Company Description:

Headquartered in Cupertino, California, Apple ("AAPL"), Inc. designs, manufactures, and sells a range of computing devices, including iPhones, iPads, Apple Watches, and Macs. The company differentiates its products with proprietary software, including the iOS and OS X operating systems.

Name	Ticker	Yield	Growth	D + G
Apple Inc.	AAPL	0.45%	11.00%	11.45%

Highlights:

We remain positive about AAPL's long-term growth opportunity, driven by the strength of its eco-system, growing services contribution, strong cash flow, and future new product opportunities. With the build-out of its services offerings, Apple is increasingly a platform business - management has been explicit about its strategy to attract users to Apple's ecosystem, and further monetize those users by selling ancillary products, peripherals, and services. And the AI opportunity plays right into this moat.

While management's outlook implies slower iPhone 16 growth in the near term, we remain optimistic about an AI-driven iPhone upgrade cycle in coming quarters. We believe Apple is uniquely positioned to offer on-device AI features given its ecosystem strength, hardware capabilities, and privacy focus. On-device AI has lower capex needs and offers faster monetization potential through consumer hardware upgrades, which we think makes AAPL stock particularly attractive as the debate surrounding GenAI monetization/ROI continues.

Bull Case:

- ***iPhone Outlook Solid*** - Following years of slowing upgrade rates, we believe Apple Intelligence could help drive a stronger product upgrade cycle. In addition, results should continue to be aided by strong U.S. carrier trade-in subsidies, continued international penetration, and a strong competitive position.
- ***Buyback and Dividend Positive*** – Apple continues to aggressively buy back shares and raise its dividend, totaling what we would consider to be a healthy shareholder return.
- ***Strong Cash Flow, High-Quality Balance Sheet → Creates Opportunity for Future Growth Expansion*** - Apple has grown free cash flow substantially over the past eight years, driven by strong revenue growth and high margins.

Bear Case:

- ***Rapid Technology Evolution*** - Historically, the global consumer electronics and computer hardware business has been characterized by aggressive price cutting, with resulting downward pressure on gross margins, frequent introduction of new products, short product life cycles, evolving industry standards, continual improvement in product price/performance characteristics, rapid adoption of technological and product advancements by competitors, and price sensitivity of buyers.
- ***New Product Adoption*** - Apple's current dominance in the world of consumer electronics has been largely the result of a ten-year run of developing hit products beginning with the first iteration of the iPhone, which was followed by the iPad. Relying on its strong margins from hardware sales, we believe that Apple could be at risk should new products not create excitement in the market and fail to support premium prices.
- ***Consumer-Centric Exposure*** - More broadly, we worry that AAPL may have been a Covid beneficiary, amid work/ learn from home and strong consumer spending, which could reverse, particularly as consumers' spending priorities change and rising rates potentially pressure demand. Apple is consumer-centric, and is highly transactional, with less than 10% of its revenues and profits being recurring - meaning it could be vulnerable to a downturn.
- ***Valuation*** - Apple's valuation is close to its peak relative and absolute multiples in the last 10 years, and while Apple has historically been a low double-digit EPS grower, the stock now appears expensive relative to other mega and large cap tech names with higher growth profiles, although the valuation looks more reasonable compared to major consumer stocks, after accounting for higher growth expectations. We note that Apple is less expensive than it appears, given its sustained very high FCF conversion averaging ~115% of net income.

Overall Thesis:

Being bullish on Apple right now is a contrarian call. On net, we've become more constructive on AAPL given its relative underperformance versus Mega-Cap peers, poor investor sentiment, and the belief that its fundamental business and financial model are intact. We also don't see prevailing regulatory challenges as thesis-changing, particularly in the next 3 - 5 years. Lastly, and this is the kicker for Apple, the iPhone 16 could be an "AI phone" that could drive adoption after two sluggish iPhone cycles in a row

Regarding the AI arms race – investors believe that Apple has lost their edge. We disagree. Apple Watch is the best-selling watch globally and if AirPods were a standalone company, would be one of the largest companies in the S&P500 by revenue rivaling Grainger, Micron, ITW, Boston Scientific, O'Reilly, Emerson, or Texas Instruments. Here's an alternative thought – Apple doesn't need to get into an arm's race. They can simply improve the AI capability on the edge of the device, remember most use cases, Apple has already figured out like improving photos, face detection, voice-to-text, etc. They can further integrate it within the phone, which Apple will still control. They don't have other ways to monetize AI like the cloud providers, so for all the use cases that require the cloud, why not partner with Google, an eventual revenue share on top of the most lucrative deal ever? This is a great example of Apple's optionality.

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