Apple's financial analysis part 2

[Finance](), [Financial Analysis]()

Income Statement

a) Apple Inc uses a multi-step income statement format. It organizes its operating section by using functional expense classification.

b) There are no unusual items presented in Apple’s income statement. Also, the company did not discontinue any of its operations, neither had any changes in accounting principles. The net income for 2008, 2007, and 200 is $4, 834, $3, 496, and $1, 989 respectively. The net income has increased continually in the past three years. Net income increased 38. 3% in 2008.

Apple’s net income growth for 2007 was 75. 7%. The income statement doesn’t need restating. I also believe that Apple is not managing its earnings. The company’s revenue and earnings per share are undervalued and Apple's financials appear radically weaker than they actually are. It is because in April 2007 they made a bad decision when announced that Apple will be using what is commonly referred to as the " subscription method of accounting" for sales of the iPhone where the sales revenue from the iPhone is deferred and recognized over a 24-month period instead of at the point of sale.

When disregarding the deferred revenue mechanism of subscription accounting, Apple actually earned $7. 48 in EPS on $38. 041 billion in revenue. That compares to the $5. 36 in EPS on $32. 479 billion in revenue that Apple reported on a GAAP-basis. During 2008, the Company adopted the Financial Accounting Standards Board’s (“ FASB”) Financial Interpretation No. (“ FIN”) 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109.

FIN 48 changes the accounting for uncertainty in income taxes by creating a new framework for how companies should recognize, measure, present, and disclose uncertain tax positions in their financial statements.

	09/27/08 Restated	09/27/09 Net Sales
	32, 479	32, 479
Cost of Goods	21, 334	21, 334
Gross Profit	11, 145	11, 145

Selling & Administrative & Depr. & Amort Expenses	4, 870	4, 870
Income After Depreciation & Amortization	6, 275	6, 275
Non-Operating Income	620	620
Pretax Income	6, 895	6, 895
Income Taxes	2, 061	2, 061
Investment Gains/Losses	0	0
Other Income/Charges	0	0
Income From Cont. Operations	4, 834	4, 834
Extras & Discontinued Operations	0	0
Net Income	4, 834	4, 834

Revenue Recognition

Apple Inc recognizes revenue from sales when persuasive evidence of an arrangement exists, the delivery has occurred, the sales price is fixed or determinable, and collection is probable. Revenue from service and support contracts is deferred and recognized over the service coverage periods. Revenue is deferred for the fair value of the specified upgrade rights when offered.

i. A/R turnover= Net Sales/Average A/R(net) A/R turnover2007= 24, 066/1637= 14. 70 times A/R turnover2008= 32, 479/2422= 13. 41 times

ii. Allowance % A/R= Allowance/ Gross A/R Allowance % A/R2007= 47/24, 066= 0. 0195 Allowance % A/R2008= 47/32, 479= 0. 001445

iii. Average collection period= 365/ A/R turnover (or 365*A/R/Net Sales)

Average collection period2007= 365/14. 70= 24. 82 (every 25 days)

Average collection period2008= 365/13. 41= 27. 22 (every 22 days)

The total sales revenues increased consistently for the past years. Net sales increased to 43. 86% in 2008 compared with 2007 ($24, 006 and $ 32, 479 respectively), A/R have increased too by 47. 95% in 2007 compared to 20056 ($1637and $2, 422 respectively). The company does not have a looser credit policy, since it does not have credit accounts whatsoever. Apple has an increasing accounts receivable turnover which is a positive sign - showing the company is successfully executing its credit policies and quickly turning its accounts receivables into cash. The ratios calculated above cannot be taken into account because they do not represent the actual A/R for the company for the entire year.

Inventory Costing:

a) The company uses FIFO in costing its inventory. I believethat the company uses this method, because even though tax expense is higher, since the Cost of Goods Sold decreases by using the lower cost items, the net effect on the net income still results in a net increase.

