Apple and Team David's Six-Month Review

David Gardner and The Stock Advisor Team | June 20, 2008

In addition to the official rerecommendation of Apple and the decision to sell Time Warner, we provide expanded coverage of David's top stocks below. For a ranking of all David's stocks -- including guidance on whether to buy, sell, or hold -- see the Report Card.

You may have to wait until July 11 to get the new iPhone, but you shouldn't hesitate to dial up some shares of **Apple** (NASDAQ: AAPL), my top stock today. Apple recently unveiled the iPhone 2.0, and with it came expected improvements -- faster (3G) Internet performance, enterprise support for corporate email calendars, and real GPS. It also comes with something many customers had hoped for but not necessarily counted on: a lower price.

While most gadget blogs went gaga, Apple investors were less certain -- and the stock actually declined more than 2% after the news broke.

Seems like uncertainty has gotten the best of some people. But it's not frigid sales of the new iPhone that has investors worried -- Apple plans to move a whopping 10 million-plus in the next year. Rather, people are uncertain about how a new price and a new deal structure with **AT&T** (NYSE: T) is going to affect Apple's bottom line.

Under the new deal, Apple and AT&T's revenue sharing -- never officially detailed, though we estimate it at $11 to $18 per customer per month for Apple -- has gone away.

Here's why I'm more excited today than I was when I recommended this stock in February. Apple apparently was having a hard time finding partners outside the U.S. that were willing to enter into AT&T-like revenue-sharing terms. While the first iPhone was sold in just five countries outside the U.S., the new 3G iPhone will be pushed globally -- and more than 70 countries are already lined up. Why the change of heart? Apple has said that typically, it "will not receive follow-on revenue generating payments

WHY BUY?

- Enhanced features, new pricing, and 3G technology will make the new iPhone a blockbuster.
- Sales of iPods and Macs continue to surpass expectations.
- With a pristine balance sheet and unparalleled innovation, this is a brand that should only get stronger.

WHAT IT DOES

Apple designs, manufactures, and sells premium quality computers, mobile devices, and personal electronics.

KEY COMPANY DATA

Recent Price: $181.43

Risk Level Rating: Medium

Position in Industry: Juggernaut

Market Cap*: $159,953

Cash/Debt*: $19,448/$0

Revenue (07/06/05)*: $28,747/$24,006/$19,315

Earnings (07/06/05)*: $4,348/$3,496/$1,989

Insider Ownership: 0.7%

Biggest Threat: Failing to meet great expectations

The Team Says: Think different. Buy Apple.

Discuss AAPL here.

Data as of 6/17/08
All dollar figures in millions except share price.

from carriers for the new iPhone 3G beyond the
purchase of the device by carriers or a commission on sales of the device by Apple."

While I'm not privy to the exact details on what all those commission structures will look like, I know that AT&T will subsidize the new iPhone. In other words, that $200 price drop is coming out of AT&T's pocket, not Apple's. It's win-win: By subsidizing $200 in up-front costs, AT&T avoids paying Apple up to twice that much in revenue per share for the next two years. I think the math is going to be particularly strong in Europe, where sales have been weak. Just think about it -- with the dollar as weak as it is, a $199 8GB iPhone is going to cost less than lunch in Paris.

As for those supposed "iPhone-killers" in the works at **Google** (NASDAQ: GOOG) and other companies ... they just got killed. It's hard to picture another manufacturer coming out with a better, cheaper product with half the sex appeal of the iPhone. And certainly not before millions of people have signed contracts that will keep them with Apple for years.

And then there's the exciting new App Store. Third-party developers will be given free reign to design applications for the iPhone, and those that win Apple's approval will be sold at a cost set by the developer (Apple takes a 30% cut).

I haven't hinged my entire argument on the iPhone, though it is currently the most exciting prong of Apple's three-legged stool. The bulk of revenue is still driven by the iPod and Mac computers. Add in Apple's deep brand loyalty (nothing will separate me from my Mac Air), and you have a sturdy stock for sure. Investors needn't worry about the steep price tag or the shares' recent climb: This stock is just booting up.

