

COMPANIES

Apple warns suppliers of 20% drop in new iPhone parts orders

Sources say US company prepares two OLED models earlier to avoid repeat of last year's delays

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A visitor uses his iPhone X to take photos of the stage at the Apple Worldwide Developers Conference on June 4 in the U.S. state of California. © Reuters

TAIPEI -- Apple has asked its supply chain to prepare around 20% fewer components for iPhones debuting in the latter half of 2018, taking a cautious approach toward smartphone shipments compared with last year's orders, industry sources say.

"Apple is quite conservative in terms of placing new orders for upcoming iPhones this year," one of the four sources, who is in the supply chain, told the Nikkei Asian Review. "For the three new models specifically, the total planned capacity could be up to 20% fewer than last year's orders."

The U.S. company last year placed orders to prepare for production of up to 100 million units of the new iPhone 8, iPhone 8 Plus and iPhone X, but this year Apple currently expects total shipments of only 80 million units for new models, two people said.

Apple did not respond to Nikkei Asian Review's request for comment.

Total iPhone shipments, including new and previous generations, declined 1% on the year in the October-December quarter to 77.31 million, Apple's data showed. The slowdown went beyond Apple, as worldwide smartphone shipments contracted 0.3% to 1.46 billion units in 2017, the first-ever decline in the industry, according to research company IDC.

The Nikkei reported earlier that the U.S. tech titan intends to introduce three new iPhones in 2018. Two will feature the costly organic light-emitting diode screens like the iPhone X, while a cost-effective model keeps the liquid crystal display screen used by the iPhone 8 range. All three models would carry the TrueDepth 3D sensing camera system to activate Face ID similar to the iPhone X model, industry sources say.

Apple's supply chain was told to prepare earlier for the two OLED models, in hopes of avoiding a delay similar to last year's, two industry sources said. The company, celebrating the 10th anniversary of the iPhone launch, introduced the premium iPhone X model last year with a price tag starting at \$999. But component shortages as well as production quality issues with the 3D sensing feature kept the iPhone X away from shelves until November, more than one month after it was unveiled, likely harming sales of the gadget.

"The scheduled time frame for components for the OLED models to go into iPhone assemblers like Foxconn and **Pegatron** for final assembly falls in July, while the schedule for components for the LCD model would be in August," a supply chain source said. "Two OLED models are likely to be ready roughly one month earlier than the cost-effective LCD model, according to the current plan."

All three new iPhones currently are set to start shipping in September after Apple's annual product launch, despite speculation that the new 6.1-inch LCD model might be delayed due to production quality issues.

"The production yield for the LCD model's 'touch' function is not satisfactory at the moment, but it is improving," one of the supply sources said. "The cost-effective model is viewed as the tool for Apple to boost its total shipment volume this year, and all the suppliers are doing everything they can to make sure the LCD one hits the shelves as soon as possible."

Two sources suggest bottlenecks exist in integrating the 3D sensing module onto the LCD screen for the first time, but that the situation is improving. Last year, only the iPhone X model -- with an OLED screen -- came equipped with the 3D sensing feature, which requires making a notch to fit the module onto the display. For this year, **Samsung Electronics** would still dominate orders for iPhone OLED screens, while **Japan Display Inc.** and **LG Display** split orders for the LCD screens.

Apple suppliers are undergoing the verification process for the new iPhones this month, one source said. Apple also is finalizing the assembly schedule with Foxconn -- known formally as **Hon Hai Precision Industry** -- Pegatron and Wistron, which will influence the factory recruitment plans of these Taiwanese companies, this individual said.

Foxconn remains the largest iPhone assembler for the upcoming models in 2018. The company will handle all of the 5.8-inch OLED smartphones, while also holding shares of 80% to 90% for the 6.5-inch OLED model and a 30% order allocation for the LCD version, according to Yuanta Securities Investment Consulting's supply chain checks.

Pegatron, a smaller compatriot to Foxconn, looks to secure 60% of the 6.1-inch LCD offering and 10% to 15% of the 6.5-inch OLED model, while Wistron snares the rest of the orders for this year's new iPhones.

COMPANIES

Apple cancels production boost for budget iPhone XR: sources

Dimmer outlook for new model contrasts with extra orders for older versions

LAULY LI and CHENG TING-FANG, Nikkei staff writers

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Demand for the iPhone XR has been weaker than expected, based on Apple's discussions with suppliers. © Reuters

TAIPEI -- Apple has signaled disappointing demand for the new iPhone XR, telling its top smartphone assemblers Foxconn and **Pegatron** to halt plans for additional production lines dedicated to the relatively cost-effective model that hit shelves in late October, sources say.

