Bad Apples and other Dangerous Fruit

by Adrian Phillips

It can hardly have escaped anyone's attention that Apple Inc. has been so moved by the plight of suffering humanity that it has offered its members the possibility of alleviating their condition through buying for a few hundreds of dollars the iPhone7. The Phillips household knows better than to mention the name Apple unless it wishes to be driven fast asleep by a lengthy disquisition on the practices of that organisation or, worse, what is referred to as a "full Clarkson". Apple's admirably designed and pleasant products mask and serve a remorseless commitment to creating wholly closed systems. Apple products are great but they only interoperate with other Apple products or systems. Try using an iPad or the like to store photos downloaded from a camera and transferring them to something else.

It is little mystery, then, that Apple should, in its own estimation, have had the "courage" to discontinue the almost universal practice of equipping the product with a jack connector for earphones or speakers. This forces users to buy costly Apple proprietary products rather than items that have become so thoroughly commoditized that they are available in all qualities and at every price point. The technical benefits of Apple's "Lightning" connector port are widely touted, but the economic cost to the consumer isn't.

I'm all wrong, Jack.

Perversely Apple's desperate need to reverse its recent disappointing top line trend by returning to growth in Christmas quarter has rather monopolised discussion of the product launch. Now that a vast number of people own smartphones, it is becoming harder and harder to sell that many more, especially when, like Apple, you charge a substantial price premium. The forced migration of owners to high cost, high margin add-on products serves both to mitigate this effect and extend the corporate purity of the Apple world. It is a fair guess that the upcoming releases of other Apple products will follow suit.

Adrian Philipps

All this is hardly hidden from anyone familiar with Apple specifically or the corporate world in general, but is an open question as to how largely it will feature in the public discussion of the corporations prospects. Deep within Apple there are doubtless measures of the strategic and financial success of this strategy that will be closely followed. How much anyone outside learns of them is a quite different question. It is correspondingly hard to base any assessment of the investment merits of the shares on this point.

Apple is hardly unique in this gulf between avowed and true strategy. The most flagrant and routine example is in the world of IPOs. The only reason why a selling company or shareholders will not aim to achieve the absolute maximum price is if they will continue to hold a percentage after the IPO and calculate that a good market debut (through a generous price to buyers) will ultimately secure a higher price when they come to sell further shares. Otherwise it is buyer beware.

The question of which equity market might be chosen as the venue for an IPO is especially rich in dishonesty. When a company floats at a location other than the company's home equity market, this is almost invariably because investors there are considered gullible enough to pay a higher price or because the disclosure requirements, above all in terms of accounting or on share sales by pre-float shareholders, are less onerous. Proximity to the main buyers of a company's products is a recurrent lie, but usually some semi-flattering guff about the "greater sophistication" of investors in the floating market is enough to do the trick.

The flotation of Glencore gives an apt illustration of how concentrating on ostensible motivations

Glencore - 5-year share-price chart - yahoo

Adrian Phillips's book on the abdication crisis of 1936 *The King Who Had To Go* https://www.bitebackpublishing.com/books/the-king-who-had-to-go will be released on 13th October

suppresses discussion of underlying goals, producing an entirely skewed debate on the share. It was clear from the beginning that the initial flotation was the first step in a two-stage strategy with the next being the use of the newly quoted shares as a currency to buy full ownership of Xstrata, in which Glencore already owned a large stake. For all the insistence on the quality of earnings at the marketing or, more accurately trading, business of the original Glencore, it was clear that Xstrata's mining business would deserve a higher rating so the rating of the combined companies would have a higher rating than the marketing/trading business as a stand-alone entity. On top of this inclusion in the FTSE100 was always a goal, with the near guarantee of large share purchases from the docile and quasi-indexed British institutional investment community, which would look first at the risk of eschewing a FTSE constituent and only then at the quality or otherwise of the business.

In a closed-door and face-to-face negotiation these kind of considerations are so clear to both sides that there is no need even to mention them. Price and terms are what count. It is different in the impersonal, open book world of public equity purchases where there is scope to bamboozle investors as to what the principals in deals truly want. Analysts have little reason to incur the wrath of corporations or their advisers (potential future employers, of course) by insisting on inconvenient truths, of which their institutional clients are perfectly aware, even if they will not act on this. As private, non-indexed investors we have the freedom to walk on the other side of the street provided we trust our sense of smell and apply due scepticism to the patter behind the outstretched hand.

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