August 10, 2017

AAPL + DIS: A Possibility or Just Speculation?

AAPL requires a new source of revenue growth…

We at The Edge believe that **Apple Inc. (AAPL)**, the big fish in the market, is rapidly becoming a $1tn company but needs to diversify its revenue stream (iPhone contributed ~64% to total revenue in 9MFY17) to achieve growth in the coming years. Despite APPL's popularity with consumers, we believe its lack of revenue diversity is likely to remain a challenge to future growth.

AAPL's revenue growth has been slowing down over the years from a growth of 29.5% y-o-y in FY15 to a decline of 7.7% y-o-y in FY16 to growth of 4.7% y-o-y in 9MFY17. As per the consensus, the total revenue growth in FY17 and FY18 is estimated to be about 6% and 11%, respectively, driven by iPhone sales and narrow to approximately 5% in the longer-term.

We remain cautious on the slowdown in the revenue growth and the concentration of revenue with growing competition in both smartphones and tablets from the upstart Chinese OEMs and bigger tech companies like Samsung and Huawei, who provide products at every price point suitable for all classes of customers. Therefore, we believe that AAPL may attempt to find a significant new source of revenue growth.

DIS needs to strengthen its distribution channels and nurture its capabilities in content creation and its Parks and Resorts businesses…

The Walt Disney Company (DIS) is in the midst of two opposing forces, positive and negative, as the outlook of the various businesses in its portfolio differs. On one hand, it is benefitting from a boom in its movie business, thanks to its number of captivating franchises, which can be milked for recurring revenue, as well as in the theme park and resorts business, which provides steady cash flows.

On the other hand, its television business is facing a secular long-term decline as the infotainment world moves away from TV to online streaming (on computers, tablets, and mobile). DIS is feeling the heat as subscribers have begun to move away from its highly-demanded sports channel, ESPN. Despite charging the highest per-subscriber fee, ESPN has been raising charges every year to try and maintain profitability against rising costs.

However, we believe that these charges are increasingly unsustainable for many viewers and may accelerate subscriber declines for ESPN. Consequently, we believe that, although the content remains desirable, distribution channels are changing rapidly and migrating to a digital platform, which has left investors worried about the long-term fate of ESPN.

"Content Assets" – the new mantra in the Media / Technology / Telecom space…

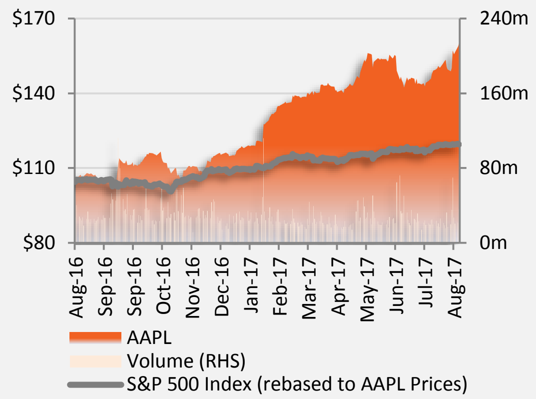
The combination of content and distribution ownership with the AT&T, Inc (T) acquisition of Time Warner, Inc (TWX) (announced in October 2016) has highlighted the value of content companies for a larger Media, Technology or Telecom company. We believe that with the strength of its own content, larger companies in these industries can sell their other products and services and in doing so reduce the churn.

There were market reports that AAPL was in talks to acquire TWX in the past, which hints at AAPL's interest in acquiring content companies. Because of this, we see the potential of AAPL acquiring DIS, which would increase AAPL's scale in content creation and distribution and enable the company to diversify away from its hardware-centric sales. With total cash & cash equivalents (including marketable securities) of $262bn and net cash of $153bn on the balance sheet, we believe that AAPL has the financial viability to buy DIS at roughly $200bn assuming a premium of ~20% to the current market cap of DIS considering that AT&T's deal to buy TWX was at a >20% premium to its last trading price prior to the announcement.

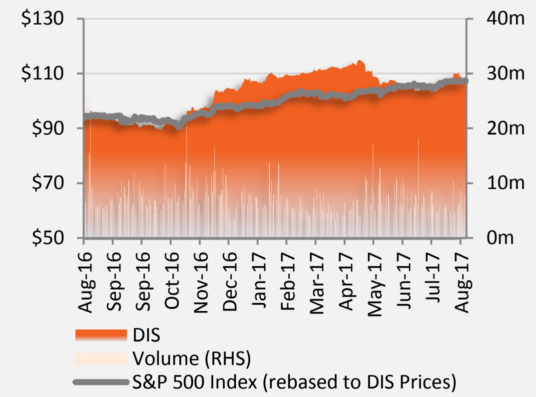
AAPL + DIS: What will the companies gain?

- This will create increased scale in content while also becoming a $1tn market cap company following the deal with strong balance sheet strength. Though APPL has created some digital content of its own, it has not made steps into content ownership & production. After a potential APPL/DIS deal, the combined company would instantly have access to global distribution (through AAPL's installed base and the global iTunes store) and a massive library of content and studio capacity (through DIS) to make future movies and shows.
- DIS would provide AAPL revenue diversification from the current hardware revenue.
- AAPL's distribution channels would enable DIS to compete with Netflix and Amazon in streaming/SVOD. On a standalone basis, neither AAPL or DIS have entered the digital streaming space considering the competition in this market.
- DIS' ESPN issue would cease to be such a big concern in the combined company, as it will have the pricing power to provide better offers to its customers.
- The combined company will also be able to pursue strategic options for the Parks and Resorts business and separate it from the remaining company to create further value for shareholders. It can then also look to divest ESPN as a separate business.

Share Price Performance – AAPL

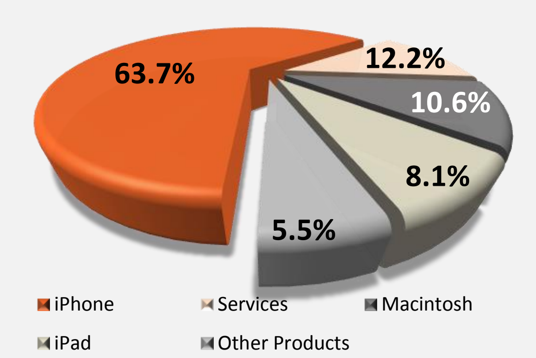


Share Price Performance – DIS

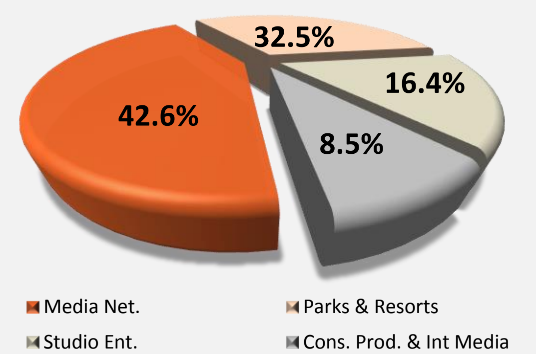


Market Data	AAPL	DIS
Current Price	**$160.08**	**$103.25**
52 Wk. H/L Price	$161.83 / $102.53	$116.10 / $90.32
Market Cap	$827bn	$159bn
Enterprise Value	$674bn	$177bn
Avg. Vol. (3m)	26.3m	6.8m

Sales Breakdown (by Product): AAPL (9MFY17)



Sales Breakdown (by Segment): DIS (9MFY17)



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