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Stock of the cycle

The company is America's biggest by market capitalization. It's beloved and slow-growing. It's buying its own shares—perhaps including a few hundred million that used to belong to Berkshire Hathaway, Inc. Its name is Apple, Inc. (AAPL on the Nasdaq), and it's an avatar of the bubbly 2024 stock market. In preview, we're bearish—or, rather, remain bearish—on it.

You may not have a position, long or short, though it's impossible to escape the financial gravity of a company that commands a 7% weighting in the S&P 500. What happens in Cupertino can't stay in Cupertino. The town's not big enough.

Measured year over year in the three months ended September, Apple's sales grew by 6.1%, faster than the 5.2% average uptick logged by the S&P 500 index components but the slowest of any member of the Magnificent 7. Tesla, Inc., the Mag 7 tortoise just ahead of Apple, grew by 7.8%.

Even so, that 6% marked Apple's fastest quarterly revenue growth in two years. There were declines in revenue and net income alike between fiscal 2022 and fiscal 2024, by 0.8% and 6.1%, respectively. Diluted earnings per share slipped to \$6.08 in fiscal 2024 from \$6.11 in fiscal 2022. The dip was striking if only because of the \$261.9 billion that management had spent to reduce the share count.

Since we had our bearish say in the issue of [Grant's dated July 22, 2022](#), AAPL has delivered a 46.8% total return, only slightly lagging the 51.2% rise in the S&P 500 (both figures include reinvested dividends). No excuses, but colleague Evan Lorenz did manage

to predict, correctly, the direction in which sales and earnings would move (it wasn't up). Apple is priced today at 36.8 times trailing earnings compared with an average of 15.8 times in the five years before Covid. At 24.7 times trailing earnings, the S&P 500 almost looks like a bargain.

On 2026 numbers, Apple is the second-most expensive member of the Mag 7 on a price-to-earnings basis, trailing only Nvidia Corp. It's a fact of which our friends at MoffettNathanson, LLC took note in assigning AAPL a grade of "neutral": "Our reticence to recommend Apple shares stems from precisely this mismatch relative to the rest of the M7—and we're admittedly a bit queasy about the valuation of the whole group."

Apple's troubles range beyond its business operations. The company has become entangled in overseas tax problems and a major U.S. antitrust action. As to taxes, suffice it to say that a \$10.2 billion tax surcharge nicked the company's fiscal 2024 net income of \$93.7 billion in a dispute that pitted, over the course of 10 years, the Irish government and Apple against the European Union and the European Court of Justice. Were tax rates of 0.0005%, levied by Ireland against the Cupertino-based Irish tax citizen, fair and just? Or did they, perhaps, constitute unlawful state aid to Apple and justify the imputation that Ireland had become the world's No.1 tax haven? Anyway, Apple is paying the alleged \$10 billion-plus deficiency with interest.

The tax bite is evidently a one-off irritant. Not so the potential damage stemming from the adverse outcome

of the antitrust case captioned *United States v. Google LLC*. On Aug. 8, U.S. District Judge Amit P. Mehta ruled that Google's search monopolizes general search services and search-text advertising alike and, in that monopolizing, violates Section 2 of the Sherman Act.

The objectionable business arrangements take the form of parent company Alphabet, Inc. paying phone manufacturers to make Google the default search engine. In its deal with Apple, Alphabet hands over 36% of the revenue from searches on iPhones and Macs; such payments will amount to 21% of Apple's estimated 2025 operating income, according to MoffettNathanson.

It will be years before the court signs off on a final remedy and before Google exhausts its inevitable appeals. Even so, such payments will likely come to an end, and a fifth of Apple's profits will stop with them. Uncertainty as to when the ax might fall has provided analysts with a pretext to omit the risks from their earnings models. For that reason and others, the Street remains bullish on Apple, with 39 of the 60 analysts covering the shares saying buy.

Perhaps the knock-on effects from the ultimate decision could lead to a more competitive market for search and phones. If so, Apple might build its own search engine to try to recapture what is today a \$25 billion stream of profits. The effort would take time and money, and who's to guarantee its success?

Alphabet owns Android, the operating system that vies with iPhone, but it allows other manufacturers—e.g.,

Rally without a reason



source: The Bloomberg

Samsung Electronics Co., Ltd.—to compete in the Android phone market. If Alphabet can no longer protect Google from competition by striking alliances with other phone manufacturers, it may become more aggressive in marketing its own line of Pixel phones. In fiscal 2024, iPhones made up 51% of Apple's total sales.

Besides, Apple has a spotty record launching products outside of its phone and computer comfort zones. Its Vision Pro, a headset mixing artificial reality and virtual reality, made its appearance in February. The price tag was \$3,499. The technology elicited raves, but customers yawned, and Apple has gone back to the drawing board for a cheaper iteration. Also in February, word leaked out that Apple was ending its 10-year quest to bring a self-driving electric car to market. Elon Musk marked the moment with a social-media post consisting of a saluting emoji and a cigarette. By way of contrast, Alphabet's Waymo unit, the world's leader in autonomous driving, has logged more than 150,000 paid rides through ride-hailing services like Uber Technologies, Inc.

