

Apple Inc. Q4 2018 Earnings Call Case Study

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Why Are Earnings Calls So Important?

On Friday, 15th March, in the U.S. District Court in Oakland, California, Apple Inc (Ticker: AAPL (US:NASDAQ)) agreed to settle a Class Action law suit on what the claimants called a “fraud”.

The case centred on Apple Inc’s Q4 2018 Earnings Call in early November 2018 during which Tim Cook, CEO, responded to a question on a slow down in sales and profits in China.

Tim Cook stated that there was "sales pressure" in some countries but he "would not put China in that category". Two months later, however, Apple downgraded its quarterly revenue forecast and cited trade tensions between China and the US - leading to a sharp drop in Apple's share price.

On the 1st November 2018, Apple’s shares traded at USD55.56, yet when the news broke 2 months later about difficulties in China on the 3rd, January 2019, they closed at USD35.55 - a 36% fall.

The error ultimately proved to be costly, with Apple Inc having to pay USD490m to shareholders.

In this article, Truth Unlocked replay the offending Apple Earnings Call from November 2018 and go on to analyse the words chosen by Tim Cook, CEO, Apple Inc.

The Apple Inc Q4 2018 Earnings Call

The Apple Inc Q4 2018 Earnings Call was held on the 1st November 2018. We have captured the salient section below so that you can see exactly what happened...

Wamsi Mohan – Analyst, Bank of America Merrill Lynch

“Yes. Thank you. Tim there has been some real deceleration in some of these emerging markets, partly driven by some concerns around some of the rules, administration is contemplating and partly driven by things that are more specific to China, for instance, like some of the regulations around gaming. So can you talk about how you see the trajectory there for the business and what you think of the initiatives of some companies like Netflix and Fortnite trying to bypass the App Store around subscriptions and I have a follow up.”

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Tim Cook - CEO, Apple Inc

“Sure. Great question. Starting with emerging markets. The emerging markets that we are seeing pressure in our markets like Turkey, India, Brazil, Russia. These are markets where currencies have weakened over the recent period, in some cases that resulted in us raising prices and those markets are not growing the way we would like to see. To give you a perspective at some detail, our business at India in Q4 was flat. Obviously, we would like to see that'd be a huge growth. Brazil was down somewhat compared to the previous year, and so I think at least the way that I see this is each one of the emerging markets has a bit of a different story. And I don't see it as some sort of issue that is common between those for the most part.

In relation to China specifically, I would not put China in that category. Our business in China was very strong last quarter. We grew 16%, which we're very happy with. iPhone in particular was very strong. Very strong double-digit growth there. Our other products category was also stronger, in fact a bit stronger than even the company, overall company number.

The App Store in China, we have seen a slowdown or a moratorium to be more accurate on new game approvals. There is a new regulatory setup in China and there are not moving the way they were moving previously. We did see a few games approved recently, but it's very far below the historic pace. And as you've probably seen some of the larger companies there that are public have talked about this, as they've announced their earnings as well. We don't know exactly when this will, the approvals will sort of return to a normal pace. So I would not want to predict that. I do not view -- just for avoidance of doubt here, I don't view that issue has anything to do with the trade related discussions between the countries. I think that is strictly a domestic issue in China.”

Kathryn Huberty – Analyst, Morgan Stanley & Co.

“Thank you, Tim. Given the current trade negotiations and broader geopolitical risk, do you have any plans to consider diversifying the supply chain and if you were to do that either on your own or sort of forced, do you think it would have significant impact on the business or profitability?”

Tim Cook - CEO, Apple Inc

“Katy, if you look at the products that we have created and are manufacturing, they're really manufactured everywhere. We have significant content from the US market, we have content from Japan, to Korea, to many countries and we have great content from China as well. And so, there are many hands in the product, the vast majority or almost all of the R&D is in the United States as well as a lot of the support organizations and -- so as I think that basic model where you look around the world and find the best in different areas, I don't expect that model to go out of style, so to speak. I think there is a reason why things have developed in that way and I think it's great for all countries and citizens of countries that are involved in that. And I'm still of the mindset that I feel very optimistic and positive, the discussions that are going on will be fruitful. These relationships, these trade relationships are big and complex and they clearly do need a level of focus and a level of updating and modernization and so I'm optimistic of that the countries in the US and China and the US and Europe and so forth can work these things out and work for the benefit of everyone.”

