Apple, Inc. AAPL [XNAS] | ★★★

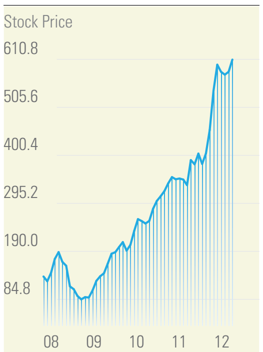
Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
621.7 USD	670.00 USD	469.00 USD	904.50 USD	Medium	Narrow	Standard		Computer Systems

As the iPhone Goes, So Does Apple; 3Q Results Below Expectations

by Michael Holt, CFA
Senior Stock Analyst
Analyst covering this company do not own its stock.

Pricing data through Aug 10, 2012.
Rating Updated as of Aug 10, 2012.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.



Analyst Note Jul. 24, 2012

Apple AAPL delivered third-quarter results below our expectations because of an unexpectedly sharp drop in iPhone shipments. We believe the headwinds are primarily short-term in nature and product-cycle driven. Competition is increasing but there is no evidence to suggest that Apple's fundamental ability to attract new customers is fading or that the lock-in of existing customers is eroding. We are maintaining our $670 fair value estimate.

Apple delivered revenue of $35 billion during the quarter, up 23% over the prior year, but down 11% sequentially and 25% from the firm's blockbuster first quarter. The iPhone and iPad account for approximately 73% of Apple's total revenue and remain the key drivers of Apple's iOS platform and the firm's overall business model. Apple shipped 26 million iPhone units this quarter, a 28% year-over-year increase, but a 26% sequential decline. The sequential decline works out to approximately 9 million units, but falls to a 6-million-unit decline after adjusting for differences in channel inventory.

We were surprised by the magnitude of the drop in iPhone unit shipments, but directionally and fundamentally, this quarter played out exactly as we expected. There are two key drivers of the iPhone softness. First, consumers are more attuned to the product release cycle and would-be customers are delaying purchases until later this year. Second, there is greater competition from Google's Android phones--larger screens and faster data connections--that can make the iPhone look stale more quickly as it ages past 6 months old.

The iPad product line was the highlight of Apple's quarter, with unit shipments rising 84% year over year and 44% sequentially. This is in line with our expectations as the third quarter represents the first full quarter of availability for both the Next Generation iPad and the discounted iPad 2.

The importance of the iPhone to Apple's bottom line is clear with the strength of iPad unit shipments unable to offset the surprise miss in iPhone shipments. Apple's gross margin fell 460 basis points to 42.8% during the quarter, largely driven by the revenue mix-shift away from the iPhone. In the second quarter, the iPhone delivered 58% of Apple's revenue--in the third quarter the revenue contribution from iPhone fell to 46%. Also contributing to the decline in Apple's gross profitability is the growing proportion of older generation devices as a percentage of iPhones and iPads sold.

This quarter also delivered one of the first signs that our long-term thesis on product mix is beginning to play out, with the average sale price of both the iPhone and the iPad falling approximately 4% sequentially. We have long held that Apple will need to offer products at lower price points in order to drive unit growth during the next few years, especially as the center of the smartphone transition shifts from developed to emerging economies. Apple has a plan in place, offering older versions of its products, the iPad 2 and the iPhone 4 concurrently with the latest and greatest iterations of these devices. Until now, however, the insatiable demand for the very latest device has kept average selling prices from falling. The product mix-shift has become more pronounced this quarter because the iPhone 4S has been out for three quarters and Apple began offering the iPad2 at the lower $399 price point. We expect prices to continue falling and will be watching the rate of decline closely during the next several years.

The true test for Apple was not this quarter, nor is it the fourth quarter. In fact, we expect to see greater volatility in Apple's quarterly results going forward due to the growing importance of the product cycle. It will not be until the next generation iPhone launches that investors will get a true reading of Apple's positioning in the market. We maintain that the next iPhone launch will demonstrate Apple's continued ability to assimilate new users and retain the existing user base by layering on additional sticky services. In the meantime, any pullback in the stock that would send this Apple's shares toward our 5-star price and below $500 would provide investors with an excellent opportunity to own

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Close Competitors	Currency (Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Microsoft Corporation	USD	255,023	73,723	21,763	16,978
Google, Inc.	USD	209,955	43,162	13,156	11,108
Hewlett-Packard Co	USD	38,845	124,040	7,579	5,226
Dell Inc	USD	21,705	61,476	4,043	3,182
Sony Corporation	USD	12,397	81,158	-1,103	-5,804

this high-quality name with an attractive margin of safety.

