CASE 10

Apple Computer and Steve P. Jobs (2006):

PIXAR ANIMATION AND WALT DISNEY COMPANY

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COMPARED TO OTHER FORTUNE 500 COMPANIES, APPLE COMPUTER HAS ALWAYS BEEN AN interesting and often exciting firm. It had been the first to make and mass-market a personal computer with its Apple IIc. The company had been the darling of the stock market in the mid-1980s when it cemented its technological advantage through the introduction of its state-of-the-art Macintosh (MAC) personal computer. Nevertheless, the Microsoft Windows operating system and Office software coupled with Intel microprocessors left Apple far behind in PC market share by the mid-1990s. Apple Computer had fallen to being just a niche player in the industry. At that time, it was rumored that the company had little future unless it merged with or sold out to another computer company. With the beginning of the 21st century, Apple's fortunes changed for the better. The introduction of the iPod catapulted Apple back into the spotlight, just at a time when Microsoft and Intel seemed to be losing momentum.

2006 was another exciting year for Apple Computer and for its management and shareholders—full of both good news and bad news.

Good News

On May 23, 2006, Apple and Nike announced a joint-technology running shoe. The new Nike shoe would have a sensor placed in a small pocket of the shoe, and a wireless receiver on the iPod Nano. The two devices were to communicate wirelessly so the runner would be able to track distances covered, calories burned, and time spent exercising. The data was to be accessible in two ways: (1) by clicking on a button and hearing it through headphones, and (2) by looking at a menu on the screen.[1]

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On August 2, 2006, Coke and Apple announced that Coke would offer codes for 70 million free iTunes to German and UK Coke customers. Coke was to be allowed to link its Web site with Apple's iTunes site.[2]

On August 23, 2006, Apple partnered with General Motors, Ford Motor, and Mazda Motor to make iPods compatible with 2007 model car stereo systems. This would cover about 70% of the cars manufactured by their three companies.[3]

On October 9, 2006, Apple Computer announced that fourth-quarter (ending September 30, 2006) profits rose 27% to $546 million, and revenues rose 32% to $4.84 billion when compared with 2005 results. Mac shipments reached 1.61 million computers, which was the highest sales in the company's history. The sales were driven by the new notebooks with the faster Intel microprocessor. Apple began using the Intel chip in January, and completed the transition in August. Mac sales were up 37% to $2.21 billion. This was the eighth straight quarter that Mac sales were over a million units. Notebooks sales were up 63% and accounted for 61% of computer sales. Notebook sales outpaced the revenues for desktop systems including the Mac. Macs comprised 46% of Apple's revenues, whereas iPods and music sold through iTunes accounted for 42%.[4]

The new iPod nano and the video player with increased storage capacity were released in September 2006. These new products assisted in driving sales up 35.3% to 8.73 million units. Apple had a 75.6% market share of music portable players in the United States, SunDisk had 9.7% and Creative Technology was in third place with 4.3%.[5] Microsoft planned to release its music player for the 2006 Christmas season with a price of $250. During fiscal 2006, Apple Computer sold 41,385,000 iPods, which was more than double the 2005 sales of 20,443,000. The quarterly growth rates from year to year for the iPods ranged from a low of 32% to an extremely high growth rate of 624.2% (see **Exhibit 1**).[6]

On November 8, 2006, Apple's management announced that iTunes Latino would offer Spanish language and bilingual shows in cooperation with NBC Universal's Telemundo. It was also to offer regional Mexican baladas y boleros and pop Latino.[7]

An announcement on November 1, 2006, stated that wireless carrier Cingular was teaming with Napster and Yahoo and did not plan to work with Apple. Napster was to have a

EXHIBIT 1
Quarterly Units Shipped and Percent Change from Year to Year Apple Computer, Inc. (Units in thousands)

Year	Quarter	Macintosh	Year to Year Change (%)	iPod	Year to Year Change (%)
2006	4	1,610	30	8,710	51
	3	1,327	12	8,117	32
	2	1,112	4	8,521	60.1
	1	1,254	20	14,043	207
2005	4	1,236	48	5,751	186.2
	3	1,182	35	6,155	624.2
	2	1,070	43	5,321	559.4
	1	1,046	26	4,580	525
2004	4	836	6	2,010	500
	3	876	14	850	183
	2	748	5	807	909
	1	829	12	733	235

Notes:
The 4th quarter ended on September 30th.
The 3rd quarter ended on June 30th.
The 2nd quarter ended on March 30th.
The 1st quarter ended on December 29th.

SOURCE: *Apple Computer, Inc., company quarterly press releases.*

$15 monthly fee. Cingular was jointly owned by AT&T and BellSouth. An analyst commented that this strategic alliance was not a major setback for Apple. According to analyst Jonathan Hoopers: "Apple might opt out with its upcoming iPhone to become 'a mobile virtual network operator' which could be a better deal."

On November 12, 2006, Apple announced that it had made an agreement with six airlines, Air France, Continental, Delta, Emirates, KLM, and United, to install iPod connections in their in-flight entertainment systems. This was scheduled for mid-2007.[8]

On November 16, 2006, Apple announced that its iPhone, the highly anticipated iPod cell phone, would include a 2.0-megapixel digital camera. An analyst estimated that this phone could add 22% to Apple's earnings in 2007. A Taiwanese source "has confirmed that an Apple iPod iPhone is now in production and that more than 10 million will be available in January, [so] . . . Steve Jobs can formally launch the new [iPhone] at Macworld in January." In addition to the iPhone, an iTV is expected in 2007. An industry analyst predicted "2007 to be one of the most exciting in Apple's history."[9]

Bad News

On August 3, 2006, a French law required Apple Computer to make its iPod player and iTunes online store compatible with rival offerings. This law was initially written to level the playing field to allow smaller rivals to compete with companies such as Sony and Apple. Apple argued that the opening of its formats would encourage software pirates. Other EU countries were looking at similar laws.[10]

On August 24, 2006, Apple management announced the recall of 1.8 million laptop batteries. The batteries were manufactured by Sony. Dell had a similar recall of 4.1 million of these Sony batteries.[11]

On September 1, 2006, the Chinese government told Hongfujin Precision Industry, a supplier of Apple Computer's iPod, to allow more than 200,000 workers to establish a trade union. China did not allow independent labor unions, but the Chinese government had been pressuring foreign-invested companies to allow state-sanctioned labor unions.[12]

On September 5, 2006, SpiralFrog, a new online music service, signed an agreement with EMI Music Publishing to authorize SpiralFrog to use EMI's music catalog for legal downloading in the United States. SpiralFrog had signed a similar deal with Universal Music Group, a unit of Vivendi. Artists covered in these deals included Sting, Nelly Furtado, Jay Z, and Kanye West.[13]

On October 21, 2006, Jon Loch Johansen, age 22, said that he had cracked Apple's iTunes copyright restrictions. The copyright protection stopped iPod users from playing downloaded music from music stores other than iTunes. The copyright protection also stopped music that had been used on an iPod from being played on a competitive music player. Johansen's Norwegian company, Double Twin Venture, planned to license the code to businesses that could use the code to sell downloadable music for playing on an iPod. Several analysts expected Apple to take legal action against Johansen and his company. In response, Johansen claimed "that he has developed (a legal) way around any restrictions."[14]