Click on any company's name in the table below to jump directly to our review.

Scroll left/right to view wide tables

Amedisys	Apple	Atwood Oceanics	Canadian National Railway
Charles Schwab	Marvel	Netflix	Netgear
Omniture	Time Warner	Whole Foods	

Buy

What follows is expanded coverage of Team David's top stocks for new money. For guidance on all of Team David's stocks, see the Report Card.

Marvel

Scroll left/right to view wide tables

Recent Share Price	52-Week Range	Action
$34.17	$21.21-$37.41	BUY

If you're afraid you've missed the boat on one of the best-performing stocks in Fooldom, don't be: We think **Marvel Entertainment** (NYSE: MVL) -- our first stock to multiply 10 times in value (in less than six years!) -- has plenty of life left.

We're big fans of the Marvel brand and its extensive 5,000-member library of superheroes. Its core operations (publishing, licensing, and toys) continue to grow at impressive rates, and all of a sudden, it's morphed itself into a major Hollywood player.

Although we spend as much time with action figures as the next comic book geek, it's the movie-making aspect that has our attention right now. Not only will this buffer the company's future revenue stream, but it will act as a powerful catalyst in each of the existing segments. In other words, while Marvel is boosting its bottom line with box office revenue and DVD sales, it's showing hours-long advertisements for its existing products (which people incidentally pay a lot of money to see -- brilliant!). We can't help but marvel (sorry) at this kind of economic beauty.

We're hoping Marvel will manage to cultivate a few more franchise superstars (a la *Spider-Man* and *X-Men*, whose movie rights are already spoken for). *Iron Man* soared into town and proved himself at the box office this spring -- and it seems as if *The Incredible Hulk* is well on his way.

It'll be two years before Marvel releases its next in-house production, but the best part about the superhero biz is that it's not a fad. People love their superheroes, and as the owner and supplier of these characters, Marvel is sitting pretty.

So if you own shares, congratulations! Don't hesitate to buy more. If you're in search of a solid stock with blockbuster potential, Marvel's the one.

Netflix

Scroll left/right to view wide tables

Recent Share Price	52-Week Range	Action
$31.30	$15.62-$40.90	BUY

Things might get awkward around the holiday table now that Tom has publicly praised Duke, archrival of David's beloved UNC Tar Heels, but at least the brothers still have **Netflix** (NASDAQ: NFLX). This six-time recommendation is the only stock to appear on both sides of the scorecard. In Tom's review last month, he ranked the DVD-by-mail pioneer near the top, citing its 8.2 million subscribers, 100,000 DVD titles, an unmatched recommendation engine, and a business model that kicks off $85 million in free cash flow a year. Can't argue with that.

In fact, we think we're still early in this game-changing growth story. CEO Reed Hastings says his digital delivery platforms can attract "well beyond" 20 million subscribers worldwide and will eventually replace Netflix's DVD-by-mail business as the primary growth engine. The company made an important stride when it unveiled the Netflix Player in partnership with device-maker Roku. This simple $99 box can stream video from Netflix straight to your TV. We can hear all the couch potatoes rejoicing now.

Competition in the digital arena from the likes of **Apple** (NASDAQ: AAPL) and **Amazon.com** (NASDAQ: AMZN) will pose a challenge to Netflix. But their services just don't match up well against Netflix's loyal subscriber base, recommendation-and-queue system, and innovative focus on delivering movies to customers. Meanwhile, the DVD-by-mail business is far from extinct -- Blu-ray is just gaining traction -- and will continue to feed gobs of cash to Netflix's digital initiatives.

That said, a buyout of Netflix or a strategic partnership is still possible. There was talk of a deal with Microsoft to make Netflix's service available on the Xbox 360. This isn't a stretch, given that Hastings sits on Microsoft's board.