Thesis Apr. 04, 2012

The list of once-great consumer electronics companies is long, but Apple has staying power because it has developed an ecosystem that connects success in one generation of devices to successive consumer purchases.

Apple is transcending the risks of the classic product cycle. Historically, consumer electronics companies have competed for the consumer's attention with the latest and greatest gadgets. Success of this type has proved fleeting, as brand loyalty is largely dead. For example, when shopping for televisions, customers look for the best combination of price and features, with few consequences arising when they replace a Sony with a Vizio. In handsets, the Motorola Razr was a breakthrough phone that dominated the market, but Motorola fell apart because it misfired on the following product cycle and lacked a connection that would pull the user from one generation of the Razr to the next. A Dell PC is easily replaced with a Hewlett-Packard PC, but for decades the user likely would be running Microsoft Windows. Apple is replicating what worked for Windows, minimizing the risk of losing customers between product cycles by using software to connect the user to not just a single device, but an ecosystem of applications and content spanning multiple devices and creating a relationship that survives the useful life of any single device.

The key difference for Apple is iOS, the operating system that spans the company's portfolio of devices. IOS envelops the user in an ecosystem of applications and content that makes it inconvenient to switch to another vendor's device down the road. A typical Apple user experience may begin with an iPod or an iPhone. The user builds a content library, a collection of applications, and routines that are not convenient to move to a competitor's device. Once the consumer enters the market for a replacement phone or additional device (tablet), the cards are stacked in Apple's favor because of the existing dependence on iOS. Once multiple devices are in place, the switching costs are magnified, because many people will be reluctant to replace their phone, tablet, and possibly other devices at the same time, but equally reluctant to split their Web and media consumption habits between ecosystems. Competitors' devices will not always be inferior, but Apple is capturing a large portion of a user base that is trading freedom of choice for an enhanced user experience.

Apple's economic moat may be widening with iCloud. We believe iCloud takes switching costs to the next level by creating a virtual presence in the cloud that encapsulates all of the consumer's communications, preferences, and content, breaking the tether to any specific device. The bond created between the user and the presence in the cloud is perpetual, and much stronger than the bond between a user and any specific device with a limited life span. The service itself may not generate tens of billions of dollars, but it secures the customer and makes it more desirable to interact with multiple devices.

The Apple story is not without risks. Co-founder and former CEO Steve Jobs was special, and even if those who follow him bring the rare combination of vision and ability to execute, it remains to be seen if they will inherit the moral authority that enabled Jobs to drive his agenda. Additionally, HTML5 and other platform-agnostic technologies could provide users with access to third-party applications on devices from all manufacturers. Finally, a stumble (albeit unlikely) on a product cycle in the early innings of smartphone adoption would come with a tremendous opportunity cost in terms of lost users. Users are only locked into Apple's ecosystem after they join, so as the nascent market emerges, each user that falls into a competitor's ecosystem carries away a significant loss of value. However, Apple already has established a narrow moat, and it will be

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some time before these issues present a risk to the growth of its customer universe.

Valuation, Growth and Profitability

We are raising our fair value estimate to $670 from $560 per share to account for greater near-term momentum with the iPhone and iPad than we had originally forecast, and more optimistic assumptions about the long-term gross margin of these two product lines.

The iPhone remains the cornerstone of Apple's consumer strategy, and few opportunities loom larger than the global handset market. The iPhone already accounts for more than 50% of revenue, and we expect this percentage to grow during the forecast period with the iPhone and iPad delivering more than 80% of Apple's revenue and gross profit by 2016. We envision a total addressable market of approximately 1 billion smartphones by 2015, with Apple claiming approximately 26% of the market. Though Apple has dominated the high end of the smartphone market to date, we estimate that budget iPhones will account for nearly half of the 300 million smartphone units we are projecting that Apple will ship in fiscal 2016. The concurrent availability of multiple iPhone versions at different price points will ensure the broadest possible market penetration. However, we anticipate that this product mix-shift will appear on the financial statements in the form of revenue growth, trailing unit growth and margin compression in key segments. The key revision to our prior model is that we forecast budget iPhones to plateau at 60% of iPhone shipments (down from 70%) and that premium iPhones should be able to sustain a gross margin in the mid-40s (up from the low-40s).

