U.S. Equities
Technology – Smartphones

cascend

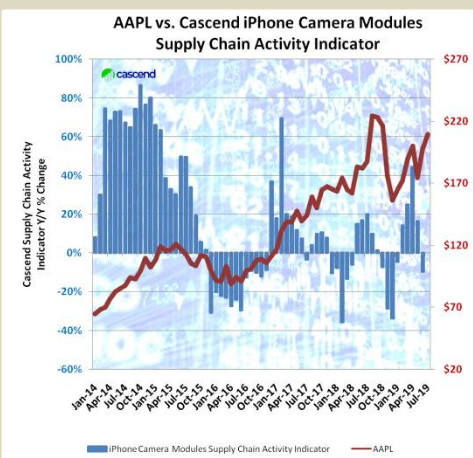
Apple, Inc.
(USA:AAPL)

31 July 2019

EARNINGS

Apple's quarter was transition from iPhone to Ecosystem: raise PT from $240 to $260

Rating: BUY
Market Cap: $960b
Price target: $240
Current Price: $208.78
Currency: USD



Summary:

- We raise our price target on AAPL from $240 to $260
    - Apple provided a good quarter in a difficult environment
    - SepQ19 guidance of 16% growth is above normal seasonality of 10%
    - Global smartphones are no longer a growth segment (now like PCs) and AAPL can't simply raise ASPs anymore
    - But other segments and Services are coming in strongly to make up the difference

- Apple beat estimates and guided higher
    - JunQ19 revenues were $53.8b, above our $53.5b
    - JunQ19 EPS were $2.18, above our $2.11
    - AAPL guided SepQ19 revenues to $63.5b, above our $61.5b

- We were most surprised by strong performance in China

- Component makers corroborate stability in other chatter from the iPhone supply chain

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Investment Thesis

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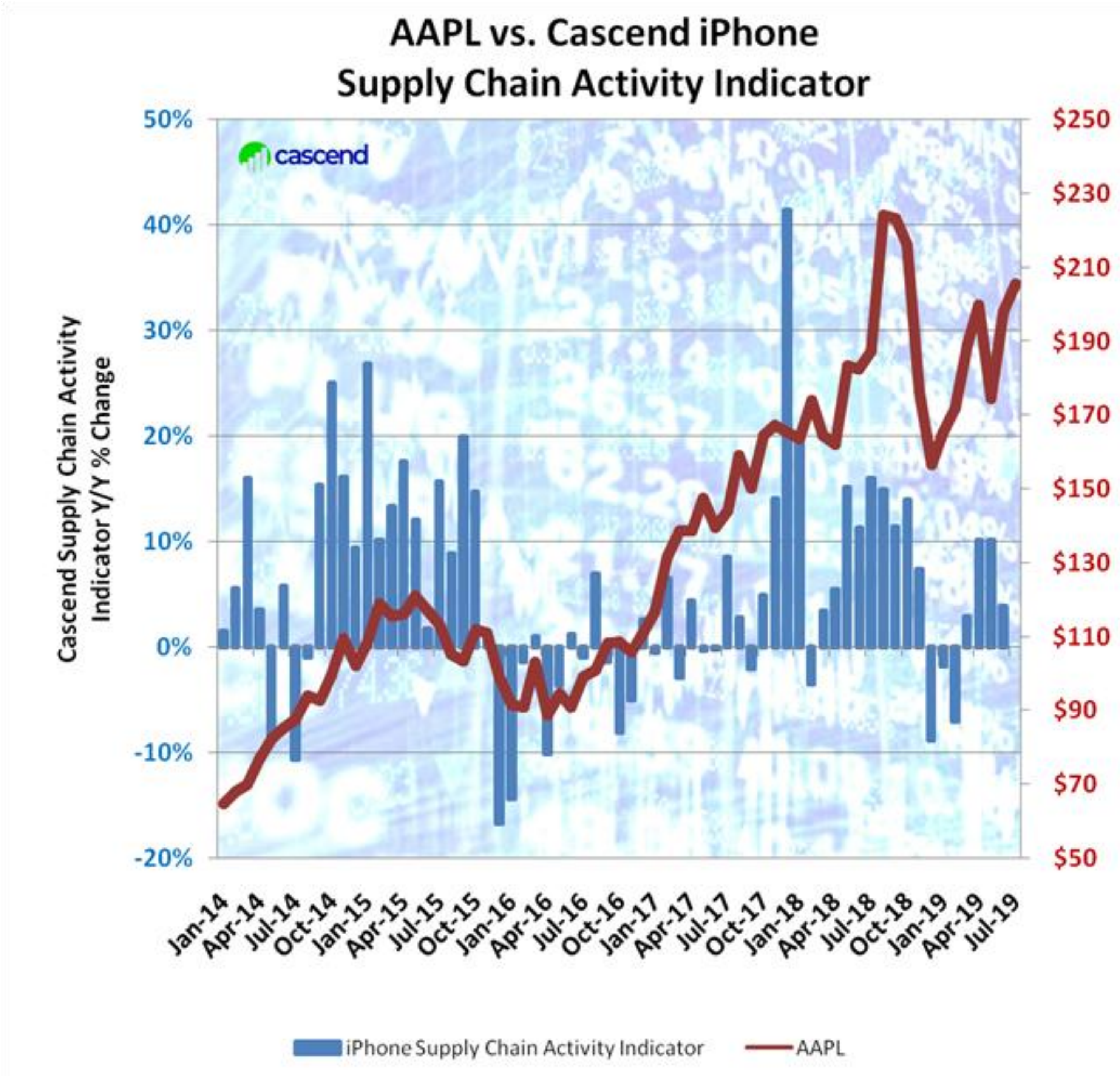
- We see AAPL's transforming much like Microsoft
  - Microsoft transformed from a seller of office software to a Cloud services provider (oversimplified)
  - This built in strong growth, strong margins and recurring annuity-like revenues
  - Similarly, Apple is transforming from an iPhone provider into an Ecosystem provider
  - Services and other products are driven by its huge installed base buying into the Ecosystem, and Services are recurring annuities as well
  - Services gross margins was 64.1% versus 30.4% for products
  - We've been writing this since 2017 but it's finally showing its benefits

