TECH

Apple Suppliers Suffer as It Struggles to Forecast iPhone Demand

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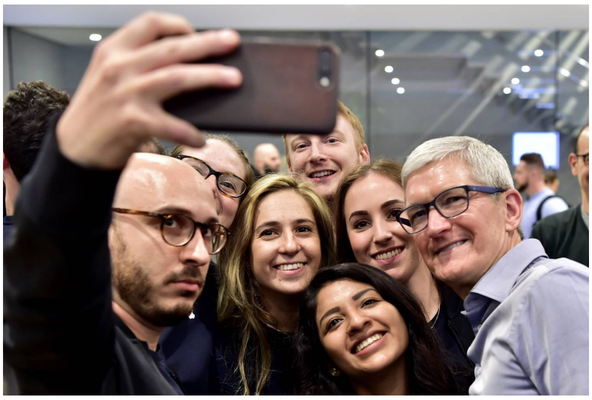

Apple CEO Tim Cook at an Apple store in Milan in October. **PHOTO:** PIAGGESI/FOTOGRAMMA/ROPI/ZUMA PRESS

By Yoko Kubota in Beijing, Takashi Mochizuki in Tokyo and Tripp Mickle in San Francisco

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Lower-than-expected demand for Apple Inc.'s AAPL **-2.96%** ▼ new iPhones and the company's decision to offer more models have created turmoil along its supply chain and made it harder to predict the number of components and handsets it needs, people familiar with the situation say.

In recent weeks, Apple slashed production orders for all three of the iPhone models that it unveiled in September, these people said, frustrating executives at Apple suppliers as well as workers who assemble the handsets and their components.

Forecasts have been especially problematic in the case of the iPhone XR. Around late October, Apple slashed its production plan by up to a third of the approximately 70 million units it had asked some suppliers to produce between September and February, people familiar with the matter said.

And in the past week, Apple told several suppliers that it cut its production plan again for the iPhone XR, some of the people said Monday, as Apple battles a maturing smartphone market and stiff competition from Chinese producers.

Apple declined to comment.

During an interview earlier this year with The Wall Street Journal, Apple Chief Financial Officer Luca Maestri said that trying to determine demand for its devices based on reports from suppliers can be misleading because the suppliers also make products for competitors.

The fallout has ripped through Apple's supply chain.

Last week, major iPhone suppliers including Qorvo Inc., Lumentum Holdings Inc. and Japan Display Inc. cut quarterly profit estimates, citing a reduction in previously-placed orders from a large customer.

Apple wasn't named, but the iPhone maker accounts for a third to half of revenue for these companies, according to filings and estimates.

Investors reacted by sending shares of the three companies sharply lower. Apple's stock is down more than 10% since before it reported earnings on Nov. 1.

At Foxconn Technology Co. , Apple's largest assembler of iPhones in China, thousands of workers have voluntarily left earlier than they intended to after Foxconn cut overtime hours that are typically available during peak production periods, people familiar with the matter said. Many workers have come to rely on overtime as a key source of income. Foxconn declined to comment.

The iPhone production cuts have reignited frustration among suppliers and raised worries about Apple's ability to forecast demand since it started releasing three flagship models instead of two last year, according to executives at Apple suppliers.

The suppliers' ability to gauge demand will also be hurt by Apple's recent decision to stop reporting unit sales, one supplier said.

The addition of new iPhones at higher prices—the devices now cost $749 to $1,000, up from $649 to $769 in 2016—have made predicting demand more difficult, analysts and forecasting experts say.

Apple is also selling some older models in its stores, complicating forecasting further.

"The more choice you introduce, the harder it is to pinpoint who will buy what," said Steven Haines, chief executive of Sequent Learning Networks, which has advised companies such as FedEx Corp. and Verizon Communications Inc. on product management.

In the past, Apple thrived on "the beauty of simplicity," said an executive at an Apple supplier. "It was very few models at massive volumes."

The company's suppliers have been rattled before. The iPhone 6, introduced in 2014, sold better than Apple's expectations and suppliers scrambled to meet increased orders. The following year, demand for the iPhone 6s fell short of forecasts, leaving suppliers to grapple with excess inventories and underused production capacity.

Last year, many suppliers were hurt by Apple's excessively optimistic initial production forecast for the iPhone X, which it then slashed by some 20 million units for the first three months of 2018.

"Doing business with Apple is very risky as it often reverses what it has promised," said an executive with a supplier.

Supplier frustrations have been compounded by the lack of growth in iPhone unit sales in recent years. Since peaking in fiscal 2015, the number of iPhones sold annually has fallen 6% to 217.7 million units.

While making components for 200-million plus iPhones is still tremendous business for suppliers, most relied on the growth in iPhones sold to increase their profits. Apple tightly controls margins and asks many suppliers to make big investments in specialized machinery to make its products, suppliers say.

"Growth fixes a lot of sins," the executive at an Apple supplier said. "When it slows, rocks start to show up in the bottom of the ocean."

Apple has offset slowing growth by raising iPhone prices and focusing more on software and services. The strategy helped the company report its best-ever year of revenue and profit for the fiscal year ended in September; for the current quarter, it projects revenue of $89 billion to $93 billion. Its growing services business has also offset the company's contracting hardware margins, industry analysts say.

But while Apple has been enjoying record revenue and profit for the past year, the same can't be said for many of its suppliers. That is because unlike Apple, they can't benefit from services and software and they rely heavily on handset volumes, suppliers and analysts say.

"The freeway of Apple suppliers is littered with roadkill," said Timothy Arcuri, an analyst with the investment bank UBS who tracks the iPhone supply chain. "That's one thing when units are growing and another when units aren't going to grow. There's an argument to be made now: Why take the risk?"

— Yang Jie in Beijing contributed to this article.

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