Apple Inc.

Those Are Some Big Numbers; Lifting Dec-12 Price Target to $715

Overweight

AAPL, AAPL US

Price: $618.63

▲ **Price Target: $715.00**
Previous: $625.00

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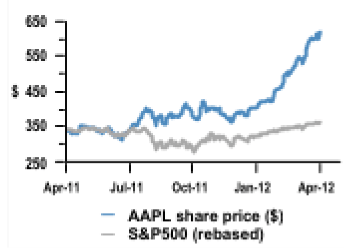
Price Performance



	YTD	1m	3m	12m
Abs	50.4%	13.5%	50.4%	81.3%
Rel	39.3%	9.9%	39.3%	74.8%

For OW-rated Apple, we are raising estimates and our Dec-12 price target to $715, vs. $625 previously. The key drivers of our estimate changes are better than expected unit sales activity of the iPhone and iPad. The purpose of our report is to highlight the incremental changes in unit growth trajectories versus our prior expectations. Looking ahead, there are plenty of potential near to mid-term catalysts, including 1) MacBook refresh, 2) iPhone refresh, and 3) increasing penetration of Asia-Pacific. Longer term, we think that the eventual introduction of Microsoft Office for the iPad should open the door for Apple to the enterprise PC segment.

- **Taking numbers higher.** We are making significant increases to our operating estimates. Our research indicates that the iPhone and iPad shipment activity in the supply chain implies major upside potential to our previous estimates. We are not trying to inflate expectations ahead of the Mar-Q print. Our intent is to communicate the incremental delta in our new and old estimates as identified by our recent research. The magnitude of the revisions, if accurate, stands to drive increased investor sponsorship of the stock in the near to mid term, in our view.
- **Big iPhone unit revisions.** Our research indicates that Mar-Q iPhone unit shipments tracked closer to 30-32 million. Our new estimate is 31.1 million, versus 28.1 million previously. We think that investors are expecting 29-31 million units. The flow-through effects of our revisions lift our new C2012 iPhone units estimate to 138.2 million, versus 128.7 million previously.
- **Big iPad unit revisions.** Our research indicates that Mar-Q iPad unit shipments tracked closer to 13-14 million. Our new estimate is 13.8 million, versus 10.1 million previously. We think that investors are expecting 11-12 million units. The flow-through effects of our revisions result in our new C2012 iPad units estimate moving to 69.6 million, versus 58.6 million previously.
- **MacBook refresh is important.** We expect Apple to refresh its MacBook portfolio, including the Air, in the next three months. Our view is that the refresh needs to introduce incremental improvements in specs/features and lower price points. Reason being, the competitive gap could narrow if the Ultrabook crowd can reduce the price points with their second and third generation launches. Plus, we think that Apple needs to sustain its competitive edge on the technology front. Otherwise, it is our view that investors could worry that future Apple product refreshes (i.e., iPhone or iPad) could lose customer appeal.

Apple Inc. (AAPL;AAPL US)

FYE Sep	2011A	2012E *(Prev)*	2012E *(Curr)*	2013E *(Prev)*	2013E *(Curr)*
EPS Reported ($)					
Q1 (Dec)	6.43	13.87A	13.87A	14.04	14.84
Q2 (Mar)	6.40	9.42	10.80	10.75	11.81
Q3 (Jun)	7.79	10.44	11.57	11.71	12.67
Q4 (Sep)	7.05	10.56	10.99	11.85	12.37
FY	27.68	44.28	47.22	48.35	51.69
CY	35.11	44.45	48.20	49.50	52.60
Bloomberg EPS FY ($)	27.91	-	44.00	-	49.94
Revenues FY ($ mn)	108,249	159,241	168,957	180,552	192,212

Source: Company data and J.P. Morgan estimates. Note: above EPS figures include FAS123R expenses.

Company Data	
Price ($)	618.63
Date Of Price	02 Apr 12
52-week Range ($)	621.45 - 310.50
Mkt Cap ($ bn)	575.97
Fiscal Year End	Sep
Shares O/S (mn)	931
Price Target ($)	715.00
Price Target End Date	31 Dec 12

See page 10 for analyst certification and important disclosures.