When only 15 years of age, Johansen worked with two other European programmers to hack the DVD protection code. The hackers created a free program, DeCSS, which was available on the Internet. DeCSS software allowed the user to unlock a DVD's copy protection. This allowed users to play and make copies of movies with their computers. Johansen earned the name "DVD Jon" for this hacking effort. There was a series of lawsuits in Norway and the United States.[15]

Real Networks, Inc., the owner of the RealPlayer Music Store, announced on October 21, 2006, that it was introducing a new product, Harmony. Harmony would let customers download music from the RealPlayer online store and allow them to use it on any portable music player. In response, an Apple spokesperson said that the company was looking into Real's actions under various laws, including the Digital Copyright Millennium Act, which prohibited the manufacture, sale, or distribution of code-breaking devices. Real Networks stood firm. A Real Networks executive said, "We remain committed to Harmony and to giving millions of consumers who own portable music devices, including the Apple iPod, choice and compatibility."[16]

Stock Option Investigation

On January 23, 2006, Apple announced "an internal probe uncovered irregularities related to the company's issuance of stock options granted between 1997 and 2001 when its shares fell 3 percent." The board of directors had hired an independent counsel to perform the investigation and to inform the U.S. Securities and Exchange Commission (SEC) of the probe.[17]

The internal probe resulted in examining more than 650,000 e-mails and documents and interviews of more than 40 current and former employees, directors, and advisors. A company representative said that "Jobs knew that some grants had given favorable dates 'in a few instances,' but he did not benefit from them and was not aware of the accounting implications." The investigative report "did not uncover any misconduct by any members of Apple's current management team, but it did raise serious concerns regarding the actions of two former executives." The investigation may have prompted the September 30, 2006, resignation of former Chief Financial Officer (CFO) Fred Anderson from the board.[18]

Steve Jobs stated: "I apologize to Apple's shareholders and employees for these problems, which happened on my watch. They are completely out of character for Apple." He further stated: "We will now work to resolve the remaining issues as quickly as possible and to put the proper remedial measures in place to ensure that this never happens again."[19]

On August 2, 2006, management announced that the company would likely need to restate earnings and delay filing its quarterly SEC report (10-Q) because of additional irregularities the company found in its accounting of stock options. Apple's stock fell 6.6% after this announcement. As of November 12, 2006, the company had not yet filed complete SEC-required financial statements or SEC 10-Q reports for the third and fourth quarters, and its yearly 10-K form.[20]

The problem of backdating stock options in order to maximize executive compensation existed in more than 120 other U.S. companies. Although backdating was not prohibited under SEC regulations, companies are now required to record non-cash charges for compensation expenses relating to these stock options and to restate past financial statements where this occurred.[21]

On October 10, 2006, McAfee announced that the board had fired President Weiss, and that George Sameriuk, CEO and Chairman, "will retire after stock option investigation into accounting problems that will require financial restatements." The restatements of $100 to $150 million "would cover a 10-year period."[22]

On October 12, 2006, the Minnesota attorney general's office was planning to investigate United Health Group Inc.'s stock options. United Health was already under investigation by federal regulators for "the stock options grant timing for 11 executives of the company."[23]

Apple Threatened with Delisting from the NASDAQ Exchange

In August 2006, Apple and more than a dozen other companies were warned by NASDAQ of their possibly delisting because they were late in filing their quarterly report (third quarter) as these companies worked to untangle their options accounting.[24]

Between 1995 and 2004, more than 7,300 companies were delisted from U.S. stock markets. About half were involuntary delisting. During the period 2000 to 2004, 3,000 companies were delisted from NASDAQ. A Georgetown study by Professor James L. Angel found that "roughly one for every five on the exchange in any given year . . . were delisted."[25]

Apple could have filed a tardy report with the SEC before its requested NASDAQ hearing. The filing was for the third quarter, which ended on July 1, 2005. As of October 10, 2006, the SEC 10-Q had not yet been filed.

History of Apple Computer[26]

The history of Apple Computer can be broken into four separate time periods, each with its own strategic issues and concerns.

1976–1984: The Founders Build a Company

Founded in a California garage on April 1, 1976, Apple created the personal computer revolution with powerful yet easy-to-use machines for the desktop. Steve Jobs sold his Volkswagen bus and Steve Wozniak hocked his HP programmable calculator to raise $1,300 in seed money to start their new company. Not long afterward, a mutual friend helped recruit A.C. "Mike" Markkula to help market the company and give it a million-dollar image. Even though all three founders had left the company's management team during the 1980s, Markkula continued serving on Apple's Board of Directors until August 1997.

The early success of Apple was attributed largely to marketing and technological innovation. In the high-growth industry of personal computers in the early 1980s, Apple grew quickly, staying ahead of competitors by contributing key products that stimulated the development of software for the computer. Landmark programs such as Visicalc (forerunner to Lotus 1-2-3 and other spreadsheet programs) were developed first for the Apple II. Apple also secured early dominance in the education and consumer markets by awarding hundreds of thousands of dollars in grants to schools and individuals for the development of education software.

Even with enormous competition, Apple revenues continued to grow at an unprecedented rate, reaching $583.3 million by fiscal 1982. The introduction of the Macintosh graphical user interface in 1984, which included icons, pull-down menus, and windows, became the catalyst for desktop publishing and instigated the second technological revolution attributable to Apple. Apple kept the architecture of the Macintosh proprietary, that is, it could not be cloned like the "open system" IBM PC. This allowed the company to charge a premium for its distinctive "user-friendly" features.

A shakeout in the personal computer industry began in 1983 when IBM entered the PC market, first affecting companies selling low-priced machines to consumers. Companies that made strategic blunders or that lacked sufficient distribution or brand awareness of their products disappeared.

1985–1997: Professional Managers Fail to Extend the Company

In 1985, amid a slumping market, Apple saw the departure of its founders, Jobs and Wozniak. As Chairman of the Board, Jobs had recruited John Sculley, an experienced executive from PepsiCo, to replace Jobs as Apple's CEO in 1983. Jobs had challenged Sculley when recruiting him by saying, "Do you want to spend the rest of your life selling sugared water, or do you want to change the world?" Jobs willingly gave up his title as CEO so that he could have Sculley as his mentor. In 1985, a power struggle took place between Sculley and Jobs. With his entrepreneurial orientation, Jobs wanted to continue taking the company in risky new directions. Sculley, in contrast, felt that Apple had grown to the point where it needed not only to be more careful in its strategic moves, but also to be better organized and rationally managed. The board of directors supported Sculley's request to strip Jobs of his duties. The board felt that the company needed an experienced executive to lead Apple into its next stage of development.

Jobs then resigned from the company he had founded and sold all but one share of his Apple stock. Under the leadership of John Sculley, CEO and Chairman, the company engineered a remarkable turnaround. He instituted a massive reorganization to streamline operations and expenses. It was during this time that Wozniak left the company. Macintosh sales gained momentum throughout 1986 and 1987. Sales increased 40% from $1.9 billion to $2.7 billion in fiscal 1987, and earnings jumped 41% to $217 million.

