

Apple's Cash Conundrum

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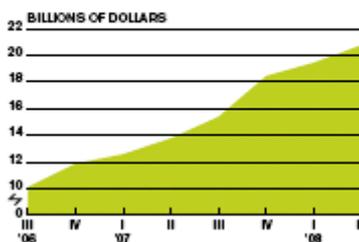


Illustration by Barry Falls

Apple Inc. (AAPL) shareholders haven't had much to carp about, with the stock up 1,474% since 2003. But if there is one complaint, it's the company's refusal to do anything with the \$20.8 billion in cash and short-term investments it has socked away. The cash just sits there, earning little more than the average savings account. "Our preference is to maintain a strong balance sheet in order to preserve our flexibility," Chief Financial Officer Peter Oppenheimer told investors earlier this year.

MONEY MOUNTAIN

Apple has recently doubled its cash



Data: Bloomberg Financial Markets

Apple's about to get a lot more flexible. While it has been adding about \$1 billion in cash each quarter, analysts predict the company's hoard could surge to nearly \$30 billion over the next year because of strong sales of computers, iPods, and iPhones. Apple may well pass Microsoft (MSFT), which has \$23.7 billion in cash. "[Apple] could have \$40 billion in the bank [in two years]," says analyst Gene Munster of Piper Jaffray (PJC).

The steep accumulation may not be obvious to investors. One reason is the way Apple accounts for iPhone sales. It books the revenue from each iPhone over 24 months because the phones are sold as part of a subscription through AT&T (T) and other carriers. But Apple gets all the money as soon as customers buy, so cash hits the balance sheet long before revenues show up. A second reason is Apple appears to be getting more for each iPhone than analysts expected. While AT&T and others charge customers \$200 for the entry-level model, some analysts now estimate the carriers pay Apple \$500 to \$600 a phone for the right to charge users lucrative service fees.

Choices, Choices

If Apple's stock keeps rising, pressure from investors to do more with its cash will remain muted. Still, some experts think it makes sense for the company to make changes, given its hefty bank account. They say Apple could seek more acquisitions, probably small ones, to hasten its expansion into new businesses. "Valuations are low, and Apple has the marketing horsepower" to turn promising technologies into hits, says Murray M. Beach, managing director at investment bank TM Capital.

One radical possibility would be for Apple to snap up content. Some analysts think the company should explore acquisitions in the music business, taking advantage of the major labels' dire straits. Though that may create conflicts, Apple could use its knowledge of shoppers to create innovative sales incentives and promote new acts. "The music industry has come to believe that their industry will be smaller," says one source close to Apple. "Apple wants it to be a bigger, more profitable industry." Apple declined to comment.

Apple has many options beyond mergers and acquisitions. With prices for raw materials skyrocketing, American Technology Research analyst Shaw Wu thinks Apple should provide funds so its suppliers can stock up before prices rise more. Apple could also take equity stakes in startups working on technologies important to its future. For example, Apple has a glaring need for better batteries for its new iPhone.

What if Apple simply keeps stuffing its mattress? Analyst Charles Wolf of Needham & Co. figures the company doesn't need more than \$5 billion on hand, but he says investors aren't likely to complain. "I'd say something if this was a sleepy company with no growth," says Wolf. "That's not Apple."

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