- **Longer-term catalyst: enterprise PCs.** While the potential of an Apple TV has captivated the media and investment communities alike, we believe that another long-term catalyst to consider is Apple penetrating the enterprise PC segment. The company has limited exposure to the enterprise segment, which comprises approximately 40% of global PC units. Our view is that the eventual introduction of Microsoft Office for the iPad could open up the enterprise PC installed base to tablets, specifically, Apple's iPad. We further discuss this topic and more in this report.

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Investment Thesis

With Apple, we reiterate our Overweight rating and increase our Dec-12 price target to $715, versus $625 previously. The stock remains on the J.P. Morgan Analyst Focus List. In our view, the best part of Apple's risk-reward profile is that plenty more upside potential exists, likely elevating Apple's revenue and earnings growth to a completely new orbit. In other words, Apple is in a league of its own. Key growth drivers include 1) Apple's low market penetration rates in tablets, PCs, China, and the enterprise, 2) the relative growth prospects of its key end markets versus other tech segments, and 3) Apple's role in enabling the burgeoning social media/networking adoption curve. In total, we believe that these drivers can sustain the relative outperformance of Apple's operating model and stock.

Key Points

Big iPhone unit revisions

Our research indicates that Mar-Q iPhone unit shipments tracked closer to 30-32 million. Our new estimate is 31.1 million, versus 28.1 million previously. We think that investors are expecting 29-31 million units. The flow-through effects of our revisions lift our new C2012 iPhone units estimate to 138.2 million, versus 128.7 million previously.

While increasing penetration of new wireless carriers has been a major tailwind, we believe that the installed base also has become large enough to support a bigger replacement cycle. Looking ahead, our assumption is that a new iPhone 5 with a thinner body and LTE capability will be launched in 2H C2012, which should sustain the iPhone's above-peer growth trajectory.

Big iPad unit revisions

Our research indicates that Mar-Q iPad unit shipments tracked closer to 13-14 million. Our new estimate is 13.8 million, versus 10.1 million previously. We think that investors are expecting 11-12 million units. The flow-through effects of our revisions result in our new C2012 iPad units estimate moving to 69.6 million, versus 58.6 million previously.

The "new iPad" launch has driven increased follow-through in the supply chain over the past 30 days, and at this point, we think the trend-line is for bigger unit levels in the coming quarters. As stated previously, we believe that Apple's latest iPad refresh and broader price bands stand to widen the gap on the trailing peers.

MacBook refresh is important

We expect Apple to refresh its MacBook portfolio, including the Air, in the next three months. Our view is that the refresh needs to introduce incremental improvements in specs/features as well as lower price points. Reason being, the competitive gap could narrow if the Ultrabook crowd can reduce the price points with their second and third generation launches. Plus, we think that Apple needs to sustain its competitive edge on the technology front. Otherwise, it is our view that investors could start to worry that future Apple product refreshes (i.e., iPhone or iPad) could lose customer appeal. We do point out that Apple's common user interface across multiple devices has not been replicated by other vendors, yet, which we think remains a major advantage for Apple. Windows 8 (to be launched in October 2012) is trying to bridge this gap, but we think that it could take a few iterations before any compelling comparisons can be made.

Longer-term catalyst: enterprise PCs

While the potential of an Apple TV has captivated the media and investment communities alike, we believe that another catalyst to consider is Apple penetrating the enterprise PC segment. The company has limited exposure to the enterprise segment, which comprises approximately 40% of global PC units. Our view is that the eventual introduction of Microsoft Office for the iPad could open up the enterprise PC installed base to tablets, specifically, Apple's iPad.

Currently, enterprise customers represent 5% to 6% of global tablet units, but we think that Bring-Your-Own-Device (BYOD) programs are not likely captured in that figure. So, we assume that total tablet units could be closer to 10% enterprise related. In any event, the current figure is a long way from the 40% enterprise representation in PCs. With Microsoft Office, we think that tablets could evolve into productivity devices instead of just content-driven experiences, and thereby open up the 40% of global PCs to the tablet market for substitution, which we think would favor Apple given the absence of compelling tablet alternatives so far.

Our latest CIO survey results (published on March 29) highlighted that enterprises continue to rank mobile device integration as a top investment priority relating to new projects. We believe that tablets and smartphones are part of this mobile device integration initiative, and again, tablets stand to gain greater traction once the Microsoft Office becomes available on tablets. Overall, we think that Apple stands to be a lead beneficiary of this emerging trend, given its product technology lead on both the hardware and software.

