

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

11 February 2018

Periodical

A weekly take on Apple news

For the week ending February 9, 2018

Apple's plans to overtake market leader Spotify in the U.S. streaming music services market was a key focus of Apple news this week with Apple disclosing that its global paid subscriber base for Apple Music has grown 20% since September to 36M. Also this week, Apple is reportedly considering oﬀering rebates on full-priced battery purchases made last year, in the wake of disclosures that the company deliberately slowed older iPhones. In other news, iPad remained the leader in the tablet market in C4Q-17, the European Commission is investigating Apple's purchase of Shazam, Apple is planning a second Chinese data center, the company could add two 3D sensing module suppliers for this year's iPhones, and Apple is partnering with a handful of top companies to oﬀer a cyber security solution for businesses.

Apple Music subscribers reach 36M

Paid subscribers to Apple Music have grown to 36M, up 6M from September, but are still well-behind industry leader Spotify's 70M paid members, according to the Wall Street Journal. While neither streaming music service discloses its U.S. membership base, Apple is reportedly looking to top Spotify's U.S. paid subscribers by this summer. Separately, Fast Company reported that Nike will be oﬀering its NikePlus members special beneﬁts for meeting their ﬁtness goals, including free customized Apple Music playlists for work-outs. Given the stiﬀ competition for new paid subscribers in the streaming music industry, partnerships with powerful brands may be a key to driving subscriber base growth.

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Apple may oﬀer rebates on iPhone batteries bought before the December discount

In response to an inquiry from the Senate Commerce Committee, Apple indicated it is considering oﬀering rebates to customers who paid full price for replacement iPhone batteries before they were discounted to $29. The committee has been investigating Apple's decision to deliberately slow the performance of older iPhones, its consumer disclosures, and subsequent actions.

(https://cdn.vox-cdn.com/uploads/chorus\_asset/ﬁle/10167025/ Apple\_Response\_to\_SCC\_Feb\_2\_2018.0.pdf)

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Companies featured

Apple Inc. (AAPL.OQ),USD155.15 Hold

2017A 2018E 2019E

|  |  |  |  |
| --- | --- | --- | --- |
| EPS (USD) | 9.21 | 10.88 | 10.80 |
| P/E (x) | 14.9 | 14.3 | 14.4 |
| EV/EBITDA (x) | 7.9 | 8.3 | 8.7 |
| *Source: Deutsche Bank* |  |  |  |

*Our price target is based on shares trading at 14x 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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iPad gains share in C4Q-17 tablet market

Worldwide tablet shipments were 49.6M in C4Q-17 and declined by 7.9% Y/Y, according to IDC data. Apple maintained its top spot with 26.6% market share, up 230bps Y/Y. Amazon moved into second place with 15.6% share and displaced Samsung who held 14.1% share. Apple units grew by 0.6% Y/Y, helped by a lower-priced iPad and refreshed iPad Pros, while holiday discounting contributed to Amazon's 50.3% shipment growth Y/Y. Samsung lost 80bps of share Y/Y and units declined by 13% Y/Y due to weak demand for its lower cost slate devices. (ht[tps://www.idc.com/getdoc.jsp?containerId=prUS43549518](http://www.idc.com/getdoc.jsp?containerId=prUS43549518) )

European Commission to investigate Shazam acquisition

Austria, France, Iceland, Italy, Norway, Spain and Sweden have asked the European Commission to evaluate the competitive implications of Apple’s proposed acquisition of Shazam. Apple announced the acquisition of the song- identifying app in December and according to the Verge, Spotify and Apple Music currently get 1 million referrals per day from the app. [(http://europa.eu/rapid/press-release\_IP-18-664\_en.htm)](http://europa.eu/rapid/press-release_IP-18-664_en.htm)) (ht[tps://www](http://www.theverge.com/2018/2/6/16979356/apple-shazam-acquisition-eu-).thev[erge.com/2018/2/6/16979356/apple-shazam-acquisition-eu-](http://www.theverge.com/2018/2/6/16979356/apple-shazam-acquisition-eu-) merger-deal)

Second Chinese data center expected by 2020

Apple is planning to build a second Chinese data center for its iCloud services in northern China, according to Xinhua News Agency. As we wrote in Slices in July, Apple announced plans to open a data center in Guizhou in partnership with Chinese internet services company Guizhou-Cloud Big Data. Under new Chinese cybersecurity laws passed on June 1, cloud services must be operated by Chinese companies and foreign companies must store customer data in China. It is unclear who will partner with Apple on the second data center, but both are expected to be operational by 2020.

[(http://www.xinhuanet.com/english/2018-02/06/c\_136953698.htm)](http://www.xinhuanet.com/english/2018-02/06/c_136953698.htm))

Apple could be lining up additional 3D sensing module suppliers

Two unnamed Chinese suppliers may be joining LG Innotek as producers of 3D sensing modules for this year's iPhone models, according to the Korea Herald. However, the report suggests LG Innotek will remain Apple's key 3D sensing module supplier and, as we've noted in prior Slices, LG announced a $821M investment in its mobile camera module and 3D sensing module production capacity in early January. [(http://www.thein](http://www.theinvestor.co.kr/view.php?ud=20180208000642))v[estor.co.kr/view.php?ud=20180208000642)](http://www.theinvestor.co.kr/view.php?ud=20180208000642))

Apple business customers eligible for cyber risk management solution

Apple, Cisco, Aon, and Allianz are partnering to help companies manage and mitigate potential cyber-attacks with a new cyber risk management solution. The solution oﬀers businesses using Apple products or Cisco integrated security products access to Aon security assessments and incident response services as well as Allianz cyber insurance coverage. (ht[tps://www](http://www.apple.com/newsroom/2018/02/cisco-apple-aon-allianz-introduce-).apple[.com/newsroom/2018/02/cisco-apple-aon-allianz-introduce-](http://www.apple.com/newsroom/2018/02/cisco-apple-aon-allianz-introduce-)

a-ﬁrst-in-cyber-risk-management/)

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 14x 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.