In the early 1990s, Apple sold more personal computers than any other computer company. Net sales grew to over $7 billion, net income to over $540 million, and earnings per share to $4.33. The period from 1993 to 1995 was, however, a time of considerable change in the management of Apple. The industry was rapidly changing. Personal computers using Microsoft's Windows operating system and Office software plus Intel microprocessors began to dominate the personal computer market place. (The alliance between Microsoft and Intel was known in the trade as Wintel.) Dell, Hewlett-Packard, Compaq, and Gateway replaced both IBM and Apple as the primary makers of PCs. The new Windows system had successfully imitated the user-friendly "look and feel" of Apple's Macintosh operating system. As a result, Apple lost its competitive edge. In June 1993, Sculley was forced to resign and Michael H. Spindler was appointed CEO of the company. At this time, Apple was receiving a number of offers to acquire the company. Many of the company's executives advocated Apple's merging with another company. When no merger took place, many executives chose to resign.

Unable to reverse the company's falling sales, Spindler was soon forced out and Gilbert Amelio was hired from outside Apple to serve as CEO. Amelio's regime presided over an accelerated loss of market share, deteriorating earnings, and stock that had lost half of its value, Apple's refusal to license the Mac operating system to other manufacturers had given Microsoft the opening it needed to take the market with its Windows operating system. Wintel PCs now dominated the market—pushing Apple into a steadily declining market niche composed primary of artisans and teachers. By 1996, Apple's management seemed be in utter disarray.

Looking for a new product with which Apple could retake the initiative in personal computers, the company bought NeXT for $402 million on December 20, 1996. Steve Jobs had formed the NeXT computer company when he left Apple. Jobs had envisioned his new company as the developer of the "next generation" in personal computers. Part of the purchase agreement was that Jobs would return to Apple as a consultant. In July of 1997, Amelio resigned and was replaced by Steve Jobs as Apple's interim CEO (iCEO). This ended Steve Jobs' 14-year exile from the company that he and Wozniak had founded. In addition to being iCEO of Apple, Jobs also served as CEO of Pixar, a company he had personally purchased from Lucasfilm for $5 million. Receiving only $1.00 a year as CEO of both Pixar and Apple, Jobs held the Guinness World Record as the "Lowest Paid Chief Executive Officer."

1998 to 2001: Jobs Leads Apple "Back to the Future"

Once in position as Apple's CEO, Steve Jobs terminated many of the company's existing projects. Dropped were the iBook and the AirPort products series, which had helped popularize the use of wireless LAN technology to connect a computer to a network.

In May 2001, the company announced the reopening of Apple Retail Stores. Like IBM and Xerox, Apple had opened its own retail stores to market its computers during the 1980s. All such stores had been closed when Wintel-type computers began being sold by mass merchandisers, such as Sears and Circuit City, and through corporate Web sites.

The iPod portable digital audio player was introduced, and the company opened its own iTunes music store to provide downloaded music to iPod users. Given the thorny copyright issues inherent in the music business, analysts doubted if the new product would be successful.

2002–2006: A Corporate Renaissance?

In 2002, Apple introduced a redesigned iMac using a 64-bit processor. The iMac had a hemispherical base and a flat-panel all-digital display. Although it received a lot of press, the iMac failed to live up to its sales expectations.

In 2004 and 2005, Apple opened its first retail stores in Europe and Canada. By November 2006, the company had 149 stores in the United States, 4 stores in Canada, 7 stores in the United Kingdom, and 7 stores in Japan.

In 2006, Jobs announced that Apple would sell an Intel-based Macintosh. Previously Microsoft had purchased all of its microprocessors from Motorola. By this time, Microsoft's operating system with Intel microprocessors was running on 97.5% of the personal computers sold, with Apple having only a 2.5% share of the market. The first Intel-based machines, the iMac and MacBook Pro, were introduced.

By this time, Apple's iPod had emerged as the market leader of a completely new industry category, which it had created. In 2006, Apple controlled 75.6% of the market, followed by SunDisk with 9.7%, and Creative Technology in third place with 4.3%. Although one analyst predicted that more than 30 million iPods would be sold in fiscal 2006, Apple actually sold 41,385,000. Taking advantage of its lead in music downloading, the company's next strategic move was to extend its iTunes music stores by offering movies for $9.99 each. An analyst reviewing this strategic move said, "Apple was able to create a $1 billion-a-year market for the legal sale of music. Apple may be able to provide the movie industry with a similar formula."

Steven P. Jobs: Entrepreneur and Corporate Executive[27]

Steve P. Jobs was born on February 24, 1955, in San Francisco and was currently married with three daughters. He was adopted by Paul and Clara Jobs in February 1955. In 1972, Jobs graduated from Homestead High School in Los Altos, California. His high school electronics teacher said, "He was somewhat of a loner and always had a different way of looking at things."[28] After graduation, Jobs was hired by Hewlett-Packard as a summer employee. This is where he met Steve Wozniak, a recent dropout from The University of California at Berkeley. Wozniak had a genius IQ and was an engineering whiz with a passion for inventing electronic gadgets. At this time, Wozniak was perfecting his "blue box," an illegal pocket-size telephone attachment that allowed the user to make free long-distance calls. Jobs helped Wozniak sell this device to customers.[29]

In 1972, Jobs enrolled at Reed College in Portland, Oregon, but dropped out after one semester. He remained around Reed for a year and became involved in the counterculture. He enrolled in various classes in philosophy and other topics. In a later speech at Stanford University, Jobs explained, "If I had never dropped in on that single course (calligraphy), that Mac would have never had multiple type faces or proportionally spaced fonts."[30]

In early 1974, Jobs took a job as a video-game designer for Atari, a pioneer in electronic arcade games. After earning enough money, Jobs went to India in search of personal spiritual enlightenment. Later that year, Jobs returned to California and began attending meetings of Steve Wozniak's "Homebrew Computer Club." Wozniak converted his TV monitor into what would become a computer. Wozniak was a very good engineer and extremely interested in creating new electronic devices. Jobs was not interested in developing new devices, but he realized the marketability of Wozniak's converted TV. Together they designed the Apple I computer in Jobs' bedroom and built the first prototype in Jobs' garage. Jobs showed the Apple I to a local electronics retailer, the Byte Shop, and received a $25,000 order for 50 computers. Jobs took this purchase order to Cramer Electronics to order the components needed to assemble the 50 computers.

The local credit manager asked Jobs how he was going to pay for the parts and he replied, "I have this purchase order from the Byte Shop chain of computer stores for 50 of my computers and the payment terms are COD. If you give me the parts on a net 30 day terms, I can build and deliver the computers in that time frame, collect my money from Turrell at the Byte Shop and pay you." With that, the credit manager called Paul Terrell who was attending an IEEE computer conference . . . and verified the validity of the purchase order. Amazed at the tenacity of Jobs, Turrell assured the credit manager if the computers showed up in his stores Jobs would be paid and would have more than enough money to pay for the parts order. The two Steves and their small crew spent day and night building and testing the computers and delivered to Turrell on time to pay his suppliers and have a tidy profit left over for their celebration and next order. Steve Jobs had found a way to finance his soon-to-be multimillion-dollar company without giving away one share of stock or ownership.[31]

Jobs and Wozniak decided to start a computer company to manufacture and sell personal computers. They contributed $1,300 of their own money to start the business. Jobs selected the name Apple for the company based on his memories of a summer job as an orchard worker. On April 1, 1976, Apple Computer Company was formed as a partnership.