A word on Apple and the TV market

With respect to the much-discussed topic of Apple potentially entering the TV market, we do not have a strong view on the timing or the full extent of any product. Given the challenging economics of the TV market, we are inclined to think that Apple could first try entering the market with a set-top box that manages users' content and programming, thus extending the common interface of the iPhone, iPad, and Mac. We believe that this approach could help the company steer clear of the lean margins facing TV makers.

Our research does not suggest any set-top box is in the demo or prototype stage. We also do not have any signposts of an actual TV product prototype, although the recent partnership of Hon Hai and Sharp has stirred media/investor speculation that Apple's largest contract manufacturer could be laying the foundation for an Apple TV supply chain. Here, we are still on the sidelines, as it could be difficult for Apple to convince TV customers to pay the Apple premium when Sony, Sharp, and Samsung make highly-competent TVs, currently.

Earnings Outlook

Summary financial model presented at the end of this report.

We are making significant increases to our operating estimates. Our research indicates that the iPhone and iPad shipment activity in the supply chain implies major upside potential to our previous estimates. We are not trying to inflate expectations ahead of the Mar-Q print. Our intent is to communicate the incremental delta in our new and old estimates as identified by our recent research. The magnitude of the revisions, if accurate, stands to drive increased investor sponsorship of the stock in the near to mid term, in our view.

For Mar-Q, our revised revenue and EPS estimates are $39.1 billion and $10.80, versus $34.9 billion and $9.42 previously. Our revised gross and operating margin assumptions are 43.3% and 34.6%, versus 42.6% and 33.7% previously. A big driver is our revised iPhone unit shipments estimate of 31.1 million, versus 28.1 million previously. Our revised iPad unit shipments estimate is 13.8 million, versus 10.1 million previously. For both product families, the upward revisions are significant, driving our top-line and bottom-line estimates well above the Street consensus estimates of $35.7 billion and $9.77. Higher mix of iPhones also lifts gross margin.

Table 1: Apple - J.P. Morgan Estimates

$ in millions, except per share; units in 000's

	F2Q12		Fiscal 2012		Fiscal 2013	
	New	Old	New	Old	New	Old
Revenue	**$39,069**	**$34,914**	**$168,957**	**$159,241**	**$192,212**	**$180,552**
iPhone	20,340	18,296	85,958	81,228	94,222	90,045
iPad	8,048	5,959	37,230	32,598	45,678	39,051
Notebook	4,117	4,095	18,283	17,814	21,218	20,097
Desktop	1,576	1,612	6,846	7,047	6,866	7,281
Total Mac	$5,693	$5,708	$25,129	$24,861	$28,084	$27,378
iPod	1,200	1,219	5,578	5,640	5,415	5,596
Other music products	2,211	2,179	8,708	8,634	11,346	11,134
Peripherals and other	774	757	3,113	3,059	3,896	3,807
Software, serv., other	803	796	3,241	3,221	3,571	3,541
Units						
iPhone	31,117	28,079	132,644	125,711	152,362	146,065
iPad	13,767	10,140	63,967	55,736	81,993	69,695
Notebook	3,326	3,308	14,893	14,506	18,156	17,171
Desktop	1,219	1,247	5,329	5,487	5,608	5,928
Total Mac	4,544	4,555	20,222	19,993	23,764	23,099
iPod	7,406	7,514	34,424	34,777	35,044	36,146
Gross margin %	43.3%	42.6%	43.5%	43.4%	42.9%	42.7%
Operating margin %	34.6%	33.7%	35.1%	34.9%	34.2%	34.0%
EPS	**$10.80**	**$9.42**	**$47.22**	**$44.28**	**$51.69**	**$48.35**

Source: Company reports and J.P. Morgan estimates.

The flow-through effects of our Mar-Q revisions lift our fiscal and calendar year estimates as well. These revisions are detailed in the above and below tables (Table 1 and Table 2). Of note, our calendar 2012 iPhone and iPad unit estimates are now 138.2 million and 69.6 million, versus 128.7 million and 58.6 million units previously. These are big numbers, affirming Apple's above-peer growth potential,

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and all of this potential exists despite Apple having defied the law of numbers previously.