"For the Foxconn side, it first prepared nearly 60 assembly lines for Apple's XR model, but recently uses only around 45 production lines as its top customer said it does not need to manufacture that many by now," a source familiar with the situation said.

That means Foxconn, the Taiwanese company traded as **Hon Hai Precision Industry**, would produce around 100,000 fewer units daily to reflect the new demand outlook -- down 20% to 25% from the original optimistic outlook, this person said.

Fellow Taiwanese manufacturer Pegatron faces a similar situation, suspending plans to ramp up production and awaiting further instructions from Apple, a supply chain source said.

"The utilization for the XR production is not reaching its maximum capacity now," the source added.

Apple also had asked smaller iPhone assembler Wistron to stand by for rush orders, but supply chain sources say the company will receive no orders for the iPhone XR this holiday season.

Apple, the world's most profitable smartphone company, had great expectations that the iPhone XR would jump-start shipments this year. This lower-cost model debuted alongside the iPhone XS and top-of-the-line XS Max.

Yet the California-based tech company instead is requesting more of the older iPhone 8 and iPhone 8 Plus models, which are up to 20% cheaper than the XR's starting price of \$749.

"Suppliers of iPhone 8 and iPhone 8 Plus are getting a combined order of around 5 million more units," one source said. Apple previously planned 20 million units for the older iPhone models this quarter, but raised the figure to 25 million units, the individual said.

Foxconn is the main supplier for iPhone 8 Plus, while Pegatron is the key supplier for the smaller-screen iPhone 8.

Apple did not respond to Nikkei Asian Review's request for comment. Foxconn, Pegatron and Wistron declined to comment.

The moves to add orders for year-old iPhone models while suspending extra production for the latest product illustrates Apple's lack of innovation and inability to energize consumers with such a pricing strategy. Last year, Apple gave rush orders for the iPhone 7 series following the launches of the iPhone 8 series and premium iPhone X.

Apple also faces a quickly maturing smartphone market. Worldwide shipments, which slipped 0.1% in 2017 for the first year-over-year decline, are expected to contract again in 2018, research company IDC says.

The Silicon Valley company prepared more cautiously for production this year, looking to avoid severe inventory corrections later. Apple asked suppliers to **prepare 20% fewer components** for this year's new iPhones compared with last year.

The company is now reviewing iPhone demand weekly to adjust orders quickly in response to the market, a source said.

Apple gave a lukewarm forecast for the holiday season on Thursday. The company also said it will cease disclosing unit shipments for iPhones, Macs and iPads beginning in the December quarter. The unexpected policy change raised concerns that the U.S. tech giant is struggling to spur unit sales growth looking ahead.

"Apple's move will hamper the predictability of earnings," Jeff Pu, a Hong Kong-based analyst for GF Securities, told the Nikkei. The American company's reluctance to disclose shipment volumes also suggests that Apple faces the possibility of its first annual decline next year and wants the public to focus elsewhere, the analyst said.

China's Huawei Technologies snatched Apple's global No. 2 smartphone share for two straight quarters this year. IDC statistics show Apple's shipments trailed Huawei's during the quarter ended in September. Apple's combined iPhone shipments grew only 1.37% on the year over the first nine months, IDC's data showed.

"The chance for Apple to revise upward its production for iPhone XR and iPhone XS during this Christmas holiday season is very thin, given the forecast provided by the company and our supply chains check," Pu said. Demand for the most premium iPhone XS Max is only slightly better than that for the other two new models, the analyst said.

TRADE WAR

Apple supplier seeks to escape trade war fallout with shift out of China

Migration begins as others step up contingency plans

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An AirPods assembler has notified suppliers that it intends to move production from China to Vietnam.

TAIPEI -- China's GoerTek has become the first of Apple's leading equipment suppliers to confirm plans to shift production out of the country to avoid being caught up in the escalating trade war between Washington and Beijing.

The AirPods assembler has notified suppliers that it intends to move production of the wireless earphones to Vietnam, the Nikkei Asian Review has discovered. At the same time, two other smartphone suppliers -- Taiwan's **Pegatron** and Cheng Uei Precision Industry -- are looking at expanding capacity outside China for similar reasons, although this may not include Apple equipment.

