

TECH

Apple Was Headed for a Slump. Then It Had One of the Biggest Rallies Ever.

Shares of the iPhone maker have more than doubled over the past year, and investors are divided on whether they can keep climbing



Analysts predict iPhone shipments soon will see growth for the first time since fiscal 2018. PHOTO: JOHANNES EISELE/AGENCE FRANCE-PRESSE/GETTY IMAGES

By Tripp Mickle

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A year ago, Apple [AAPL -0.29% ▼](#) Inc. looked to be headed for a prolonged slump. Chief Executive Tim Cook slashed guidance because of sluggish iPhone sales and analysts fretted over slowing demand in China.

But instead of a slump, investors got one of the biggest one-year stock rallies in history. The tech giant's share price has more than doubled, adding over \$725 billion to its value, more than JPMorgan Chase & Co. and Exxon Mobil Corp. [XOM -0.67% ▼](#) combined—and well above the total value of Facebook Inc. [FB -0.83% ▼](#)

The surge is driven partly by renewed iPhone anticipation, and investors are eager for more even as some are aware of the cyclical nature of the company's past rallies. Apple's stock closed Friday at \$318.31, and the company now has a market value of nearly \$1.4 trillion.

Apple, which reports earnings Tuesday afternoon, is expected to release its first handsets with 5G wireless technology this fall. Its potential for faster connection speeds has led analysts to predict iPhone shipments will see growth for the first time since fiscal 2018.

Exuberance about the iPhone business has been amplified by rising sales from smartwatches, AirPods wireless earbuds and services such as streaming-music subscriptions and mobile payments. Growth in those businesses helped Apple last year offset the 14% decline in its iPhone business, which accounts for the majority of sales, and the downturn in China, its second-most important market.

The strength of Apple's non-iPhone business has provided a jolt to Apple's price-to-earnings ratio, lifting it to its highest level since 2010. It is currently trading at about 27 times its earnings per share in its last fiscal year, according to FactSet, well above its five-year average of 16 times earnings.

"This is almost a violent rerating," said Mike Bailey, research director at FBB Capital Partners, which counts Apple among the holdings in its \$1.3 billion under management. He compared it to how Microsoft Corp.'s valuation leapt about five years ago as investors began valuing it as a cloud company rather than a mature software company.

Apple's skyrocketing valuation has divided investors. Some shareholders have sold off stakes, believing the iPhone company is riding a wave of enthusiasm that could crash after the release of its next handset. Others have added to their position, arguing Apple's growing services business means growth will come from a business with higher margins than its hardware products.

The company's stock will experience volatility in the months ahead as investors wrestle with the question of whether Apple is a services company or a hardware company, which is valued lower. "Right now, the company is priced like many things in the market—to perfection," said Greg Hersch of New York City-based Florence Capital Advisors, an investment firm with \$200 million under management that has reduced its Apple holdings.

Apple's growth last year helped drive U.S. stocks to their best annual performance in six years. The S&P 500 surged 29%, while the tech-heavy Nasdaq rose 35% behind an improved economic outlook, interest-rate cuts by the Federal Reserve and the U.S.-China trade deal, which was signed this month.

The confusion over Apple's identity reflects its transition from a company that emphasized shipping more iPhones into one touting sales of services and accessories. Apple last year deepened its portfolio of products for the 900 million iPhone owners world-wide, adding TV- and videogame-subscription services, higher-priced AirPods and a credit card.

The rise in Apple's share price accelerated after the company reported its fiscal-year results in October. Though it didn't disclose subscribers for new services, it reported services sales jumped 17% to \$46.29 billion for the year ended in September. In 2017, Mr. Cook set a goal to double services revenue to \$50 billion by 2020.

AirPods helped juice sales of the company's other growing business, wearables, which includes smartwatches, iPods and accessories. Revenue from those products rose 41% to \$24.48 billion

for the fiscal year, with AirPods accounting for a quarter of the total, according to Bernstein Research, which estimates sales of the wireless earbuds nearly doubled last year to \$6 billion.

Jeremy Bryan, portfolio manager at Gradient Investments, LLC, said those growing businesses have given investors confidence that Apple can navigate future slowdowns in iPhone sales.

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Are you confident Apple can maintain its rising momentum for the next quarter? Why or why not? Join the conversation below.

“A lot of the knock on Apple is that they haven’t been very innovative, but they changed the game more than anyone else with things like AirPods and ancillary things,” said Mr. Bryan, whose firm in Arden Hills, Minn., has \$2.6 billion under management and owns 41,000 shares of Apple.

Apple’s share price has continued to rise since last fall as sell-side analysts touted the potential of the company’s forthcoming 5G iPhone. In December, Piper Jaffray reported that a quarter of U.S. iPhone owners planned to buy a \$1,200 5G model, according to a survey of about 1,000 people.

The surge in Apple’s valuation is reminiscent of the gains it had in 2017 ahead of the release of its 10th anniversary iPhone. In the course of a year, Apple’s share price increased 70%, adding about \$300 billion in market capitalization. It largely added to those gains after the device’s release before shares tumbled in the fall of 2018 amid concern about weak iPhone sales. The slowdown followed the release of the iPhone XS and XR models, which weren’t as popular as preceding models, especially in China, where an economic downturn blunted interest.

A similar correction immediately after the release of Apple’s 5G iPhone is unlikely because adoption of 5G technology isn’t expected to truly take off until 2021, analysts said.

The strength of those iPhone sales will influence how investors continue to see Apple, FBB Capital’s Mr. Bailey said. While the company is showing it can deliver sales growth from more than smartphones, he said investors know Apple needs its iPhone business to remain strong to maintain a user base to sell AirPods and services.

“It’s a blend,” he said. “Most investors have figured out they have this services business that is growing nicely and a big part of the story, but iPhones need to execute.”

Write to Tripp Mickle at Tripp.Mickle@wsj.com

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