

Apple Inc.

Services continue to grow

USA | TECHNOLOGY | RESULTS

- Revenue down 15% yoy and Net Income down 27% yoy
- Service revenue grew by 19%
- iPad performed better than expected
- Maintain "BUY" rating and lower TP of **US\$114.74** (previously US\$119.92)

Results at a glance:

| Y/E Sep, USD bn | 3QFY16 | 3QFY15 | yoy | Comments |
|--------------------------|-------------|-------------|---------------|--|
| Revenue | 42.4 | 49.6 | -14.6% | While Revenue was down, it beat general consensus estimates of US\$42 bn. |
| Services Rev | 6.0 | 5.0 | 18.9% | Services up on the back of App Store growth, which was up 37% in Q3 iPhone units shipped 40.4 mn units, compared to consensus estimate |
| iPhone Rev | 24.0 | 31.4 | -23.3% | 40.02mn New iPad shipped 9.95 mn vs our expectation of 8.9 mn |
| iPad Rev | 4.9 | 4.5 | 7.4% | |
| Net Income | 7.8 | 10.7 | -27.0% | |
| DPU (cents)(per Quarter) | 0.57 | 0.52 | 9.6% | |

Source: Company, Phillip Securities Research (Singapore)

- Fall in revenue and earnings.** AAPL [reported](#) record quarter revenue of US\$42.4 bn, falling short of our estimate of US\$46.7 bn. Consensus estimates had AAPL earning US\$42 bn, and AAPL guided between US\$41 bn to US\$43 bn. While AAPL performed better than consensus, they fell short of our estimates, which had AAPL selling more iPhones and at higher Average Selling Prices (ASP). EPS of US\$1.42, missing by US\$0.42. Gross margins was 38% compared to 39.7% yoy. Margins fell on the back of lower iPhone ASPs, which fell about US\$65 due to introduction of the iPhone SE as well as the stronger US\$, which accounted for US\$20 of that US\$65. Overall, while AAPL had better than expected results when compared to consensus estimates, it is still concerning that revenue and net income are trending down and performing worse than our estimates. Additionally, the ASPs for iPhone fell more than expected.
- Services were still the saving grace.** Service revenue came in at about 5.9 bn, which was in line with our estimates. YTD, AAPL services segment has garnered almost US\$18 bn in revenue, the entire previous year service revenue was US\$19.9 bn. The App Store's grew at 37% yoy compared to the previous quarter, which grew 35%. Install-based related purchases grew 29% yoy to US\$10.3 bn. Apple Pay grew monthly active users by more than 450% yoy, with over half of transaction volume coming from outside the USA. It is also useful to note that the wildly successful Pokemon Go was released only in July 2016 and related revenue would not yet be included in this quarter results. The numbers from the Services segment continue to show AAPL's progress to Apple as a service.
- iPad Sales beat estimates on the back of new iPad.** iPad registered the highest quarterly sales in 2 years. The new 9.7 inch iPad Pro, which launched in end March 2016, helped to boost sales volumes as well as ASPs. iPad ASPs grew to US\$490 compared to US\$415 yoy. AAPL cites businesses as the reason for the growth in iPad, with half of iPad Pro purchasers buying them for work.

27 July 2016

BUY (Maintain)

| | |
|---------------|------------|
| CLOSING PRICE | USD 96.67 |
| FORECAST DIV | USD 2.28 |
| TARGET PRICE | USD 114.74 |
| TOTAL RETURN | 21.1% |

COMPANY DATA

| | |
|--------------------------------|-----------------|
| O/S SHARES (MN) : | 5,477 |
| MARKET CAP (USD mn / SGD mn) : | 529503 / 529503 |
| 52 - WK HI/LO (USD) : | 123.91 / 89.47 |
| 3M Average Daily T/O (mn) : | 39.52 |

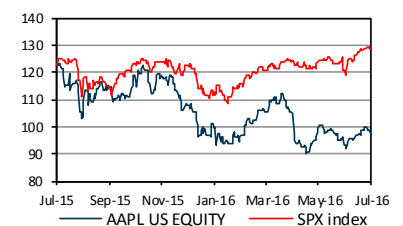
MAJOR SHAREHOLDERS (%)

| | |
|---------------------|-------|
| VANGUARD GROUP | 6.02% |
| BLACKROCK | 5.77% |
| STATE STREET CORP | 3.94% |
| FMR LLC | 2.65% |
| NORTHERN TRUST CORP | 128% |

PRICE PERFORMANCE (%)

| | 1M TH | 3M TH | 1Y R |
|------------|-------|-------|--------|
| COMPANY | 3.5 | (6.8) | (20.8) |
| SPX RETURN | 6.62 | 4.28 | 6.62 |

