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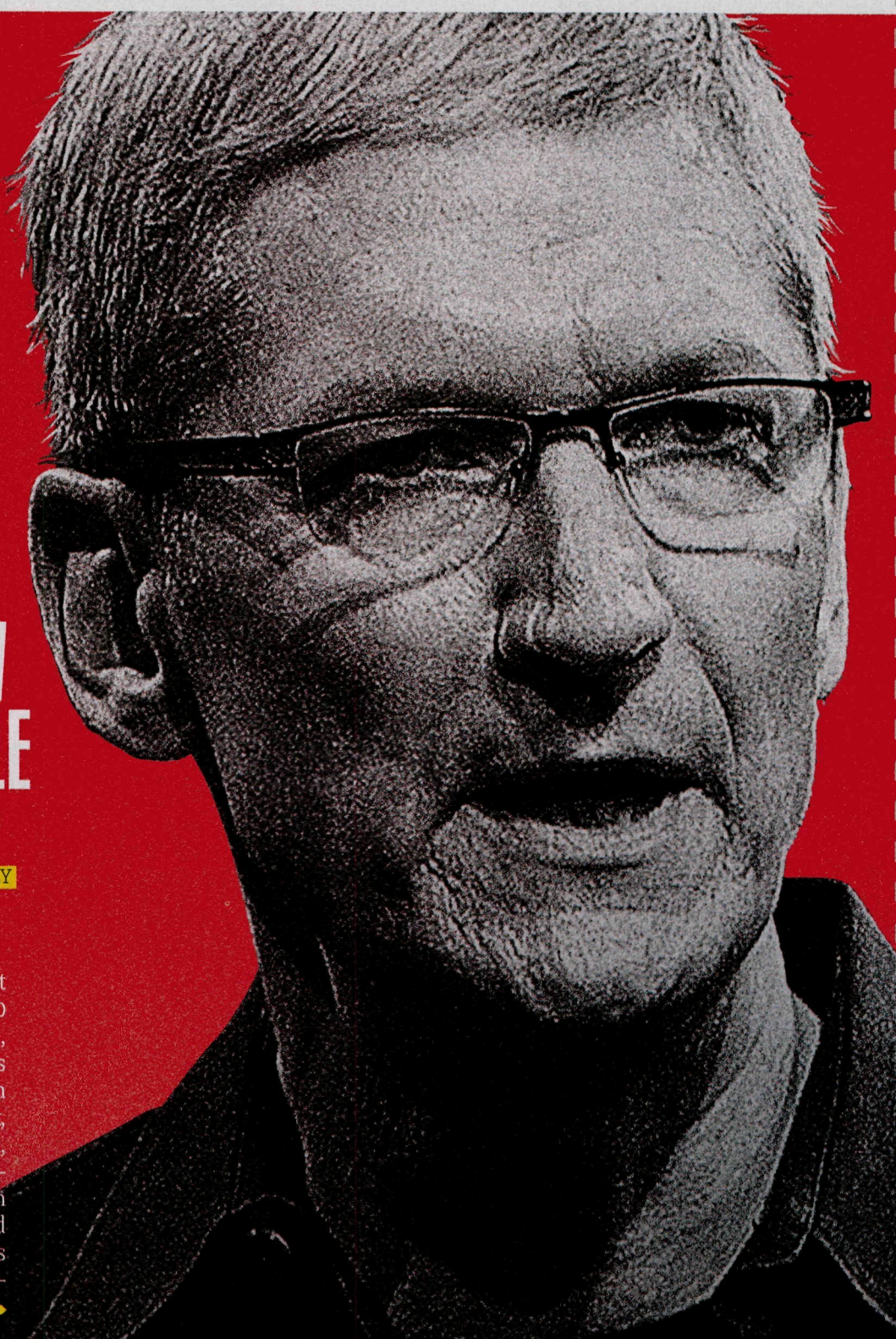
**INNOVATING IN
MICROSOFT'S GARAGE**

