Apple's Magic Wears Thin as Its Earnings Disappoint

Apple shares fell around 10% after the company posted flat earnings for its first fiscal quarter on Wednesday afternoon. MarketWatch's Dan Gallagher reports. (Photo: Getty Images)

Apple Inc. AAPL +1.83% recorded a flat profit despite selling 18 million more iPhones and iPads, as it spent heavily to roll out new products to fend off intensifying competition.

Spooked investors erased nearly $47 billion from the company's stock-market value in after-hours trading, about as much as the combined worth of Dell Inc., DELL -0.30% Nokia Corp. NOK1V.HE +1.99% and Research In Motion Ltd. RIM.T -2.48%

The flat earnings in the holiday quarter come after several years of supercharged growth that made Apple the most valuable U.S. company and fan worries about the Silicon Valley giant's momentum and demand for its new devices.

Apple executives predicted growth would continue to slow. The company expects revenue to rise about 7% in the current period after reporting an 18% gain in the holiday quarter.

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A sales assistant, left, holds an iPad Mini next to a customer during the China launch of the iPad Mini, in Wuhan, Hubei province in December, 2012.

Apple's quarterly report was considered among the most important in years for the company, as concerns about demand for its new iPhone 5 and its iPad tablets dragged its stock from highs of more than $700 a share in September to less than $500 in mid-January. In after-hours trading Wednesday, Apple's stock fell 9.7% to $464.09.

Late last year, the company warned that its aggressive product rollout schedule for the holidays, including new iPhones, iPads, iPods and a new iMac desktop, would hurt profit as the company perfected manufacturing efforts. Manufacturing costs more in early stages until the company perfects production processes.

The iPhone 5 alone was expected to be available in more than 100 countries by the end of 2012, a speed which Apple said was the fastest release schedule ever for the device.

As Apple releases its quarterly earnings, Brett Arends joins The News Hub to look at some key points investors should be aware of. Photo: AP.

Tim Cook, Apple's chief executive, in a conference call pointed to the recent product launches to argue that the company is in "one of the most prolific periods of innovation" in its history. He said that Apple engineers keep churning out products that customers love, not merely buy. "It's simply phenomenal."

Apple chief Tim Cook said the company is in a prolific period of innovation.
He urged investors to be skeptical of reports about the company cutting orders with manufacturers. Mr. Cook said Apple gets parts from various suppliers, and manufacturing efficiency can vary, making it hard to discern the company's overall business based on individual pieces of information.

"There's just an inordinately long list of things that would make any single data point not a great proxy for what's going on," he said.

Apple said it sold 47.8 million iPhones, up from 37 million from the year-earlier period and below some analyst expectations. The fiscal first quarter began soon after the release of the iPhone 5 and Apple's new mapping software, and encompassed the debut of the iPad Mini, a smaller tablet carrying an equally slimmer price tag.

Apple said it sold 22.9 million iPads, up about 48% from last year and roughly in line with some analyst expectations.

Peter Oppenheimer, Apple's chief financial officer, said in an interview that demand for the company's new 7.9-inch tablet that debuted in November outstripped supplies. "We sold every one we could make," he said. "Customers are loving it."

But the results highlighted potential weaknesses in Apple's business. The iPhone, which represented more than half of the company's overall revenue, only grew at the same rate as the rest of the market, according to Gene Munster, an analyst at Piper Jaffray. He said that is unusual for Apple, which usually grows faster and grabs market share in quarters surrounding the release of a new smartphone such as this.

"It's confirmation of a trend," he said, noting that much of the industry's growth is coming from emerging markets, where cheaper smartphones are more popular.

For the quarter ended Dec. 29, Apple reported a profit of $13.08 billion, up from $13.06 billion a year earlier. On a per-share basis, earnings fell to $13.81 from $13.87 a share as the latest period had slightly more shares outstanding. Revenue rose to $54.5 billion from $46.3 billion.

The quarter adds to signs that any honeymoon period is over for Mr. Cook, who took the reins of the company in August 2011. His first major product launch at the helm was the iPhone 4S, just a day before Apple's co-founder, Steve Jobs, died.

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Since that time, Mr. Cook has attempted to keep a steady hand on the company, initiating a dividend and stock buyback after years of investor pleas and instituting corporate giving programs for various causes, including the Red Cross.

He has also made his mark on Apple's management, pushing out Scott Forstall, a longtime lieutenant of Mr. Jobs from before he rejoined Apple in 1997. Mr. Forstall headed the company's iOS team, whose software powers mobile devices like the iPhone and iPad.

Investors initially supported Mr. Cook's efforts, roughly doubling the company's shares from the day he was promoted from operations chief until the iPhone 5's launch day. Now, they have begun to question his efforts, and whether or not the company that created the personal computer and jump-started the mobile device revolution has lost its edge.

Competition has stiffened, particularly from Samsung Electronics Co. 005930.SE -1.36% The South Korean company's Galaxy line of smartphones and tablets are seen as the strongest competition yet against Apple's own devices. Samsung hasn't only been able to compete with various features that help it stand out against the iPhone, but also on price.

As a result, Samsung's devices held nearly 27% share of the U.S. mobile subscriber market in the three months ended in November, according to market researcher comScore, up from more than 25% in the summer. Apple, by comparison, commanded 18.5% market share in November, up from 17.1% in the previous quarter.

Apple appears to be preparing a response, however. The Wall Street Journal reported earlier this month that the company is working on a lower-end iPhone that could launch later this year.

Corrections & Amplifications
Apple sold 47.8 million iPhones in its fiscal first quarter, up 10.8 million units, or 29%, from the year-earlier period, while iPad sales rose about 48% to 22.9 million. An earlier version of this article incorrectly said iPhone sales grew 26.9 million and iPad sales rose 63%.

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