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# Another iPhone Launch – New Dynamics; Same Results

iPhone 6 S



September 26, 2015

## Another iPhone Launch – New Dynamics; Same Results

Apple (AAPL) officially launched its new iPhone handsets, the iPhone 6S and 6S+ yesterday (Friday September 25<sup>th</sup> at 8:00AM local time). I have been through the launch “shenanigans” a number of times – as a consumer, investor, re-seller and blogger. Ironically, I have been in Hawaii for the past three launches, but was in Dallas for the 6S / 6S+ launch yesterday. I wanted to outline a few items that I observed about the new products, the launch, and the financial implications of the fiscal calendar.

### What did I get?

I opted for the 128GB T-Mobile (unlocked) 6S+ in Space Gray. As a frequent business traveler, I like the bigger screen, the extended battery life and the 6+ / 6S+ are still the only iPhones that have Optical Image Stabilization (OIS) – most people don’t know this (and I would bet, most do not care either, haha).

### The new phones:

This year was a “tock” year in the tick-tock tech nomenclature, which for Apple means same form-factor (for the most part), with new components and an OS with certain features that can only be used on the latest versions. I am not going to do a full of review the phone here, but here is a summary of the key feature upgrades:

- **TouchID:** TouchID is ‘markedly’ faster and more reliable than in any other previous iOS device. This may seem ‘inconsequential’, but there is near instantaneous access now between ‘locked’ and ‘unlocked’. If you want to see how much faster, click [here](#).
- **New SoC:** Apple continues to move its proprietary chip designs (based on ARM architecture) forward and the A9 promises 70% more CPU performance and 90% more graphics performance than its predecessor (the A8) – what this means for actual ‘normal’ use – I can’t really tell you. For the first time, Apple has embedded the M9 motion coprocessor in the A9 chip, which should improve efficiency and battery life.
- **2GB of RAM:** Apple has historically been very conservative with RAM, with the iPhone 6 and 6+ still only having 1GB of RAM. Apple has doubled the RAM in the 6S / 6S+ to 2GB. Once again, what this means for your normal user, not sure yet, but certainly factors into some of the new features.
- **3D Touch:** Ok, let’s face it. 3D Touch was, by-far, the most discussed feature of the new handsets. Essentially, it is as it sounds – it enables a 3<sup>rd</sup> dimension (pressure sensitivity) that enables direct access to certain key features within apps. One example is if you hard-press on the camera icon, it gives you direct access to a set of features such as taking a selfie, recording video, etc. This may sound like “*I’ll try it a few times and never use it again*”, but I think that is very premature. I view 3D Touch as all about efficiency – in the way you navigate the interface, which enables faster access to the features within apps that you use the most. I think we know that Apple has a pretty phenomenal developer community and they will probably do some things with it that even Apple has not thought of. Most apps are not 3D Touch enabled yet, so we’ll just have to wait-and-see.
- **12MP iSight Camera:** Apple has never had the highest MP cameras (6 and 6S used an 8MP shooter), but it seems that its control of the entire silicon infrastructure has allowed it to stay on-par, if not exceed, its competitors, when it comes to image quality. Additionally, the new camera enables 4K video, which is sure to make all those that opt for the 16GB configuration feel very inadequate.
- **Rose Gold Option:** The rose gold option was new for the 6S / 6S+ and it appears to be the most popular color as all configurations (storage capacity / carrier) of the rose gold color sold out first and have the longest current wait times. The [‘most mysterious Apple analyst in the world’](#) (they need to make a Dos Equis commercial about him) has gone on record saying that as much as 40% of pre-orders were rose

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gold 6S models. The real question is – could a guy get away with the rose gold variant? After seeing it in person – more than I thought, but still questionable.

- **Weight:** The 6S is 14 grams heavier (10.8%) than the 6, and the 6S+ is 20 grams heavier (11.6%) than the 6+. This weight gain was originally thought to be due to the new 7000 series aluminum chassis, but it is actually attributed to the taptic engine and associated display components that enable the 3D Touch functionality. I will say that the weight is noticeable. After all, you hold this thing a lot throughout the day – all the more reason why the Apple Watch serves a big purpose - limiting the need to pull your phone out (oh yeah, it tells time too).

