

Apple: Average Selling Price Is Lower Than Reported

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Summary

- Apple has announced an average selling price of \$796 in the latest quarter against \$695 in the year-ago quarter.
- This massive improvement in ASP has been credited to higher retail prices of iPhone X, 8 and 8 Plus.
- However, there were other factors which should have had a negative impact on ASP.
- The biggest tailwind which helped in boosting the ASP has been a weaker dollar which has lifted the dollar value of iPhones.
- The currency benefit is a one-time factor which will not help in masking lower unit sales.

Apple (NASDAQ: AAPL) reported a massive boost to its average selling price (NYSE:ASP) of its iPhones in the latest quarter but it comes with several caveats. Apple's ASP growth has been helped by a weaker dollar and the actual ASP growth due to pricier iPhone X is much less than what is reported.

iPhones contribute 70% of the total revenue base of Apple and have a larger profit share. Hence, any increase in the ASP of iPhones is taken as a big positive for the company. In the latest quarter, Apple's CFO, Luca Maestri, noted that the ASP of iPhones came at \$796 which is 14.5% higher than the \$695 ASP shown in the year-ago quarter. A large part of this increase is credited to higher prices of iPhone X, 8 and 8 Plus. But digging deeper tells a different tale.

What is behind this double-digit ASP growth?

First, we can look at a report compiled by CIRP.

Chart 1: iPhone Models US Sales Mix, 30 days after launch of iPhone X, iPhone 7, iPhone 6S, and iPhone 6

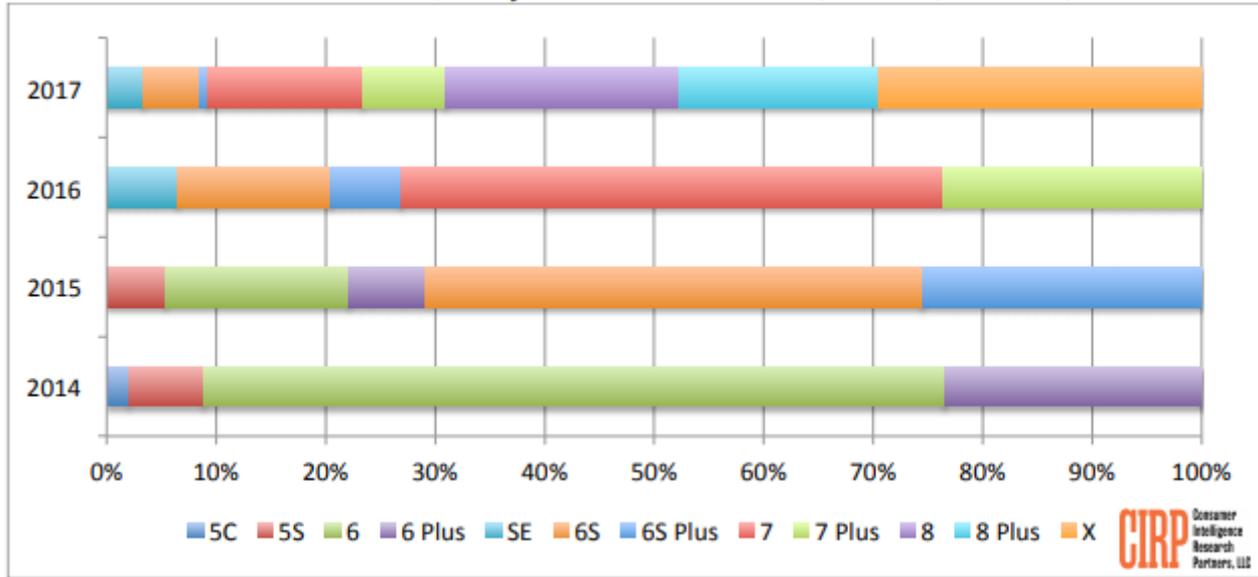


Figure 1: Product mix of different iPhone models, 30 days after the launch of the product.

Source: CIRP

In the last quarter, Apple had 8 iPhone models compared to only 5 models in the year-ago quarter. Looking closely at the product mix, we can see that the new models in this release ended up getting the lowest share in the last four years. Apple did not discontinue 6S and 6S Plus, as it usually does with models which are two years old. Instead, the prices on these models were slashed by another \$100. They are now being sold at only \$449 and \$549. We can see in the above chart that these two models ended up cornering close to 10% of the total unit sales. Even iPhone 7 and 7 Plus had over 20% of the total unit sales, similar to the share which earlier models had in 2016.