During Jobs' early tenure at Apple, he was a persuasive and charismatic evangelist for Apple. Some of his employees have described him at that time as an erratic and tempestuous manager. An analyst said "many persons who look at Jobs' management style forget that he was 30 years old in 1985 and he received his management and leadership education on the job." Jobs guided the company's revenues to $1,515,616,000 and profits of $64,055,000 in 1984. Jobs was cited in several articles as having a demanding and aggressive personality. One analyst said that these two attributes described most of the successful entrepreneurs. Jobs strategically managed the company through a period of new product introduction, rapidly changing technology, and intense competition—a time when many companies have failed.

In 1985, after leaving Apple, Jobs formed a new computer company, NeXT Computer Inc. NeXT was a computer company that built machines with futuristic designs and ran the UNIX-derived NeXT step operating system. It was marketed to academic and scientific organizations. NeXT was not a commercial success, in part because of its high price. Jobs served as Chairman and CEO.[32]

In 1986, Jobs purchased Pixar Animation from Lucasfilm for $5 million. He provided another $5 million in capital, owned 50.6% of the stock, and served as Chairman and CEO. Pixar created three of the six highest domestic grossing (gross revenues) animated films of all time—*Toy Story* (1995), *A Bug's Life* (1998), and *Toy Story II* (1999). These films were released under a partnership with the Walt Disney Company. Each of these films was the highest grossing animated film for the year in which it was released. During this period, Jobs delegated more to his executives. Many analysts felt that the excellent executive staff and animators were prime reasons that Disney management subsequently wanted to acquire Pixar. Jobs served as CEO of NeXT and Pixar from 1985 to 1997. Jobs sold NeXT in 1996 to Apple for $402 million and became iCEO of Apple in July 1997.[33]

At Pixar, Jobs focused on business duties, which was different than his earlier management style at Apple. The creative staff was given a great deal of autonomy. Sources say he spent less than one day a week at the Pixar campus in Emeryville, just across the San Francisco Bay from Apple's headquarters. A Pixar employee said, "Steve did not tell us what to do." He further stated, "Steve's our benevolent benefactor."[34]

Michael D, Eisner, CEO of the Walt Disney Company, did not have a smooth relationship with Jobs during the years of the Pixar/Disney partnership. Critics explained that Eisner was unable to work with Jobs because both men were supremely confident (some said arrogant) that their own judgment was correct—regardless of what others said. In 2005, in response to Eisner's unwillingness to modify Disney's movie distribution agreement with Pixar, Jobs refused to renew the contract. At the time, Disney's own animation unit was faltering and unable to match Pixar's new computer technology and creativity. Concerned with Eisner's leadership style and his inability to support the company's distinctive competence in animation, Roy Disney led a shareholders' revolt. On October 1, 2005, Eisner was replaced by Robert A. Iger as CEO of Disney.[35]

On January 24, 2006, CEO Iger announced that Disney had agreed to pay $7.4 billion in stock to acquire Pixar Animation Studios. Since this deal made Jobs the largest stockholder (6.67%) in Disney, he was appointed to Disney's board of directors.[36]

Edward S. Woodward, Jr., former Chairman of Apple Computer, told Apple's board of directors: "He (Jobs) has a good relationship with you; there is nobody better with you; there is nobody better in the world to work with. Iger made a very wise move, and two years from now everyone will be saying that."[37]

Peter Burrows and Ronald Grover in an article said: "The alliance between Jobs and Disney is full of promise. If he can bring to Disney the same kind of industry-sharing, boundary-busting energy that has lifted Apple and Pixar sky-high, he could help the staid company become the leading laboratory for media convergences. It's not hard to imagine a day when you could fire up your Apple TV and watch net-only spin-offs of popular TV shows from Disney's ABC Inc. (DIS). Or use your Apple iPhone to watch Los Angeles Lakers superstar Kobe Bryant's video biog delivered via Disney's ESPN Inc. 'We've been talking about a lot of things, said Jobs. 'It's going to be a pretty exciting world looking ahead over the next five years.'"[38]

An expert on Jobs asked, "*So what is Jobs' secret*?" His answer: "There are many, but it starts with focus and a non-religious faith in his strategy." In his return to Apple, he took a proprietary approach as he cut dozen of projects and products. Many on Wall Street were not initially happy with Jobs' new directions for the company, but soon were impressed by the Apple's successful turnaround.[39]

Corporate Governance[40]

Exhibit 2 lists the seven members of the board of directors and the executive officers as of October 8, 2006. Steve Jobs, as CEO, was the only internal board member and the only member who had served on the original board. On September 30, 2006, Fred Anderson, who had joined the board in 2004, resigned from the board over the stock options investigation. On August 28, 2006, Dr. Eric Schmidt, CEO of Google, was appointed to the board. He did not accept the automatic 30,000 stock options available to all new board members. Shaw Nu, analyst, said, "He (Schmidt) gives Jobs and Apple more perspective on dealing with Microsoft. . . . And like Jobs, Schmidt has lost at times against (Microsoft)." As soon as Schmidt's board appointment was announced, speculation began about the potential for future partnerships between Google and Apple.

External board members received $50,000 as an annual retainer. In addition, directors were eligible to receive up to two free computer systems, and discounts on the purchase of additional products. On the fourth anniversary of joining the board, each member was entitled to receive an option to acquire 30,000 shares of stock.

Although Steve Jobs' annual salary was only $1.00 as CEO of Apple, the board gave Jobs a bonus of $84 million in 2001, consisting of $43.5 million for a private jet, a Gulfstream V, as well as $40.5 million to pay Jobs' income taxes on this bonus. Jobs owned 10,200,004 (1.25%) of Apple's stock. The closing price on November 21, 2006, was $88.60 per share. Together, the directors and executives owned 16,307,625 (1.94%) shares of stock. Barclay Bank Plc owned 67,094,321 (8.09%) shares and FMR Corporation owned 51,250,663 (6.18%) shares of Apple. These are the two financial institutions with more than 5% ownership.

EXHIBIT 2
Directors and Executive Officers: Apple Computer Inc.

A. Directors

Name	Position	Age	Since
Fred A. Anderson	Director	61	2004
William V. Campbell	Co-lead Director	65	1997
Millard S. Drexler	Director	61	1999
Albert A. Gore, Jr.	Director	57	2000
Steven P. Jobs	Director and CEO	50	1997
Arthur D. Levinson	Co-lead Director	55	2000
Jerome B. York	Director	67	1997

B. Executives

Steven P. Jobs
CEO, Apple
CEO, Pixar
Director, Apple
Director, Walt Disney

Timothy D. Cook
Chief Operating Officer

Nancy R. Heinen
Senior Vice President
and General Counsel

Ron Johnson
Senior Vice President Retail

Peter Oppenheimer
Senior Vice President
Chief Financial Officer

Dr. Avdias "Avie" Tevanian, Jr.
Chief Software Technology Officer

Jon Rubinstein
Senior Vice President
iPod Divison

Philip W. Schiller
Senior Vice President
Worldwide Product Marketing

Bertrand Seriet
Senior Vice President
Software Engineering

Sina Tamaddon
Senior Vice President, Applications

SOURCE: *Apple Computer, Ind., SEC 10-K Report (December 1, 2005), p. 102.*

Management's View of the Company[41]

Apple Computer's 10-K Report for the fiscal year ended September 24, 2005 contained the following analysis of the company by management:

First, the company designed, manufactured, and marketed personal computers and related software, services, peripherals, and networking solutions. The company also designed, developed, and marketed a line of portable digital music players along with related accessories and services including the online distribution of third-party music, audio books music videos, short films and television shows. The company's products and services included the Macintosh line of desktop and notebook computers, the iPod digital music player, the Xserve G5 server and the Xserve RAID storage products, a portfolio of consumer and professional software applications, the Mac OS X operating system, the iTunes Music Store, a portfolio of peripherals that support and enhance the Macintosh and iPod product lines, and a variety of other service and support offerings. The company sold its products worldwide through its online stores, its own retail stores, its direct sales force, and third-party wholesalers, resellers, and value added resellers. In addition, the company sold a variety of third-party Macintosh compatible products, including computer printers and printing supplies, storage devices, computer memory, digital camcorders and still cameras, personal digital assistants, and various other computing products and supplies *through its online and retail stores. The company sells to* education, consumer, creative, professional, business, and government customers.

