# ON THE MONEY

## A modest proposal (in more than 140 characters) of what Apple should do with its cash hoard

Barry Ritholtz

ON INVESTING

A Tumblr blog called "Things Apple Is Worth More Than" details, not surprisingly, an astonishing list: All of the gold at the New York Federal Reserve; the world's entire supply of illegal drugs; the franchise value of "Star Wars"/"Star Trek"/Harry Potter/Stephen King/"Twilight" combined; the entire U.S. aircraft carrier fleet; all 32 euro-zone banks.

All of which is to say, Apple is fantastically valuable. In fact, it sports the biggest market cap of any company in the world. This enormous worth comes from two sources: Its $100 billion cash hoard and its highly valued stock.

Last week, we found out what Apple is going to do with some of that cash: It is going to pay a dividend and buy back stock. But that won't make much of a difference. Apple's revenue and profit are growing so quickly that this $2.65 per quarter (about 1.77 percent) dividend will barely dent its cash pile. (Apple's stock is even more valuable.)

The upcoming $100 billion Facebook IPO made me wonder whether Apple needs to get more creative about some of the new competition coming along. No, I am not suggesting it should buy Facebook. (Mark Zuckerberg's path will not likely run through Cupertino.)

But the dividend/stock buyback started me thinking about all the other things Apple could do. That huge pile of dough and rapidly appreciating currency (AAPL stock) is a powerful combination. It opens up an incredible range of options.

My preference? Use some of that money to make strategic acquisitions that will shore up the few weaknesses Apple has. The preemptive strike could also prevent anyone else from making a move that damages Apple's position in its chief markets.

Before we proceed, a caveat: I find mergers and acquisitions to be wildly overrated (IPOs as well). Most companies choose poorly; they end up unwinding these deals at great cost eventually. The AOL Time Warner marriage of 2000 may be the poster child of bad mergers. Outside of big resource mergers in oil or minerals, major mergers rarely work out well. A few distressed bank deals worked out — J.P. Morgan Chase's purchases of Bear Stearns and Washington Mutual, as well as Wells Fargo's grab of Wachovia. (Most of the banking-sector mergers of the past decades have been disasters.) Companies pay huge iBank fees to conglomerize, and they pay even bigger fees to deconglomerize. So no, I am not a fan of most of these big deals.

There are exceptions. A handful of firms have made strategic acquisitions into an art form. In the 1980s and '90s, Cisco Systems was the best tech firm at this; GE also made excellent industrial strategic acquisitions. Oracle has been making larger acquisitions that added to earnings per share over the years (BEA, PeopleSoft, Siebel Systems, Hyperion and SunMicro). Consider Microsoft's strategic investment into Facebook — they bought a 1.6 percent stake for $240 million in 2007, effectively shutting out Google from cutting a deal.

One acquisition stands out to me as a model for what Apple could do: Google's all-stock acquisition of YouTube for $1.65 billion in 2006.

Essentially, it was free. The market rallied Google's stock enough on the news that the acquisition had an effective cost of zero (though it was slightly dilutive to earnings). YouTube became one of the fastest-growing parts of Google, replacing the underperforming Google Video. Monetization of YouTube appears to be increasingly close.

And Apple? Its history is primarily of small, almost tactical purchases. Even its biggest buy, the 1997 purchase of Next Computer that returned the prodigal son Steve Jobs to Apple, was "only" $400 million.

But Apple was a very different company then — a small, niche computer maker, with a visionary at the helm. The Apple of today is a giant consumer electronics firm, selling mobile devices, telephones, tablet computers and, in the near future, televisions. Maintaining mindshare, staying on the cutting edge of consumer tastes, is more important to Apple today than it was 15 years ago.

What is out there for Apple to buy? What is the Apple equivalent of Google Video?

The obvious answer is in social networking, where Apple has not gained any traction. The solution (queue the jeers) is for Apple to scoop up Twitter for $9 billion in cash or stock.

Why Twitter?

Apple does software and hardware very well; it is outstanding at the integration between the two. But it hasn't managed to break the code for social. In fact, Apple may be the only tech company without a Twitter account. Go ahead, check out @Apple — 0 Tweets/0 Following. As good a piece of software as iTunes is, its Ping social network was DOA. Twitter would automagically make Apple a de facto player in social.

In fact, Twitter is its own unique product category, and other forms of short messaging are going nowhere fast. The Fed has a Twitter account. The SEC tweets. President Obama and every other presidential candidate tweets. Indeed, nearly every world leader and every major product has a Twitter handle.

Twitter makes even more sense for Apple when we consider who its biggest competitors are likely to be over the next decade. It will no longer be the competitors of olde — not HP or Dell or even Microsoft — but Apple is in a tough battle for the future with the likes of Google and Facebook.

It seems that all roads lead us back to social networking, and the best fit for Apple leads to Twitter.

