



Highlights From Apple's Event

Description

Apple ([NASDAQ: AAPL](#)) unveiled the iPhone 11 last week, along with some other news. In this episode of [Industry Focus: Tech](#), host Dylan Lewis and Fool.com contributor Evan Niu dive into the event and what it says about Apple's long-term strategy. In a rare move, the newest iPhone model will cost less than its antecedent, the iPhone X. The pricing for Apple TV+ will be much lower than **Disney** + or **Netflix**'s plans, but that makes sense given Apple's strategy. New marketing around the Watch may work for a while, but probably won't do much for long-term sales. Tune in to hear more!

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This video was recorded on Sept. 13, 2019.

Dylan Lewis: Welcome to *Industry Focus*, the podcast that dives into a different sector of the stock market every day. It's Friday, Sept. 13, and we're talking about everything from Apple's recent event. I'm your host, Dylan Lewis, and I've got fool.com's Evan Niu with me on Skype. Evan, this is kind of like your Christmas, huh?

Evan Niu: Yeah, it's that time of year! iPhone week.

Lewis: iPhone week. Everyone's writing about this, but you are one of my favorite people to read when it comes to all things Apple. You've been covering the company for such a long time. You know the yearly cadence. You have the charts to break down everything that's going on. We're going to be talking about the hardware side of their business, some of the flashier upgrades that we got with some of their product lines, and we're going to be talking about the services side of their business, too.

Why don't we kick things off talking about the iPhone? This is the bread-and-butter segment for them. It's where most of the money comes from. What's new?

Niu: Not a lot. This year it's the iPhone 11 and iPhone 11 Pro and 11 Pro Max. The 11 basically takes the place of the iPhone XR from last year. The 11 Pro and 11 Pro Max, respectively, take the place of

the XS and XS Max. All screen sizes are pretty much the same. Basically all the phones are getting an extra camera. For example, the iPhone 11 now has a dual-camera system compared to the single camera on the XR. The flagships 11 Pro and Pro Max now have a triple-camera system vs. the dual camera from the past couple of years. That's the big upgrade there.

One smaller but probably more meaningful upgrade is the battery life. The iPhone 11 Pro gets four hours more battery life than the XS. The 11 Pro Max gets like five hours more than the 10 XS Max. That's a pretty massive jump. That's the biggest jump in battery life we've seen in many, many years. So I think that they are making a lot of progress in terms of their work on power efficiency, which they can do because they spend so much time designing their own silicon now.

Lewis: So, it's fewer surprises with the core form factor. We have some changes with the cameras and things like that. But by and large, a lot of the improvements that we're seeing under the hood with this device.

Niu: Right. These are still more or less the same designs that we've seen for the past couple of years. Of course, Apple likes to say they're new designs whenever they tweak any part of it. In this case, they tweaked the camera bumps and camera parts because they added extra cameras. On top of that, there are some other improvements to the Pro models. When you call something a Pro model, you have to be able to justify that. In this case, they're using similar display technology that is comparable to what they're putting in their upcoming Pro Display XDR, which stands for extended dynamic range. There's some improvements on display. It does get a little bit brighter. But, pretty minor little bumps. Overall size is still the same, as mentioned.

Lewis: The folks that love gadgets might have loved the specs breakdown there. I think the investing folks are like, "OK, let's talk price." And I think that's where we got a little bit more of a surprise than we were possibly expecting.

Niu: Right. The iPhone 11 starts at \$700, which is down from \$750 for the XR a year ago. That's pretty meaningful. It's very rare for Apple to actually come down on iPhone prices. If you go back many years, the iPhone used to sell for \$650, always started at \$650. A couple of years ago, it started creeping up. Then it went to \$700, then \$750. Then they did this \$1,000 iPhone X. It'd been creeping up for the past few years. It really helped their average selling prices back when we actually had that data. But now, what we're seeing is, they're coming back down as an acknowledgement that maybe the phones are priced too high, which is hurting demand, hurting unit sales, particularly in emerging markets, where Apple's always been weak because the phones are simply just too expensive.

Lewis: It seems to me like Apple was testing the limits of their pricing power, seeing what they might be able to do there. Of course, this is a company, as we've talked about before, they have to make money on the hardware that they're selling. That's the model. They're very used to getting some pretty solid hardware margins. And it is such a large part of their business that they can't just bring devices down to parity with what you might see over with Android devices in some developing parts of the world. But this does seem to be an acknowledgement that, if we want our products to be more palatable in places like China, we do need to make them a little bit more competitive on price.