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

| USD BN | FY 14 | FY 15 | FY 16e | FY 17e |
|---------------|-------|-------|--------|--------|
| Revenue | 182.8 | 233.7 | 217.3 | 2312 |
| EBITDA | 70.5 | 93.6 | 86.9 | 92.5 |
| NPAT (adj.) | 39.5 | 53.4 | 47.3 | 50.2 |
| EPS (adj.) | 6.45 | 9.22 | 8.17 | 8.66 |
| PER, x (adj.) | 15.0 | 10.5 | 11.8 | 11.2 |
| P/BV, x | 5.3 | 4.7 | 4.4 | 4.2 |
| DPS (USD) | 1.8 | 2.0 | 2.3 | 2.3 |
| Div Yield, % | 2% | 2% | 2% | 2% |
| ROE, % | 34% | 46% | 38% | 39% |

Source: Company Data, PSR est.

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- **iPhone shipped more units than expected, ASP fell to US\$595.** iPhone unit [sales](#) were down 15% yoy, with a 23% reduction in revenue. However iPhone unit sales beat consensus estimates of 40 mn units shipped, shipping 40.4 mn units. This was due to the release of the iPhone SE, which was released in March this year. This quarter represented the first full quarter that the iPhone SE has been available, and shows that there is strong demand for a cheaper iPhone. iPhone SE would have significant appeal in emerging markets and AAPL reported that they have had double digit growth yoy in countries like Brazil and India. AAPL also reported double digit growth in Japan, Canada and Sweden and that sales in Russia more than doubled yoy. AAPL commented that iPhone SE has seen higher new-to-iPhone customer numbers, indicating that iPhone SE has not done much cannibalization of iPhone sales.

AAPL guidance for 3QFY16:

- Revenue between \$45.5 billion and \$47.5 billion, down about 9.7% yoy from US\$51.5 bn
- Gross margin between 37.5% and 38%, about 1-2% difference yoy from 39.9%
- Operating expenses between US\$6.05 bn and US\$6.15 bn, up yoy from US\$5.9 bn
- Other income/(expense) of US\$350 mn
- Tax rate of 25.5%, about 0.6% lower yoy

Investment Actions

We maintain our “**BUY**” call on AAPL with a slightly reduced target price of **US\$114.74**. While AAPL has been able to outperform overall this quarter, the continued fall of their main revenue driver; the iPhone, is concerning. In light of the continued down trend in sales volume as well as the larger than expected impact on ASPs, we have reduced our estimate of AAPL’s sales going forward. The future of iPhone sales is likely still contingent on the new iPhone 7. However, the iPhone 7 is rumored to only be an incremental update of features rather than a new innovative device. It remains to be seen if iPhone 7 can drive numbers up or if iPhones have truly hit saturation point.

Services on the other hand, continue to be the bright spot, with continued double digit growth and looks set to continue having accelerated growth. With new exciting Apps like Pokemon Go helping to contribute to the Services revenue, we remain optimistic in AAPL’s strategy to transition to Apple as a Service.

AAPL also announced a dividend increase to US\$0.57 from US\$0.52, up 9.6%. This brings AAPL’s dividend yield to 2.36%. AAPL has now completed US\$177 bn of its US\$250 bn capital return program, having spent US\$127 bn in share repurchases.

Financials

Income Statement

| Y/E Sep, USD bn | FY14 | FY15 | FY16e | FY17e | FY18e |
|--------------------------|--------------|--------------|--------------|--------------|--------------|
| Gross revenue | 182.8 | 233.7 | 217.3 | 231.2 | 236.6 |
| Cost of sales | -112.3 | -140.1 | -130.4 | -138.7 | -142.0 |
| Gross Profit | 70.5 | 93.6 | 86.9 | 92.5 | 94.6 |
| Other Expenses | -18.5 | -23.3 | -22.7 | -24.1 | -24.7 |
| Finance (Exp)/Inc, Net | 1.4 | 2.2 | 0.2 | -0.1 | -0.2 |
| Profit Before Tax | 53.5 | 72.5 | 64.4 | 68.3 | 69.7 |
| Taxation | -14.0 | -19.1 | -17.1 | -18.1 | -18.5 |
| Profit After Tax | 39.5 | 53.4 | 47.3 | 50.2 | 51.2 |