But we're not holding our breath for that type of deal. Netflix doesn't need it. We think it has years of upside as a stand-alone company -- so with shares off a good 25% from their recent high, take this opportunity to build or add to your position in one of the best growth stories out there.

Canadian National Railway

Scroll left/right to view wide tables

Recent Share Price	52-Week Range	Action
$49.95	$41.89-$58.50	BUY

Do you think fuel prices are going to stay high? Will commodities remain in top demand? Does Warren Buffett know a thing or two when it comes to reading the tea leaves on an industry?

If you answered yes to these questions, you should take a peek at railroads for your next investment -- specifically, **Canadian National Railway** (NYSE: CNI). Its margins far outstrip its rivals, and it boasts superior return on equity and a better balance sheet than almost all other large railways. It's also the only railway to cross North America both East-West and North-South, with the most proximate ports to Asia.

We feel this is a pretty safe bet, and for this kind of relative security you can usually expect to trade in some of the potential returns you might see with a riskier stock. So while we've never been predicting Canadian National to triple in the next few years, we're pleased to see this stock up almost 10% just three months after being singled out -- and the 1.7% dividend yield doesn't hurt.

We see this company valued at substantially more than it is today, so if you haven't invested yet, you've by no means missed the boat ... er, rather, you can still catch the train.

Omniture

Scroll left/right to view wide tables

Recent Share Price	52-Week Range	Action
$23.13	$19.07-$38.57	BUY

When your business revolves around selling a product that **Google** (NASDAQ: GOOG) essentially gives away for free, the going can be tough. Two-time recommendation **Omniture** (Nasdaq: OMTR), which provides business optimization software, has proved that point, with shares getting hammered to the tune of 30% so far in 2008.

But we know that Google alone can't account for all of the headwinds hitting Omniture. We've witnessed an incredible flight to safety among investors who desperately want to leave behind any stock containing the words *growth* or *tech* -- or a combination of the two. It's simply not a good time to be a fast-grower that has yet to produce a cent on the bottom line -- and that's precisely what Omniture is.

But we're standing our ground on this one. Omniture commands greater market share than Google, regularly locks up long-term contracts with Fortune 500 businesses, and obviously gets *paid* for its efforts. But it also offers a fully superior product, as evident in its staggeringly high rate of repeat customers (95%). For a company dealing in the e-commerce space, that's world-class good. Trust us.

Unfortunately, the competition (Google) can afford to give away its product for free, which is part of the risk for Omniture. But it's overcome this hurdle so far by targeting a different crowd (bigger companies) with what we believe is a superior product. The customers are well-heeled, will pay up for the best solutions, and seem to respond better to Omniture's extensive software suite.

Omniture is not an investment for the weak-willed: It comes with greater risk than many of our recommendations. But it also comes with more potential reward, and we think Omniture is going to delight shareholders from here.

Amedisys

Scroll left/right to view wide tables

Recent Share Price	52-Week Range	Action
$52.53	$34.27-$53.50	BUY

This home health-care and hospice provider has colored our scorecard with a nice bit of green by doing exactly what we expected. **Amedisys** (NASDAQ: AMED) has used its leverage as one of the two industry big dogs (the other is Gentiva Health Services) to roll up the small players. The fact that it's managed to do this without amassing excessive debt or slowing growth as it digests new acquisitions supports our faith in the quality of management and its advantages over rivals in the space. An aging population also works in Amedisys' favor.

In the most recent quarter, revenue was up 39% year over year and net income climbed 24%. February's acquisition of TLC Healthcare -- which will start adding to Amedisys' bottom line in 2009 -- brought on an additional 92 home health and 11 hospice facilities, and Amedisys acquired even more locations in June. TLC is concentrated in California and the northeast, producing higher average revenue per case than the rest of Amedisys. That's one reason we think this stock, trading at 16 times estimated 2009 earnings, still has a lot of gains ahead of it.