Niu: Right, exactly. They are saving money in the sense of, in general, when Apple introduces new products, they start at the high end of the cost curve. They put all this money into manufacturing, infrastructure, and all these assets that they end up amortizing over time. Basically, those costs slowly

come down over time. The more they use the infrastructure, the more efficient it becomes from a capital use perspective. So what we're seeing now, since the 11 is basically the same as the XR with some minor tweaks, the costs for the manufacturing are starting to come down. Instead of pocketing those savings, they're passing them along to consumers in the form of these lower prices.

Lewis: We also got some updates on a couple of their other hardware segments. Seems like the general theme here is incremental upgrades.

Niu: Right. There's a new entry-level iPad. The cheapest \$329 model gets a slightly bigger display, it's now 10.2 inch. A couple of other minor improvements. It supports other keyboard accessories and things like this. Nothing really game-changing there. They're supposedly working on an iPad Pro, but they didn't say anything. Maybe that will come out next month. Sometimes they have events in October. But we'll just have to wait and see on that front.

Apple Watch, also pretty minor. The Series 5 gets an always-on display. They're adding a bunch of other material choices for the cases. You can now get titanium. Not sure why they're going back and forth with the ceramic, but it's back. They discontinued it last year, but it's back, for what it's worth. The Watch Series 5 is also another story about power efficiency. The display can dynamically adjust its refresh rate all the way down to just one hertz, which means one time per second, which is how they can have it always on so you can always read the time. It makes it a little bit more convenient, so you don't have to tap your Watch to wake it up, or, sometimes, the Watch doesn't recognize when you're lifting it, turning it to face you. Again, very minor stuff.

I'm personally not buying any of it, which is surprising for me.

Lewis: Yeah, usually you are a hardcore Apple early adopter. I do think about some of these improvements, and what I hope is that with these battery life improvements that we see — people are always super excited when they get their hands on the new model, and the performance is incredible compared to what they used to have, because they're a couple of generations behind. The operating system and all the apps that come along with it have been upgraded. And they find that the battery power gets zapped like that. Apple has been slightly better recently at making their products last a little bit longer and not be immediately nullified by these OS updates. I hope that, if they're making some significant improvements in battery life, that's something that will continue to be enjoyed when we're a couple of generations away from these devices down the road.

Niu: Right. I think that's the key. The average upgrade time in the U.S. is now getting close to three years. I think it's around 33 months. This is going to be my first three-year cycle, which is interesting. I think that a lot of what they're doing is really on the power efficiency side. For example, the battery life improvements on the iPhone are mostly about increased efficiency with A13 bionic chip. The sheer capacity of the battery itself is not going up very much. It's going up a tiny bit, but that's not what's attributable to this big increase in battery life. People upgrading this year are probably coming off an iPhone 7, iPhone 8. If you have an iPhone X or later, it's not really a big change.

Lewis: Evan, we've split the show up basically the way that investors have looked at Apple. We talked hardware in the first half. We're going to talk primarily software and what that means as services now on the second half. This is a segment that Apple has spent a lot of time emphasizing over the past couple of years.

Niu: Right. Earlier this year, they unveiled four different services, at least, if you consider the Apple credit card [a] service, which I do because it contributes to their services segment. They also unveiled Apple News+, which launched back in March. And they announced Apple Arcade and Apple TV+. That was six months ago. The whole time, we've been waiting for more details on very specifically pricing, and as well as availability. They finally provided that information this week. Both services will be \$5 each per month, which was about what people expected for Apple Arcade, but less than what people expected for Apple TV+. Apple Arcade launches later this month. TV+ launches in November.

Lewis: I think the pricing on this is really interesting. I'm reminded a little bit of the conversation that we had about smart speakers a little while back, Evan. We ran through the market share of all of the major smart speaker manufacturers. Noticeably absent from that list was Apple. And we made the point that Apple generally needs to make money on the hardware that they sell because they're a hardware-oriented business. Companies like **Amazon** do not. They can sell things at cost because they're really putting the platform. What we're seeing here on the streaming side is, Apple doesn't really need to make money on streaming. They can have it be a nice kicker and eventually grow it over time. But they're really willing to put out a low cost, build a big audience for any of these products they're putting out there. Conversely, a company like Netflix, they're a pure play on streaming, and they need to charge enough to be able to make money on their services, Evan.