### The Pre-Order Period and Same-Day Reservation System:

Apple has, for all the launches I can remember, had a pre-order period between a few days after the product unveiling and the actual availability:

Model	Product Unveiling	Pre-Order [A]	Availability [B]	Gap [B] – [A]
iPhone 4S	Oct. 4, 2011	Oct. 7, 2011	Oct. 14, 2011	7 Days
iPhone 5	Sept. 12, 2012	Sept. 14, 2012	Sept. 21, 2012	7 Days
iPhone 5C	Sept. 10, 2013	Sept. 13, 2013	Sept. 20, 2013	7 Days
iPhone 5S [1]	Sept. 10, 2013	N/A	Sept. 20, 2013	N/A
iPhone 6 / 6+	Sept. 9, 2014	Sept. 12, 2014	Sept. 19, 2014	7 Days
iPhone 6S / 6S+	Sept. 9, 2015	Sept. 12, 2015	Sept. 25, 2015	13 Days

**Note:**

The iPhone 5S was not available for pre-order and was available in extremely limited quantities on launch day – this was largely attributed to this model being the first where Apple implemented its TouchID biometric authentication home button based on technology acquired from AuthenTec in July-2012.

In any case, the decision for the longer pre-order period could have been due to a number of reasons:

- **Simultaneous China launch**  
One of the big mysteries from the 6/6+ launch in 2014 was the delay in the launch of the new handsets in China due to necessary “regulatory approvals”. The 6/6+ was eventually launched in China on October 17, nearly a month after the U.S. launch. It is possible that Apple wanted to ensure a simultaneous U.S. and China launch with the 6S and 6S+ this year, and therefore had to wait that extra week to obtain necessary approvals.
- **New Same-Day Reservation System**  
This was the first iPhone launch where customers could reserve a specific model when pre-orders started and be able to have a guaranteed time slot to pick-up the phone without having to wait in some crazy line – it is basically the “Personal Pick-Up” equivalent. In past launches, the Personal Pick-Up reservation system usually becomes available after the launch weekend. With this new system, Apple very well could have wanted that extra time for people to utilize the reservation system. It proved very effective and efficient for those (like me) who used it – no lines, no camping out, no robots (yup – [robots](#)). I put this pretty high up on the ‘reasons list’ for an extended pre-order period.
- **Apple Financing**  
As many people have heard, Apple is now offering its own financing (“[The iPhone Upgrade Program](#)”) to compete with the carriers’ installment plans. Apple is using Citizens Bank to provide 24-month financing on its iPhones to customers with an optional upgrade right after 12-months. The new plan allows a customer to finance with Apple and have an unlocked phone that it can then take to its carrier of choice and basically be on a month-to-month plan. While I will not discuss the ramifications for Apple or the

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carriers with this new plan, there very well could have been an extra ramp-up period needed to ensure that this could be logistically supported. The Apple-provided financing seems to be quite popular as people would rather direct their loyalty to Apple, as opposed to the wireless carriers. There were [multiple reports](#) floating around about Citizens being overwhelmed with the amount of credit checks it was running for these financings yesterday. A sales rep that I spoke to said that a little over half of the phones he sold during his 8-hour shift were done through Apple's financing program.

### ▪ **Revenue Smoothing**

While Apple claims that it never does anything for the "90-day clicks" (e.g., quarterly financials), it is still the most valuable and watched company in the world that is judged on its quarterly reporting. Apple recognizes revenue on its iPhone units using the following criteria:

- **In-store purchase at an Apple retail store:** Point-of-Sale;
- **Online purchases through Apple.com:** Evidence (via signature from a 3<sup>rd</sup> party carrier) that delivery has been made; and,
- **3<sup>rd</sup> Party channel sales:** Sell-in to authorized 3<sup>rd</sup> party retailers (wireless carriers, big box retailers, etc.) – note that these sales are recognized at the point when the channel takes delivery, regardless of when these units are sold through to a 3<sup>rd</sup> party.