Table 2: Apple - J.P. Morgan Estimates – Calendar Year

$ in millions, except per share; units in 000's

	Calendar 2012		Calendar 2013	
	New	Old	New	Old
Revenue	$175,538	$162,579	$197,504	$186,588
iPhone	88,263	81,893	95,087	92,006
iPad	39,998	33,943	48,262	41,239
Notebook	19,023	18,230	21,973	20,950
Desktop	6,798	7,133	6,861	7,251
Total Mac	$25,821	$25,363	$28,834	$28,201
iPod	5,476	5,619	5,381	5,562
Other music products	9,351	9,234	12,156	11,921
Peripherals and other hardware	3,320	3,245	4,119	4,025
Software, service and other sales	3,310	3,283	3,666	3,635
Units				
iPhone	138,228	128,745	155,865	151,446
iPad	69,556	58,649	87,665	74,564
Notebook	15,720	15,061	19,025	18,068
Desktop	5,369	5,635	5,669	5,942
Total Mac	21,089	20,696	24,694	24,010
iPod	34,534	35,374	35,535	36,653
Gross margin %	43.2%	43.1%	42.7%	42.5%
Operating margin %	34.6%	34.4%	34.0%	33.8%
EPS	$48.20	$44.45	$52.60	$49.50

Source: Company reports and J.P. Morgan estimates.

Valuation

We reiterate our Overweight rating and increase our Dec 12 price target to $715, versus $625 previously. Apple is also on the J.P. Morgan Analyst Focus List and remains one of our top picks in our coverage universe. Our price target is derived from a weighted blend of EV/EBITDA and P/E scenarios utilizing historical peak/trough multiples. With Apple, we think it is time for the "value stock" valuation multiples to be re-rated higher. Our revenue and EPS growth estimates position Apple as the lone star in large cap tech. Currently, Apple trades at 12.8x our C2012 EPS estimate, versus the peer group average of 12.3x. In our view, Apple is still trading like a value stock and not as the high-growth story in large cap tech. We expect Apple to continue outperforming on both top- and bottom-line growth metrics relative to the peers as the company's rapid growth phenomena of the iPhone and iPad intensify. Plus, do not forget about the Mac business, we think that the company's incremental market penetration opportunities can help the Mac become a major contributor to overall company growth in the coming years.

Table 3: Apple Inc. P&L Scenarios

$ in millions, except per share data, C2012

	Worst Case	Base Case	Best Case
Sales	$159,801	$175,538	$185,369
Y/Y growth %	25.0%	37.3%	45.0%
Operating profit	$50,337	$60,689	$69,514
% of sales	31.5%	34.6%	37.5%
Interest/other inc. (exp.)	500	500	500
Pre-tax income	$50,837	$61,189	$70,014
Income taxes	$12,817	$15,426	$17,651
Tax rate	25.2%	25.2%	25.2%
EPS	**$40.05**	**$48.20**	**$55.15**
Y/Y growth %	14.0%	37.3%	57.1%
Diluted shares	949	949	949
D&A	$3,436	$3,436	$3,436
EBITDA	$53,773	$64,125	$72,949
% of sales	33.6%	36.5%	39.4%

Source: J.P. Morgan estimates. Note: Base case represents current J.P. Morgan estimates.

Table 4: Apple Inc. EV/EBITDA

$ in millions, except per share data, C2012

	Worst Case	Base Case	Best Case
EV/EBITDA multiple	9.5x	8.5x	7.5x
Implied enterprise value	$510,843	$545,060	$547,118
Net debt	($140,031)	($140,031)	($140,031)
Implied market cap	$650,874	$685,091	$687,149
Implied stock price	**$685.54**	**$721.58**	**$723.75**
Probability	20%	60%	20%
Average stock price	**$714.81**		

Source: J.P. Morgan estimates. Note: Base case represents current J.P. Morgan estimates.

Table 5: Apple Inc. Forward P/E

	Worst Case	Base Case	Best Case
P/E Multiple	16.5x	15.0x	13.5x
Implied stock price	**$660.76**	**$723.00**	**$744.54**
Probability	20%	60%	20%
Average stock price	**$714.86**		

Source: J.P. Morgan estimates. Note: Base case represents current J.P. Morgan estimates.

Table 6: Apple Inc. Blended Price Target

	Price	Weight
EV/EBITDA	$714.81	50%
P/E	$714.86	50%
Average stock price	**$715.00**	

Source: J.P. Morgan estimates.

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Risks to Rating and Price Target

Macroeconomic and secular conditions

We assume that Apple possesses partial buffers to any shocks in the macroeconomic environment or the ASP challenges in the PC or smartphones markets. Should incremental weakness blunt end market demand more than expected or slow Apple's International and retail store expansion, then our view and estimates could be at risk.