WHAT YOU DON'T KNOW ABOUT APPLE

**FIVE TRUTHS THAT EXPLAIN
OUR LOVE-HATE AFFAIR
WITH THE QUINTESSENTIALLY
ICONIC COMPANY.**

BY AUSTIN CARR

When Apple's market cap soared to \$660 billion last fall, the company was worth more than Amazon, Facebook, Google, Microsoft, two Nokias, and three Black-Berrys—combined. But then Apple's share price tumbled 35%, and it lost its mantle as the world's most valuable company. So what's gone wrong? ■



Could it be that Apple's best quarter ever—and the second most profitable in U.S. corporate history, at \$13.1 billion—is a head-for-the-hills disaster? With margins declining and no imminent “insanely great” new products (as Steve Jobs liked to call them), has the age of Apple come abruptly to an end?

To understand what's happening with Apple, it's prudent to step back from the noise of Wall Street and recognize five essential truths about Apple's success.

TRUTH NO. 1: Apple has never been a non-stop, new-product machine.

Apple's stock wouldn't have plunged if expectations, financial and otherwise, hadn't been so high. Apple is the market's most emotionally driven brand, “the Super Bowl for stock lunatics,” as Stock-Twits CEO Howard Lindzon puts it. Every tech blogger, hedge-fund manager, and fan has a fervent opinion about it. We have been emotionally conditioned to believe in Apple's game-changing powers.

Apple thrived on this attention and the belief that the next revolutionary product was coming: iPod, iPhone, iPad. What is too easily forgotten is that Apple's quantum leaps were never fast and furious. We forget that six years separated the launches of the iPod and the iPhone,

The marvel of Apple has been its seemingly inexhaustible capacity to pummel consumers again and again with product refinements.

and three years came between the iPhone and iPad. What is more, the pace of adoption of these products, meteoric of late, was not always so. The iPad took two years to sell 100 million units; the iPhone nearly four years; the iPod six.

Is there impatience about what's coming next? Of course. Wall Street is indignant that Apple hasn't announced a wearable computer, say, or a voice-controlled TV. As Lindzon says, “Apple's problem is that it can't dance to what Wall Street wants.” But, frankly, it never has.

TRUTH NO. 2: The real driver of Apple's success has been incremental innovation.

If the magic of Steve Jobs was his aptitude for conceiving new product categories, the marvel of Apple has been its seemingly inexhaustible capacity to pummel consumers again and again with product refinements. Apple has earned a distinc-

tive reputation for thriving with only a handful of products; often overlooked is how many different versions of these few products Apple continually rolls out.

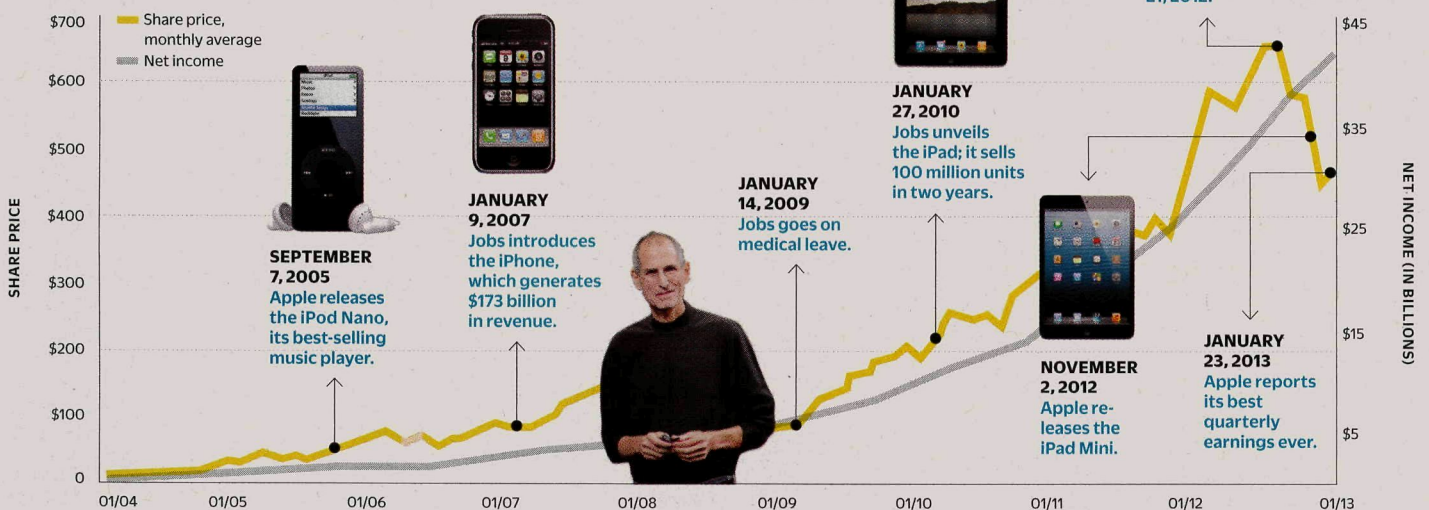
The Apple gadgets we know and love today are markedly different from their first iterations. Yes, the 2001 launch of the iPod marked the beginning of a revolution in how we consume music. But most forget that iPod sales didn't explode until 2005, when Apple released the Nano. Apple released two dozen versions of the iPod—including generations of the Classic, Nano, Mini, Shuffle, Touch, even one branded and distributed by Hewlett-Packard—and gobbled up 70% of the market.

