Raising PT June 17, 2024

AAPL: Stock re-rates, more to go

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Even after the sharp move in the stock post-wwdc, we do not believe many investors appreciate the real value in the stock. The value lies not in gigantic LLMs or snazzy demos. Rather, AAPL's value lies in a rich vein of gold that hyperscale peers do not have access to. And even if they did, they lack the means to mine it as efficiently as Apple can, thanks to the low-power consuming Apple Silicon. Even after the sharp move to the upside last week, the stock has merely caught up with SPX on an ytd basis

*Apple's value lies in its ability to **personalize** the AI experience for its 2+billion installed base of devices and billion+ paid subscribers based on its access to private data locked up in Apple devices and guarded by Apple's privacy rules. From a financial perspective, Apple's value lies in its apparent ability to ramp up AI offerings without having to spend a king's ransom in capex. Evidence of this ability was demonstrated by Apple announcing a major stock buyback at the previous earnings call, which would not have been possible if capex were to increase anywhere close to the spending at hyperscale peers.*

*The debate ought not to be merely about whether iPhone16 benefits from an **upgrade cycle**. We are confident it will, as iPhone16 offers a new class of capabilities. Gen AI joins a long line of capability upgrades over the years – touch-based apps, 5G connectivity, enhanced cameras - each of which triggered a **multi-year** device upgrade cycle. After two tepid years of iPhone growth, it is only reasonable to expect pent-up demand from the early adopters.*

*In keeping with historical precedence, we expect iPhone16 to carry mostly **in-house** developed Gen AI applications. We expect iPhone16 to garner demand from early adopters. We expect Gen AI apps developed by **3rd party** ISVs to start showing up next year in iPhone17, which should then encourage another round of upgrades, this time from mainstream consumers and enterprise customers.*

But it is more than just iPhones. We expect Apple to integrate Gen AI functionality into its Macs, iPads and even Watches. We expect functionality to steadily improve over the years which then incentivizes more users to upgrade the gamut of Apple devices. We are not looking for heroics. We are modeling back-to-back years (FY25/26) of overall revenue growth slightly above mid-single digit and eps growth in the high single digits (Exhibit 1). We model Fy25 as $415bn/$7.15 and Fy26 at $443bn/$7.73; revenue in both years up ~7% and eps up 8%.

*The two-day surge following the wwdc event took the stock up intra-day to our current PT$220. Based on 34x to our Fy26 eps estimate, discounted at 5% back to this year we derive **a new PT of $240**.*

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The next leg in the AI revolution: AI models in the cloud having reached a certain level of maturity, the next leg in the AI revolution is the distribution of distilled versions of LLMs to hundreds of millions of client/edge devices. This step needs to be taken with great care, as novel forms of attacks and malware running on powerful client SoCs could spell disaster on a scale unimaginable. To preserve its brand as a

trusted personal device, we think Apple needs to necessarily stay deliberate in launching AI apps and in allowing 3rd party ISVs into its walled garden of devices. In our view, Apple is not being slow in its AI roll-out; Apple is merely being cautious in its approach to AI. And there is value in that.

Personal data – the real store of value: Having exhausted publicly available data for training giant LLMs, AI vendors thrash about looking for new sources of data to train their models (to reduce hallucinations further). However, there are just two giant **untapped data sources**, both in private domains, inaccessible to internet-facing Gen AI players such as OpenAI. One such domain is the vast amount of enterprise data locked up in secure corporate data centers, the kind of data which the likes of CRM are trying to monetize. The other untapped domain is the vast amount of personal data locked up in secure personal devices such as the iPhone, Mac, iPad and Apple Watch.

Have LLMs become commoditized? The one idea that we can take away from wwdc – AAPL plans to provide a personalized AI experience to its billion-plus paying customers and 2+billion Apple devices based on ultra-small models trained on data locked up in Apple devices and Apple Cloud. And if there is a corollary, it is this – LLMs have become **commoditized**. Why else would OpenAI give away its prized models, on which it may have spent $billions, to Apple for free?