A similar dynamic is likely play out in the iPad segment with premium and budget models, but we expect a much lower impact on margins between the two models. Based on teardowns by industry analysts and our own estimates, we believe the iPad is already selling at a much lower gross margin than the iPhone (lower 30s versus lower 50s). Therefore, we model only modest gross margin deterioration in this segment, even though we project that Apple will launch alternative form factors to compete with the 7-inch Kindle Fire and 7-inch Android alternatives. We are now projecting that iPad shipments will jump from 32 million units in fiscal 2011 to more than 150 million units in fiscal 2016.

We anticipate firmwide gross margins will fall during the forecast period from 40% to the mid-30% range. Though the firm's economic moat will drive impressive returns, we believe increased competition will provide some pressure on Apple's pricing power.

Risk

In our view, Apple's success during the last decade is largely attributable to the leadership of Steve Jobs, and his passing has dealt a heavy blow to the company. We think CEO Tim Cook is an able manager and Apple has an extremely deep talent pool. But we also believe Jobs' product- and user-focused vision had been instrumental to Apple's renaissance and had served investors incredibly well. There is clearly some continuity in the transition, and a full pipeline of Jobs-approved launches will drive the firm forward for a few years, but Jobs' death chips away at our faith that Apple can continue to innovate faster and better than competitors in the long run. Ultimately, asking "What would Steve do?" is a lot easier than getting the answer correct.

Apple has created a powerful position in the minds of consumers, but its current feature set only creates moderate switching costs, in our opinion. Long-term value creation will be a function of Apple's ability to raise these switching costs with iCloud.

Finally, any stumble in the early product cycle as smartphone adoption sweeps the globe would come with a tremendous opportunity cost in terms of lost users. Users are only locked into Apple's ecosystem after they join, so as the nascent market emerges, each user who falls into a competitor's ecosystem carries away a significant loss of value.

Bulls Say

- Unlike hardware-focused consumer electronics firms, Apple's expertise in software and content provides a bridge from one generation of devices to the next.
- As users become more tethered to Apple's iOS ecosystem rather than a specific device, integrating additional Apple devices into users' routines becomes seamless.
- Apple's retail stores provide a platform for exposing new consumers to the breadth of the company's expanding product line.

Bears Say

- The ultimate size of the global handset and tablet markets remains ambiguous. While the high end is secure, if Apple fails to penetrate the masses in emerging markets, revenue growth could slow dramatically.
- More than 40% of Apple's revenue comes from the iPhone line, and our valuation assumes that the iPad becomes a significant growth driver. If either the iPhone or iPad disappoints, our fair value estimate will fall.
- Apple's sales are concentrated in the United States, exposing the firm to significant customer concentration risk in the event of a big economic downturn. Although the firm has a significant international presence, the high price points of its products could limit growth in emerging markets.

Financial Overview

Financial Health:The company has $30 billion in cash and short-term investments, holds another $68 billion in long-term investments, and generated more than $33 billion in free cash flow during fiscal 2011. It carries no debt.

Company Overview

Profile: Apple designs consumer electronic devices, including PCs (Mac), tablets (iPad), phones (iPhone), and portable music players (iPod). Its iTunes online store is the largest music distributor in the world; it sells and rents TV shows and movies and sells applications for the iPhone and iPad. In early 2011, Apple launched the Mac app store, an online store that sells first- and third-party applications for Mac desktop and notebook computers. Apple's products are distributed online as well as through company-owned stores and third-party retailers.

Management: Steve Jobs' passing was a major blow for Apple, as he was an irreplaceable leader. Nonetheless, the co-founder of Apple established a sustainable culture and strategy for the firm and we expect the current management team has enough structure and momentum to deliver a long period of success. Jobs personally recruited much of the current management team, and most have worked with him for a long time. CEO Tim Cook came to Apple from Compaq in 1998. CFO Peter Oppenheimer has been with the company since 1996. Nonetheless, Jobs was special, and even if those who follow him bring the rare combination of vision and ability to execute, it remains to be seen if they will inherit the moral authority that enabled Jobs to drive his agenda.