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Truth Unlocked's Summary Analysis

There is enough to suggest from the Apple Q4 2018 Q&A that China was a sensitive issue to Tim Cook, CEO, Apple Inc.

Two Analysts ask questions in respect to China, the initial one of which prompted the comment alluded to in the BBC News article where Tim Cook told investors on 1st, November 2018 that there was "sales pressure" in some countries but that he "would not put China in that category".

The above provides some context to that answer given to the question asked by Wamsi Mohan, Bank of America, Merrill Lynch. In answering the part about emerging markets, Tim Cook says he doesn't see the issue as being a common one between the markets. In his language he sees them as, "not growing," "flat" or "down somewhat."

This is the language of minimisation and passivity, the latter of which seeks to withhold information. He hedges only saying what he thinks as, "being a bit of" and "for the most part." All of which come under the umbrella of "seeing pressure" and it is against this uncertainty and background in which he would not put China.

When speaking about China, Tim Cook after using the negative of "not" putting China in "that" category moves from present distancing language to past tense success. This past success of "very good" is said three times before being supported by other products being "a bit stronger."

Brevity is key and the repetition can speak to a need to persuade or convince an audience of what is being said. What's not said is as equally important as to what is said. The question asked him to talk about how he saw the trajectory there for the business. The expected would be some past tense which would influence the future tense. The future tense is omitted.

We listen to see where and if the expected future tense arises. What we see is a change of language where a "slowdown" becomes a "moratorium" indicative of others being to blame and the issue being out of Apple's control which is further weakened by a 'new regulatory set up' which is not moving the way they were previously.

This is passive language and withholds information. It speaks to time and problems without an obvious end unless Tim Cook tells us so. Only "a few games", potentially a very small amount, have been approved which doesn't tell us when or if they will go on sale, especially when there is a, "new regulatory set up which is not moving the way they were previously." The only form of reassurance given is that Apple are not alone as other companies have talked about this. This is crowd sourcing which can seek to minimise the problem at hand being a collective one and masks the real problem closer to home by deflecting attention elsewhere.

The issue of time is picked up on again when Tim Cook expresses in the negative before self-editing, giving himself time to think, that Apple don't know when after a momentary pause, "the approvals will sort of return to a normal pace". What Apple are experiencing is not 'normal' and there is no foreseeable end in sight.

Tim Cook ends with a long 'Hina Clause', needing to explain the reason why, with numerous negatives and repetition, when the market will return to normal. This lacks both confidence and commitment.

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Regarding Apple's future in China, Tim Cook deflects to the positives of the past, referencing events out of their control and lacking any confidence, clarity or positive comment. Little or nothing is said about the future leaving the question in part unanswered.

In respect to the answer Tim Cook gives to Kathryn Huberty, Analyst, at Morgan Stanley and Co, he says, "And I'm still of the mindset that I feel very optimistic and positive, the discussions that are going on will be fruitful".

"These relationships, these trade relationships are big and complex and they clearly do need a level of focus and a level of updating and modernisation and so I'm optimistic of that the countries in the US and China and the US and Europe and so forth can work these things out and work for the benefit of everyone." The sensitivity of the optimism conveyed is caveated by further actions outside of Apple's control, namely relationships which are big and complex and in need of a level of focus, updating and modernisation before "things" can be worked out. This has the potential of being a long haul and having a potentially significant effect on Apple's trading in China.

The answers lack commitment and positivity and require unnecessary language to convince as opposed to simply convey a positive future message which is notably absent.

References

Link to BBC News article:

<https://www.bbc.co.uk/news/technology-68580235>

Link to Apple Q4 2018 Earnings Call:


https://finance.yahoo.com/news/apple-inc-aapl-q4-2018-010416875.html?guccounter=1&guce_referrer=aHR0cHM6Ly9kdWNrZHVja2dvLmNvbS8&guce_referrer_sig=AQAAAFonfTK-ww0ObA9PEN7gxYDcjgl6ggJcTbsxq62nu74FYlRqSJshw9JXR9NKaUKb94AwczU-KQDEi-p1-8y2vOYh3BQC0MVQa2EkcEGybXEDf584waFIRN146i0d02I3V_G6PSprlKF20OfMwibB0vS63qv2A-O-ID1KImExBhjQ

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