Consider Apple's last mobile operating system (iOS) upgrade: It tightly integrated "Tweet This" in all of its mobile products and apps. Apple could easily do a strategic investment in Twitter — $1 billion or more — and lock in an inside track with Twitter. But for less than 10 percent of its cash horde, it can acquire an enormous strategic product. Twitter would operate as a stand-alone entity, but built more tightly into all of Apple products as the social network.

Ping gets replaced with a version of Twitter for iTunes; various Apple photo services (and competitors such as Flickr and Instagram) see new competition from iPics. There are innumerable ways to integrate.

Should they? Can Apple achieve its goals without Twitter? Sure. But buying Twitter gets Apple four things:

1. It becomes, presto, a competitive player in social networking.
2. They fix Ping, and begin to monetize it, driving more sales of music, books and video.
3. Apple TV plus Twitter allows tight integration of social with video viewing. Instant social leverage during prime-time viewing has enormous potential value.
4. Perhaps most important, Twitter is kept out of the clutches of Google, Facebook or Microsoft.

Twitter is an IPO candidate in its own right. I suspect that Google might be the better technological fit — infrastructure expertise, monetizing search, etc. — but there seems to be some estrangement between Google and Twitter, for reasons with which I am not familiar.

If Apple buys Twitter, it's a huge win. It even has an exit: If they decide the deal doesn't work out, they can spin Twitter out as an IPO. But more importantly, it gives Apple a leg up in this fast-growing space.

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STEVEN PEARLSTEIN

## For the other 90 percent, where's the incentive?

PEARLSTEIN FROM G1

In a society where incomes are made to be too equal, there is little reason to work harder or to defer current consumption in order to save and invest. There is no incentive to take the risk of launching a new enterprise or to spend hours in the lab or the garage dreaming up the next breakthrough technology. Without the prospect of earning more or getting ahead, there would be less reason for getting much beyond the most basic education and training. And it is precisely these factors — work effort, investment in human and physical capital, development of technology — that are key to determining how fast an economy grows.

In 1974, the late, great economist Arthur Okun gave a series of lectures in which he argued that there was a "nagging and pervasive trade-off" between economic equality and economic efficiency.

"We can't have our cake of market efficiency and share it equally," Okun told his Harvard audience. The hard questions in public policy, he argued, most often involved a balancing of these two priorities.

Four decades later, however, Okun's "big trade-off" has been hijacked by Ryan Republicans eager to use it as a rationalization for tax cuts for the rich and service cuts for the poor. Ignoring Okun's premise that society wants both fairness and economic growth, Republicans have not only elevated growth as the sole objective of economic policy, but declared that fairness is everywhere and always a deterrent to growth. For them, the relationship is perfectly linear: If some inequality is required to increase economic growth, as it surely is, then more inequality must always beget even more economic growth.

Or maybe not. What if the relationship between inequality and economic growth is more complicated than that? What if there is a diminishing return to inequality? What if we've reached the point where any additional increase in inequality results in less growth, not more?

There is, in fact, some empirical evidence of this. Last year, two economists at the International Monetary Fund, Andrew Berg and Jonathan Ostry, published a paper showing that countries that experienced longer periods of strong economic growth were significantly more likely to be characterized by more equality than less. Inequality, they speculated, might amplify the risk of financial crises, which are often followed by long periods of slow or negative growth. It might bring about political instability, which can discourage investment. Inequality might make it harder for ordinary citizens to invest in entrepreneurial activity, or even invest in their own training and education.

If that story sounds a bit familiar, it should.

It is hardly coincidence that the past 20 years — a period in which inequality has risen noticeably in the United States and around the world — has also been characterized by repeated and severe financial crises. There was the junk bond sell-off of 1987, the continuing savings-and-loan crisis of the early '90s, the Asian financial crisis and the tech-and-telecom bust of the late '90s, and the near meltdown of financial markets in 2008.

Surely one explanation for the most recent crisis is that too many households took on too much debt as they struggled to maintain their standard of living in the face of nearly three decades of stagnant wages and salaries. Another might be that with so much of the nation's wealth accumulating in so few hands, it was inevitable that they would misallocate much of it by bidding up the price of "positional" goods such as houses in the Hamptons and seats at the best private schools.

It is worthy of note that this period of rising inequality also coincided with a dramatic slowdown in college graduation rates, particularly among men. More recently, it has also coincided in a decline in business startups and other measures of entrepreneurial activity.

And can anyone doubt the connection between rising inequality and the increasingly partisan and divisive nature of American politics, which has made it difficult, if not impossible, for government to respond quickly and intelligently to the major economic challenges facing the nation? Surely that can't be good for growth.

I find it strange that Republicans assign such overriding importance to economic incentives for investors, executives and hedge-fund managers while remaining totally clueless about the economic incentives faced by everyone else. Over the past 30 years, the entire increase in the nation's income has been captured by the 10 percent of households at the top of the income scale. Do you think that maybe, just maybe, the lack of a pay raise for the other 90 percent might have had any impact on their productivity, their work effort, their creativity or their willingness to take risk?

Paul Ryan was spot on last week when he warned that the country was approaching an "insidious moral tipping point." Too bad he is too blinded by ideology to see what that tipping point it really is.

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