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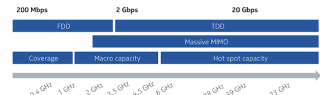
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Thursday, April 25, 2019

Apple (AAPL): Apple Pay Revenue Estimates and Future Potential

Since its launch 4 years ago, Apple Pay has seen strong growth in active users and transaction volume, but revenue has been relatively inconsequential. The challenge facing Apple Pay to impact the top line is straight forward: it is widely estimated that Apple only collects 15 cents for every \$100 in credit card purchase value, thus it would require \$1T (trillion) in PV just to generate \$1.5B in revenue. Even then, one or two billion barely nudges the needle for a company with \$260B annual sales. Annual transaction value for credit cards is over \$3T in the U.S. and more than \$10T globally. Thus, Apple Pay would have to capture a significant portion of global transaction volume and/or boost its percentage take in order to become a significant revenue contributor. Debit transaction volume is not quite as much as credit volume, but Apple likely collects less than a penny per debit transaction. It is possible the economics are more favorable internationally.

APPLE PAY NON-REVENUE BENEFITS:

While revenue from POS (point-of-sale) transactions would still be modest with widespread Apple Pay usage, Apple stands to benefit in other ways. First, Apple Pay can increase platform loyalty and enhance the value of Apple's overall ecosystem. Second, AP gives Apple a foothold in the payment space from which it can expand into other verticals. Apple could move into a processing like PayPal, or become a POS (point-of-sale) acquirer like Square. We have already seen Apple expand into online payments as well as peer-to-peer payments with Apple Cash. Most recently, Apple partnered with Goldman Sachs to become a credit card issuer.

Another benefit is Apple Pay places Apple at the beginning of the chain in the payment process. Being at the start of a process (or the gateway) is immensely valuable. Amazon dominates online retail because it's the first place (sometimes only) that a consumer checks for an item he/she needs. Google succeeds because anyone looking for something on the internet comes to them first. With the popularity of the iPhone, Google now shares billions to Apple annually because when users need to find something on the internet, they pull out their iPhones. To keep Apple from switching search engines or building one, Google pays to be the default search option. If Apple Pay becomes the standard in which consumers make purchases, Apple gains leverage over the card networks and issuers, as well as merchants.

APPLE PAY REVENUE ESTIMATES:

Apple Pay has done \$387M in total sales (1Q15-2Q19), \$175M in revenue for FY18, and \$242M in the last year. While Apple has not announced Q2 results yet, I am basing my estimates from the disclosure at last month's special event that Apple Pay has reached 10B transactions.

Apple Pay revenue is calculated from multiplying Apple's commission of 0.15% (or 15 basis points) by the total value of transactions where Apple Pay is used. We calculate total transaction value from multiplying the number of Apple Pay transactions by the average transaction amount.

- 1) # of Transactions x Average \$ Value per Transaction = Total Transaction Value
- 2) Total Transaction Value x .0015 (commission) = Apple Pay Revenue

My estimates are based on management comments from earnings conference calls and other disclosures which are shown in the table below. I have the highest degree of confidence in the assumption for the Apple Pay commission (U.S. transactions), followed by the estimates for transaction volume. Last, the estimates for average transaction amount are guesses.

APPLE PAY	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19
# of Transactions					100's of M's								1B+	1.8B 10B Total
Y/Y Transaction Growth		5x		6x	6x+	5.5x+		4.3x		3x	3x	3x	2x+	
Users		1M New / Wk	10's of M's											
Y/Y User Growth			5.5x+		3x+			2x+		2x+				
Purchase Value	B's to date				B's in Ctr				up 3x+					
# of Markets				9	13	15			20	21	24		27	33
Total Locations	5M	10M	11M		20M									
US Locations		2.5M	3M		3.3M	4.5M		<5M	50%+			60%		

For a couple of quarters, Apple has given transaction volume figures and for most quarters it has provided year-over-year growth rates. Taking the two together, we work backwards to estimate transaction volume for earlier periods.

The industry average credit card purchase is higher than \$50, but I believe Apple Pay is less. The only guidance we have for the average Apple Pay transaction amount is a comment from 1Q17: "100's of millions of transactions and billions of dollars in purchase value." This implies that transaction volume was 200M or greater and that average transaction was \$50 or less. This assumes purchase value was \$10B or less, otherwise the comment would have been: "over \$10B" or "10's of billions." I use \$25 per transaction for my estimates.

The sum of the number of transactions since launch is slightly more than 10B which is consistent with Apple's recent disclosure of attaining 10B cumulative transactions.