Even with the consolidation, Amedisys' revenue this year will represent less than 2% of total home health-care spending in the United States. With the number of Medicare participants expected to nearly double to 79 million by 2030, the demand for home health and hospice services will keep Amedisys growing organically (it plans to open 40 new home health facilities this year).

There's no question that this healthy company deserves a spot in your portfolio. Now grab some shares today and call us in the morning.

Atwood Oceanics

Scroll left/right to view wide tables

Recent Share Price	52-Week Range	Action
$106.96	$61.02-$113.56	BUY

Investors in **Atwood Oceanics** (NYSE: ATW) can afford a little smile as they empty their wallets at the gas station. High-priced oil is being driven by high demand, and demand is driving frantic exploration. And there sits Atwood, with eight -- soon to be nine -- platforms plying the world's oceans for new sources of black gold (Texas tea).

Rising dayrates for rigs have driven higher profits, with net income up 31% in the most recent quarter over the prior year. That's hardly a surprise -- one of the appeals of this business is the long-term contracts, so barring a disaster that takes a rig offline, we have a pretty clear idea what earnings will look like for the rest of the year. By the same token, the rig days are only 38% booked for 2009 and just 11% booked for 2010, so the company can continue to take advantage of dayrate hikes as it fills in its calendar.

Better yet, Atwood has added two new rigs. The Aurora, a shallow-water platform, comes online in November. And in 2011, construction should be complete on a deep-water submersible rig that can drill to a depth of 32,000 feet. That's going to fill a gap in the company's capabilities, as it didn't have a true deep-water rig before.

Yes, dayrates could move down, but we think Atwood is on the right side of this whole crazy supply and-demand thing. And sure, this stock has put in a solid performance on our scorecard so far, but at just 10 times 2009 earnings, and with new capacity coming online, we think this one has plenty of room to go deep.

Netgear

Scroll left/right to view wide tables

Recent Share Price	52-Week Range	Action
$15.99	$15.26-$41.33	BUY

Benjamin Graham's Mr. Market analogy is a perfect illustration of investing. As we know, Mr. Market, an odd man, knocks on our doors every trading day and offers us the simple choice of whether to buy stocks at his quoted price. We're under no obligation to buy, and most of the time it's in our best interest to decline his offer. But Mr. Market is also a fickle man who can be overly pessimistic. And this occasionally presents us with quite the opportunity.

We think that's the case with **Netgear** (NASDAQ: NTGR), a manufacturer of wireless routers and other connectivity devices. Mr. Market has been down on Netgear for quite a while, and this time we think he's gone overboard.

Netgear derives 38% of its revenue from U.S. sales -- and that figure is decreasing every year. But it's picking up the slack internationally, where the need for top-of-the-line wireless equipment is real and populations have the means to acquire it. Yet Mr. Market is treating this company like it's among the worst provincial investment opportunities out there.

Reject that assumption.

Netgear has a sterling balance sheet, produces nice levels of free cash flow, and should continue to grow at a strong rate for years to come. It's a top buy today.

Charles Schwab

Scroll left/right to view wide tables

Recent Share Price	52-Week Range	Action

Recent Share Price	52-Week Range	Action
$22.35	$17.41-$25.72	BUY

Did someone forget to tell **Charles Schwab** (Nasdaq: SCHW) that we're in the middle of a nasty housing slump and credit crunch? Our favorite online broker and financial services company gathered $41 billion of net new client assets in the first quarter of 2008. Trading activity among the company's brokerage clients was strong, and first-quarter results showed that year-over-year profits came through with a stellar 29% increase.

All this in the face of the S&P 500's worst quarterly performance in five years.

The secret to Schwab's success can be put squarely on its rapid and successful evolution from primarily a discount brokerage business to a full-fledged financial services company. Today, less than 20% of net revenue comes from trading commissions. The nontrading businesses, including mutual funds, banking, and financial advisory services, are attracting new clients and steady inflows of assets, supplanting the slower-growing brokerage business as the firm's primary growth engine.