So what's the point? Well, given that Apple's fourth and final fiscal quarter will end today (September 26<sup>th</sup> at 11:59PM PDT), there will only be **2 full days of sales** of the 6S / 6S+, as compared to last year when there was 9 full days (a [point originally surfaced](#) by my friend, [Chuck Jones](#) of Forbes – *the most accurate Apple analyst in the world*). That extra week may not seem like a lot, but when you think about the types of volumes of iPhones that Apple moves at the front-end of a launch, it is very significant. Last year, Apple shipped (or recognized sales of) approximately 10 million units in its launch weekend alone, and it was extremely supply-constrained (as it is this year). I have done an analysis of what the potential revenue and unit shift impact could be of having only 2 full sales days of the new iPhones (6S / 6S+) this year versus the 9 full sales days last year:

Impact of Y-O-Y Sales Days of New iPhones		FQ4 2014 (Sept-14) [1]	FQ4 2015 (Sept-15) [2]	Potential Shift (FQ4-15 to FQ1-16)
	Sales Days of New Models	9	2	7
Unit	Low Range - New Models (mm)	15.0	8.8	6.2
Sales	High Range - New Models (mm)	20.0	10.4	9.6
	Average Selling Price [3]	\$ 650.00	\$ 650.00	\$ 650.00
Revenue	Low Range - New Models (\$mm)	\$ 9,750	\$ 5,720	\$ 4,030
	High Range - New Models (\$mm)	\$ 13,000	\$ 6,760	\$ 6,240

#### Notes & Assumptions:

- [1] For FQ4-14
  - A low-end of 15M iPhone 6 / 6+ units and a high-end of 20M iPhone 6 / 6+ were included
  - Of the 10M units reported as sold during 2014 opening weekend – 50% sold on Friday, 30% sold on Saturday, and 20% sold on Sunday.
- [2] For FQ4-15
  - A low-end of 11M iPhone 6S / 6S+ units and a high-end of 13M iPhone 6S / 6S+ units will be sold on opening weekend, with the same pro-rata allocation by-day as 2014. However, amounts only include Friday (9/25/15) and Saturday (9/26/15) as all sales on Sunday (9/27/15) will be pushed into FQ1 16.
- [3] ASP of \$650 – this is an estimate based on 6 / 6S ASPs knowing that ASPs were depressed at the beginning of the cycle and will be again due to supply constraints of the 6+ / 6S+ model, which has a +\$100 entry price.

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So ultimately, I am estimating that the 7 days of fewer sales of the new iPhones that Apple will be recording in its fiscal fourth quarter on a year-over-year basis will ultimately shift:

- **Between 6.2M and 9.6M iPhone unit sales into the holiday quarter (FQ1-16)**
- **Between \$4.0B and \$6.2B of iPhone revenue into the holiday quarter (FQ1-16)**

I did mention “smoothing”. It is no secret that Apple is facing tough year-over-year compares this upcoming holiday quarter. They shipped a staggering 74.5M iPhone units in last year’s holiday quarter (most of which were assumed to be 6 / 6+ models) and recorded total revenues of \$74.6B. So, this shift may actually prove to be a tailwind for that year-over-year compare. Of the [32 analysts polled](#) on *Yahoo! Finance*, they have an average estimate of \$74.54B for Apple’s FQ1-16, which is pretty meager growth of less than 3%. While that number may rise, there is still many questions about growth that will probably keep it range-bound.

### **But what about this quarter?**

So with my estimates of \$4B - \$6B of revenue being shifted to the holiday quarter, the question becomes, how will Apple make up for it this quarter? After all, the company provided decent guidance of revenues between \$49 billion and \$51 billion. Assuming they come in at the top-end of that range (as has been the norm), it would imply year-over-year revenue growth of 21%, which would include forex headwinds (likely 8% – 10%). I think it is safe to say that Apple knew exactly when they would be launching the new iPhones and how the quarter cut-off would affect the recording of revenue – meaning, I don’t think Luca Maestri provided the guidance to the Street and then looked at the calendar and had an “oh crap” moment. Here is where I think they make it up:

- **Stronger sales and higher ASPs of the iPhone 6 / 6+ models than the 5S / 5C leading up to the respective product refreshes.**

You will certainly have that contingent of buyers that will hold off on purchases knowing that a refresh is coming. However, the “S” refreshes tend to be more subtle to the general public and there was so much ‘buzz’ last year about the larger screens which I believe led to a lot more people hold off on buying. Going along with that, let’s call a dud a dud – the 5C did not sell very well and I would imagine that Apple was not refilling the channel on those SKUs in FQ4-14. In fact, they were likely just watching any remaining channel inventory bleed off until it was officially discontinued.