Per share data (Cents)

| Y/E Sep | FY14 | FY15 | FY16e | FY17e | FY18e |
|-----------------|------|------|-------|-------|-------|
| Basic EPS (USD) | 6.5 | 9.2 | 8.2 | 8.7 | 8.8 |
| net DPS - (USD) | 1.8 | 2.0 | 2.3 | 2.3 | 2.5 |
| BVPS (USD) | 18.2 | 20.6 | 21.9 | 23.0 | 25.1 |

Cash Flow

| Y/E Sep, USD bn | FY14 | FY15 | FY16e | FY17e | FY18e |
|----------------------------------|--------------|--------------|--------------|--------------|--------------|
| CFO | | | | | |
| Net Income | 39.5 | 53.4 | 47.3 | 50.2 | 51.2 |
| Adjustments | 7.9 | 11.3 | 6.0 | 6.8 | 6.8 |
| WC changes | 7.0 | 11.6 | 4.6 | 7.2 | 6.7 |
| Others | 5.2 | 5.0 | 5.0 | 5.1 | 5.2 |
| Cashflow from ops | 59.7 | 81.3 | 63.0 | 69.3 | 70.0 |
| CFI | | | | | |
| CAPEX, net | -9.6 | -11.2 | -11.9 | -12.9 | -13.9 |
| Others | 5.2 | 5.0 | 5.0 | 5.1 | 5.2 |
| Cashflow from investments | -22.6 | -56.3 | -38.7 | -39.1 | -39.2 |
| CFF | | | | | |
| Share issuance, net | -44.3 | -34.7 | -26.4 | -29.4 | -24.4 |
| Loans, net of repayments | 18.3 | 29.3 | 12.8 | 16.5 | 16.1 |
| Dividends | -11.1 | -11.6 | -13.2 | -13.5 | -14.5 |
| Others | 5.2 | 5.0 | 5.0 | 5.1 | 5.2 |
| Cashflow from financing | -37.5 | -17.7 | -27.5 | -27.2 | -23.6 |
| Net change in cash | -0.4 | 7.3 | -3.1 | 3.0 | 7.2 |
| CCE, end | 13.8 | 21.1 | 18.0 | 20.9 | 28.1 |

Balance Sheet

| Y/E Sep, USD bn | FY14 | FY15 | FY16e | FY17e | FY18e |
|--------------------------------------|--------------|--------------|--------------|--------------|--------------|
| ASSETS | | | | | |
| PPE | 20.6 | 22.5 | 28.4 | 34.5 | 41.7 |
| Intangibles | 4.1 | 3.9 | 3.9 | 3.9 | 3.9 |
| Investment | 133.9 | 169.6 | 190.0 | 208.8 | 222.6 |
| Others NCA | 4.6 | 5.1 | 5.1 | 5.1 | 5.1 |
| Total non-current assets | 163.3 | 201.1 | 227.3 | 252.3 | 273.4 |
| Accounts receivables | 27.2 | 30.3 | 28.2 | 30.1 | 30.8 |
| CCE | 25.1 | 41.6 | 38.5 | 41.4 | 48.6 |
| Inventory | 2.1 | 2.3 | 3.0 | 3.5 | 4.0 |
| Others CA | 14.1 | 15.1 | 16.0 | 16.9 | 17.9 |
| Total current assets | 68.5 | 89.4 | 85.7 | 91.9 | 101.3 |
| Total Assets | 231.8 | 290.5 | 313.0 | 344.3 | 374.6 |
| LIABILITIES | | | | | |
| Accounts payables | 30.2 | 35.5 | 33.0 | 35.1 | 36.0 |
| Short term loans | 6.3 | 11.0 | 11.4 | 14.4 | 12.4 |
| Others CL | 26.9 | 34.1 | 38.9 | 44.5 | 50.1 |
| Total current liabilities | 63.4 | 80.6 | 83.3 | 94.0 | 98.4 |
| Long term loans | 29.0 | 53.5 | 69.4 | 85.4 | 101.3 |
| Others NCL | 27.9 | 37.1 | 34.0 | 31.9 | 30.2 |
| Total non-current liabilities | 56.8 | 90.5 | 103.4 | 117.2 | 131.5 |
| Total Liabilities | 120.3 | 171.1 | 186.7 | 211.3 | 230.0 |
| EQUITY | | | | | |
| Retained Earnings | 87.2 | 92.3 | 99.4 | 106.0 | 117.8 |
| Others Equity | 24.4 | 27.1 | 27.4 | 27.4 | 27.4 |
| Shareholder Equity | 111.5 | 119.4 | 126.8 | 133.5 | 145.2 |