The stock-option backdating scandal raises our stewardship concerns, but we believe aggressive moves by the board have enabled the company to turn the page. Apple has taken other steps in the right direction, including the appointment of lead co-directors in 2006. The majority of executive compensation is aligned with shareholder interests in the form of restricted stock units tied to long-term company performance. We applaud the board's long-term view in awarding Cook 1 million options vesting over 10 years, aligning his long-term interests with those of shareholders.

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Apple delivered revenue of $35 billion during the quarter, up 23% over the prior year, but down 11% sequentially and 25% from the firm's blockbuster first quarter. The iPhone and iPad account for approximately 73% of Apple's total revenue and remain the key drivers of Apple's iOS platform and the firm's overall business model. Apple shipped 26 million iPhone units this quarter, a 28% year-over-year increase, but a 26% sequential decline. The sequential decline works out to approximately 9 million units, but falls to a 6-million-unit decline after adjusting for differences in channel inventory.

We were surprised by the magnitude of the drop in iPhone unit shipments, but directionally and fundamentally, this quarter played out exactly as we expected. There are two key drivers of the iPhone softness. First, consumers are more attuned to the product release cycle and would-be customers are delaying purchases until later this year. Second, there is greater competition from Google's Android phones--larger screens and faster data connections--that can make the iPhone look stale more quickly as it ages past 6 months old.

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This quarter also delivered one of the first signs that our long-term thesis on product mix is beginning to play out, with the average sale price of both the iPhone and the iPad falling approximately 4% sequentially. We have long held that Apple will need to offer products at lower price points in order to drive unit growth during the next few years, especially as the center of the smartphone transition shifts from developed to emerging economies. Apple has a plan in place, offering older versions of its products, the iPad 2 and the iPhone 4 concurrently with the latest and greatest iterations of these devices. Until now, however, the insatiable demand for the very latest device has kept average selling prices from falling. The product mix-shift has become more pronounced this quarter because the iPhone 4S has been out for three quarters and Apple began offering the iPad2 at the lower $399 price point. We expect prices to continue falling and will be watching the rate of decline closely during the next several years.

The true test for Apple was not this quarter, nor is it the fourth quarter. In fact, we expect to see greater volatility in Apple's quarterly results going forward due to the growing importance of the product cycle. It will not be until the next generation iPhone launches that investors will get a true reading of Apple's positioning in the market. We maintain that the next iPhone launch will demonstrate Apple's continued ability to assimilate new users and retain the existing user base by layering on additional sticky services. In the meantime, any pullback in the stock that would send this Apple's shares toward our 5-star price and below $500 would provide investors with an excellent opportunity to own this high-quality name with an attractive margin of safety.

Surging iPhone Sales Propel Apple to Another Stellar Quarter Apr. 24, 2012

Apple AAPL delivered tremendous results for the March-ending quarter, exceeding our near-term expectations. We are maintaining our fair value estimate of $670 per share. Total revenue of $39 billion was Apple's second-highest quarterly total, representing a 59% increase over the prior-year quarter. Apple's cash and investments on hand now total $110 billion, or $118 per share. The clear standout metric, however, was Apple's gross margin of 47.4%, up 600 basis points year over year and 270 basis points sequentially. The ability to expand the gross margin and deliver massive unit shipment growth signals that Apple is having no trouble moving premium-priced units. With nearly 75% of revenue derived from the iPhone and iPad, these product segments are clearly the driving force behind Apple's momentum. The March quarter represented a sequential decline in key unit shipments, but following the blockbuster December quarter, this was to be expected. Year-over-year unit shipment growth of 88% and 151% for the iPhone and iPad, respectively, was a strong showing for Apple, considering it was the second quarter of availability for the current generation iPhone and that the third generation iPad was only on the market for a few weeks during the quarter.

Despite Apple's near-term momentum, we are reluctant to change our longer-term forecast based on this quarter, though we are lowering the uncertainty rating to medium to reflect the stability of the firm's cash generation. As we look over a longer forecast period, we believe a product mix-shift could dampen Apple's earnings trajectory, even given our high expectations around unit shipment growth. There is no evidence to suggest that we have reached the inflection point in Apple's ascent yet, but a key issue for investors to determine is if Apple can continue its current growth trajectory as the smartphone market in the U.S. and other developing markets begins to mature. Clear opportunities exist in emerging markets. China, for example, is positioned to account for a greater percentage of smartphone shipments in 2012 than the United States and it delivers a much longer runway for smartphone growth. We believe Apple will successfully build its user base in these geographies. However, in addressing a market that lacks carrier subsidies and has more price-sensitive consumers, success against lower-priced Android phones could come from a higher mix of older models that could drive down the average sales prices and gross margins of its devices.

