Earnings preview Oct 31, 2024

AAPL: Taking a contrarian view

LYNX EQUITY STRATEGIES

KC Rajkumar, CFA, PhD
(408) 425-5680
KC@LynxEq.com

Versus the muted expectations on the Street for near-term iPhone momentum, we are long into print. The Street is inundated with chatter of order cuts at iPhone16. We take a more nuanced view and look for upside to Street's lowered expectations for Dec quarter.

*Our expectation for Dec upside is not based on a boost from Apple Intelligence. Rather, we focus on more traditional dynamics. Our view is based on the potential opportunity Apple may be seeing in the general weakness at **Samsung**, unrelated to the relative progress either of the smartphone players have made in AI.*

*Signs of Samsung weakness are out there, and yet the Street has not picked up on them; not just in the weak qualitative outlook Samsung provided for its smartphones at its earnings call earlier today, but also in QRVO's disastrous guidance two days ago. Our work into the supply chain shows Samsung potentially **giving up shelf space** this holiday season at telcos and retailers, an opening we believe Apple would be only too willing to pounce on. Instead of Apple, we think it is more likely that Samsung has cut build plans for the holiday season. And that leaves Apple with a competitive opening.*

*Following Apple's WWDC event a few months ago we took the view that Apple Intelligence, which we are bullish over a multi-year basis, would be no more than a moderate catalyst for iPhone sales in FY25. Into the June quarter earnings call, Apple bulls were looking for iPhone growth in the teens for Fy25 and overall revenue up double digits vs. our estimates of both up mid-single digit (link). Apple's tepid guidance for the September quarter and the negative news flow over three months whittled Street expectations down to **more realistic levels**, now inline with our estimates a quarter ago.*

*Over the past three months, AAPL has traded only inline with the market, justifying our call into the previous quarter earnings event to sit out the June quarter earnings event. Into the earnings call today though, given muted Street expectations, we would be long into print. FQ1 iPhone guidance inline with average consensus of up mid-single digit **may be enough to lift the stock**.*

*We remain comfortable with our long-term view that the hidden value in the stock lies in its potential to pull up to par with AI peers over time but without the extraordinary spending on opex/capex at peers. At a slightly reduced multiple of 32x to a slightly higher FY25 eps estimate vs a quarter ago, we maintain our $240 PT (link). However, depending on the tenor of the call today, we could be **looking to raise our PT**.*

--xx--

The Android ecosystem runs into headwinds: Our work into the smartphone channel shows Samsung potentially **cutting build** of its high-volume smartphone models, a rather odd finding given that Samsung's A-series models have become a mainstay on shelves in the high-volume pre-paid cellular market. When **QRVO**, at its earnings call two days ago, talked of its largest Android customer cutting back its mid-tier models (the A-series at Samsung) and tilting towards entry level model, we think we have confirmation of our suspicion.

This trend towards 'bar-belling' smartphone models, i.e. terminating mid-tier models and allocating volume towards the entry-level and premium ends of the spectrum has been going on for 1-2 years. However, in recent months, for reasons we don't quite understand, this trend appears to have accelerated at Samsung. The latest IDC report for Q3 shows Samsung shipment **down mid-single digit** vs. overall global smartphone units **up mid-single digit**. Apple our performed Samsung- iPhone unit growth was reported **inline** with the overall market. Apple picked up 200bps to share q/q, at the expense of Samsung and Xiaomi, according to the report.

China shipments for Apple too seems benign, with the Canalys report showing iPhones holding up at ~10mn units every quarter for the first three quarter of every year for multiple years, and a seasonal uptick to the high teens in CQ4.

Signs of stress at Samsung, Apple likely to exploit: Across the gamut of its product segment, Samsung appears to demonstrate weakness and a loss of traditional leadership- logic fabs, HBM innovation, consumer goods and mobile phones. We find that a **general weakness** at Samsung is having observable effects on its upstream/downstream partners. Into the AMD print a few days ago, we anchored our negative thesis on, among other reasons, Samsung's HBM woes (link).

In the mobile space, we believe Samsung is pulling back on its shipment plans into the holiday season. At its recent earnings call, QRVO said revenue at its largest Android customer was less than that anticipated earlier this year.

We think Apple is likely to exploit the pullback in Samsung's positioning in the retail space by potentially **building additional** iPhone volume for the holiday season. We expect Apple management to signal more optimism for iPhone in the Dec quarter than it did for the Sept quarter.