Second, the company's business strategy leveraged its ability, through the design and development of its own operating system, hardware, and many software applications and technologies, to bring to its customers around the world compelling new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design.

Third, the company participated in several highly competitive markets, including personal computers *with its* Macintosh line *of computers,* consumer electronics *with its* iPod line *of digital music players, and distribution of third-party digital content through its online* iTunes Music Store. *While the company was widely recognized as an innovator in the personal computer and consumer electronic markets as well as a leader in the emerging market for distribution of digital content, these were all highly competitive markets that are subject to aggressive pricing and increased competition. To remain competitive, the company believed that increased investment in research and development (R&D) and marketing and advertising was necessary to maintain and extend its position in the markets where it competes. The company's R&D spending was focused on delivering timely updates and enhancements to its existing line of personal computers displays, operating systems, software applications, and portable music players; developing new digital lifestyle consumer and professional software applications: and investing in new product areas such as rack-mount servers, RAID storage systems, and wireless technologies. The company also believed investment in marketing and advertising programs was critical to increasing product and brand awareness.*

Fourth, in June 2005, the company announced its plan to begin using Intel microprocessors in its Macintosh computers. The company planned to begin shipping certain models with Intel microprocessors by June 2006 (which the company did) and to complete the transition of all of its Macintosh computers to Intel microprocessors by the end of calendar year 2007.

Fifth, the company utilized a variety of direct and indirect distribution channels. The company believed that sales of its innovative and differentiated products were enhanced by knowledgeable salespersons who can convey the value of the hardware, software, and peripheral integration, demonstrate the unique digital lifestyle solutions of the Windows platform and networks. The company further believed that providing a high-quality sales and after-sales support experience was critical to attracting and retaining customers. To ensure a high-quality buying experience for its products in which service and education are emphasized, the company had expanded and improved its distribution capabilities by opening its own retail stores in the U.S. and internationally. The company had 124 stores open as of September 24, 2005.

Sixth, the company also staffs selected third-party stores with the company's own employees to improve the buying experience through reseller channels. The company had deployed Apple employees and contractors in reseller locations around the world including the U.S., Europe, Japan, and Australia. The company also sold to customers directly through its online stores around the world.

Seventh, to improve access to the iPod product line, the company had significantly expanded the number of distribution points where iPods are sold. The iPod product line can be purchased in certain department stores, member-only warehouse stores, large retail chains, and specialty retail stores, as well as through the channels listed above.

Business Strategy[42]

The company was committed to bringing the best personal computing and music experience to students, educators, creative professional, businesses, government agencies, and consumers through its innovative hardware, software, peripherals, services, and Internet offerings. The company's business strategy leverages its unique ability through the design and development of its own operating system, hardware, and many software applications and technologies, to bring to its customers new products and solutions with superior ease-of-use, seamless integration, and innovative industrial design. The company believed continual investment in research and development is critical to facilitate innovation of new and improved products and technologies. Besides updates to its existing line of personal computers and related software, services, peripherals, and networking solutions, the company continued to capitalize on the convergence of digital consumer electronics and computers by creating innovations like the iPod and iTunes Music Store. The company's strategy also included expanding its distribution network to effectively reach more of its targeted customers and provide them a high-quality sales and after-sales support experience.

Digital Hub

The company believed personal computing was in an era in which the personal computer functions for both professionals and consumers as the digital hub for advanced new digital devices such as the company's iPod digital music players, personal digital assistants, cellular phone, digital camcorders and still cameras, CD and DVD players, televisions, and other consumer electronic devices. The attributes of the personal computer included a high quality user interface, relatively inexpensive data storage, and the ability to run complex applications and easily connect to the Internet. Apple was the only company in the personal computer industry that controls the design and development of the entire personal computer—from the hardware and operating system to sophisticated application. Additionally, the company's products provided innovative industrial design, intuitive ease-of-use, and built-in networking, graphics, and multimedia capabilities. Thus, the company was uniquely positioned to offer integrated digital hub products and solutions.

The company developed products and technologies that adhere to many industry standards in order to provide an optimized user experience through interoperability with peripherals and devices from other companies. The company had played a role in the development, enhancement, promotion, and/or use of numerous of these industry standards.

Expanded Distribution

The company believed that a high quality buying experience with knowledgeable salespersons who can convey the value of the company's products and services was critical to attracting and retaining customers. The company sold many of its products and resold certain third-party products in most of its major markets directly to consumers, education customers, and businesses through its retail and online stores in the U.S. and internationally. The company had also invested in programs to enhance reseller sales, including the Apple Sales Consultant Program, which consisted of the deployment of Apple employees and contractors to selected third-party reseller locations. The company believed providing direct contact with its targeted customers is an efficient way to demonstrate the advantage of its Macintosh computer and other products over those of its competitors. The company had significantly increased the points of distribution for the iPod product family in order to make its products available at locations where its customers shop.

From inception of the retail initiative in 2001 through 2005, the company had opened 116 retail stores in the U.S. and 8 international stores in Canada, Japan, and the U.K. The company opened 2 additional stores in October of 2005. The company had typically located its stores at high traffic locations in quality shopping malls and urban shopping districts.

One of the goals of the retail initiative was to bring new customers to the company and expand its installed base through sales to computer users who currently did not own a Macintosh computer and first time personal computer buyers. By operating its own stores and building them in desirable high traffic locations, the company was able to better control the customer retail experience and attract new customers. The stores were designed to simplify and enhance the presentation and marketing of personal computing products. To that end, retail stores configurations had evolved into various sizes in order to accommodate market demands. The stores employed experienced and knowledgeable personnel who provided product advice and certain hardware support services. The stores offered a wide selection of third-party hardware, software, and various other computing products and supplies selected to complement the company's own products. Additionally, the stores provided forum in which the company was able to present computing solutions to users in areas such as digital photography, digital video, music, children's software, and home and small business computing.

Education

For more than 25 years, the company had focused on the use of technology in education and had been committed to delivering tools to help educators teach and students learn. The company believed effective integration of technology into classroom instruction can result in higher levels of student achievement, especially when used to support collaboration, information access, and the expression and representation of student thought and ideas. The company created solutions that enable new modes of curriculum delivery, better ways of conducting research, and opportunities for professional development of faculty, students, and staff. The company had designed a range of products and services to help schools maximize their investments in the needs of education customers. These products and services included the eMac™, and the iBook®, video creation and editing solutions, wireless networking, student information systems, high-quality curriculum and professional development solutions, and one-to-one (1:1) learning solutions (primarily in K–12). 1:1 learning solutions typically consisted of iBook portable computers for every student and teacher along with a wireless network connected to a central server.