In order to analyze the impact of this potential shift in Apple's product mix, we are closely tracking two key indicators: the average revenue per iPhone and iPad. During the March quarter, the average revenue per iPhone shipped was $643, down just 1.9% year over year. Similarly, the average revenue per iPad shipped was $559, down 7.5% year over year. As we expected, this indicates that Apple is not yet experiencing the financial pressure of the potential product mix-shift. Over time, however, we suspect this mix-shift could be the key driver of Apple's results.

Looking ahead, Apple's guidance of $34 billion in revenue for the third fiscal quarter and a 41.5% gross margin sets a low

Analyst Notes (continued)

bar, but we are forecasting a decline in both of these metrics. As we enter the later stages of the current iPhone's product cycle, there should be less benefit from launching in new geographies (the iPhone 4S launched in China during the March quarter), a few million less units shipped into channel inventory as supply and demand have balanced, and some demand being shifted into later quarters as consumers begin speculating about the availability of the next generation iPhone. On the gross margin side, management commented that roughly two thirds of the projected decline will be from product mix-shifts and an additional one third will be from reduced leverage and the loss of other nonrecurring benefits realized during the March quarter. Therefore, while we expect Apple to exceed the low bar it has set, the general direction of the firm's guidance is in line with our forecast.

Raising Apple's Fair Value Estimate to $670 Apr. 04, 2012

We are raising our fair value estimate for Apple AAPL to $670 from $560 per share to account for greater near-term momentum with the iPhone and iPad than we had originally forecast and more optimistic assumptions about the long-term gross margin of these two product lines.

The iPhone remains the cornerstone of Apple's consumer strategy, and few opportunities loom larger than the global handset market. The iPhone already accounts for more than 50% of revenue, and we expect this percentage to grow during the forecast period with the iPhone and iPad delivering more than 80% of Apple's revenue and gross profit by 2016. We envision a total addressable market of approximately 1 billion smartphones by 2015, with Apple claiming approximately 26% of the market. Though Apple has dominated the high-end of the smartphone market to date, we estimate that budget iPhones will account for nearly half of the 300 million smartphone units we are projecting that Apple will ship in fiscal 2016. The concurrent availability of multiple iPhone versions at different price points will ensure the broadest possible market penetration. However, we anticipate that this product mix-shift will appear on the financial statements in the form of revenue growth trailing unit growth and margin compression in key segments. The key revision to our prior model is that we are forecasting budget iPhones to plateau at 60% of iPhone shipments (down from 70%) and that premium iPhones should be able to sustain a gross margin in the mid-40s (up from the low-40s).

A similar dynamic is likely play out in the iPad segment with premium and budget models, but we expect a much lower impact on margins between the two models. Based on teardowns by industry analysts and our own estimates, we believe the iPad is already selling at a much lower gross margin than the iPhone (lower 30s versus lower 50s). Therefore, we model only modest gross margin deterioration in this segment, even though we project that Apple will launch alternative form factors to compete with the 7-inch Kindle Fire and 7-inch Android alternatives. We are now projecting that iPad shipments will jump from 32 million units in fiscal 2011 to more than 150 million units in fiscal 2016.

Apple's near-term momentum continues to look unstoppable, with challengers still scrambling to roll out viable substitutes and a stream of software and services that are increasing lock-in to the iOS platform. Triple-digit growth rates will abate, but Apple still enjoys a long runway of profitable growth.

Apple Puts War Chest to Work Mar. 19, 2012

Apple AAPL announced a dividend and share repurchase program this morning, expecting to utilize approximately $45 billion of domestic cash during the next three years. Apple

Analyst Notes (continued)

plans to initiate a quarterly dividend of $2.65 per share beginning in the September-ending quarter of this year. At the current share price this represents a yield of approximately 1.8% per share. In addition, the company's board of directors has authorized a $10 billion share repurchase program with the aim of neutralizing dilution from employee equity grants and stock purchase programs. The third use of cash will be Apple's program to adjust unvested RSUs to account for the dividend.