The earnings per share also increase, as well as inventory in the balance sheet. If the cost of the inventories exceeds their market value, provisions are made currently for the difference between the cost and the market value. The Company’s inventories consist primarily of finished goods for all periods presented. If they use LIFO the net income would have been higher, it can benefit from tax savings and improve its cash flow. On the other hand, the average cost achieves a net income somewhere in the middle. b)Looking at the vertical analysis of the Income Statement cost of goods sold has decreased to 0. 34% (from 66. 3 % in 2007to 65. 69% in 2008), and net sales increased by $8475. At the same time, looking at the horizontal analysis, while in 2008 COGS increased by nearly 39. 97% compared to 2007, sales increased only by 43. 86%, and in 2007 while GOGS increased by 15. 56%, sales increased by 24. 29%. This, in my opinion, indicates inventory stock (50 items), and fast-moving inventory (7days). i. Inventory Turnover=(COGS)/(Ave. Inventory) Inventory Turnover2007= 15, 852/(270+346)/2= 51. 047? 51 items Inventory Turnover2008= 21, 334/(509+346)/2= 49. 904? 50 items ii. Gross Profit Percentage= Gross Profit/Net Sales

Gross Profit Percentage2007= 8, 154/24, 006= 0. 3397? 33. 97% Gross Profit Percentage2008= 11, 145/32, 479=. 3431? 34. 31%

iii. Average Days in Inventory= 365/Inventory Turnover Average Days in Inventory2007= 365/51= 7. 16 days Average Days in Inventory2008= 365/50= 7. 3 days

c) Apple is doing extremely well in terms of inventory turnover, which is one of the lowest in the industry only 7 days. While a sizable inventory can be important to cope with sudden surges in demand, excessive inventory is wasteful and can exacerbate financial problems if a new product is introduced before old inventory is cleared.

Inventory is increased from 346 million in 2007 to 509 million in 2008. Because the sales are increased too, therefore it is an indication of heavy business activities, rather than the problem with the sale of existing products. The gross profit margin is flat for the year 2007 and 2008 at 34%.

Property, Plant, and Equipment

a) Apple Inc uses the straight-line method of depreciation based upon the asset’s estimated useful life.

b) Asset Turnover= Net Sales/Ave total assets Asset Turnover2007= 24, 006/[(25, 347+17, 205)/2)]= 1. 1283 Asset Turnover2008= 32, 479/[(39, 572+25, 347)/2]= 1. 0006

c) PPE has increased in the last year by $632 million.

The company has purchased PPE in 2007 in the amount of $735 million and $1, 091 million in 2008. In 2008 Apple declared a loss on disposition of property, plant, and equipment for $22 million, which has increased by $10 million since 2007(12million)

Liabilities

a) Apple’s liabilities are composed of short-term debt, Accounts Payable, Accrued Expenses, Long-term debt, non-current liabilities. The major current and non-current liabilities account for the years of 2007 and 2008 are shown in the table below: September 27, 2008, September 29, 2007_ Current liabilities:

Accounts payable $5, 520 $4, 970 Accrued expenses 8, 572 4, 310 Total current liabilities 14, 092 9, 280 Non-current liabilities 4, 450 1, 535 Total liabilities 18, 542 10, 815

b) Ratios:

i. Debt Ratio= Total Liabilities/Total Assets Debt Ratio2008= 18, 542/39, 572= 0. 468564 or 46. 86%

ii. Debt to Equity= Total Liabilities/Stockholders Equity Debt to Equity2008= 18, 542/21, 030= 0. 8817

iii. Times interest earned= Income before income taxes and interest expense/Interest Expense Times interest earned2008= 6, 275/ 0

c) Ratios for Microsoft’s for the year ended 06/30/2008

i. Debt Ratio2008= 36, 507/72, 793= 0. 015 or 50. 15%

ii. Debt to Equity2008= 36, 507/ 36, 286= 1. 0061

iii Times interest earned2006= 22, 492/0

These ratios are derived from Dillard's financial statements that can be found on http://www. sec. gov/Archives/edgar/data/789019/000119312508162768/d10k. html. Looking at Apple's and Microsoft's debt ratios, I can say that Microsoft's debt ratio is 3. 29% higher, or it has 3. 29% more debt compared to its total assets. I think that 50. 15% indicates that Apple can be categorized as a company of moderate risk level. Comparing Apple's debt to equity ratio of 0. 8817% to Microsoft's ratio of 1. 61%, I can tell that Apple's are doing well since it uses $. 88 derived from liability in addition to every $1 of equity in its business, taking advantage of the lower cost of debt for financing projects to relatively more expensive equity financing. Microsoft's ration is only 0. 1793% lower, which indicates a normal debt ratio for Apple Inc. Comparing Apple's ratio results to Microsoft's gives me the confidence to say that Apple's liabilities fall into the industry's average.

