VAN DIEN ASSET MANAGEMENT LLC

RECOMMENDATION REPORT

APPLE INC. (AAPL)
Price: $486.59 (10/09/13)
S&P 500: 1656.40
NASDAQ: 3677.78

As our clients know, I am a member of The Analysts' Club, a private club of investment professionals that dates its origins back to the 1920s. Each month members meet in Manhattan to discuss investment ideas and review the results of our monthly survey of market expectations. Last night, for our October meeting (Wednesday October 9), I presented Apple shares as my number one pick for the month.

Apples shares have had a difficult 2013, down almost 8% YTD, and off 31% from its high of $700+ reached thirteen months ago. More recently, AAPL experienced a late summer run-up in anticipation of its September 10 product introductions of the iPhone 5S and iPhone 5C. Unfortunately, the investment community reacted with disappointment when Apple failed to introduce a mid-priced iPhone in a bid to move down market and take share. The high price points made it clear that Apple remained intent on protecting its high profit margins and many analysts saw a missed opportunity, particularly in the emerging markets. UBS, Bank of America and Credit Suisse were among sell-side firms that downgraded the shares to neutral. However, a funny thing happened in the immediate aftermath. Once again consumers lined up for blocks to buy these new iPhones (mostly the 5S), and Apple announced that this particular product introduction had a record breaking first weekend. Analysts quickly began recalibrating earnings estimates, and several sell-siders pivoted from their cautious outlook.

Concurrently, two other "situations" are taking shape that we believe further support the bull case on AAPL. First, Apple's competitors appear to be stumbling further behind. On the same day as Apple's launch of its new iPhones (September 20), Blackberry (BBRY) announced that it was retreating further, cutting its workforce by 40% while offering some dismal preliminary estimates to its current quarter. Blackberry expects to take an inventory write-off of almost $1 Bil for its failed Z10 smartphone, and guided to units and revenues for its October quarter that are roughly half of what the street had expected. BBRY stock fell 17%. Two weeks later, Taiwanese smartphone manufacturer HTC, an Android supporter, announced its first ever quarterly loss as a public company and took a massive writedown for its failed HTC One smartphone. Lastly, we highlight Samsung, Apple's principal competitor at the moment. Samsung has seemingly stolen some of Apple's "cool factor" during the past twleve months with its Galaxy line of smartphones and tablets. However, demonstrating that it isn't easy to stay in front of the innovation and consumer taste curve, its hastened introduction of the Galaxy Gear smartwatch was met with negative reviews from some of the technology world's most influential reviewers (see some of David Pogue's commentary).

The second important "situation" that has materialized is the public arrival of Carl Icahn. Icahn has built a modest stake in Apple (about $1 Bil) and has developed a dialog with CEO Tim Cook. Icahn believes that Apple's balance sheet, notably its $145 Bil in cash, coupled with its ability to borrow at very low interest rates, warrants a much more aggressive share buyback. Whether or not Icahn gets his way or not, we don't believe is important right now. What is important is that Icahn will be on CNBC and tweeting frequently that Apple needs to return more cash to shareholders. His arrival will only serve to highlight to investors Apple's amazing balance sheet and cash generating abilities. For the time being, investors will stay involved with the hope that greater cash returns (dividend or buyback) may be in the cards.

We don't expect Apple's stock to show performance like it did on its way to $700. However, we do believe that it will outperform the greater indices over the near to intermediate term. With the iPhone 5S launch, Apple has again shown us that it continues to design and build innovative products that generate strong consumer demand. At the same time, several of its key competitors are failing, creating a larger moat around Apple's ecosystem. With Carl Icahn on the scene, we see an investment backdrop with little downside risk.

Kent Blair, CFA
October 10, 2013

TIMELINE OF RECENT EVENTS
9/10/13
iPhone 5S and 5C unveiled. Investors/sell-siders disappointed over pricing (i.e., 5C priced at $733 in China w/out contract), reluctance of Apple to move down market and choosing margin over market share.

9/11/13
Downgrades to Neutral include UBS (target moved from $560 to $520), CS (cuts ests. but keeps target at $525) and Bank of America.

9/13/13
Jefferies cuts target from $450 to $425, cuts '14 estimate to $37.95 (consensus at $42.66).

9/18/13
Mossberg reviews new iPhones positively:
"After a week of testing the iPhone 5S, I like it and can recommend it for anyone looking for a premium, advanced smartphone. If you are an iPhone fan with any model older than the iPhone 5, the new 5S will be a big step up. If you own an iPhone 5, there's less of a case for upgrading, unless you want the fingerprint reader and improved camera. You can get the new OS free of charge....Overall, however, the new iPhone 5S is a delight. Its hardware and software make it the best smartphone on the market."

9/19/13
Icahn op-ed, tweets, begin shifting narrative.

9/20/13
Long lines reported at Apple stores, customers lining up to buy 5S.

9/20/13
Blackberry preannounces, stock down 17%. Company to cut 40% of workforce and stop selling devices to consumers.

9/23/13
Apple announces blow-out weekend of iPhone sales (record breaking 9 mil units in three days, includes 3.5 mil of channel fill). For comparison, BBRY shipped 3.7 mil smartphone units in its entire 2Q.

9/24/13
RBC raises target from $525 to $550, SocGen downgrades to N (keeps target at $500), Susquehanna upgrades to buy (target from $440 to $625)

9/27/13
T-Mobile to no longer stock BBRY phones in stores.

10/01/13
Icahn on TV, Twitter about his mtg with Tim Cook, pushing for $150 Bil buyback.

10/03/13
David Pogue reviews new Samsung Gear smartwatch:
"The Gear is a human-interface train wreck. All of it. The software design, user guide, English translations and design consistency.... Nobody will buy this watch, and nobody should. But there's something here under all the rubble. Sometimes the Gear can be liberating; sometimes it makes possible tasks that you can't do while you're holding a smartphone. We just need somebody to find the right balance of labor between the watch and its companion device — to figure out what a smartwatch should and shouldn't be."

10/04/13
Taiwanese smartphone manufacturer HTC reports its first quarterly loss since its 2002 IPO.

10/07/13
Jefferies reverses course: moves target to $600 from $425

10/08/13
WFC and Barclays both on tape reiterating Outperform, excitement over iPad Mini launch.