Neither is Apple in the vanguard of the rush to AI. Mag 7 confrères Alphabet and Meta Platforms, Inc. have created their own artificial-intelligence models, but Apple is licensing the technology from OpenAI. Alphabet has already released AI enhancements on new Android phones that debuted

this year; Apple is releasing AI features in dribs through next March.

In phone design, too, Apple is following more than leading. On Sept. 10, Huawei Technologies Co., Ltd. inaugurated its Mate XT, a trifold phone that can expand to a 10.2-inch screen. The Information relates that Cupertino is working on its own folding phone but reportedly on a 2026 release schedule. Jony Ive, the designer who came up with many of Apple's iconic products, including the iMac, the iPod and the iPhone, is now de-

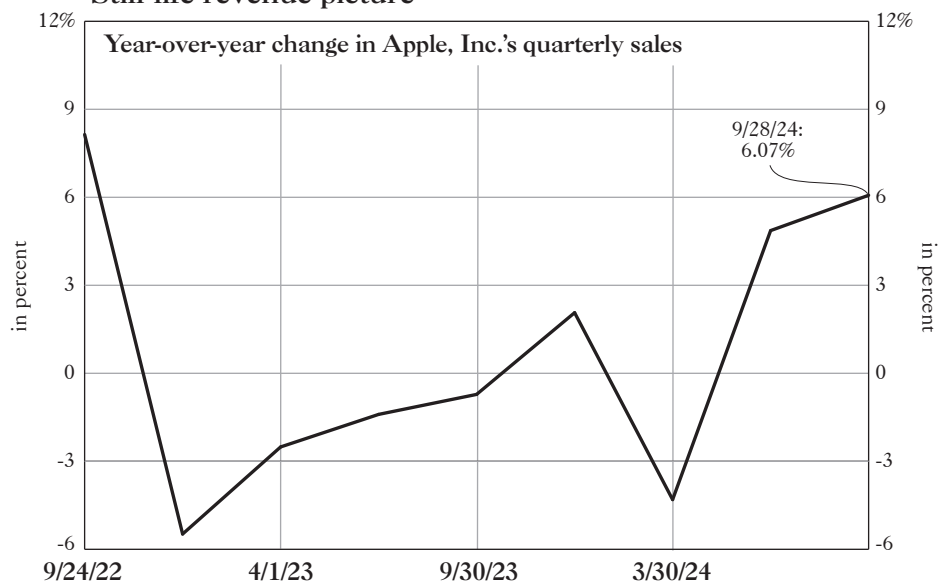
veloping a specialized AI device for OpenAI, not Apple.

The iPhone 16 line premiered on Sept. 20 without the kind of major new features that typically open retail wallets. "The iPhone 16 cycle appears weak, confirming investor concerns and initial data points, with Apple guiding to flattish revenues for [the quarter ending Dec. 31], which would point to flat-to-down iPhone revenues for FY 25, based on historical seasonality," Sanford C. Bernstein & Co. analyst Toni Sacconaghi remarked the other day. "Executives' tone on the call was more muted than usual, with commentary underscoring the slow rollout of Apple Intelligence."

A lackluster phone lineup alone is hardly enough to drive the Apple faithful into the arms of Android; the iPhone ecosystem of apps, data and accessories is easy to enter and a pleasure to reside in. Few leave it on a whim. But Apple would surely be at risk if a truly new, new thing—one that actually supplants the mobile phone—were coming down the pike.

On that score, Meta unveiled a demo of Orion on Sept. 25. It's a pair of lightweight glasses that combine augmented reality with transparent lenses. "We've been working on this one for about a decade, and it gives you a sense of where this is all going," Meta CEO Mark Zuckerberg explained on the Oct. 30 earnings call. "We're not too far off from being able

Still-life revenue picture



source: The Bloomberg

to deliver great-looking glasses that let you seamlessly blend the physical and digital worlds so you can feel present with anyone, no matter where they are. And we're starting to see the next computing platform come together, and it's pretty exciting."

The product is hardly ready for prime time (it's rumored to be too expensive

to manufacture at scale and has a battery life of just two hours). But Orion is "the most convincing demo of a post-smartphone augmented reality future that I've ever seen," according to YouTube reviewer and mega-star Marques Brownlee.

Informed investors are listening. Over the past 12 months, Apple execu-

tives have sold 1.3 million shares for proceeds of \$257.8 million. Between Dec. 31, 2023 and Sept. 30, 2024, Berkshire Hathaway cut its stake in Apple to \$69.9 billion from \$174.3 billion despite a 21% rally in the Apple share price over those nine months. Your move, Mr. Market.

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