
From: Richard Kahn [REDACTED]
Sent: Thursday, February 2, 2017 8:06 PM
To: jeffrey E.
Subject: Fwd: Apple, Inc.: 10-Q Confirms Margin Stability, Revenue Re-acceleration

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Begin forwarded message:

From: Morgan Stanley [REDACTED]
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Date: February 2, 2017 at 1:47:26 PM EST
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Apple, =nc.: 10-Q Confirms Margin Stability, Revenue Re-acceleration

Katy L. Huberty, CFA – Morgan =tanley

February 2, 2017 6:44 PM =MT

Apple's =0-Q suggests normalized gross margin was better than reported after =djusting for above average warranty accruals. Off-balance sheet =ommitments and supplier receivables signal a continued revenue =ecovery. New references to "Digital Content" could preview upcoming =nvestments and/or M&A.

December gross margin stronger than reported after normalizing for =arranty and hedging. After adjusting for above average warranty =ccruals and small hedge gains, normalized gross margin of 39.4% was =loser to flat Y/Y (vs. reported decline of 160bps) despite the stronger =SD (1). We believe this is a function of 1) Apple's efforts to =ressure suppliers for more favorable pricing in light of the company's =igh share of volume and currency movements that benefit suppliers, and =) rising mix of and margins on Services revenue which account for =lmost 12% of LTM revenue versus 9% a year ago. Off-balance sheet =urchase commitments returned to growth ahead of supercycle. Off =alance sheet purchase commitments for outsourcing and components grew =6% Y/Y compared to a 6% decline in FY16. The return to growth occurred = quarter earlier than ahead of iPhone 6 (returned to growth June 2014, =18% Y/Y). Off balance sheet commitments are 96% correlated to next =uarter revenue (3), implying March quarter sales north of \$60B compared =o guidance of \$51.5-53.5B. Similarly, vendor non-trade receivables =ncreased 19%, an acceleration from flat in September and decline of -8% =n FY16. These receivables have 92% correlation to next quarter revenue =4), and also imply revenue upside. While extrapolations from these =etrics are not always precise and there is a bigger seasonal =iscrepancy in March quarters, directionally they do suggest Apple is =lanning for strong demand and/or making purchase commitments to lock in =avorable pricing, especially in memory. Maintaining strong Capex =uidance and previewing move into content? Other notable updates in =pple's December 10-Q include: 1) A

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