Valuation Ratios

| Y/E Sep | FY14 | FY15 | FY16e | FY17e | FY18e |
|---------------------|------|------|-------|-------|-------|
| P/E (X), adj. | 15.0 | 10.5 | 11.8 | 11.2 | 10.9 |
| P/B (X) | 5.3 | 4.7 | 4.4 | 4.2 | 3.9 |
| EV/EBITDA (X), adj. | 7.2 | 5.3 | 5.9 | 5.6 | 5.5 |
| Dividend Yield (%) | 1.9% | 2.0% | 2.4% | 2.4% | 2.6% |

Growth & Margins (%)

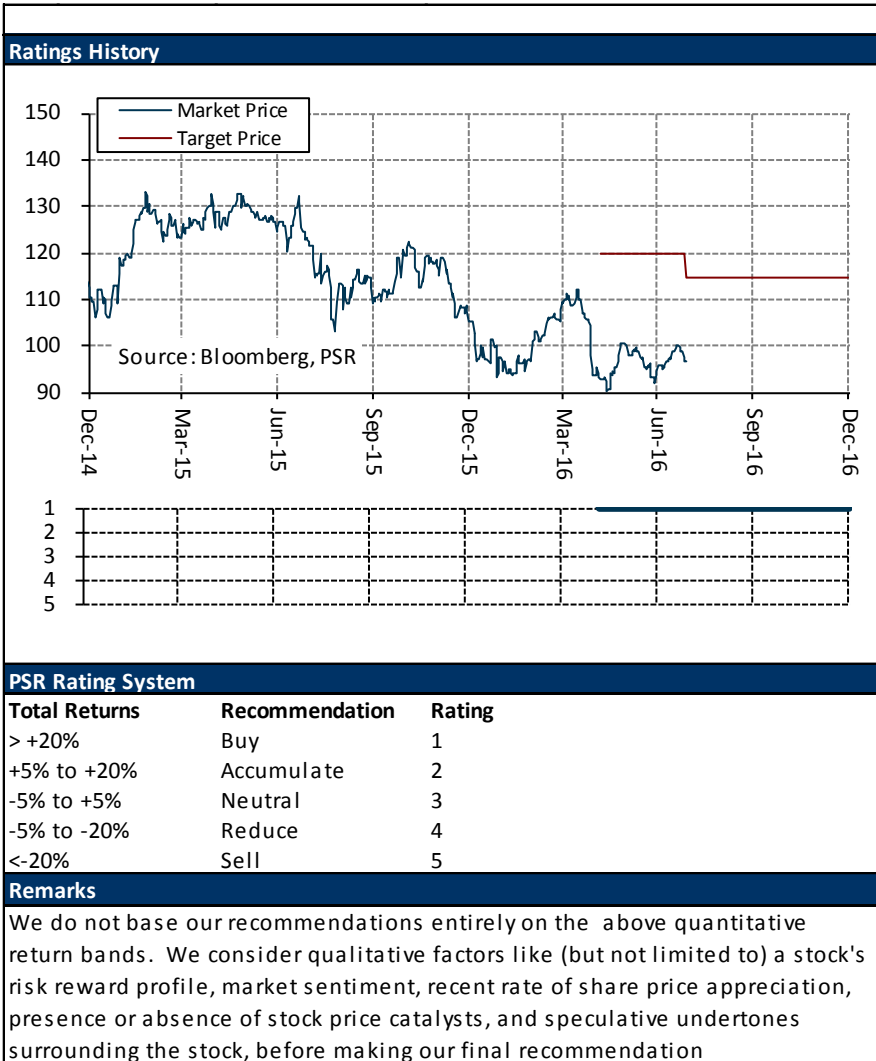
| Growth | | | | | |
|-------------------|-------|-------|--------|-------|-------|
| Gross revenue | 7.0% | 27.9% | -7.0% | 6.4% | 2.4% |
| EBIT | 6.6% | 35.6% | -11.2% | 6.0% | 2.2% |
| Profit After Tax | 6.7% | 35.1% | -11.3% | 6.0% | 2.2% |
| Margins | | | | | |
| Operating margin | 29.3% | 31.0% | 29.6% | 29.5% | 29.5% |
| Gross margin | 38.6% | 40.1% | 40.0% | 40.0% | 40.0% |
| Net Profit Margin | 21.6% | 22.8% | 21.8% | 21.7% | 21.7% |

Key Ratios

| | | | | | |
|---------|-------|-------|-------|-------|-------|
| ROE (%) | 33.6% | 46.2% | 38.5% | 38.5% | 36.8% |
| ROA (%) | 18.0% | 20.4% | 15.7% | 15.3% | 14.3% |

Source: Company, Phillip Securities Research (Singapore) Estimates

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.



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