

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

14 January 2018

Periodical

A weekly take on Apple news

For the week ending January 12, 2018

The negative backlash from Apple’s disclosure that it limited the performance of older iPhones continued this week, with consumer class action lawsuits increasing in the U.S. and the French government opening an investigation. Also this week, two top Apple investors asked the company to do more to understand the eﬀect of smartphone use on children. In other Apple news this week, Apple maintained its fourth place spot in the PC market in C4Q-17, the company reportedly met with AR suppliers at CES, Apple may be investing in LG Innotek to expand production of 3D sensing modules, the company’s planned use of AMOLED displays in iPhones may be squeezing out Chinese smartphone makers, Jimmy Iovine denied reports he is leaving Apple, and the company handed over iCloud accounts to a Chinese government-owned entity.

Reduced performance disclosure leads to investigation and class action lawsuits

According to the BBC, France's consumer protection agency is investigating Apple over the shortening of the lifespan of its phones, after the company disclosed that it slowed down older iPhones. Under French law, "planned obsolescence” of products is a criminal oﬀense, and penalties could include ﬁnes of up to 5% of annual revenue or a potential jail term. In late December, Apple disclosed it limited the performance of older iPhones through software updates claiming the practice was used to smooth out peak performance and prevent unexpected shutdowns. Following the disclosure, a number of consumers ﬁled class action lawsuits against the company, with MSN.com noting last week that the number of class action lawsuits ﬁled in the U.S. related to the performance- slowing issue had risen to 32 lawsuits.

[(http://www.bbc.com/news/world-europe-42615378)](http://www.bbc.com/news/world-europe-42615378)) [(http://www.msn.com/en-us/news/technology/iphone-throt](http://www.msn.com/en-us/news/technology/iphone-throttling-class-actions-)t[ling-class-actions-](http://www.msn.com/en-us/news/technology/iphone-throttling-class-actions-) pile-up-as-apple-hit-with-32nd-lawsuit/ar-AAuz06f?li=AA4Zoy&ocid=ientp)

Top shareholders ask Apple to do more to understand the eﬀect of smartphones on kids

In an open letter to Apple, top shareholders JANA Partners and the California State Teachers' Retirement System asked Apple to do more to limit the negative impact of smartphone use on children and teens. Citing a number of studies that point to students with higher levels of distraction in classrooms, increased risk of depression, and growing sleep deprivation from high smartphone usage, the authors ask Apple to play a "pioneering role" and to set an "example about the obligation of technology companies to their youngest children." The letter asks Apple to take the initial steps of convening an expert committee to study the

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Companies featured

Apple Inc. (AAPL.OQ),USD175.28 Hold

2017A 2018E 2019E

EPS (USD) 9.21 10.45 9.70

P/E (x) 14.9 16.8 18.1

EV/EBITDA (x) 7.9 9.2 9.9

*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.*

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issue, assist researchers studying the eﬀects of smartphone use children and teens, provide better tools and options for parents to manage their children's smartphones, and hiring a top-level executive to monitor the issue. (https://thinkdiﬀerentlyaboutkids.com/index.php?acc=1)

Apple remains 4th in PC market with above-market unit growth in C4Q-17 According to preliminary IDC data, Apple maintained its fourth place position in the worldwide PC market in C4Q-17 with 8.2% share, up 50bps Y/Y. Apple's unit

shipments grew by 7% Y/Y, well-above overall PC shipment growth of 0.7%. ASUS and Acer tied for ﬁfth place with 6.4% share and trailed Apple by 180bps in the quarter.

(ht[tps://www.idc.com/getdoc.jsp?containerId=prUS43495918)](http://www.idc.com/getdoc.jsp?containerId=prUS43495918))

Apple reportedly met with AR suppliers at CES

Apple, along with a handful of other tech giants, met with AR (augmented reality) suppliers at the Consumer Electronics Show last week, according to Bloomberg. In November, Bloomberg reported that Apple was working on an AR headset, with the goal of having the technology ready by 2019, to possibly ship in early 2020. The device is expected to have its own operating system and function independently from the iPhone. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-01-12/vr-lives-another-day-as-)ws/art[icles/2018-01-12/vr-lives-another-day-as-](http://www.bloomberg.com/news/articles/2018-01-12/vr-lives-another-day-as-) amazon-apple-explore-ar)

Apple may be investing in LG Innotek

Apple may be an investor in LG Innotek's expanding production of 3D sensing modules, according to the Korea Economic Daily. Based on a report in the Korea Herald, LG Innotek's regulatory ﬁlings disclosed an 873.7B Won (roughly $821M) investment in its mobile camera module and 3D sensing module production capacity which the Korea Economic Daily believes is from Apple. [(http://www.thein](http://www.theinvestor.co.kr/view.php?ud=20180109000879))v[estor.co.kr/view.php?ud=20180109000879)](http://www.theinvestor.co.kr/view.php?ud=20180109000879))

iPhone use of AMOLED supply pushing Chinese smartphones to mini LED Expectations that Apple will add AMOLED displays to a broader range of iPhones in 2018, beyond the iPhone X, is reportedly forcing Chinese smartphone makers

to seek out micro LED displays, according to Digitimes. Samsung is currently Apple's sole AMOLED supplier and plans to add the display to other iPhone models would limit supply. Industry sources suggest Huawei, Oppo, and Xiaomi have asked Taiwanese suppliers to ramp mini LED backlit panel supply by June for C2H-18 smartphone production. [(http://www.digitimes.com/news/a20180110PD216.html)](http://www.digitimes.com/news/a20180110PD216.html))

Jimmy Iovine denies reports of his departure

In an interview with Variety, Apple Executive Jimmy Iovine denied media reports that he is planning to leave the company. Mr. Iovine, a well-known record producer who joined Apple following its acquisition of Beats, noted that he will continue to work with Apple Music and is committed to developing its music streaming services. Mr. Iovine's comments were in response to a Jan. 4 Billboard article that claimed he would be leaving the company in August. [(http://variety.com/2018/music/news/jimm](http://variety.com/2018/music/news/jimmy-iovine-refutes-rumors-leaving-)y[-iovine-refutes-rumors-leaving-](http://variety.com/2018/music/news/jimmy-iovine-refutes-rumors-leaving-)

apple-1202658511/)

China iCloud operations handed over to local ﬁrm

Starting February 28, Apple iCloud accounts registered in China will be managed by a Chinese government owned company named Guizhou-Cloud Big Data Industry, according to China Daily. Apple is transferring the accounts in order to

comply with China’s new cloud computing laws which require all cloud services be operated by Chinese companies. [(http://www.chinadaily.com.cn/a/201801/10/](http://www.chinadaily.com.cn/a/201801/10/) WS5a55882fa3102e5b17371da0.html)

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.