- Still fawning over Dark Mode – we don't get it (Android had this for years)

- Our iPhone supply chain indicator appears continue to rebound, but June was weaker growth than April and May
  - June was the fourth month in a row of Y/Y growth after three months of declines
  - The JuneQ19 is up 8.0% Y/Y (versus -1.7% in MarQ19) and 8.3% Q/Q (versus -40.6% in MarQ19) – looks healthy to us
  - This implies demand is fine (not breathtaking) and the supply chain is now clear

- Investors are worried about China longer term but Apple is performing well in China:
  - Apple saw growth in constant currency in China
  - And dollar growth in everything but iPhone
  - Will tariffs bite earnings?
  - Will the Chinese wait until after the 2020 election to negotiate trade? (You can do that if you have a President For Life)
  - Consumers in China appear to be buying Apple products

- There's concern building that CY19's iPhone releases won't have enough "must have" features to drive volumes:
  - Not having the "future-proofing" of 5G capability could hurt Apple's Fall iPhone releases
  - Now 3D camera tech is skipping this generation as well
  - Battery life may be much better, but this isn't an easy selling feature
  - With no meaningful feature upgrade in 2H19, ASPs could trend lower as well


AAPL vs. Cascend iPhone
Supply Chain Activity Indicator
cascend
Cascend Supply Chain Activity Indicator Y/Y % Change
50%
40%
30%
20%
10%
0%
-10%
-20%
$250
$230
$210
$190
$170
$150
$130
$110
$90
$70
$50
Jan-14
Apr-14
Jul-14
Oct-14
Jan-15
Apr-15
Jul-15
Oct-15
Jan-16
Apr-16
Jul-16
Oct-16
Jan-17
Apr-17
Jul-17
Oct-17
Jan-18
Apr-18
Jul-18
Oct-18
Jan-19
Apr-19
Jul-19
iPhone Supply Chain Activity Indicator
AAPL

- We reiterate our BUY rating on Apple (AAPL) and raise our price target from $240 to $260:
    - The components supply chain appears healthy
    - There is tremendous value in AAPL's protected ecosystem and massive installed base
    - We don't believe the wheels are falling off
    - We're already talking about the next-gen iPhones for 2H19 (although this is mixed for expected demand)
    - We expect there is an opportunity for long-term value, and the Street is coming around to this viewpoint
    - But China is a real issue for Apple – not only headline risk but also earnings

China

- China was particularly strong
- Better Y/Y comparisons in iPhone in China versus last two quarters
- Grew in constant currency in China overall
- Growing Chinese engagement to the Apple ecosystem was a positive
- So were government stimulus, trade-in programs and financing offers
- Saw particular strength from the BRIC countries where JunQ19 revenues grew 3% versus DecQ18 + MarQ19 revenues declining 25%
- Currency headwinds removed $1.5b from revenues

Services

- Services were a record $11.5b, up 13% Y/Y
- Services were 21% of revenues and 36% of gross margin dollars
- Services was up even more when subtracting out last JunQ's one-time $236m item

- Have 420m paid subscribers
- Launched Apple TV app in over 100 countries
- Monthly Apple TV viewers are up over 40% Y/Y
- Integrating 150 content providers in one place
- Apple Pay is now completing roughly 1b transactions per month
- Up 100% Y//Y
- Apple Pay launched in 17 countries in JunQ19 for a total of 47
- Best ever quarter for AppleCare – increasing service contracts attach rates

iPhone

- iPhone was $26b in revenue, down 12% Y/Y
- Strong customer response to trade-ins and financing programs
- Products outside of iPhone grew 20% Y/Y
- Retail stores returned to growth in June

Wearables

- Apple Watch set a new June record

- Over 75% of Watch buyers were buying their first watch
- Wearables were up 48% Y/Y to $5.5b

iPad

- iPad revenues were $5b, up 15% Y/Y
- Growth driven by iPad Pro, iPad Mini and iPad Air

Mac

- Mac grew 11% Y/Y to $5.8b
- Half of customers buying a Mac were new to Mac
- $999 MacBook Air for college students
- Believe macOS Catalina will be a “breakthough” in the Mac ecosystem to bring iOS apps to the Mac

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