

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

7 January 2018

Periodical

A weekly take on Apple news

For the week ending January 5, 2018

Top news over the holiday was the reduction of iPhone X production plans from 50M to 30M in C1Q-18, suggesting that iPhone X demand has been more modest than original expectations. Also this week, Apple is addressing security issues to its Macs and iOS devices following a report of industry-wide security issues at the chip level for many PCs and servers, and one-day App Store sales hit a record of $300M on New Year's Day. In other news, Apple is reducing the cost of iPhone replacement batteries following the disclosure that the company manages battery usage in older iPhone models, streaming rival Spotify's subscriber base hit 70M, Apple acquired app developer tool company buddybuild, Siri is expected to be able to stream news podcasts in future versions of iOS 11.2.5, Apple plans to produce a true-crime drama, and Jimmy Iovine will reportedly be leaving the company in August.

Report suggests C1Q-18 iPhone X build plans have been cut

Apple has reportedly lowered its C1Q-18 iPhone X production forecast to 30M units from 50M, according to supply chain sources cited by Taiwan's Economic Daily News and reported on by Reuters. The report follows increased availability of iPhone X devices on Apple's website and at stores, suggesting supply of the device is adequately meeting demand. When the iPhone 6 was released in 2014, supply was not able to meet demand until C1Q due to the huge popularity of the new device. Growth in China was a key component of the success of the iPhone 6, but a Reuters analysis of Chinese social media showed that while interest for the iPhone X spiked around the release, Weibo activity on iPhone X in December was less than half that of iPhone 6 activity in 2014. (ht[tps://www.streetaccount.com/ReferenceLinkHand](http://www.streetaccount.com/ReferenceLinkHandler.axd?r=https%3a%2f)ler[.axd?r=https%3a%2f](http://www.streetaccount.com/ReferenceLinkHandler.axd?r=https%3a%2f)

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No known Mac or iOS device issues from processor security issues

Following reports of security vulnerabilities at the chip level for PCs and servers, Apple disclosed that all Macs and iOS devices could be vulnerable. However, the company indicated that no customer incidents have been reported related to the Spectre and Meltdown processor issues. Apple has already released iOS updates addressing the Meltdown vulnerabilities and an update to protect against Spectre is forthcoming.

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Companies featured

Apple Inc. (AAPL.OQ),USD172.23 Hold

2017A 2018E 2019E

|  |  |  |  |
| --- | --- | --- | --- |
| EPS (USD) | 9.21 | 10.45 | 9.70 |
| P/E (x) | 14.9 | 16.5 | 17.8 |
| EV/EBITDA (x) | 7.9 | 9.0 | 9.7 |
| *Source: Deutsche Bank* |  |  |  |

*Our price target is based on shares trading at 16x our FY-19E EPS. Upside risks include stronger-than-expected smartphone sales and share gains, signiﬁcantly higher margins, and a faster ramp of new product categories including Watch and Apple Pay. Downside risks include slower smartphone sales, market share losses in smartphones, and weaker growth in Services sales.*

Deutsche Bank Securities Inc.

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Scribner's Slice of Apple

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(https://support.apple.com/en-us/HT208394)

New record for one-day App Store sales

Apple’s App Store generated sales of $300M on January 1, 2018 a new one- day record and a 25% increase from January 1, 2017 sales. App Store sales reached $890M in the week between Christmas Eve (Dec. 24) and New Year's Eve (Dec. 31), due in part to the redesign of the App Store and the release of an AR (augmented reality) enhanced version of Pokemon GO. Apple also disclosed that developers earned $26.5B from App Store sales in 2017, up 32.5% Y/Y, adding to the $86B earned by developers since the App Store’s 2008 launch. We note that in June, Apple disclosed that App Store subscription sales grew by 58% Y/

Y. Assuming the same growth rate for subscription sales in CY-17 and that Apple receives 30% of gross sales for non-recurring App Store purchases and 15% for subscriptions, suggests Apple’s App Store net sales were in the $10B range in 2017, $640M of which were from subscription sales. While growing App Store sales are positive for Apple, these calculations suggest that the business still represents less than 5% of Apple’s total revenue. (ht[tps://www](http://www.apple.com/newsroom/2018/01/app-store-kicks-o%EF%AC%80-2018-with-).apple[.com/newsroom/2018/01/app-store-kicks-oﬀ-2018-with-](http://www.apple.com/newsroom/2018/01/app-store-kicks-o%EF%AC%80-2018-with-) record-breaking-holiday-season/)