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Fig: Comparison of popularity and price of iPhones in emerging market (\$1= INR 65).

Source: iPhone 6S, 8, X

After the launch of all models in November, the older versions of Apple have continued to sell at a good pace due to heavy discounts. The higher proportion of older versions in the product mix should have a negative impact on the ASP.

Actually, the negative impact of a \$449 iPhone 6S on quarterly ASP of \$796 is much higher than the positive impact of a \$999 iPhone X.

According to IHS Markit teardown, iPhone X had bill of materials of \$370.25 which puts the material cost at 37% of the retail price. The BOM of iPhone 8 is \$247.51 while it had a retail price of \$699. Hence, BOM cost is only 35.4%, which is lower than that of iPhone X. Hence, the positive impact of iPhone X on Apple's ASP has been overestimated and at the same time, the BOM margin is higher than other versions of iPhones which ends up having a negative impact on operating margin.

Currency impact

I believe that Apple has got a huge one-time benefit due to a weaker dollar in the last quarter. Although the price of individual models in international locations did not rise much in terms of their local currency, the increase in terms of the dollar was much higher. For example, an iPhone 8 256 GB is currently selling for RMB 7,188 in China while iPhone 7 256 GB was sold for RMB 6,988 immediately after its launch in 2016. This accounts for 2.8% year-on-year increase. A model like iPhone 8 Plus 256 GB is sold at RMB 7,988, which is exactly the price at which iPhone 7 Plus 256 GB was sold in 2016.

Hence, we can see that the actual increase in local currency has been much lower than the ASP increase of 14.5%. On the other hand, the prices in dollar terms have seen a much higher increase. In the first quarter of Fiscal 2017, Oct-Dec 2016, the highest exchange price for the dollar to RMB was RMB 6.959 for 1 dollar. In the last quarter, the highest exchange price for the dollar to RMB was RMB 6.655 for 1 dollar (dollar is weaker by 4.5%).

At the time of earnings release in early February, the exchange was RMB 6.30 for 1 dollar against RMB 6.90 for 1 dollar in early February 2017 (dollar was weaker by 9%). A similar trend can be seen in Euro vs Dollar exchange rate. A weaker dollar inflates the value of the revenue and retail price of iPhones and other Apple products sold in international locations.



Fig: Weaker dollar trend since last year.

The weakness in the dollar has allowed Apple to show double-digit revenue growth while its unit shipments have declined.

A weaker dollar will also increase the component price and hence the positive impact on margins will not be there. But it certainly increases the reported revenue and ASP. A higher ASP has generally been attributed to the higher price tag of iPhone X, however, the negative impact of discounted iPhone 6s to the ASP has not been accounted.

Apple's ASP growth should have been marginal or in low single digits due to the fact that iPhone X had only two months of sale period, the lower overall product share of the higher priced recent launches (refer figure 1) and the availability as well as strong sales of heavily discounted iPhone 6s. However, the heavy decline in dollar strength against Euro, Yuan, and other currencies has helped in lifting the revenue growth as well as ASP for the last quarter.

Impact on valuation

If Apple has delivered double-digit revenue growth solely due to a better product which has allowed it to charge a higher price, then it should be a good fundamental boost for the stock. However, if a large part of the revenue and ASP growth have been due to a weaker dollar then the bullish thesis in the stock will get dubious. The entire bull run of 2017 in AAPL was on the premise that iPhone X is a revolutionary product which will allow the company to chart new territories. However, we have already seen a unit shipment decline in the last quarter, even though it was claimed that there was enormous pent-up demand, etc.

The stock has still withered this news because of two important points. One, that Apple had one less week in the recent quarter which is a legitimate point. Second, Apple delivered ASP and revenue growth even though it had unit ship decline in iPhone category. A higher ASP has been inferred as the pricing power of Apple and the ability of the company to charge higher prices. I believe this point has been overstated and does not take into account the tailwinds due to a weaker dollar.

Investor Takeaway

Apple is still priced at a valuation multiple which does not take into account the tepid performance of iPhone X. Most of the bullish points for Apple include issues which are not related to the fundamental performance of Apple and its products and services. Tax reform and a weaker dollar can provide a short-term boost to the company but they will not overcome unit shipment decline and increase in competitive pressures faced by Apple.

Disclosure: I/we have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.

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