Additionally, the 6 / 6+ has significantly higher ASPs than the 5S / 5C did. In fact, even with the challenging forex headwinds, iPhone ASPs were up to \$660 last quarter. Apple went so far as to [mention](#) that on a constant-currency basis, ASPs would have been up by an additional \$24 to \$684. Given these data points, there is clearly strong demand for higher storage configurations and the 5.5” 6+ form-factor (+\$100 addition to ASP).

- **The Watch**

The Street was not particularly impressed with implied watch sales when the company reported in late-July. Estimates have been all over-the-board, but I would say consensus was about 2.5M units shipped. On its earnings call, Apple noted significant supply constraints, including not being able to put inventory into its own retail stores until mid-June – specifically it noted that distribution was limited to 680 points-of-sale (for perspective, the iPhone is distributed at over 200,000 points-of-sale). In the September quarter, Apple will receive the one-time benefit of building a channel inventory for Watch, where revenue is reported on a “sell-in” basis, as well as expanded geographical distribution through its own retail stores. This expanded channel and geographic distribution includes:

- **Best Buy.** The electronics retailer reported that given strong demand, it had accelerated the rollout of the Apple Watch to include 900 of its “Big Box” stores carrying the product

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by the beginning of September, and all 1,050 “Big Box” stores carrying it by the end of September. Given that sell-in happens in-advance of actual sales to end-customers, I would imagine that all of this sell-in revenue will be captured in the September quarter.

- **U.S. Wireless Carriers.** Both Sprint and T-Mobile indicated that they would both be carrying the Apple Watch starting on September 25<sup>th</sup> at 200+— once again, sell-in channel revenue that will be captured this quarter.
- **International Retailers.** In addition to Best Buy, T-Mobile, and Sprint, Apple has expanded 3<sup>rd</sup> party Watch sales to retailers throughout Europe, Australia and Canada.
- **Geographic Expansion.** Lastly, Apple expanded sales of Apple Watch at its own retail stores in 7 countries (Italy, Mexico, Singapore, South Korea, Spain, Switzerland, and Thailand) on June 26 and another 3 on July 17 (Netherlands, Sweden and Thailand).

While the 3<sup>rd</sup> party channel inventory build will be a nice tailwind revenue stream in the September quarter, it is unknown how many units are being carried by these retailers. Additionally, there is a one-time benefit nature to this revenue as once it is established, Apple will refill it, but you’ll likely not see the unit sell-in at the levels they are to initially establish it. I fully expect that once the holiday season rolls around, Apple will further expand distribution of Apple Watch in the United States and abroad, which could be the second catalyst to Watch revenue growth. In the United States, I could foresee the following being strong candidates to carry the product:

- **Hermes** (Confirmed – sales to start in October – proprietary model)
- **Target** (Sport only)
- **Nike** (Sport only)
- **Nordstrom & Bloomingdales** (Watch and maybe Edition)
- **Neiman Marcus** (Watch and maybe Edition)

### Overall Thoughts

- The iPhone 6S and 6S+ appear to have gotten off to strong starts with healthy demand (as evidenced by [lead times](#)) and will receive a nice tailwind from the quarter cutoff helping with the year-over-year compare;
- The iPhone units and revenue that will be shifted to the holiday quarter (FQ1-2016) due to the quarter cutoff will be made up by:
  - Stronger sell-through and higher ASPs of the legacy 6 / 6+ models
  - Strong watch revenue due to substantial expansion of the 3<sup>rd</sup> party channel as well as expanded geographic distribution.
- The mechanics of iPhone launch distribution (e.g., reservation system) and the new financing programs are both net positive to the brand and will further increase retention of the growing installed base;
- Apple will report strong Mac sales based on the back-to-school season and very weak iPad sales, neither of which will be significant to the Street’s sentiment; and finally,
- I will be keenly interested in any changes to the revenue recognition of iPhone sales specifically related to units financed through Apple’s Upgrade program.



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