Apple Pay	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19
Transactions (M)	50	59	89	109	300	327	417	467	857	980	1,250	1,400	1,800	2,000
\$ Value per Transaction	\$25	\$25	\$25	\$25	\$25	\$25	\$25	\$25	\$30	\$25	\$25	\$25	\$25	\$25
Total Purchase Value (M)	1,250	1,471	2,216	2,713	7,500	8,167	10,417	11,667	25,714	24,500	31,250	35,000	45,000	50,000
% Out-Apple	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%	0.15%
Apple Pay Revenue (M)	1.9	2.2	3.3	4.1	11.3	12.3	15.6	17.5	38.6	36.8	46.9	52.5	67.5	75.0

For FY19, Apple Pay revenue will reach \$330M, and if growth can continue at 100%+ revenue will hit \$775M in FY20. These estimates could be too high since I am assuming that all transactions are credit card payments. While the number is certainly not 100%, credit cards are the vast majority. I do not adjust for this since it is likely offset by the low estimate of average transaction value.

IMPORTANCE TO APPLE MANAGEMENT:

It is apparent that Apple's ambitions for Apple Pay extend well beyond its revenue potential from contactless payments. If that were not the case, I don't believe Apple would talk-up the service as much as it does, nor continue to expend effort and resources on development. Surely, not all of that for a business that perhaps in the future only generates modest revenue. Practically on every earnings calls, management boasts about Apple Pay's success despite having little to no effect on the quarter's results, as they have occasionally conceded. Obviously, they believe the future holds bigger and brighter things for the service.

Just to highlight how serious Apple is about AP, look at the case of the new Apple Card. This is the credit card Apple is introducing in partnership with Goldman Sachs. As the issuer, Apple stands to collect 2%-2.5% (interchange fee) from the merchant. Obviously, the economics are much better as a card issuer. Apple offers cash back rewards of 2% on Apple Pay purchases and 1% for purchases where Apple Pay is not accepted and the card is physically swiped (inserted). After accounting for the cost of rewards, the economics look less attractive, but still much better than the Apple Pay transactions from 3rd-party card issuers. This is especially true for Apple Card transactions that Apple only has to pay 1% if Apple Pay is not used. One would think Apple would prefer Apple Pay not be used since those transactions are more lucrative. Since Apple is the card issuer, an Apple Pay transaction does not result in any additional revenue. So why would Apple spend 1% for the use of Apple Pay when there is no financial benefit? Obviously, Apple's goal is to increase Apple Pay usage and is willing to spend money for it. Naturally, the next question becomes "Why would Apple spend money to increase usage when even if Apple Pay becomes ubiquitous, revenues would still be relatively small?" I believe that is the crux. Apple sees AP as much larger than just POS transactions because it makes no sense to pay 1% to your card holders to boost a business that only collects 0.15%. In short, Apple's vision for Apple Pay longterm is ambitious and is therefore seriously committed to accelerating its adoption.

APPLE PAY GROWTH POTENTIAL:

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much motivation or incentive to use the service, and many are unsure and/or do not ask if the merchant accepts Apple Pay. For their entire lives, people have been in the habit of reaching for their wallets when making a purchase, not their phones. This will change for Apple Card users since they are essentially paid 1% of the purchase amount to use Apple Pay.

Payment card terminals that accept EMV (chip) are also equipped with NFC to handle contactless payments such as Apple Pay. EMV began rolling out across the U.S. a couple years ago and has become the new standard. Not only does this help Apple Pay since it increases merchant acceptance, it should also help lift usage on the part of the consumer. In general, the process of inserting and reading a chip card takes considerably more time than swiping. This is a situation where contactless payments provide a noticeable advantage to the user. Merchants that have busy checkout lines also benefit from a quicker transaction process.

Apple Pay has potential for online and in-app payments. Since these transactions do not involve physical cards, merchants pay higher fees for "card not present" transactions due to the increased risk of fraud. It is possible that the acceptance of Apple Pay reduces such fees since it decreases the risk of fraud. In addition, Apple Pay online payments is beneficial to users since it eliminates the need to have to enter credit card information as buyers can simply tap or click the Apple Pay button and be done with it. Merchants benefit as it reduces the friction in the checkout process moving the customer from product selection to sale with fewer steps increasing the likelihood that more transactions reach completion which also helps merchants capitalize on impulse purchases. Personally, I have encountered situations where I went to purchase an item to later discover my wallet was not nearby causing me to abandon the purchase.

The full potential of Apple Pay is not currently clear. Apple firmly believes Apple Pay has vast potential as evidenced by its continued efforts and the introduction of Apple Card.

Posted by [Turley Muller](#)

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