Creative Professionals

Creative professionals constitutes one of the company's most important markets for both hardware and software products. This market was also important to many third-party developers who provide Macintosh-compatible hardware and software solutions. Creative customers utilized the company's products for a variety of creative activities including digital video and film production and editing; digital video and film special effects, compositing, and titling; digital still photography and workflow management; graphic design, publishing, and print production; music creation and production; audio production and sound design; and web design, development, and administration.

The company designed its high-end hardware solutions, including servers, desktops, and portable Macintosh systems, to incorporate the power, expandability, and features desired by creative professional. The company's operating system, Mac OS X, incorporated powerful graphics and audio technologies and features developer tools to optimize system and application performance when running powerful creative solutions provided by the company or third-party developers. The company also offered various software solutions to meet the needs of its creative customers.

Business Organization[43]

The company managed its business primarily on a geographic basis. The company's reportable operating segments are comprised of the Americas, Europe, Japan, and Retail. The Americas, Japan, and reportable segments did not include activities related to the Retail segments. The Americas segment included both North and South America. The Europe segment included European countries as well as the Middle East and Africa. The Retail segment currently operates Apple-owned retail stores in the U.S., Canada, Japan, and the U.K.

Other operating segments included Asia-Pacific, which included Australia and Asia except for Japan, and the company's subsidiary, FileMaker, Inc. Each reportable geographic operating segment provided similar hardware and software products and similar services.

Current Products

Apple Computer designed, manufactured and marketed PCs and related software, services, networking solutions, worldwide and peripherals. The company products and services included the (1) Macintosh line of notebooks and desktop computers (iMac, MacBook, Mac mini, Mac Pro); (2) iPod digital music players (iPod Nano, iPod, iPod Hi-Fi); (3) Mac OS X operating system; (4) Xserve, G5 server, and Xserve RAID storage products; (5) a portfolio of professional and consumer software applications; (6) Mac OS X operating system; (7) iTunes Music Store; and (8) a portfolio of peripherals that support and enhance the Macintosh and iPod product lines. The company's pro video peripherals support the Macintosh and iPod product lines. The company offered products and services for the educational industry which included the eMac, iMac, and iBook, creation and editing solutions, wireless networking and student information systems, curriculum and professional development solutions, and one-on-one learning solutions. The company makes announcements on new products and services on a continuous basis.

Competition

The company was confronted by aggressive competition in all areas of business. The market for personal computer and related software and peripheral products was highly competitive. This market continued to be characterized by rapid technological advances in both hardware and software that had substantially increased the capabilities and use of personal computers and had resulted in the frequent introduction of new products with competitive price, features, and performance characteristics. Over the past several years, price competition in the personal computer market had been particularly intense. The company's competitors that sold personal computers based on other operating systems had aggressively cut prices and lowered product quality to maintain market share. The company's results of operations and financials can be adversely affected by these and other industry-wide downward pressures on gross margins.

The principal competitive factors in the market for personal computers included price, retail price performance, product qualities and reliability, design innovation, availability of software, product features, marketing and distribution capability, service and support, availability of hardware peripherals, and corporate reputation. Further, as the personal computer industry and its customers placed more reliance on the Internet, an increasing number of Internet devices that are simpler, and less expensive, than traditional personal computers may compete for market share with the company's existing products.

The company was currently taking and will continue to take steps to respond to the competitive pressures being placed on personal computer sales. The company's future operating results and financial condition were substantially dependent on its ability to continue to develop improvements to the Macintosh platform in order to maintain perceived functional and design advantages over competing platforms.

The company's services and products relating to music, and other creative content, had already encouraged significant competition from other companies, many of whom had greater financial, marketing, and manufacturing resources than those of the company. The company faced increasing competition from other companies promoting their own digital and distribution music products services, subscription services, and free peer-to-peer music services. The company anticipated the competition will intensify as hardware, software, and content providers work more collaboratively to offer integrated products competition with the company's offering. However, the company believed it currently maintained a competitive advantage by more effectively integrating an entire solution, including the hardware (iPod), software (iTunes), and distribution of third-party digital content (iTunes Music Store).[44]

The chief iPod competitors were SunDisk and Microsoft's new MP3 player, Zune. The iPod had a 77 percent market share and SunDisk had a 10 percent market share. Peter Lewis of *Fortune* magazine reported "It [Zune] was bigger and heavier and more difficult to use." Zune will sell for around $250. Microsoft will use Universal Music Group, which was owned by Vivendi, and its artist, Microsoft will pay a fee for each song and an additional payment will be made. Apple paid the studios per song. Vivendi was the largest music company, and did not sell music to Apple[45].

The company's competitors were Dell, HP, Gateway, Toshibo, Lenovo, and Acer. U.S. market share information for the 3rd quarter of 2006 was:

Company	Market Share[46]
Dell	32.1%
HP	23.0
Gateway	6.4
Apple	6.1
Toshiba	5.1

The U.S. Mac market share had grown 31 percent in the 3rd quarter, when compared with the 3rd quarter of 2005. In 2005, 744,000 units were sold compared to 975,000 units being sold in 2006. Dell sales declined by 7.1 percent, while Hewlett-Packard's (HP) share grew from 21.2 percent to 23.0 percent.

During this period, Apple's worldwide share did not place it among the top-selling PCs. HP moved into first place with 16.1 percent market share. HP had not been in first place since first quarter of 2003. Dell was in second place with a 16.0 percent market share. Lenovo's market share was 7.5 percent, followed by Acer with a 5.1 percent, and Toshiba with 4.3 percent.

Distribution and Marketing[47]

The company believed that a high quality buying experience with a knowledgeable salesperson who can convey the values of the company's products and services was critical to attracting and retaining customers. The company sold many of its products and resold certain third-party products in most of the major markets directly to customers, education customers and business through its retail and online stores in the U.S. and internationally. The company had invested in programs to enhance reseller sales, including the Apple Sales Consumer Program, which consisted of the department of Apple employees and contractors to select third-party reseller locations. The company believed in providing direct contact with its products over those of its competitors. The company had significantly increased the points of distribution for the iPod product family, in order to make its products available at locations where its customers shopped.

One of our goals of retail initiative was to bring new customers to the company and expand its installed base through sales to computer buyers who do not own a Macintosh computer and the first time personal computer buyer. By operating in its own stores and building them in desirable high traffic locations, the company was able to better control the customer's retail experience and to attract new customers. The stores were designed to simplify and enhance the presentation and marketing of personal computing products. To that end retail store configurations had evolved into various sizes in order to accommodate market demands. The stores employ experienced and knowledgeable personnel who provided product advice and certain hardware support services. The store offered a wide selection of third-party hardware, software, and various other computing products and supplies selected to complement the company's own products. Additionally, the store provided a forum in which the company was able to present computing solutions to users in areas such as digital photography digital video, music, children's software, and home and small business computing.

Advertising[48]

Advertising costs totaled $205 million, $193 million, and $209 million for 2004, 2003, and 2002, respectively. All forms of advertising (print, internet, etc.) were used by Apple to introduce new products and sustain existing products. Advertising was focused on the target market.

