

ZAGG, INC.

(OTC-BB: ZAGG: \$0.80, BUY)

INDUSTRY: SPECIALTY RETAIL

Disclosures: 1, 5, 10

FY: Dec	2006A	2007E	2008E
EPS	(\$0.42)	(\$0.01)	\$0.05

Parsing AAPL's F1Q08 Call: Rumors of Gadgets' Death Greatly Exaggerated

- iPod, which sold 52 million units in Apple's (Nasdaq: AAPL – Not Rated) fiscal year ending September 29, 2007, had gone into its December quarter with a consensus estimate among analysts of about 23 million units. Some thought it could go even higher.
- Then, on January 22, AAPL reported that 22.1 million iPods, representing 5% unit growth over the year-ago quarter, and 2.3 million iPhones were actually sold worldwide during the December quarter.
- This was also the first time that unit sales growth of iPods fell to single digits in the December quarter. iPhone may be cannibalizing iPod, or perhaps it's just stumbling on the high hurdle of last year's comparisons.
- However, ZAGG can prosper even in a slow sales environment for AAPL by increasing its market penetration. Also, 50% of ZAGG's sales come from the top 15% of its products, including shields for the Motorola (NYSE: MOT – Not Rated) Razr and Palm (Nasdaq: PALM – Not Rated) Treo in addition to the iPhone and iPod.

Worries About iPod, iPhone Sales Blowing Out Of Proportion

Are iPhone inventories piling up? AAPL announced that over 3.7 million iPhones were sold in all of calendar 2007, an apparent discrepancy with AT&T's (NYSE: T – Not Rated) announcement January 24 that it ended 2007 with "just at or slightly under two million iPhone customers."

Assuming 0.4 million or so iPhones were sold outside the U.S., we still have **some 1.3 iPhones unreconciled**. Are they all "unlocked," that is, operating outlaw-style on networks other than T? The company has estimated that some 18% of iPhones sold, or 0.7 million, are unlocked. Is 18% a wild undershoot, with international visitors able to buy iPhones here with cheap dollars and take them home? Or are the other 0.6 million or so iPhones piling up on shelves somewhere?

Whatever the case, recent chatter about a dramatic plunge in iPhone sales seems overblown to us. The Chinese-language *Economic Daily News* of Taiwan, according to Digitimes news service, wrote that sources at a Taiwanese supplier say that AAPL has cut its F2Q08 iPhone component orders in half due to lower sales in Europe.

A 10% to 15% drop from the December quarter to the March quarter would be understandable, but **we're not going to take their say-so about a 50% drop**. Just before the Taiwanese report broke, AAPL CFO Peter Oppenheimer reconfirmed on the January 22 earnings call that the company is "confident" about projected sales of 10 million iPhones by the end of 2008.

In any case, ZAGG can succeed even if iPod and iPhone sales do slow

The four largest market opportunities for ZAGG are

- digital music players,
 - cellular telephones,
 - digital cameras and
 - gaming systems.
- Cell phones sell a billion units a year, with iPhone's market share now 20%. Over 26 million digital cameras were sold in 2005. Sony's Play Station Plus game console sold over 20 million units as of August 2006 and Nintendo's DS Lite sold over 21 million.
 - ZAGG's penetration of these markets has so much room to grow that ZAGG does not depend on the markets themselves growing. For instance, boosting its penetration of the cell phone market in units to a 1% position, or ten million units, would represent about a \$200 million revenue opportunity for ZAGG.
 - ZAGG does not need to accomplish this right away to fulfill our projections. Our 2008 revenues model represents the sale of under 700,000 units of all devices.

If and when ZAGG penetrates a big-box retailer, we consider that this would be a catalyst. We expect ZAGG 2007 results in February. We estimate 4Q07 sales of \$1.7 million. We maintain our BUY rating.

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