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November 30, 2004

## Option Investment Idea

### Apple Computer Inc. (AAPL, NYSE)

**Industry: Computer Hardware**

**Main Product(s): Personal Computers/Personal Entertainment Systems**

## Recommendation: Call Option

**July 2005 – \$75.00 Strike; Ticker: AAQGO**

**Current Option Price \$7.10**

**Underlying AAPL Price: \$68.44**

Many had thought Apple Computer Inc. (“Apple” or the “Company”) could never return to the former glory it enjoyed in 1980’s, yet the company now dominates the market in one of the hottest technology products since the personal computer. The product is the enormously popular iPod digital music player and in the recently concluded fiscal fourth quarter the company reported shipping 2 million iPods which was an increase of 500% over the same quarter last year. Also, the popularity of iPod is helping to revive growth in is Apple’s stodgier personal computer segment.

Traders with a high tolerance for risk should consider purchasing the July 2005 call, \$75.00 strike that currently trades for \$7.10 on the ask. WinningStocks.com has a target price of \$90.00 for Apple’s shares over the coming six months and this would translate into at least a 100% gain on the underlying option. The July call is favored as it allows the holders to participate in the next two earnings releases, which includes the December quarter where we believe Christmas iPod sales will be very strong, providing greater upward momentum for the shares.

## **Apple Computer Inc: Operational Highlights**

### Financial Highlights (All data for latest 12 months)

Sales	\$8.28 Bil	Revenue/Share	\$21.41
Income	\$276.00 Mil	Earnings/Share	\$0.71
Net Profit Margin	3.33%	Book Value per Share	\$12.98
Return on Equity	6.02%	3 Year EPS Growth Rate	0%
Debt/Equity Ratio	0%	3 Year Revenue Growth Rate	13%

## The Company

AAPL designs, manufactures and markets personal computers (PCs) and related software, peripherals and personal computing and communicating solutions. Its products include the Macintosh line of desktop and notebook computers, the Mac OS X operating system, the iPod digital music player and a portfolio of software and peripheral products for education, creative, consumer and business customers. The Company

sells its products through its online stores; direct sales force, third-party wholesalers and resellers and its own retail stores. As of September 30, 2003, Apple operated 65 retail stores. In addition to its own hardware and software products, the Company's retail stores carry a variety of third-party hardware and software products.

It is important to think of the impact of iPod much in the same way the Sony Walkman revolutionized personal audio in the 1980's. While the Walkman had its limitations it still managed to earn Sony billions.

The iPod comes in 2 types, the 20-gigabyte version and the 40-GB and retail from \$299.00 to \$399.00 respectively. They contain a rechargeable battery that is good for 12 hours and the device is small enough to fit in a pocket. Owners can upload their own music library or purchase songs electronically from the Company's iTunes subsidiary for \$0.99 per song. As the AAPL's marketing department put it: you can now slip 10,000 songs in your pocket – we have come a long way since the Walkman.

### **Rationale**

The Company's fiscal fourth quarter was the best in nine years and this was driven by the popularity of the iPod. Among the highlights of the fourth quarter ended September 30, 2004:

- For the Company's fiscal fourth quarter ended September 30<sup>th</sup> 2004, net income rose 141%, coming in at \$106 million, which compares to \$44 million in the year-earlier quarter. The growth came primarily though the aforementioned 500% increase in iPod shares. Improving operating margins also aided the bottom line. Earnings per share, on a diluted basis, totaled \$0.26, which was a quarter over quarter improvement of 117%. Equally impressive was that on a sequential basis AAPL managed 63% EPS growth. For the full year ended 09/30/04, net income grew 274% compared to the same period in 2003.
- Revenues grew on a quarter over quarter basis by 37%. For the fourth quarter, total revenues were \$2.4 billion versus \$1.7 billion a year ago. For the year the Company saw revenues grow by 34%. Historically, AAPL has a three-year revenue growth rate of 13%.
- Operating cash flows for the nine months ended June 30<sup>th</sup> 2004 came in at \$491 million and were 128% better than the same period last year.
- The Company reported shipping 2,016,000 iPods during the quarter and 836,000 Macintosh units. Sales of the Macs were up six percent. Many analysts believe, and WinningStocks.com agrees, the increase in Mac sales are being driven by the iPod purchases. Company management does not provide sales guidance, however analysts estimate that iPod sales for the fiscal first quarter will range between 3 million and as high as 4 million due to the holidays.

### **Conclusion**

Shares of AAPL have been moving higher over the past week in brisk trade as more and more analysts are beginning to buy into this growth story. As a result, valuations seem to be high, however this should not dissuade high-risk tolerant investors. There are currently many stocks that are not displaying the same growth rates yet still have P/E ratios over 100X. WinningStocks.com believes that AAPL will be admitted to that club - and relatively quickly.

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