Research and Development[49]

Because the personal computer and consumer electronics industries were characterized by rapid technological advances, the company's ability to compete successfully was heavily dependent upon its ability to ensure a continuing and timely flow of competitive products and technology to the market. The company continued to develop new products and technologies and to enhance existing in the areas of hardware, and peripherals, consumer electronic products, system software, application software, networking and communications software and solutions, and the Internet. The company may expand the range of its product offerings and intellectual property through licensing and/or acquisition of third-party business and technology. The company's research and development expenditures totaled $534 million, $489 million, and $471 million in 2005, 2004 and 2003, respectively.

Patents, Trademark, Copyright, and Licensing[50]

The company currently held the rights to patents and copyrights relating to certain aspects of its computer systems, iPod, peripheral, and software. In addition, the company had registered, and/or had applied to register, trademarks and service marks in the U.S. and a member of foreign countries for "Apple," the Apple logo, "Macintosh," "iPod," "iTunes," "iTunes Music Store," and numerous other trademarks and service marks. Although the company believed the ownership of such patents, copyrights, trademarks, and service marks was an important factor in its business, and that its success does depend in partly on the ownership thereof, the company relied primarily on innovative skills, technical competences, and marketing abilities of the personnel.

Many of the company's products were designed to include intellectual property obtained from third parties. While it may be necessary in the future to seek or renew licensing relating to various aspects of its products and business methods, the company believed that, based upon past experience and industry practice, such licenses generally could be obtained on commercially reasonable terms. However, there was no guarantee that such licenses can be obtained at all. Because of technologies changes in the computer industry, current extensive patent coverage, and the rapid rate of issuance of new patents it was possible certain components of the company's products and business methods may unknowingly infringe existing patents of others. From time to time, the company had been notified that it may be infringing certain patents or intellectual property rights of third-parties.

Properties[51]

The company headquarters were located in Cupertino, California. The company had manufacturing facilities in Cork, Ireland. The company owned or leased buildings in other locations.

Foreign and Domestic Operations and Geographic Data[52]

The U.S. represented the company's largest geographic marketplace. Approximately 60 percent of the company's net sales in 2005 came from sales inside the U.S. Final assembly of products sold by the company was conducted in the company's manufacturing facilities in Cork, Ireland and external vendors in Fremont and Fullerton, California, Taiwan, Korea, the People's Republic of China, and the Czech Republic. Currently, manufacture of many of the components used in the company's products and final assembly of substantially all of the company's portable products including PowerBooks, iBooks, and iPods were performed by third-party vendors in China. Margins on sales of the company's products in foreign countries, and sales of products that included components obtained from foreign suppliers, can be adversely affected by foreign currencies exchange rate fluctuations and international trade regulations, including tariffs and antidumping penalties.

Seasonality[53]

The company had historically experienced increased net sales in the first and fourth quarters compared to other quarters in the fiscal year (ending September 24, 2005) due to seasonal demand related to the holiday season and the beginning of the school year. This historical pattern should not be considered a reliable indicator of the company's future net sales or financial performance.

Raw Materials[54]

Although most components essential to the company's business were generally available from multiple sources, certain key components [including microprocessors and application-specific integrated circuits ("ASIC")] were currently obtained by the company from single or limited sources. Some other key components, while currently available to the company from multiple sources, were at times subject to industry-wide availability constraints and pricing pressures. In addition, the company used some components that were not common to the rest of the personal computers and consumer electronics industries, and new products introduced in the company often initially utilize current components.

Environmental Laws[55]

Compliance with federal, state, local, and foreign laws for the protection of the environment had to date no material effect on the company's capital expenditures, earnings, or competitive position. In the future, these laws could have a material adverse effect on the company.

Production and marketing of products in certain states and countries may subject the company to environmental and other regulations, such as the requirement that the company provide consumers with the ability to return product to the company at the end of its useful life, and place responsibility for environmentally safe disposal or recycling with the company. Such laws and regulations had recently been passed in several jurisdictions in which the company operates, including various European Union member states, Japan, and California. In the future, these laws could have a material adverse effect on the company.

Employees[56]

The company had 14,800 full-time employees and 2,200 temporary employees and contractors.

Legal Proceedings[57]

Apple Computer was subject to certain legal proceedings and claims, which have arisen in the ordinary course of business and had not been fully adjudicated in the opinion of management, the company did not have a potential liability related to any existing legal proceedings and claims that will have a material adverse effect on the financial condition and operating results. In 2005, the company settled several issues and the settlements individually or in the aggregate have a material impact on the company's financial results.

The European Commission had notified the company that it was being investigated relating to the iTune Music Store in the European Union (EU). The case focuses on EU competition law and contended that Apple was charging more for online music in the UK than in Eurozone countries.

An analyst expects legal action against Jon Loch Johansen and RealNetworld, over their breaking of the protection codes on the iPod.

Financial Performance[58]

Management's view of the company's 2005 financial performance (see **Exhibits 3–6**) follows:

> *Net sales of iPods rose $3.2 billion during 2005 compared to 2004. Unit sales of iPods totaled 22.5 million in 2005, which represented an increase of 400% from the 4.4 million iPod units sold in 2004. Strong sales of iPods during 2005 continued to be experienced in all the company's operating segments and was driven by a strong demand for the iPod Shuffle introduced in January 2005, the release of an updated version of the iPod Mini in February 2005, the release of the iPod Nano in September 2005, and expansion of the iPod distribution network. Net sales per iPod unit sold decreased 32 percent primarily due to the introduction of the lower priced iPod Shuffle in January 2005, and iPod Mini pricing reductions in February 2005. From the introduction of the iPod in 2002 through 2005, the company sold approximately 28 million iPods.*

Other music related products and services consisted of sales associated with the iTune Music Store and iPod services and accessories. Net sales of other music related products and services increased $621 million or 223 percent during 2005 compared to 2004. The company had experienced strong growth in sales of iPod services and accessories consistent with the increase in overall iPod unit sales for 2005. The increases sales from the iTune Music Store was primarily due to the substantial growth of net sales in the U.S. and expansion in Europe, Canada, and Japan.

Total Macintosh net sales increased $1.4 billion or 27 percent during 2005 compared to 2004. Unit sales of Macintosh systems increased 1.2 million units or 38 percent during 2005 compared to 2004. The increase in Macintosh net sales and unit sales related primarily to strong demand for the company's desktop products, which was experienced in all of the company's operating segments. The company believed that the success of the iPod was having a positive impact on Macintosh net sales by introducing new customers to the company's other products. Desktop demand was stimulated in 2005 due to the new iMac G5 and the introduction of the Mac Mini in January 2005. Net sales and unit sales of desktop products increased 45 percent and 55 percent, respectively, during 2005 compared to 2004. Macintosh net sales and unit sales also included sales of the company's portable products, which increased 11 percent and 21 percent, respectively, compared to 2004.

Future Possibility

On December 11, 2006, a *Fortune* article, "Happiness Is a Warm iPod," discussed the possibility that the Beatles may give Apple Computer's iTunes an exclusive to their recordings. The Beatles had refused for years to allow MP3, Microsoft's MSN, and Rhapsody to use their music.