Niu: I think it's more an acknowledgement that this service is not going to be competitive with everything that's out there and everything that's coming out there at \$10 a month. If you remember, Disney+ launches in November as well, about two weeks after Apple TV+. Disney+ is going to have thousands of shows. Apple will have nine. You can't charge \$10 a month for a service that has nine shows, no matter how good they are. It just doesn't add up. People aren't going to pay for out of pocket. I think they're acknowledging that, in a way. At the same time, they're also being very generous with this. They're offering a year free of service any time you buy a device, as a limited-time promotion. Over the fourth quarter, over the holiday shopping season, they're going to sell 90 to 100 million devices that will be eligible for this promotion. That's giving away a ton of free memberships and subscriptions, getting people on for free. I don't think very many people are going to sign up for this out of pocket separately. What they're basically doing, in my mind, is saying, "We're not in any rush to recoup all this money that we've invested so far in original content. We're basically going to give away a year. That buys us some time. Over the next year, we're going to be adding more and more stuff." By the time that free year is up, hopefully the catalog will be strong enough to convince people to renew their subscriptions. They might even increase the price over time as they start adding more and more stuff. But right now, it's barely worth \$5 a month, definitely not \$10.

Lewis: Yeah, the strategy is interesting. You think about Netflix, so much of the stuff that they featured early on was other people's content that they were paying some license to use. Over time, they were able to roll originals into the strategy. And then originals became how they were keeping people. That was the tentpole franchise. *House of Cards*, *Orange Is the New Black*. Apple is saying, "We're going to start with what we think are some pretty interesting franchises. We know the catalog isn't that big. We're going to grow it over time strictly on originals." It seems interesting. It's an admission, I think, that this is going to take a while to build up into something that people are really willing to pay for.

Niu: Right. I definitely think they're in the long game. At the same time, this Apple Arcade thing is actually pretty interesting, too. Mobile gaming is such a huge business in the industry nowadays. Apple

reportedly is investing about \$500 million into this program to get people on board. At \$5 a month, if they can just get 100 million people to sign up, they'll make that back in a year. The whole idea is to provide a new monetization model for mobile games. Mobile gaming is dominated by freemium revenue models, which is really competitive and really hard to differentiate. The idea is, if you just pay \$5 a month, you'll get access to all these really high-quality games. We'll see how they do.

The overall combined effect is going to be, they're probably going to accelerate their growth in paid subscriptions. Right now, they're at about 420 million paid subscriptions. Their goal that they had set earlier this year was to hit 500 million at some point in 2020. They've been adding 30 million a quarter for the past seven quarters. They're very much on track to hit that target by early next year. With these new services, that could potentially accelerate how quickly they're adding these subscriptions.

Lewis: We've spent a lot of time over the past couple of years talking about the interesting ways that Apple chooses to report some of their numbers, comparing them to Fortune 500 companies, Fortune 200 companies, talking about their relevance in all these different ways. I'll be very curious to see what winds up coming out for their reporting when it comes to some of these services, particularly because so many of the users, especially on the TV side, are going to be free for such a long time.

Niu: Right, exactly. It'll be interesting how they classify all those free users. There'll be a lot of them in my opinion. They're not going to convert into paid subscriptions for quite some time. It'll be interesting to see what they say, particularly in the management commentary that they give over the next couple of conference calls with how these services are doing, and what kind of reception that they're seeing.

Lewis: We will wait and see, and happily report on it. Apple is one of our favorite companies to talk about. Evan, thanks for hopping on today's show!

Niu: Thanks for having me!

Lewis: All right, listeners, that does it for this episode of *Industry Focus*! If you have any questions or you want to reach out and say, "Hey," you can shoot us an email over at industryfocus@fool.com, or you can tweet us @MFIndustryFocus. If you want more of our stuff, subscribe on iTunes, or you can catch some of our live-broadcast new program that we're running over on YouTube. We're doing them weekly. As always, people on the program may own companies discussed on the show, and The Motley Fool may have formal recommendations for or against stocks mentioned, so don't buy or sell anything based solely on what you hear. Thanks to Dan Boyd for all his work behind the glass! He is my version of Grammarly. For Evan Niu, I'm Dylan Lewis. Thanks for listening and Fool on!

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Date

2025/06/28

Date Created

2019/09/19

Author

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