We view this move as a positive for Apple, but our fair value estimate does not change as this simply represents a partial distribution of the $98 billion in cash and investments that we were already accounting for in our fair value estimate. This move is a positive, however, because it lowers the risk that Apple will pursue aggressive acquisitions or other riskier uses of cash. This move could also generate interest in the stock from shareholders that have a dividend focus. Furthermore, given the massive amount of cash available to Apple, this program will not limit Apple's strategic moves for the foreseeable future. The largest remaining question surrounding Apple's cash and investments is if the firm will be forced to pay tax on repatriating the funds (currently two thirds of total or $64 billion) that are domiciled in international jurisdictions. In the current political climate, we assume that Apple will be forced to take a tax hit on the funds located overseas.

Our valuation, however, is more sensitive to our assumptions around the market sizes for smartphones and tablets, and how Apple's gross margin profile changes as it penetrates more deeply into the emerging markets.

The new iPad: Apple Extends its Tablet Lead Mar. 07, 2012

The new iPad was unveiled today at Apple's AAPL highly anticipated launch event. Key hardware upgrades and a familiar price point positions the iPad as an attractive successor to the very successful iPad 2. More importantly, however, it cements Apple's technological lead over the tablet competition at a critical point in time for the emerging tablet market.

The new iPad boasts upgrades, including a sharper screen, faster data connectivity, a more powerful processor, and a higher-quality camera. These upgrades, especially the higher resolution screen, are features that we expect will resonate with mainstream consumers. In the smartphone market, Android phones have largely closed the technological gap with the iPhone. In contrast, we believe the new iPad cements Apple's technological advantage over the tablet competition for the foreseeable future.

This technological advantage is a critical component of Apple's strategy to lock users into the iOS platform. As the platform wars evolve, the iOS and Android ecosystems are becoming stickier, with customers less likely to switch back and forth between platforms with each subsequent device purchase. Therefore, the most effective way to acquire a sticky customer is to bring them into your ecosystem by winning their mindshare on the initial device purchase. Though the new iPad is clearly differentiated from its predecessor, the iPad 2, it is more important right now to focus on Apple's ability to secure its share of initial tablet purchases, rather than debate the upgrade pattern of existing iOS users.

In an effort to capture a greater share of price-sensitive customers, Apple is going to continue offering the now year-old iPad 2 at a reduced price. Apple is replicating the strategy it employs in the smartphone market to fend off lower-priced alternatives. Price has been the only effective

Analyst Notes (continued)

weapon available to tablet competitors, as we can see by comparing the success of Amazon's $199 Kindle Fire with dozens of other tablet launches. By lowering the price of the iPad 2 to $399, Apple is positioning itself to avoid ceding large chunks of market share to low-cost products. We were anticipating a greater discount to be offered on the iPad 2 because at $199, the Kindle Fire still offers a significant discount--even though at 7 inches, the Fire is a smaller class of device. This may indicate that Apple intends to launch a competing 7-inch device in response to the Kindle Fire and the additional low-cost, Android-based tablets that we expect to hit the market during the next two years. The greatest risk of offering both devices is that as the technological gap narrows, sales of the higher-margin device could be cannibalized.

The iPhone remains the most important device in Apple's product portfolio. Nonetheless, the tablet market could challenge the PC market in terms of unit shipments during the next 10 years and the iPad is establishing itself as the second-most important device driving Apple's success. In the near term, the combination of another solid product launch and disorganized competition suggest Apple's current momentum is unstoppable.

Apple, Inc. AAPL

Sales USD Mil	Mkt Cap USD Mil	Industry	Sector
148,812	581,876	Computer Systems	Technology

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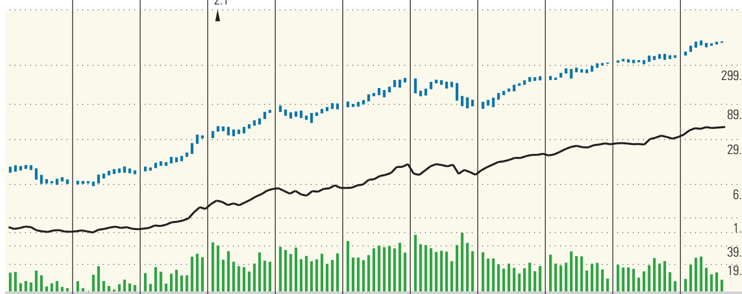
Morningstar Rating	Last Price	Fair Value	Uncertainty	Economic Moat™	Stewardship
—	620.73	—	—	—	—

per share prices in USD

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD
Annual Price High	13.09	12.51	34.78	75.46	93.16	202.96	200.26	213.95	326.66	426.70	644.00
Low	6.68	6.36	10.59	31.30	50.25	81.90	79.14	78.20	190.25	310.50	405.00
Recent Splits				2:1							



