GBH INSIGHTS

Technology Research

Company Update

February 1, 2018

Apple (AAPL) | **Highly Attractive**

Daniel Ives, Head of Technology Research | 917.210.3220 | daniel.ives@gbhinsights.com

Good Enough December Results; All Focus on March Guidance and Weaker iPhone X Demand and "Ripping the Band-Aid Off"

In what we would characterize as one of the most feared prints for Apple in recent memory the company delivered FY1Q18 (December) total revenues and pro forma EPS of $88.29 billion and $3.85 after the bell, exceeding the Street's $87.5 billion revenue estimate while meeting on EPS. This compares to guidance of between $84 billion and $87 billion, as strong iPhone demand was front and center in the quarter with the release of iPhone X and follow through demand from iPhone 8/8+. That said, iPhone shipments of 77.3 billion came in below the steadily climbing Street number of 80 million units with ASPs of $796 coming in well ahead of ASP expectations of $756, neutralizing the unit miss. Overall, services revenues of $8.47 billion came in below the Street's $8.67 billion estimate as this continues to be a major growth driver for Cook & Co. over the coming years with our expectations that this revenue stream could be $50 billion by 2020 and we believe a slight miss this quarter is a blip on the radar. Importantly, Apple plans to reduce its net cash to "roughly zero" which means major buybacks and dividends are on the way for shareholders as the repatriation party is now in full gear with Cook leading the charge, a major positive for shares in our opinion.

- **Drumroll……..March guidance.** The main event of tonight's earnings is around the much anticipated March guidance cut with iPhone X demand weaker than expected, especially out of China and the US to a lesser extent hurting the company's near-term outlook. March revenue guidance and gross margins were better than feared with total revenue of $61 billion better than the feared $59 billion to $60 billion whisper numbers that bears were clawing to and below the Street at $65.4 billion, with a guidance cut already well telegraphed through supply chain data points out of Asia. Gross margins of 38%-38.5% were generally in line with expectations although a modest downtick which was already priced into shares. While we now expect iPhone shipments for FY2018 closer to 235/240 million units vs our 255 million estimate, we believe the combination of stronger than expected ASPs, a "push out" of roughly 15-20 million iPhones from FY18 into FY19, repatriation/buyback tailwinds, multiple device launches on the horizon, and a China growth story which is showing signs of renewed growth prospects (albeit with some soft spots) gives us confidence that Apple will be able to navigate near term headwinds and emerge a stronger fundamental story exiting 2018.

Seeing the forest through the trees, we estimate Apple has roughly 350 million iPhones that are in the window of opportunity to upgrade over the next 12 to 18 months, now it's about which model and price point "strike a chord" for these customers to ultimately upgrade as the iPhone X demand has softened since reaching a supply/balance level in late December. To this point, we still expect three new iPhone releases (5.8 inch to 6.5 inch OLED designs with an LCD model) staggered over the next 6-9 months to hit the market that will help capture the underlying demand/upgrades among customers that have decided to bypass the 8/8+/X cycle this time around, with price points and features that catalyze fence sitting iPhone customers onto their next smartphone during the course of 2018. While this is a hand holding period starting with tonight's call, we believe near term turbulence does not change our long term bullish thesis on Apple and the underlying demand/upgrade drivers for the next 12 to 18 months remain intact as **we maintain our Highly Attractive rating and $205 price target.**

Daniel H. Ives
917.210.3220
daniel.ives@gbhinsights.com