Schwab is becoming the one-stop shop for millions of investors. Though some competitors have stumbled recently, our very first *Stock Advisor* recommendation continues to grab serious market share. Just imagine how Chuck will do once this pesky bear market goes back into hibernation. If you're looking for an investment that can deliver years of market-beating returns, log on to your favorite online brokerage account (hopefully Schwab) and place your order today.

Whole Foods

Scroll left/right to view wide tables

Recent Share Price	52-Week Range	Action
$26.88	$26.71-$53.65	BUY

This two-time recommendation has withered on the vine, but we still believe in the power of the **Whole Foods** (Nasdaq: WFMI) brand and experience to drive long-term growth and maintain its edge over other grocery chains.

The latter statement would have once seemed obvious, but that's no longer the case. Whole Foods has an enterprise value that's 0.6 times trailing sales -- no longer much of a premium to **Safeway**'s (NYSE: SWY) 0.5 trailing EV-to-sales multiple, especially when you consider that Whole Foods traditionally has far superior margins (although the Wild Oats acquisition is currently eating those).

In one sense, today's difficult environment for Whole Foods would not seem to bode well for its future. Food prices are soaring, and some consumers who might otherwise shop at Whole Foods are finding it more cost effective to frequent conventional grocers. It's this scenario that has the stock trading near four-year lows. However, while these marginal customers may choose to forgo organic produce, many others have made a lifestyle commitment and are unlikely to change their habits.

Here's a little more food for thought: A recent *New York Times* article observed that some of the forces pushing up food prices could actually start to level the playing field, price-wise, between traditionally farmed food and food produced locally with fewer fossil fuel inputs. Whole Foods is positioned to take advantage, catering to the "locavore" movement as well as conventional organics. This is only theoretical right now, because organic prices have also gone up, but we think it's simply wrong to argue that an environment of rising prices will only favor the cheapest possible goods.

Whole Foods will continue to see growth from the new Wild Oats stores, its own expansion, and, we expect, same-store sales. As it moves toward $12 billion in sales by the end of 2010, we could see the stock move closer to its traditional 1.0 price-to-sales multiple -- and that would mean more than a triple from today's levels. But even with slower growth and a lower multiple, we see the stock posting respectable returns from here.

Sell

What follows is coverage of Time Warner, the only stock David and the team recommend selling today. For guidance on all of David's stocks, see the Report Card.

Time Warner

Scroll left/right to view wide tables

Recent Share Price	52-Week Range	Action
$15.02	$13.65-$21.97	SELL

To quote Popeye, the spinach-toting sailorman, "That's all I can stands, and I can't stands no more!" At this point, we've had all we can stand of media giant **Time Warner** (NYSE: TWX).

Shares have been on a downward spiral since their peak days in the 2000 dot-com bubble and never mounted a sustained recovery. This has made for a lousy investment on our scorecard -- and one we're ready to cut loose today.

A variety of things have gone wrong with Time Warner, not the least of which includes questionable managerial leadership, poor operational execution, misguided strategic efforts, and significant shifts in the consumer landscape. These problems have spawned a bloated giant incapable of adapting to consumers' needs. We still believe Time Warner has high-potential assets whose value remains locked up, but we're not convinced that the wait-and-see approach is the correct one here.

We have no visibility as to what this company will look like in years to come, and we can't know whether management will be able to recapture any of the company's lost value. The show's over, Time Warner.

David owns shares of Activision, Amazon.com, American Eagle, Apple, Best Buy, Disney, eBay, Electronic Arts, FedEx, GameStop, Marvel, Netflix, Priceline.com, Charles Schwab, Sina, Starbucks, Time Warner, and Whole Foods. Team member Matt Argersinger owns shares of Whole Foods; Nick Kapur owns shares of Omniture and Marvel. The Motley Fool owns shares of American Eagle, Best Buy, and Starbucks.