Competitive dynamics

We assume that Apple will continue to outgrow the market in smartphones, tablets, and PCs. Should competitive responses in these three segments disrupt Apple's business, then our view could be at risk to the downside.

Gross margin

Our view assumes that Apple's gross margin profile hovers near the 39-40% threshold as component pricing eases and manufacturing yields on newer products improve. Should these dynamics not manifest, then our view and estimates could have risk to the downside.

Rate of new product cycles

We expect Apple to sustain its rigid cycle of new product refreshes. Should the company begin to slow in its technology improvements and frequency of refreshes, the company's image as a provider for leading-edge solutions could take a hit. In such a case, we fear that investors could begin to lose interest in the story.

Apple Inc.: Summary of Financials

Income Statement - Annual	FY11A	FY12E	FY13E
Revenues	108,249	168,957	192,212
COGS	64,431	95,453	109,804
Gross profit	43,818	73,504	82,408
SG&A	7,599	11,041	12,859
R&D	2,429	3,227	3,844
Other expense	-	-	-
Total operating expenses	10,028	14,268	16,703
Operating income	33,790	59,235	65,705
Interest expense	-	-	-
Other income / (expense)	415	512	500
Pretax income	34,205	59,747	66,205
Income taxes	8,283	15,072	16,684
Net Income	25,922	44,675	49,521
EPS PF	28.62	48.55	53.02
Options expense per share	(0.95)	(1.33)	(1.33)
FAS 123 EPS	27.68	47.22	51.69
Diluted shares outstanding	937	946	958

Income Statement - Quarterly	1Q12A	2Q12E	3Q12E	4Q12E
Revenues	46,333A	39,069	41,823	41,732
COGS	25,630A	22,136	23,624	24,063
Gross profit	20,703A	16,934	18,199	17,668
SG&A	2,605A	2,629	2,861	2,946
R&D	758A	781	811	876
Other expense	-	-	-	-
Total operating expenses	3,363A	3,411	3,672	3,823
Operating income	17,340A	13,523	14,527	13,846
Interest expense	-	-	-	-
Other income / (expense)	137A	125	125	125
Pretax income	17,477A	13,648	14,652	13,971
Income taxes	4,413A	3,446	3,692	3,521
Net Income	13,064A	10,202	10,959	10,450
EPS PF	14.21A	11.12	11.90	11.33
Options expense per share	(0.33)A	(0.32)	(0.33)	(0.34)
FAS 123 EPS	13.87A	10.80	11.57	10.99
Diluted shares outstanding	942A	945	948	951

Balance Sheet and Cash Flow Data	FY11A	FY12E	FY13E
Cash and short-term investments	25,952	58,424	98,256
Inventories	776	1,356	1,510
Accounts receivable	5,369	8,232	10,029
Other	12,891	16,860	19,073
Total current assets	44,988	84,871	128,869
Net property, plant and equipment	7,777	9,325	11,136
Long-term portfolio investments	55,618	69,489	72,310
Other assets	7,988	8,949	9,349
Total assets	116,371	172,635	221,664
Current debt	0	0	0
Accounts payable	14,632	20,305	24,189
Accrued expenses and other	13,338	16,218	18,339
Total current liabilities	27,970	36,524	42,528
Long-term debt	0	0	0
Other non-current liabilities	11,786	38,544	58,060
Total liabilities	39,756	75,068	100,588
Shareholders' equity	76,615	97,567	121,076
Total liabilities & shareholders' equity	116,371	172,635	221,664
Net Income	25,922	44,675	49,521
D&A	1,814	3,257	3,729
Other	4,036	3,759	(6,299)
Change in working capital	5,757	1,977	1,840
Cash flow from operations	37,529	53,669	48,792
Capex	**(4,260)**	**(8,305)**	**(7,920)**

Ratio Analysis	FY11A	FY12E	FY13E
Sales growth	66.0%	56.1%	13.8%
EBIT growth	83.8%	75.3%	10.9%
EPS growth	82.6%	70.6%	9.5%
Gross margin	40.5%	43.5%	42.9%
EBIT margin	31.2%	35.1%	34.2%
EBITDA margin	32.9%	37.0%	36.1%
Tax rate	24.2%	25.2%	25.2%
Net margin	23.9%	26.4%	25.8%
Return on assets (ROA)	27.1%	30.9%	25.1%
Return on equity (ROE)	41.7%	51.3%	45.3%
Free cash flow yield	9.1%	13.6%	13.9%