The value going forward lies not in LLMs by themselves, but in access to proprietary data for training the LLMs further and for developing useful apps. Personalized Gen AI apps so built and distributed to billions of users worldwide are a work in progress, in our view. Whereas cloud-based Gen AI applications, such as ChatGPT and CoPilot have reached a level of maturity, client-device based Gen AI applications are **very much in their infancy**.

Apple's AI apps to launch in waves: We think the **first generation** of AI-centric devices from AAPL, such as the iPhone16, are likely to carry mostly internally developed Apple apps. To recall, iPhone2 the model that first launched the apps revolution, carried mostly home-built apps. Apps from ISVs took some time to make their way into Apple's roster of iPhone apps. We expect a similar cadence from Gen AI apps as well. We expect Gen AI apps from ISVs to appear on the **second generation** of Apple devices, such as the iPhone17. This second wave of Ai apps is a Fy26 opportunity.

Apple has a moat others lack: Even after the sharp move to the upside after wwdc, the stock has merely caught up with SPX on an year-to-date basis. Its under-performance all year we believe was due to a series of investor misperceptions which got corrected after Apple events, the most notable being 1) iPhones were in secular decline due to share loss and 2) Apple did not have an AI strategy. The first one was addressed at Apple's earnings event, the second was addressed at the wwdc event

However, investor skepticism lingers. Apple is seen as having been late to the AI party. But is it though? Just as NVDA is seen as having a moat due to CUDA, Apple too has a moat due to its control over billions of personal devices, every one of them a carrier of future AI apps. Google may have had a jumpstart over Apple in the development of in-house AI infrastructure. But Google does not have the kind of control over Android as Apple does over iPhones. And Google does not have Apple's ecosystem of non-phone personal devices.

Apple is a one-stop shop for ISV access to Apple's client devices. ISVs could build AI apps based on a range of inputs- touch, pencil, visual inputs and voice activates. That is Apple's moat. And that is why we think OpenAI is willing to give away its prized LLMs to Apple.

Apple silicon in the cloud: Apple has another weapon its hyperscale peers, outside of Google, lack – Apple Silicon capable of running complex LLM workloads in the cloud. While peers such as MSFT, AMZN and META struggle to develop internal Ai silicon just so they could escape the onerous pricing and power consumption of AI GPUs, Apple announced at the wwdc event that it plans to use its internally developed, fully mature, low-power consuming Apple Silicon for cloud AI workloads.

Will Apple servers be made available in the merchant server market? Down the road, after Apple established an AI beachhead, we think merchant Apple severs are a possibility. As META's Llama LLMs are compatible with Apple Silicon, we can see **META** becoming a potential future customer. But we will leave this possibility out of our fin models.

Net/net: We are raising our PT to $240 from $220. We expect AI adoption for Apple customers in waves, the 1st generation of Apple devices carrying internally developed apps to launch in Fy25, the 2nd generation introducing apps from ISVs to launch in Fy26. We see at the very least two years of ~7% revenue growth and ~8% growth in EPS growth. After two years of stagnation, we expect pent-up demand from early adopters this year to extend to mainstream adopters next year and beyond. Furthermore, thanks to its internally developed Apple Silicon, muted capex needs may allow Apple exhibit superior ROI and free cash flow compared to its peers

Exhibit 1: Key financial estimates

$bn	FY24	FY25	FY26
iPhone	200.0	212.0	224.7
Mac	30.2	31.8	32.7
iPad	26.7	27.5	28.0
Wearables	36.4	37.5	39.3
Services	95.8	106.4	118.1
Total revenue	**389**	**415**	**443**
Gross margin	46.5%	47.0%	47.0%
Op margin	32%	32%	31%
EPS $	6.61	7.15	7.73

Source: Bloomberg, Lynx Equity Strategies

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