

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

28 January 2018

Periodical

A weekly take on Apple news

For the week ending January 26, 2018

Apple reports C4Q earnings this Thursday, with some reports pointing to iPhone X sales of 29M in C4Q, making iPhone X the most popular smartphone in C4Q, although this would be lower than expectations and well below C4Q sales for prior new models. In addition, Apple's long-awaited HomePod smart speaker became available for pre-order this past Friday, and will be available for purchase on February 9. In other Apple news, supply chain reports point to larger future iPhone models, and App Annie estimates C4Q-17 iOS App store sales accounted for 68% of total app sales. Also, Qualcomm was ﬁned nearly $2B for anti- competitive treatment of Apple, Apple's self-driving car ﬂeet jumped to 27 from 3, the company launched a new Health Records feature in the iOS Health App, and Apple issued security patches for the Meltdown and Spectre vulnerabilities.

iPhone X tops holiday smartphone shipments but not past launches

Apple shipped roughly 29M iPhone X units in C4Q-17, making it the top shipping smartphone over the holiday season, according to research by Canalys. China accounted for roughly 7M (24%) of the units despite intense competition in the region. However, the report suggests that total iPhone X shipments were modestly below industry expectations in the 30-35M range. In addition, shipments were below past December shipments for prior new iPhone launches, likely due to Apple's double model release (X and 8) and the high price point of the iPhone X.

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(https://techcrunch.com/2018/01/23/the-iphone-x-was-the-top-shipping- smartphone-over-the-holidays-according-to-analysts/)

HomePod became available for pre-order on Friday

Apple announced the availability of HomePod, the company's $349 voice- controlled smart speaker featuring Siri. HomePod pre-orders began on Friday, January 26 in the U.S. and the device will be available for sale on February 9. In November, the company announced the HomePod launch would be delayed from December 2017 until early 2018.

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Larger iPhone form factor expected possibly for the fall

Apple is reportedly developing four new versions of the iPhone, including its largest phone yet, a 6.4 to 6.5-inch OLED device, according to Digitimes. The

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Companies featured

Apple Inc. (AAPL.OQ),USD174.22 Hold

2017A 2018E 2019E

|  |  |  |  |
| --- | --- | --- | --- |
| EPS (USD) | 9.21 | 10.45 | 9.70 |
| P/E (x) | 14.9 | 16.7 | 18.0 |
| EV/EBITDA (x) | 7.9 | 9.1 | 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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other iPhone projects include two LCD models in a 5.7 to 5.8-inch size and a 6.0 to 6.1-inch size, and a 6.0 to 6.1-inch OLED model. All new models would feature wireless charging and 3D sensing capabilities. All of the new iPhone models would be larger than the current iPhone 8 (4.7" LCD), 8 plus (5.5" LCD), and X (5.8" OLED). The report also suggests Apple is working on a new version of the iPhone SE which would include wireless charging but no 3D sensing functionality. [(http://www.digitimes.com/news/a20180126VL203.html?mod=2)](http://www.digitimes.com/news/a20180126VL203.html?mod=2))

iOS App Store spend outpaces Google Play in C4Q-17

Worldwide app downloads and consumer spending on apps reached record levels in C4Q-17, according to App Annie. Total app downloads of 27 billion from both Apple's App Store and Google Play grew by 7% Y/Y and 4% Q/Q. Consumers spent $17B on app downloads in C4Q, which was up 20% Y/Y but ﬂat Q/Q. While Google Play continues to account for the vast majority (70%) of downloads, Apple still dominates in sales, with App Store sales of $11.5B more than double that of Google's $5B. Growing app demand and downloads remain a positive trend for Apple's App Store sales, although App Store sales represent less than 5% of Apple’s total sales by our estimates. (ht[tps://www.appannie.com/en/insights/mark](http://www.appannie.com/en/insights/market-data/app-downloads-consumer-)et[-data/app-downloads-consumer](http://www.appannie.com/en/insights/market-data/app-downloads-consumer-)- spend-q4-2017/)

Qualcomm ﬁned for anti-competitive treatment of Apple

The European Commission imposed a 997M Euro ($1.2B) ﬁne on Qualcomm, after it ruled that the company used rebate payments to force Apple to use only Qualcomm communication chips in its devices. The practice, which went on from 2011 and 2016, was found to unfairly eliminate competition from other LTE chip manufacturers. We note that Apple and Qualcomm have ﬁled lawsuits against each other, with Apple's suits claiming that Qualcomm overcharged for chips, failed to pay agreed-upon rebates, and infringed its battery life patents. [(http://europa.eu/rapid/press-release\_IP-18-421\_en.htm)](http://europa.eu/rapid/press-release_IP-18-421_en.htm))

Growing ﬂeet of self-driving cars

Apple has received approval from the California Department of Motor Vehicles to test 27 self-driving cars, up from the approval for three cars granted last April. Apple is reportedly leasing its ﬂeet of Lexus RX450h SUVs from Hertz and is believed to be focused on developing autonomous driving systems rather than its own self-driving cars.

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Health Records introduced in iOS 11.3 beta

Apple has introduced a Health Records feature in the iOS 11.3 beta of its Health app. The feature stores and organizes data from multiple sources, including hospitals and clinics, and combines it with information already in the user's existing Health app. Data gathered in Health Records can provide a single view of a patient's allergies, current conditions, lab results, medications, and vitals, as well as deliver notiﬁcations to the user when data is updated. The app is encrypted and protected by an iPhone passcode. The new feature is the result of Apple's partnerships with several hospitals and electronic medical record companies, including Epic Systems, Cerner, and AthenaHealth.

(ht[tps://www](http://www.apple.com/newsroom/2018/01/apple-announces-e%EF%AC%80ortless-).apple[.com/newsroom/2018/01/apple-announces-eﬀortless-](http://www.apple.com/newsroom/2018/01/apple-announces-e%EF%AC%80ortless-) solution-bringing-health-records-to-iPhone/)

Apple issues patches for Meltdown and Spectre

Apple issued two new security patches addressing the Meltdown and Spectre chip vulnerabilities on Macs running macOS Sierra and OS X El Capitan. Mac users were advised to install the available software patches as soon as possible via the Mac App Store.

(https://techcrunch.com/2018/01/23/apple-issues-meltdown-ﬁx-for-macs- running-sierra-and-el-capitan/) (ht[tps://www.macrumors.com/2018/01/23/macos-sierra-el-capitan-spectre-](http://www.macrumors.com/2018/01/23/macos-sierra-el-capitan-spectre-) meltdown-ﬁxes/)

*Source: IDC*

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.