

# Analyzing Apple<sup>1</sup>

Apple's Form 10-K for the fiscal year ended September 24 2016 (the '2016 fiscal year') and related case materials are provided as online exhibits at:

[http://www.lundholmandsloan.com/case\\_materials.html](http://www.lundholmandsloan.com/case_materials.html). Use this information to answer the following questions:

## QUESTIONS

### Business Strategy Analysis

1. Summarize Apple's business strategy and identify the key success factors associated with this strategy.
2. Identify the key risks associated with Apple's business strategy.
3. Compute Apple's return on common shareholders equity (ROE) for the 2016 fiscal year.

### Accounting Analysis

4. Standardized Apple financial statement data from S&P are provided with the online case materials at [http://www.lundholmandsloan.com/case\\_materials.html](http://www.lundholmandsloan.com/case_materials.html) in the Excel file labeled 'Apple Standardized Data for eVal'. For the 2016 fiscal year, reconcile each line item in the standardized financials back to the 'as reported' financials in Apple's Form 10-K (most line items will be straightforward to reconcile, but a few will be challenging).
5. Identify and evaluate Apple's key accounting policies.
6. Identify one example of an economic asset or liability of Apple's that is missing from Apple's balance sheet or is carried on Apple's balance at a value that differs significantly from its true economic value.

---

<sup>1</sup> This case was prepared by Professor Richard Sloan as the basis for classroom discussion, rather than to illustrate either effective or ineffective handling of a business situation. Copyright 2017 by Richard Sloan.

7. Do you think that Apple's reported earnings are a good reflection of Apple's underlying economic performance? Briefly explain your answer.

### **Ratio and Cash Flow Analysis**

8. Compute Apple's return on common shareholders equity (ROE) for the 2016 fiscal year using average common equity in the denominator.
9. Use the advanced Dupont model to decompose Apple's ROE (as computed in question 8 above) into RNOA, leverage and spread.
10. Also provided with the Apple case materials is the associated Form 10-K for Microsoft Corporation. Use the advanced Dupont model to decompose Microsoft's ROE into RNOA, leverage and spread. Identify any major differences in these ratios between Apple and Microsoft and try to explain the reasons for these differences.
11. Perform detailed margin and turnover analyses for Apple and Microsoft. Use these analyses to explain the sources of the difference in RNOA between the two companies.
12. During fiscal 2016, Apple generated over \$60 billion of cash flows from its operating activities. Identify the main ways in which Apple deployed these cash flows.

### **Forecasting**

13. This is a real-time forecasting exercise. Your objective is to forecast Apple's income statement, balance sheet, and statement of cash flows for its fourth fiscal quarter ending September 30, 2017. You should place particular emphasis on generating an accurate forecast of Apple's quarterly EPS. Use the following framework and data sources in constructing your forecasting model:
  - a. Familiarize yourself with Apple's recent financial information. You will find this information at Apple's investor relations site: <http://investor.apple.com/>.

- b. Use the forecasting framework developed in the course to prepare forecasts of Apple's income statement, balance sheet, and statement of cash flows for the fourth quarter.
- c. Do a "reality check" on your forecasting model by comparing your EPS forecasts to sell-side analysts' forecasts. Try to identify the sources of any major differences.

### **Valuation**

- 14. Assume that Apple's sales growth rate trends linearly between 2016 and 2021 to a terminal growth rate of 3%. Further assume that Apple's margin, turnover and leverage ratios remain constant at their 2016 levels indefinitely. Forecast Apple's income statements and balance sheets through 2021, stating any additional assumptions that you make (note: you may use forecast turnover and leverage ratios based on year-end balance sheet values).
- 15. For the purpose of answering this question, use the forecast financial statements from question 14 and a cost of equity capital of 8%. Compute the value per share of Apple stock using:
  - a. The discounted cash flows to common equity holders approach, and
  - b. The residual income to common equity holders approach.
- 16. Adjust the forecasting assumptions in question 15 above to represent what you consider to be most appropriate. Provide justifications for the forecasting assumptions that you have selected. How does the resulting valuation compare with the Apple's current market valuation? Try to identify the key reason(s) for any difference.