

### Apple update following the results

Following on from our Apple comment on Wednesday (22 July) and having perused the numbers, it is clear to us that the market's concerns (which led to the share retreating c. 8% in after-market trading on the day of the results) are two-fold:

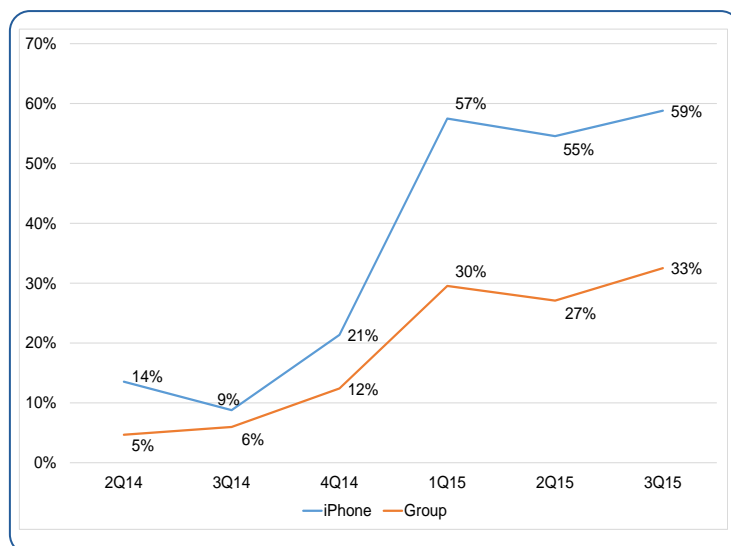
- Apple's forward guidance has concerned the market that iPhone sales may be peaking.
- The rate of decline of iPad sales appears to be rapidly accelerating.

Below we expand on this:

**Group sales guidance for 4Q15 implies a sharp slow-down in the rate of growth, despite a still easy comparative prior-year base.**

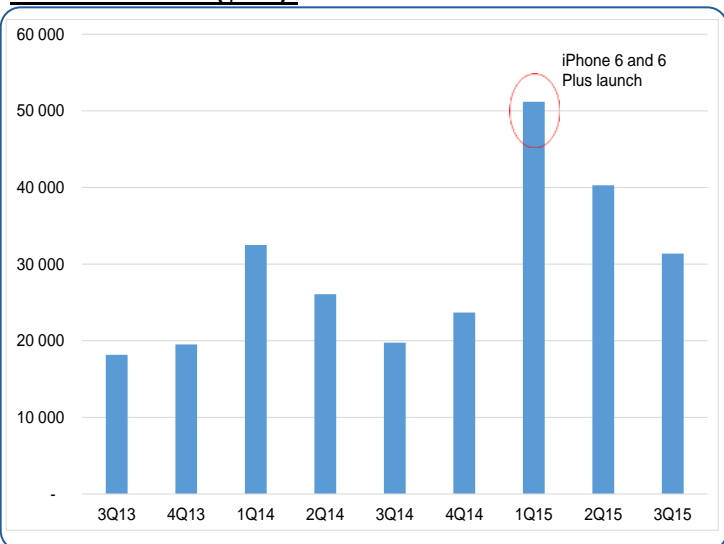
With the iPhone 6/ 6 Plus launched during Apple's 1Q15, this was the quarter that saw a sharp bounce in sales YoY (it is also a seasonally strong quarter with the Christmas holiday but growth YoY in this period accelerated sharply as shown in the second chart below - *Apple: Group YoY growth vs iPhone YoY growth*).

### Apple: Group YoY growth vs iPhone YoY growth, 2Q14 to date:



Source: Company data, Anchor Capital

### iPhone revenue (\$mn):



Source: Company data, Anchor Capital

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We scan the globe looking for good opportunities. We provide our model portfolios, as well as news and views on our watch-list, which is continually reviewed and updated.

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**Apple continued...** So, growth in revenue YoY ramped up significantly in 1Q15 and continued in the following quarters because of base effects (lack of the larger screen iPhone 6/6 Plus models in the prior year). However, the Group has now guided to 4Q15 total revenue of \$49bn-\$51bn, the mid-point of which represents 20% YoY growth. This is down from 33% growth in 3Q15 - a deceleration of >10 percentage points.

Importantly, this slowdown would occur despite the fact that 4Q14 revenue did not have the benefit of a full quarter of iPhone 6 and 6 Plus sales, while 4Q15 will. We would therefore guess that the run-rate impact on Group sales of the iPhone 6 models' launch must have been a net \$10bn-\$15bn sales boost on a quarterly basis (see table below). So, if we adjusted the 4Q14 revenue base to assume the Group had benefitted from these sales in that quarter, the guidance of 20% revenue growth in 4Q15 probably decelerates to zero or even worse when stripping out the iPhone 6/6 Plus launch base effect. This means that as we move into 1Q16 (a quarter which will now have a high prior-year base), sales growth could decelerate rapidly in the absence of any new major product (read revamped iPhone as in the case of the larger screen model last year) launch.