Source: Company reports and J.P. Morgan estimates.
Note: $ in millions (except per-share data).Fiscal year ends Sep

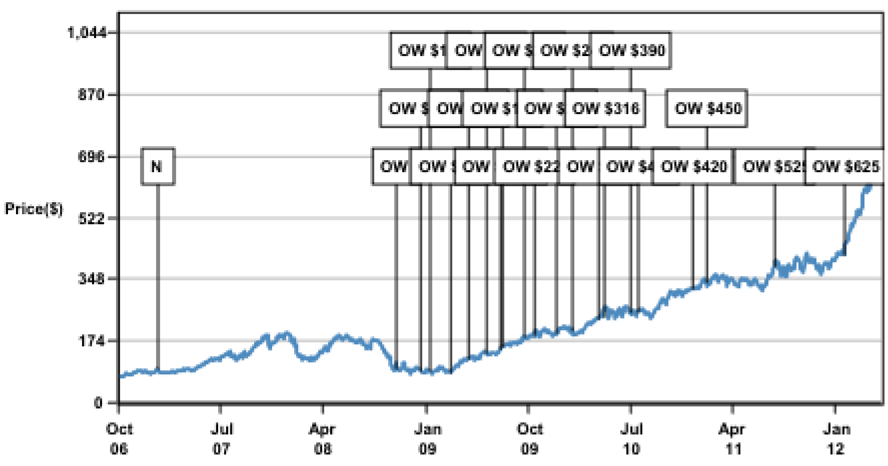
Analyst Certification: The research analyst(s) denoted by an "AC" on the cover of this report certifies (or, where multiple research analysts are primarily responsible for this report, the research analyst denoted by an "AC" on the cover or within the document individually certifies, with respect to each security or issuer that the research analyst covers in this research) that: (1) all of the views expressed in this report accurately reflect his or her personal views about any and all of the subject securities or issuers; and (2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report.

Important Disclosures

- **Market Maker:** JPMS makes a market in the stock of Apple Inc..
- **Client:** J.P. Morgan currently has, or had within the past 12 months, the following company(ies) as clients: Apple Inc..
- **Client/Non-Investment Banking, Securities-Related:** J.P. Morgan currently has, or had within the past 12 months, the following company(ies) as clients, and the services provided were non-investment-banking, securities-related: Apple Inc..
- **Non-Investment Banking Compensation:** J.P. Morgan has received compensation in the past 12 months for products or services other than investment banking from Apple Inc..
- Analyst Position: The following analysts (and/or their associates or household members) own a long position in the shares of Apple Inc.: Richard Wright

Company-Specific Disclosures: Important disclosures, including price charts, are available for compendium reports and all J.P. Morgan–covered companies by visiting https://mm.jpmorgan.com/disclosures/company, calling 1-800-477-0406, or emailing research.disclosure.inquiries@jpmorgan.com with your request.

Apple Inc. (AAPL, AAPL US) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Break in coverage Jan 18, 2007 - Oct 15, 2008.

Date	Rating	Share Price ($)	Price Target ($)
18-Jan-07	N	94.95	--
15-Oct-08	OW	97.95	--
18-Dec-08	OW	89.16	104.00
14-Jan-09	OW	87.71	102.00
06-Mar-09	OW	85.30	100.00
23-Apr-09	OW	125.40	135.00
09-Jun-09	OW	142.72	155.00
17-Jul-09	OW	151.75	167.50
22-Jul-09	OW	156.74	170.00
21-Sep-09	OW	184.02	210.00
20-Oct-09	OW	189.86	220.00
14-Dec-09	OW	196.98	230.00
26-Jan-10	OW	203.08	240.00
05-Apr-10	OW	238.49	305.00
21-Apr-10	OW	244.59	316.00
01-Jul-10	OW	251.53	390.00
21-Jul-10	OW	251.89	400.00
16-Dec-10	OW	321.25	420.00
19-Jan-11	OW	338.84	450.00
20-Jul-11	OW	386.90	525.00
25-Jan-12	OW	420.41	625.00

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.
J.P. Morgan ratings: OW = Overweight, N= Neutral, UW = Underweight

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