EXHIBIT 3
Consolidated Statements of Operations: Apple Computer, Inc. (Dollar amounts in millions, except per share data)

Three Fiscal Years Ending September 24, 2005	2005	2004	2003
Net sales	$13,931	8,279	6,207
Cost of sales	9,888	6,020	4,499
Gross margin	4,043	2,259	1,708
Operating expenses:			
Research and development	534	489	471
Selling, general, and administrative	1,859	1,421	1,212
Restructuring costs	—	23	26
Total operating expenses	2,393	1,933	1,709
Operating income (loss)	1,650	326	(1)
Other income and expense:			
Gains on non-current investments, net	—	4	10
Interest and other income, net	165	53	83
Total other income and expense	165	57	93
Income before provision for income taxes	1,815	383	92
Provision for income taxes	480	107	24
Income before accounting changes	1,335	276	68
Cumulative effects of accounting changes, net of income taxes	—	—	1
Net income	$ 1,335	276	69
Earnings per common share before accounting changes:			
Basic	$ 1.65	$ 0.37	$ 0.09
Diluted	$ 1.56	$ 0.36	$ 0.09
Earnings per common share:			
Basic	$ 1.65	$ 0.37	$ 0.10
Diluted	$ 1.56	$ 0.36	$ 0.09
Shares used in computing earnings per share (in thousands):			
Basic	808,439	743,180	721,262
Diluted	856,780	774,622	726,932

SOURCE: *Apple Computer, SEC 10-K Report (December 1, 2005), p. 61.*

The Beatles' music was controlled by Apple Corps. Apple Corps had been in and out of courts for more than 20 years over the exclusive use of the name—"Apple." Apple Corps had opposed the use of *Apple* in *Apple* Computer. In May 2006, a London judge ruled in favor of Apple Computer in the use of the word *Apple* in the company's name. This ruling was appealed by the Beatles, and was scheduled to be heard in February 2007. Tim Arango, author of the article, said, "Clearly, if the two Apples wind up in business together, the matter is likely to be dropped."

Britain's EMi Group served as a peacemaker between Steve Jobs and Neil Aspinall, who was the Beatles' road manager and is now serving as the guardian of the Beatles' music as the business manager for Apple Corps.

The Beatles have been very protective of the use of their music. In 1987, Nike used a Beatles song as part of a TV commercial. Nike management believed it had all the legal licenses to use the song, but Nike was sued by the Beatles. Nike got caught in the crossfire between EMi and the Apple Corps. A lawyer said, "The Beatles' position is that they don't sing jingles, or anything else." Jobs would like to be able to link Paul and/or Ringo to the iPod if the deal is finalized. An analyst said that this issue could be a deal breaker. This deal could be worth hundreds of millions of dollars.

EXHIBIT 4
Consolidated Balance Sheets: Apple Computer, Inc. (Dollar amounts in millions, except per share data)

Year Ending	September 24, 2005	September 25, 2004
Assets:		
Current assets:		
Cash and cash equivalents	$3,491	$2,969
Short-term investments	4,770	2,495
Accounts receivable, less allowances of $46 and $47, respectively	895	774
Inventories	165	101
Deferred tax assets	331	231
Other current assets	648	485
Total current assets	10,300	7,055
Property, plant, and equipment, net	817	707
Goodwill	69	80
Acquired intangible assets, net	27	17
Other assets	338	191
Total assets	$11,551	$8,050
Liabilities and Shareholders' Equity:		
Current liabilities:		
Accounts payable	$ 1,779	$1,451
Accrued expenses	1,705	1,200
Total current liabilities	3,484	2,651
Non-current liabilities	601	323
Total liabilities	4,085	2,974
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value; 1,800,000,000 shares authorized; 835,019,364 and 782,887,234 shares issued and outstanding, respectively	3,521	2,514
Deferred stock compensation	(60)	(93)
Retained earnings	4,005	2,670
Accumulated other comprehensive income (loss)	—	(15)
Total shareholders' equity	7,466	5,076
Total liabilities and shareholders' equity	$11,551	$8,050

SOURCE: *Apple Computer, SEC 10-K Report (December 1, 2005), p. 60.*

EXHIBIT 5
Geographic Data: Apple Computer, Inc. (Dollar amounts in millions)

	2005	2004	2003
Americas			
Net sales	$6,590	$4,019	$3,181
Operating income	$ 798	$ 465	$ 323
Depreciation, amortization, and accretion	$ 6	$ 6	$ 5
Segment assets (a)	$ 705	$ 563	$ 494
Europe			
Net sales	$3,073	$1,799	$1,309
Operating income	$ 454	$ 280	$ 130
Depreciation, amortization, and accretion	$ 4	$ 4	$ 4
Segment assets	$ 289	$ 259	$ 252

EXHIBIT 5
(Continued)

	2005	2004	2003
Japan			
Net sales	$ 920	$ 677	$ 698
Operating income	$ 140	$ 115	$ 121
Depreciation, amortization, and accretion	$ 3	$ 2	$ 3
Segment assets	$ 199	$ 114	$ 130
Retail			
Net sales	$2,350	$1,185	$ 621
Operating income (loss)	$ 151	$ 39	$ (5)
Depreciation, amortization, and accretion (b)	$ 43	$ 35	$ 25
Segment assets (b)	$ 555	$ 351	$ 243
Other Segments (c)			
Net sales	$ 998	$ 599	$ 398
Operating income	$ 118	$ 90	$ 51
Depreciation, amortization, and accretion	$ 2	$ 2	$ 2
Segment assets	$ 133	$ 124	$ 78

Notes:
(a) The Americas asset figures do not include fixed assets held in the U.S. Such fixed assets are not allocated specifically to the Americas segment and are included in the corporate assets figures below.
(b) Retail segment depreciation and asset figures reflect the cost and related depreciation of its retail stores and related infrastructure. Retail store construction-in-progress, which is not subject to depreciation, is reflected in corporate assets.
(c) Other segments include Asia-Pacific and FileMaker.

SOURCE: *Apple Computer, SEC 10-K Report (December 1, 2005), p. 94.*

EXHIBIT 6
Segment Information: Apple Computer, Inc. (Dollar amounts in millions)

Information regarding net sales by product is as follows:

	2005	2004	2003
Net Sales:			
Desktops (a)	$ 3,436	$2,373	$2,475
Portables (b)	2,839	2,550	2,016
Total Macintosh net sales	6,275	4,923	4,491
iPod	4,540	1,306	345
Other music related products and services (c)	899	278	36
Peripherals and other hardware (d)	1,126	951	691
Software, service, and other net sales (e)	1,091	821	644
Total Net Sales	$13,931	$8,279	$6,207

Notes:
(a) Includes iMac, eMac, Mac mini, Power Mac and Xserve product lines.
(b) Includes iBook and PowerBook product lines.
(c) Consists of iTunes Music Store sales and iPod services, and Apple-branded and third-party iPod accessories.
(d) Includes sales of Apple-branded and third-party displays, wireless connectivity and networking solutions, and other hardware accessories.
(e) Includes sales of Apple-branded operating system, application software, third-party software, AppleCare, and Internet services.

SOURCE: *Apple Computer, SEC 10-K Report (December 1, 2005), p. 96.*

Conclusion

Industry analysts were very impressed with Apple Computer's recent history, but were concerned about the company's future. How long would Steve Jobs continue as CEO? Can Apple be successful without Jobs' leadership? Strategically, where should Apple go from here? What does it need to do to keep its competitive advantage in iPods?

NOTES

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