Meanwhile on the AI front, Apple ploughs on as the Android ecosystem hesitates: We think Apple's M4 chip does not have the horsepower required to perform the kind of Gen AI functions that is likely to make Gen AI a selling point for Apple devices. On the other hand, AI SoC at QCOM and MediaTek appear to have more raw horsepower than Apple M4's 38 TFLOPS. Both in terms of TFLOPS and the sophistication of the o/s, we think the Android universe has an edge over iPhones.

However this edge Android currently has over the Apple universe could soon disappear as 1) the Android universe hesitates pushing its advantage; Samsung, Google and QCOM seem unable to come together and deliver eye-popping solutions and 2) the vertically integrated Apple ecosystem, with a line of sight to 2nm silicon next year has a shot at better integrating hardware/software and vault over the present-day advantages the Android ecosystem may have.

We think major improvements in image/video generation in iPhones can be expected only in the FY26 cycle when 2nm M5 silicon launches.

Apple- patient and prudent: We expect investors to complain about the lack of eye-popping AI applications on the current iPhone16. However, Apple's hyperscale peers, despite their heavy investment in opex/capex find themselves unable to impress investors, witness the dour response to META and MSFT earnings last night. Do investors really have a choice but to give Apple the benefit of the doubt and hope that Apple extracts superior ROI from its prudent, one might even say skeletal AI investments?

Financials: We are leaving our model relatively unchanged from a quarter ago. We continue to model iPhone segment and the overall revenue growth up 6% and 6.7% respectively. Street estimates have drifted down to where we have been, as the more bullish expectations got whittled down. We have been modeling Fy26 revenue at $443bn. Three months ago, the bulls **got to our F26 estimate in Fy25 itself**! Not anymore. Expectations for FY25 have moderated even as the stock has held up inline with the market.

At a slightly reduced multiple of 32x to our slightly higher FY25 eps estimate, we maintain our $240 PT. However, depending on the tenor of the call today, we could be **looking to raise our PT**.

Exhibit 1: Key financial estimates

$bn	FY24	FY25	FY26
iPhone	199.2	211.2	223.8
Mac	30.2	31.7	32.6
iPad	27.2	28.0	28.5
Wearables	37.0	38.1	40.0
Services	96.2	106.8	118.5
Total revenue	**389.8**	**415.8**	**443.4**
Gross margin	46.5%	47.0%	47.0%
Op margin	32.0%	32.0%	31.0%
EPS $	6.63	7.34	7.84

Source: Bloomberg, Lynx Equity Strategies

Disclosures and Disclaimers

Lynx Equity Strategies, LLC is an independent equity research provider. The Company is not a registered broker dealer or investment adviser. No employee or member of the Company, or immediate family member thereof, exercises investment discretion over securities of any issuer analyzed in this report two days prior and/or two days after this report is issued. It participates in "Alpha Capture Systems" that seeks investment or trading ideas from the sell-side and may pay for the participation based on relative performance

Limitations of Information

This report has been prepared for distribution to only qualified institutional or professional clients of Lynx Equity Strategies, LLC (the "Company"). The contents of this report represent the views, opinions, and analyses of its authors. The information contained herein does not constitute financial, legal, tax or any other advice. All third-party data presented herein were obtained from publicly available sources which are believed to be reliable; however, the Company makes no warranty, express or implied, concerning the accuracy or completeness of such information. In no event shall the Company be responsible or liable for the correctness of, or update to, any such material or for any damage or lost opportunities resulting from use of this data. Nothing contained in this report or any distribution by the Company should be construed as any offer to sell, or any solicitation of an offer to buy, any security or investment. Any material received should not be construed as individualized investment advice. Investment decisions should be made as part of an overall portfolio strategy and you should consult with a professional financial advisor, legal and tax advisor prior to making any investment decision. Lynx Equity Strategies, LLC shall not be liable for any direct or indirect, incidental or consequential loss or damage (including loss of profits, revenue or goodwill) arising from any investment decisions based on information obtained from Lynx Equity Strategies, LLC. Reproduction and Distribution Strictly Prohibited. No user of this report may reproduce, copy, distribute, sell, resell, transmit, transfer, license, assign or publish the report itself or any information contained therein. This report is not intended to be available or distributed for any purpose that would be deemed unlawful or otherwise prohibited by any local, state, national or international laws or regulations or would otherwise subject the Company to registration or regulation of any kind within such jurisdiction.