Replacement iPhone battery prices cut by $50

Apple has reduced the price of out-of-warranty replacement batteries for iPhone 6 and later models worldwide to $29 from $79, through December 2018. The move comes after software ﬁrm Primate Labs reported that iPhone 6s and iPhone 7 devices using iOS 10.2 and 11.2 had slower processing speeds. Following the report, Apple defended the practice, noting that it manages battery usage on older iPhones through iOS in order to prevent unexpected device shutdowns. (ht[tps://www.cnbc.com/2017/12/21/apple-ios-11-slo](http://www.cnbc.com/2017/12/21/apple-ios-11-slowdown-on-iphone-6s-john-)wdo[wn-on-iphone-6s-john-](http://www.cnbc.com/2017/12/21/apple-ios-11-slowdown-on-iphone-6s-john-) pooles-advice.html)

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Spotify's subscriber base reaches 70M

Streaming music industry leader Spotify announced that its paid subscribers now total 70M, according to a company Tweet. Spotify's paid membership base has grown by 17% or 10M subscribers since July 2017, and is more than double the size of Apple Music's 30M paid subscribers, as of September 2017. (https://9to5mac.com/2018/01/04/spotify-subscriber-count/#more-514295)

App development tool startup acquired

Apple has acquired buddybuild, a Canadian startup specializing in providing app developer tools, for an undisclosed fee. Following the acquisition, buddybuild’s tools will be integrated into Apple’s Xcode development tools. (ht[tps://www](http://www.buddybuild.com/blog/buddybuild-is-now-part-of-apple)).[buddybuild.com/blog/buddybuild-is-no](http://www.buddybuild.com/blog/buddybuild-is-now-part-of-apple))w[-part-of-apple)](http://www.buddybuild.com/blog/buddybuild-is-now-part-of-apple)) (https://techcrunch.com/2018/01/02/apple-buys-app-development-service- buddybuild/)

Siri to be able to play news

A beta version of iOS 11.2.5 reportedly gives Siri a new skill: the ability to stream a news podcast when prompted by users. While the default news podcast is from The Washington Post, users can also request podcasts from Fox News, NPR, and CNN. The skill would bring Apple in line with peers Amazon and Google who already provide users the ability to stream news through their virtual personal assistants on their Echo and Home devices. (https://9to5mac.com/2018/01/03/siri-homepod-news-podcasts/)

Apple to produce a true-crime drama series

Apple plans to produce an original drama series by Reese Witherspoon’s Hello Sunshine production company called “Are You Sleeping,” according to Deadline. The true-crime series will star Oscar-winning actress Octavia Spencer and will be the second Apple project handled by Hello Sunshine following a previously announced morning show drama starring Reese Witherspoon and Jennifer Anniston.

[(http://dead](http://deadline.com/2018/01/are-you-sleeping-drama-series-octavia-spencer-)l[ine.com/2018/01/are-you-sleeping-drama-series-octavia-spencer-](http://deadline.com/2018/01/are-you-sleeping-drama-series-octavia-spencer-) star-apple-reese-witherspoon-peter-chernin-producing-1202234750/)

Jimmy Iovine moving on

Jimmy Iovine is reportedly planning to leave Apple in August, according to Billboard. Jimmy Iovine joined Apple in 2014 when the company acquired Beats, the streaming music service he founded with Dr. Dre. (ht[tps://www](http://www.billboard.com/articles/business/8092650/jimmy-iovine-leaving-).bill[board.com/articles/business/8092650/jimm](http://www.billboard.com/articles/business/8092650/jimmy-iovine-leaving-)y[-iovine-leaving-](http://www.billboard.com/articles/business/8092650/jimmy-iovine-leaving-) apple-music-august)

Apple Investment Thesis

Outlook

Apple has a dominant position in smartphones and tablets where its products represent the gold standard in both categories. These segments continue to oﬀer good growth opportunities, particularly smartphones, allowing Apple to outgrow overall IT spending. Despite healthy growth, slowing smartphone and tablet sales, as well as Apple’s already signiﬁcant revenue levels suggest growth will be more diﬃcult going forward. With puts and takes currently balanced, in our view, we consider shares as fairly valued and rate Apple a Hold.

## Valuation

Apple has traded at an average forward P/E of 13x since 2010 with a range of 9x to 16x. We believe shares should trade in line with these historical multiples and, because of its large market cap (3-4% of the S&P 500), should trade at a modest discount to the market. Our price target is based on shares trading at 16x our FY-19E EPS.

## Risks

Company-speciﬁc positive risks to Apple include stronger-than-expected smartphone sales and share gains, signiﬁcantly higher margins, and a faster ramp of new product categories including Watch and Apple Pay. Negative risks include slower smartphone sales, market share losses in smartphones, and weaker growth in Services sales.