Stock price

a) YahooFinancechart

PRICE Date	Open	High	Low	Close	Avg Vol	Adj Close*
Sep-08	172. 401	73. 50	120. 68	128. 43	9, 370, 800	128. 24
Aug-08	159. 90	180. 45	152. 91	169. 53	23, 273, 800	169. 53

Jul-08	164. 23	180. 91	146. 53	158. 95	33, 096, 200	158. 95
Jun-08	188. 60	189. 95	164. 15	167. 44	34, 281, 100	167. 44
May-08	174. 96	192. 24	172. 00	188. 75	32, 650, 300	188. 75
Apr-08	146. 30	180. 00	143. 61	173. 95	38, 841, 700	173. 95
Mar-08	124. 44	145. 74	118. 00	143. 50	42, 313, 100	143. 50
Feb-08	136. 24	136. 59	115. 44	125. 02	46, 645, 400	125. 02
Jan-08	199. 27	200. 26	126. 14	135. 36	62, 108, 100	135. 36
Dec-07	181. 86	202. 96	176. 99	198. 08	31, 771, 400	198. 08
Nov-07	188. 60	192. 68	150. 63	182. 22	46, 553, 700	182. 22
Oct-07	154. 63	190.	152.	189.	37, 438,	189. 95

		12	93	95	400	
Sep-07	153. 44	154. 60	152. 75	153. 47	43, 935, 800	153. 47

b) In my opinion, there is a strong positive correlation between the two charts. There are several noticeable changes in Apple’s stock price over the last year. In October 2007 Apple’s stocks increases to $189. 95 from $153. 47in Sept. The increase was due to people’s interest to get their hands on Mac OS X Leopard, the newest version of Apple's operating system. After that since markets in general, and tech stocks, in particular, were hit hard by poor earnings reports posted by Intel, Apple’s stock price dropped in the first weeks of November.

At the begging of January 2007, the stock dropped to $126. 14 after Jobs announced iPhone sales to date of 4 million, and AT&T said that only 3. 9 million were activated, which means 100, 000 iPhones still in their Christmas wrapping or more likely unlocked. The company’s stock decline in the first quarter was due to an antitrust suit that has been filed against Apple accusing the company of illegally maintaining a monopoly in the digitalmusicmarket by failing to support Microsoft’s Windows Media Audio format. In May Stock reached $188. 55 because Apple reported its second-quarter earnings and its revenues of $7. 05 billion and a net profit of $1. 05 billion for the quarter. In the second quarter, Apple had slightly decreased and increases in stock value. On July 22, 2008, Apple reported its third-quarter earnings results. The company earned $7. 46 billion during the quarter, a 37% increase from the same quarter 2007. Last month of the third quarter the company had a downturn to $ 120. 68 per stock.

Final Review

I believe that the company has strong results in the industry that it operates.

Compared to its direct competition, Apple Inc is doing well. I also believe that Apple Inc is trying to grow, and became a leader in the consumer electronics market. Based on my analysis, I agree with the company's strategy of increasing investment in Research and Development. Specifically, I suggest the sometime down the line after provider contracts are over and equipment andtechnologycosts have gone down Apple should enter the wireless cellular provider arena. This would allow Apple to recoup all profits instead of sharing/splitting profits with the providers.

Customers buy the hardware/phone at cost rather than the current model of wireless provider subsidized phones at the expense of expensive plans. They should offer quality engineered, eco-friendly, workplace computer that is economically practical for corporations and large organizations. However, due to Apple's unique designing nitch and brandloyalty, we feel they have the ability to capture a portion of the bottom market that has always wished to own an Apple without diluting its luxury product image. Apple Inc would do a lot better if it was not in the declining economicenvironmentas of now.

Increasing questions about Jobs'healthand lack of transparency into a succession plan is decreasing the company's stability. Contrary to Wall Street's expectations Apple reports earnings of $1. 61 billion ($1. 78 per share), which was up 2 cents a share from the year-earlier period. Revenue also increased from $9. 6 billion to $10. 17 billion. With a stock price of $102, " Apple Inc. shares have catapulted back atop the century mark today after brokerage firm FTN Equity upgraded the stock from " neutral" to " buy. " We now believe investors are more prepared for the Chief Executive taking a smaller role and we have not seen the multiple compression we expected," wrote analyst Bill Fearnley, Jr. " I believe that by looking at the past performance of Apple, one can derive a future prognosis of Apple’s performance, bound to the industry development. I believe that an investor may want to buy Apple’s shares, since it looks like it is a strong company, and take advantage of the current low stock prices. I also would recommend to an investor not to invest all of hismoneyin Apple, because of the uncertainty of the market.