

Apple faces music on iPhone flaw but recall unlikely

(Reuters) - Apple Inc is likely to announce a fix for the iPhone 4's reception problems on Friday rather than recall the device, hoping to stem a growing chorus of complaints and avert any lasting damage to its carefully earned reputation for quality products.

Apple, which surprised consumers and investors when it said it will convene an iPhone 4 press conference, has kept mum on what it will do. But analysts are betting that -- despite lawsuits, a poor review from Consumer Report and growing user complaints -- it will not initiate a costly and embarrassing recall.

Investors will be looking for a fuller explanation of what analysts call a minor issue, but which has managed to cause a media firestorm. A growing furor over iPhone 4 signal-strength flaws has hurt Apple's shares ahead of its quarterly results next week.

Since June 28 -- days after the launch, when complaints about faulty reception began surfacing on Internet technology websites -- Apple has lost about \$16 billion in market value, with at least some of that related to the iPhone controversy.

The stock fell as much as 2.1 percent on Thursday, before closing down 0.5 percent at \$251.45 on Nasdaq.

"We do believe that Apple needs to be more proactive in identifying and addressing the issues for the iPhone 4," BMO Capital Markets analyst Keith Bachman wrote in a research note. "A real risk is if the press keeps talking about this issue, iPhone 4 growth could slow."

Some analysts suggest Apple could simply offer free protective cases for the device -- which prevent the signal interference -- at a cost of \$1 to \$2 each.

That solution could cost as much as \$45 million, according to one estimate. An in-store repair program could run as much as an estimated \$300 million.

Bloomberg and the Wall Street Journal on Thursday reported that Apple engineers had warned Chief Executive Steve Jobs in the early design phase of the iPhone 4 about the antenna design. Both reports cited people familiar with the matter.

But Apple spokesman Steve Dowling said the Bloomberg report was "simply not true," while later declining to comment on the Journal report.

Some users of the phone complain that reception turns weak when the device is held in a certain way that has come to be jokingly called the "iPhone 4 death grip."

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But the problem does not appear to be widespread.

QUICK FIX

Apple has blamed a software glitch that overstates network strength, but others have said the antenna on the redesigned device is at fault.

Cross Research analyst Shannon Cross expected Apple to use the press conference to provide a remedy to users who are experiencing the problem, and try to redirect attention back to the iPhone 4's strengths.

"We do not expect a recall and believe Apple will quickly move past this issue," Cross wrote in a research note.

She said Apple could provide free, low-cost iPhone cases -- which appear to solve the reception problem -- to consumers at a cost of less than 5 cents a share.

And it could add a thin coating over the antenna in future models to fix the issue, Cross added.

Analysts noted that Apple has bowed to pressure in the past to mollify consumers. In 2007, after Apple slashed the price of the original iPhone two months after it went on sale, the company offered a \$100 store credit to appease angry buyers.

Apple's July and August option implied volatility, which measures the expected magnitude of share price movement, surged on Thursday.

In all, about 214,000 calls and 158,000 puts traded in Apple, above its combined average daily volume of 290,000 contracts, according to option analytics firm Trade Alert.

"Apple option traders are bracing for a big move in the underlying shares boosted by uncertainty over the iPhone 4 smartphone and next week's earnings," said Jon Najarian, a co-founder of Web information site optionMonster.

"Professional investors believe this is a big deal judging by the amount of Apple options that are being bid up on both the call and put side, indicating how nervous players are."

(Additional reporting by Doris Frankel; Editing by Edwin Chan and Richard Chang.)

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