Apple repeated the trick with the iPhone and iPad. The iPhone launched in 2007; sales surged in 2009, with the launch of the iPhone 3GS. Last quarter, the iPhone 4, 4S, and 5 were among the top five best-selling smartphones in the United States. The iPad, launched in 2010, went through four generations in two years, prolonging Apple's stock surge; last quarter, 43% of tablets shipped were iPads.

Apple's software innovations helped turn these products into objects of lust, as the iTunes Store did for the iPod and the App Store and Siri did for the iPad Mini and iPhone 4S. ▶

TAKING STOCK OF APPLE

An unsteady relationship between share price and earnings



TRUTH NO. 3: Apple's distinctive reputation can hurt as much as help.

"Apple has become a victim of its own success," says Piper Jaffray analyst Gene Munster. As the lore of Apple's innovative prowess spreads through the culture, its iterative improvements have started to feel like too little, too late. Some consumers have begun to discount (or be disappointed by) the latest product tweaks, waiting for revolutionary disruptions that, in fact, come only rarely. Others feel burned by Apple's habit of holding back features to create demand for the next generation (as Apple purportedly did by omitting the camera in the original iPad).

The result is that Apple doesn't get full credit anymore for some great products. Apple's last major launch was the iPhone 5. It is the lightest, thinnest, and fastest-selling iPhone yet, with 5 million snapped up on its first weekend. But like Apple's exceptional quarterly earnings, the iPhone 5 drew lukewarm reaction from critics. Apple's success has led everyone to judge it by a different set of standards. It's the M. Night Shyamalan effect: The more people expect the unexpected—and incessantly guess what's coming—the harder it is to surprise them.

TRUTH NO. 4: The legacy of Jobs is haunting the company.

The impatience with Apple isn't driven solely by emotion. Tangible changes in the business are at issue too. When Jobs died, in late 2011, many speculated Apple's unprecedented market run would end. Instead, its share price continued to swell, leading some to believe that the fears about Jobs's passing were overblown.

In actuality, we're seeing the post-Jobs slump today, a year later than expected. Why the delay? After his death, Apple continued to churn out hit products, and just as important, the outpouring of support for Jobs devolved upon the company, which was seen to embody his spirit—the archetypal American innovator. The halo effect is gone today; Apple is clearly Tim Cook's company now. He has put his stamp on it most noticeably by ousting top executive Scott Forstall, who was one of Jobs's closest confidants. Forstall was chiefly behind the company's success in mobile—but

had since been named as responsible for Apple's Maps fiasco.

In the wake of Maps, and with no apparent breakthrough product coming, investors and consumers alike are wondering what the post-Jobs era will really be like.

TRUTH NO. 5: Apple won't give up the magic without a fight.