This is what we believe the market is worried about...

\$mn	4Q14	1Q15	2Q15	3Q15	Avg increase 1Q-3Q
Sales increase for iPhone YoY	4 168	18 684	14 218	11 617	14 840

Source: Company data, Anchor Capital

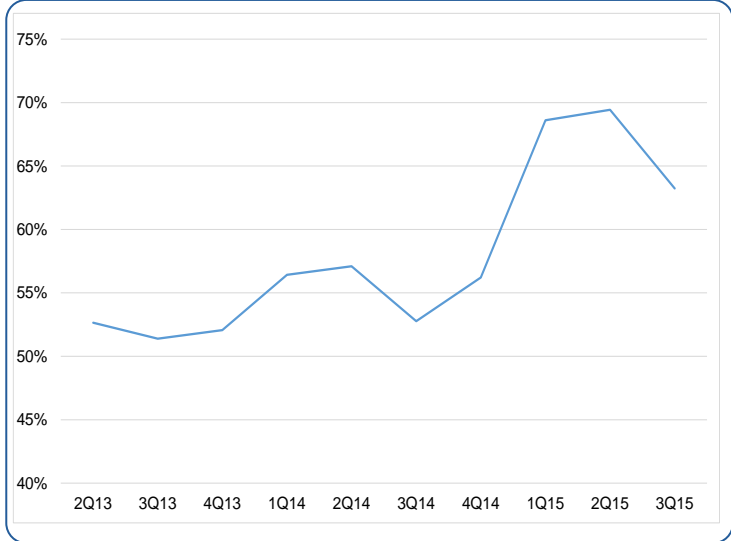
Seasonally, 4Q is a slow quarter so perhaps the iPhone 6/ 6 Plus base effect could be assumed to be \$10bn+:

\$mn	4Q14	4Q15	
Group revenue	42 123	50 000	
add: estimated benefit of iPhone 6 (not in Q4 sales base)	10 000		
<b>Run rate ex iPhone 6 base effect</b>	<b>52 123</b>	<b>50 000</b>	<b>-4.1%</b>

Source: Company data, Anchor Capital

In the past Apple has managed to silence its critics by pulling a rabbit out of the hat so to speak (as with the launch of the bigger screen iPhone 6/ 6 Plus). We venture to guess that any material upgrades it makes to future iPhone models would, in all likelihood, see similar success especially in light of Apple's performance in China and the possibility of other potentially large markets such as India. However, we do believe it is important to note that this has essentially become an iPhone business – so future models need to be very successful!

**iPhone sales % of total revenue:**



Source: Company data, Anchor Capital

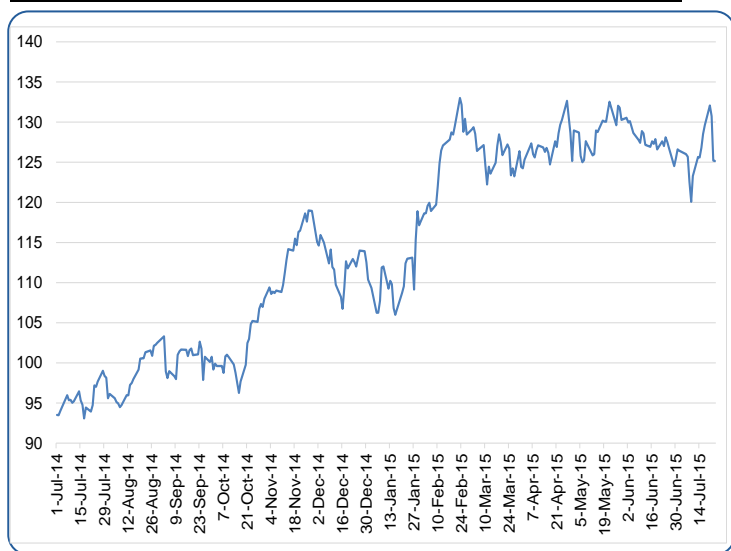
**iPad**

In terms of the iPad, sales of the device now comprise 9% of Group sales, but were down 23% YoY during 3Q. This compares with a 29% decline in 2Q, -22% in 1Q, -14% in 4Q14 and -8% in 3Q14. Therefore, even off a reduced sales base, sales are falling sharply.

At a forward 13x P/E multiple this company is not being valued as a growth business, in our view, and what we do know is that the Group does have a good track record of new product launches (although the Apple Watch still needs to prove its worth), which it's probably not being given credit for.

The share was initially down 8% post the results but has since clawed its way back. We will be watching the sales evolution with keen interest to see if indeed Apple is out of runway, but we do think at the moment the share still warrants ownership:

**Apple share price performance, July 2014 to date (\$):**



Source: Bloomberg, Anchor Capital

Sean Ashton



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