GoerTek has asked all suppliers involved in AirPods production to confirm by the end of this week whether they can ship all necessary materials and parts directly to Vietnam, according to a source in the supply chain who showed the notice to the Nikkei Asian Review. The decision has not yet been finalized as it requires further discussion with Apple, which has been informed of the plans. The Chinese company, based in the eastern city of Weifang, also said it hopes all suppliers maintain original contract prices and deliver to previously agreed schedules.

GoerTek and Apple did not immediately respond to a request for comment. However, the company's decision to escape the crossfire generated by the trade spat between Beijing and Washington reflects the difficult position in which Apple and its suppliers find themselves. U.S. President Donald Trump has repeatedly urged the world's most valuable company to move production back to the U.S. However, China is not only Apple's most important manufacturing base, but the U.S. company also relies on the Chinese market for some 20% of its annual revenue. Any shift by Apple could trigger big consequences.

"Apple is the most obvious target if China wanted to retaliate on American companies," said James Wei, a Hong Kong-based analyst at Yuanta Investment Consulting. "Apple and its key suppliers are without doubt subject to highly uncertain political risks as the trade battle continues to heat up."

AirPods, along with the Apple Watch and smart speaker HomePod, were initially included in the \$200 billion worth of Chinese goods that were hit with 10% tariffs beginning on September 24. However the products won a last-minute exemption. Industry sources said many suppliers are concerned that they could be hit again soon with the U.S. president threatening to impose additional tariffs on the remaining \$267 billion of imports from China in the near future.

Meanwhile, Cheng Uei, which supplies chargers and connectors for iPhones and Android smartphones, said it is considering bringing some production back to Taiwan and Southeast Asia because of the U.S.-China trade tensions.

"We are thinking about increasing capacity at our plant in [New Taipei City's] Tucheng District. It won't take long. We can do it in one or two months," company chairman T.C. Gou told the Nikkei at an industry association event in Taipei.

Gou said his company plans to hire an additional 200 to 300 workers at its Taiwan site as part of a contingency plan. It was not a large-scale diversification from Cheng Uei's manufacturing hub in China, he said.

The group is also evaluating new facilities in Thailand, Vietnam and the Philippines, the chairman said. "The supply chains there are more developed compared with other emerging markets, while the labor costs are also cheap."

However, Gou said it is not easy to shift away from China, with mature supply chains established there for decades. Local Chinese governments are also offering more tax incentives and friendly investment policies to encourage manufacturers to stay, he said.

Cheng Uei will decide whether to invest in increasing capacity in Taiwan when it becomes clearer whether President Donald Trump will implement his threat to impose more tariffs on Chinese imports.

Finally, Pegatron, the second-largest iPhone assembler after Foxconn, is assessing locations in Taiwan for a new plant where it would make non-Apple products and be able to offset the rising costs due to the trade war, according to another senior supply chain source.

"The management of Pegatron have been traveling back and forth in southern and northern Taiwan this week," the source said.

The Taiwanese company also makes notebook computers, tablets, networking equipment, consumer electronics and Internet of Things devices for clients including Microsoft, Sony, and Google.

A second source said Pegatron's planned new facility in Taiwan would be for networking-related equipment and some IoT devices. "It is because those products [networking gear and routers] are already being hit by Washington's additional tariffs, and the business is growing that it needs more capacity to fulfill the demand," he said.

Pegatron declined to comment.

The shifts in Apple's supply chain will be closely watched by Chinese authorities. AirPods are assembled in China by suppliers Inventec, Luxshare-ICT, and GoerTek. Apple shipped roughly 20 million pairs of AirPods from the end of 2016, when the product became available, through 2017, and industry sources expect the number to rise to 28 million units this year. The U.S. company had been planning to launch updated AirPods by the end of this year, but the plan could now be rescheduled to next year, according to industry sources. It is not clear whether GoerTek plans to produce the existing or new models of AirPods in Vietnam.

GoerTek currently has a production facility in North Vietnam near Hanoi city making wired headsets for iPhones.

Inventec, a key AirPods assembler, said it maintains close communication with clients about the U.S.-China trade war but currently does not have a confirmed plan.

Inventec makes a wide range of electronic products in Shanghai and Nanjing in China, Taoyuan in Taiwan, in the Czech Republic and in Mexico. The Taiwanese company's AirPods production site is in Shanghai.

The AirPods manufactured by Luxshare come from the Chinese supplier's facility in the Chinese city of Kunshan. Luxshare currently does not have Apple production capacity outside of China. Luxshare did not respond to a request for comment.