Apple's aura of Oz-like omniscience has always been carefully cultivated. Jobs famously cloaked Apple in a mantle of paranoid secrecy, perpetually grooming the rumor mill to hype the Next Great Thing. With Jobs gone, Apple's constituents (including carping Wall Streeters) are less patient with this approach.

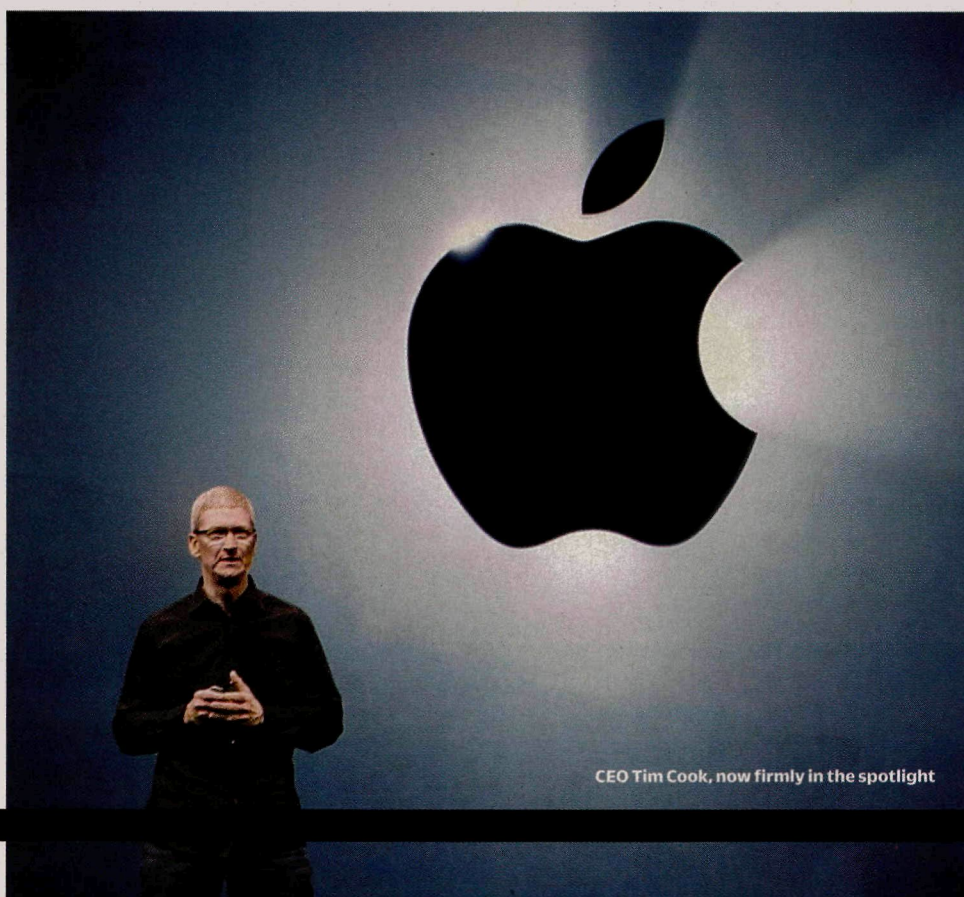
In the meantime, competitors are filling the void, which explains why Google

has spent so much time talking up Google TV and Google Glass, its futuristic eyewear project. Google's openness about the projects on its docket differs markedly from the Apple model: The effect is both to sustain interest and to temper expectations—training followers that when the company discusses a product, it isn't necessarily just around the corner. So if Google doesn't introduce, say, a driverless car in the next three years, nobody will be (too) disappointed.

The question is whether Apple can defy the odds and retain its sorcerer's hat or whether it will settle down into a life more ordinary. The latter has been the fate of tech stars before Apple (witness Microsoft) and since (witness Facebook). The transition would be a tough one for Apple; if it sheds its status as an agent of revolutionary change, there's no telling how proponents—consumers and investors—will react.

But all will be forgiven, and the question forgotten, if Apple can indeed deliver something unexpected and terrific. So will Apple produce another iPod? Another iPhone? Another iPad? We can only do what we have always done with Apple: wait and wonder. ☉

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CEO Tim Cook, now firmly in the spotlight

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