Price Volatility
Monthly High/Low
Rel Strength to S&P 500
52 week High/Low
644.00 - 354.24
10 Year High/Low
644.00 - 6.36
Bear-Market Rank
6 (10=worst)
Trading Volume Million

Growth Rates Compound Annual

Grade: A	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	66.0	49.4	41.2	35.0
Operating Income %	83.8	75.3	69.0	—
Earnings/Share %	82.7	72.8	64.9	—
Dividends %	—	—	—	—
Book Value/Share %	58.0	51.4	47.7	30.9
Stock Total Return %	66.7	55.6	37.6	55.0
+/- Industry	29.8	27.0	20.8	38.2
+/- Market	41.4	44.1	38.9	52.9

Profitability Analysis

Grade: A	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	44.3	32.8	38.6	22.8
Return on Assets %	29.8	20.0	15.0	9.3
Fixed Asset Turns	17.3	16.1	11.9	7.7
Inventory Turns	82.7	55.5	21.4	17.0
Revenue/Employee USD K	2350.9	1398.8*	—	1055.7
Gross Margin %	44.1	37.7	35.6	39.7
Operating Margin %	35.6	24.9	11.2	16.6
Net Margin %	27.0	18.8	14.2	11.1
Free Cash Flow/Rev %	28.0	23.7	15.7	0.1
R&D/Rev %	2.1	0.0	—	9.5

Financial Position

Grade: A	09-11 USD Mil	06-12 USD Mil
Cash	9815	7945
Inventories	776	1122
Receivables	11717	14298
Current Assets	44988	51943
Fixed Assets	7777	10487
Intangibles	4432	5461
Total Assets	116371	162896
Payables	15772	18406
Short-Term Debt	—	—
Current Liabilities	27970	33060
Long-Term Debt	—	—
Total Liabilities	39756	51150
Total Equity	76615	111746

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	14.6	21.9	13.5	—
Forward P/E	11.5	—	—	13.2
Price/Cash Flow	11.2	14.4	10.0	—
Price/Free Cash Flow	14.0	16.7	13.2	—
Dividend Yield %	0.4	—	0.8	2.0
Price/Book	5.2	5.7	4.7	—
Price/Sales	3.9	4.0	1.9	—
PEG Ratio	0.6	—	—	0.3

Stock Performance

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	YTD	Stock Performance
-34.6	49.1	201.4	123.3	18.0	133.5	-56.9	146.9	53.1	25.6	53.9	Total Return %
-11.2	22.7	192.4	120.3	4.4	130.0	-18.4	123.5	40.3	25.6	42.4	+/- Market
-9.5	22.2	188.1	124.0	0.0	99.0	-17.7	72.8	32.3	10.8	23.8	+/- Industry
—	—	—	—	—	—	—	—	—	—	0.4	Dividend Yield %
5146	7859	25893	60587	72901	173427	75997	190983	297089	377519	581876	Market Cap USD Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Financials
5742	6207	8279	13931	19315	24006	32479	42905	65225	108249	148812	Revenue USD Mil
27.9	27.5	27.3	29.0	29.0	34.0	34.3	40.1	39.4	40.5	44.1	Gross Margin %
17	-1	326	1650	2453	4409	6275	11740	18385	33790	53007	Oper Income USD Mil
0.3	0	3.9	11.8	12.7	18.4	19.3	27.4	28.2	31.2	35.6	Operating Margin %
65	69	276	1335	1989	3496	4834	8235	14013	25922	40133	Net Income USD Mil
0.09	0.10	0.36	1.56	2.27	3.93	5.36	9.08	15.15	27.68	42.55	Earnings Per Share USD
0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	Dividends USD
724	727	775	857	878	889	902	907	925	937	943	Shares Mil
5.73	5.89	7.20	9.94	13.07	19.19	25.73	39.47	59.35	96.61	119.21	Book Value Per Share USD
89	289	934	2535	2220	5470	9596	10159	18595	37529	52149	Oper Cash Flow USD Mil
-174	-164	-176	-260	-657	-986	-1199	-1213	-2121	-7452	-10472	Cap Spending USD Mil
-85	125	758	2275	1563	4484	8397	8946	16474	30077	41677	Free Cash Flow USD Mil

