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**From:** Richard Kahn [REDACTED] >  
**Sent:** Monday, February 5, 2018 1:48 PM  
**To:** jeffrey E.  
**Subject:** Fwd: Apple, Inc.: 10-Q Highlights Elevated Component Inventory

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Begin forwarded message:

**From:** "/b>"Morgan Stanley" <[REDACTED]>  
**Subject:** "/b>Apple, Inc.: 10-Q =ighlights Elevated Component Inventory  
**Date:** "/b>February 5, 2018 at 12:37:13 AM =ST  
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Apple, Inc.: 10-Q =ighlights Elevated Component Inventory

Katy L. Huberty, CFA =E2 Morgan Stanley

February =, 2018 5:01 AM GMT

Off-balance sheet =ommitments, vendor non-trade receivables & inventory are at record =evels, possibly leading to more supply chain noise as levels are worked =ower. Normalized gross margin of 38.3% is just below reported margin of =8.4% with currency & other hedges largely offsetting each other.

On and off balance sheet component inventory hit new highs. =he combination of reported balance sheet inventory and vendor non-trade =eceivables (component inventory transferred to manufacturing partners) =ncreased 41% Q/Q in December 2017, the highest sequential increase =ince 2013, and above 12% average seasonality over the prior three years =2). As a result, total non-vendor trade receivables and inventory on =he balance sheet is up \$15.2B Y/Y (3). The bulk of the increase was =riven by vendor non-trade receivables (+\$13.5B Y/Y) that are =istorically correlated to revenue growth (5). However, we believe the =rimary driver of the acceleration is associated with the company =urchasing more of its components directly rather than through =anufacturing partners potentially making this metric less predictive of =uture Apple revenue growth. Inventory dynamics provide mixed signals =or suppliers. From a supply chain perspective, the higher levels of =nventory at Apple and at suppliers could translate to slower unit =rowth relative to sell-out for Apple devices in the near-term, which =ur US Semiconductor team led by Joe Moore published on today. =nterestingly, off-balance sheet purchase commitments for outsourcing =nd components at the end of December 2017 - essentially Apple's =ommitment to manufacture product and purchase components in the near =uture - grew 40% Y/Y and fell only 11% Q/Q, less than the 3-year =istorical seasonal decline of 19% (4). This would suggest a robust =rowth outlook or that the company revised its view of demand after the =nd of the quarter. Any meaningful revision or lack thereof to this line =tem at the end of March will be an importan

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