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Profitability
1.1	1.1	3.7	13.6	13.8	16.4	14.9	18.9	22.8	27.1	29.8	Return on Assets %
1.6	1.7	5.9	21.3	22.8	28.5	27.2	31.3	35.3	41.7	44.3	Return on Equity %
1.1	1.1	3.3	9.6	10.3	14.6	14.9	19.2	21.5	23.9	27.0	Net Margin %
0.93	0.95	1.11	1.42	1.34	1.13	1.00	0.99	1.06	1.13	1.10	Asset Turnover
1.5	1.6	1.6	1.6	1.7	1.7	1.9	1.5	1.6	1.5	1.5	Financial Leverage

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	06-12	Financial Health
3730	3530	4375	6816	8038	12657	20598	20049	20956	17018	18883	Working Capital USD Mil
316	—	—	—	—	—	—	—	—	—	—	Long-Term Debt USD Mil
4095	4223	5076	7466	9984	14532	21030	31640	47791	76615	111746	Total Equity USD Mil
0.08	—	—	—	—	—	—	—	—	—	—	Debt/Equity

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TTM	Valuation
—	57.5	50.5	38.8	30.8	43.5	15.9	20.5	18.0	11.5	14.6	Price/Earnings
—	—	—	—	—	—	—	—	—	0.6	—	P/E vs. Market
0.9	1.2	2.6	3.8	3.6	6.7	2.3	4.1	3.9	3.0	3.9	Price/Sales
1.3	1.8	4.5	7.2	6.5	10.3	3.3	5.3	5.4	4.2	5.2	Price/Book
33.0	19.7	17.2	30.1	19.8	27.5	7.2	16.0	13.3	8.4	11.2	Price/Cash Flow

Quarterly Results

Revenue USD Mil	Sep 11	Dec 11	Mar 12	Jun 12
Most Recent Period	28270.0	46333.0	39186.0	35023.0
Prior Year Period	20343.0	26741.0	24667.0	28571.0

Rev Growth %	Sep 11	Dec 11	Mar 12	Jun 12
Most Recent Period	39.0	73.3	58.9	22.6
Prior Year Period	25.3	70.5	82.7	82.0

Earnings Per Share USD	Sep 11	Dec 11	Mar 12	Jun 12
Most Recent Period	7.05	13.87	12.30	9.32
Prior Year Period	4.64	6.43	6.40	7.79

Industry Peers by Market Cap

	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Apple, Inc.	581876	148812	14.6	44.3
Microsoft Corporatio	255694	73723	15.2	27.5
Google, Inc.	210070	43162	18.9	19.0

Major Fund Holders

	% of shares
	—
	—
	—

*3Yr Avg data is displayed in place of 5Yr Avg

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

Morningstar's Approach to Rating Stocks

Our Key Investing Concepts

- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock's fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at $40 than they were at $50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such

Morningstar Research Methodology for Valuing Companies

Competitive Analysis → **Economic Moat™ Rating** → Company Valuation → **Fair Value Estimate** → Uncertainty Assessment → ★★★★★

Competitive Analysis	Economic Moat™ Rating	Company Valuation	Fair Value Estimate	Uncertainty Assessment	★★★★★
Analyst conducts company and industry research: • Management interviews • Conference calls • Trade-show visits • Competitor, supplier, distributor, and customer interviews	The depth of the firm's competitive advantage is rated: • None • Narrow • Wide	Analyst considers company financial statements and competitive position to forecast future cash flows. Assumptions are input into a discounted cash-flow model.	DCF model leads to the firm's Fair Value Estimate, which anchors the rating framework.	An uncertainty assessment establishes the margin of safety required for the stock rating.	★ ★★ ★★★ ★★★★ ★★★★★ The current stock price relative to fair value, adjusted for uncertainty, determines the rating.

economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

Discounted Cash Flow
This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate
We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

Fair Value
This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty
To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety
This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth.The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling
The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades
Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.