

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

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Periodical

A weekly take on Apple news

For the week ending February 16, 2018

U.S. wireless carrier iPhone discounts were in focus this week, with AT&T's move to oﬀer a buy one, get one free oﬀer for iPhone X worth $1,000 vs peers' discounts of $700. Apple held its shareholder meeting this week, with CEO Tim Cook suggesting a special dividend is unlikely. In other news, future iOS upgrades will emphasize quality vs. frequency, HP Inc. has added Apple to its Device-as-a-Service oﬀering, MacBook units grew 18% Y/Y in CY-17 well above the global notebook market's 2% Y/Y growth, Apple Music is expanding its student membership availability, HomePod is less proﬁtable than competing smart speakers and is leaving white rings on furniture, and the company is in talks with China's Yangtze for future NAND chips.

AT&T launches most aggressive buy one, get one free iPhone deal yet

AT&T may kick oﬀ a wave of aggressive iPhone discounting with its recently launched buy one, get one free iPhone X deal, according to DB's Telecom Services analyst Matt Niknam. As we have noted in prior Slices, peers Verizon, T-Mobile, and Sprint are currently oﬀering buy one, get one free oﬀers of $700 oﬀ an iPhone X, 8, or 8 Plus. In contrast, AT&T's deal is the equivalent of a more substantial

$1,000 discount oﬀ of a second device. The broad availability of buy one, get one free deals from U.S. carriers could suggest elevated levels of new iPhone model inventory, in our view. (https://research.db.com/Research/Document?rid=3d812315-1158-4761-b387- e3d11da8ddad-604&kid=RP0001&documentType=R)

Special dividend appears unlikely

At its annual shareholder meeting, Apple CEO Tim Cook noted that he is "not a fan" of special dividends, suggesting the company is unlikely to announce one following the repatriation of substantial overseas cash. Cook noted that the company remains committed to annual dividend increases, and, as noted on its last earnings call, the company plans to get to a cash neutral position over time. Apple has indicated that it will provide an update on its capital return plans on the company's April earnings call, which is when dividend and buyback plans are typically announced.

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Upcoming iOS upgrade to emphasize reliability, delay some new features

Apple is reportedly revising the strategy behind its annual software update cycle to give engineers more time to develop new features, according to Bloomberg.

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Companies featured

Apple Inc. (AAPL.OQ),USD172.99 Hold

2017A 2018E 2019E

|  |  |  |  |
| --- | --- | --- | --- |
| EPS (USD) | 9.21 | 10.88 | 10.80 |
| P/E (x) | 14.9 | 15.9 | 16.0 |
| EV/EBITDA (x) | 7.9 | 9.5 | 10.0 |
| *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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Scribner's Slice of Apple

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The company is adopting a longer, two-year view of updates and will place a greater emphasis on the quality of the new features it releases. Apple's prior strategy had focused on developing and releasing new features annually, which resulted in some bugs and other quality issues. For this fall's upcoming iOS release, Apple has decided to delay the roll out of some features, including the ability to run several windows in one app similar to a web browser, as well as new Apple Pencil features, and likely, multi-user FaceTime video calls. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-02-12/how-apple-plans-to-)ws/art[icles/2018-02-12/how-apple-plans-to-](http://www.bloomberg.com/news/articles/2018-02-12/how-apple-plans-to-) root-out-bugs-revamp-iphone-software)

HP Inc. adding Apple devices to Device as a Service (DaaS) oﬀering

HP Inc. announced that it will be adding support for Apple hardware to its Device as a Service (DaaS) oﬀering for businesses. According to Neowin, the move reﬂects the growing diversity of operating systems and device types in use at today's companies.

[(http://www8.hp.com/us/en/services/daas-for-apple.html)](http://www8.hp.com/us/en/services/daas-for-apple.html)) (ht[tps://www](http://www.neowin.net/news/hp-announces-device-as-a-service-for-apple)).neo[win.net/news/hp-announces-device-as-a-service-f](http://www.neowin.net/news/hp-announces-device-as-a-service-for-apple))or[-apple)](http://www.neowin.net/news/hp-announces-device-as-a-service-for-apple))

Double-digit MacBook unit growth outpaces notebook market in CY-17

Global notebook shipments reached 164.7M units in 2017, up 2.1% Y/Y, according to TrendForce. Apple shipments of 15.8M grew by 18% Y/Y, helped by the release of new MacBook Pro devices. Apple moved from ﬁfth place to fourth in the market with 9.6% share, up 130bps Y/Y. HP Inc. remained the market leader with 24.3% share, followed by Lenovo at 20.2% and Dell with 15.2% share. (ht[tps://www.businesswire.com/news/home/20180212005527/en/Apple-](http://www.businesswire.com/news/home/20180212005527/en/Apple-) Surpassed-ASUS-Recording-9.6-Market-Share)

Apple Music looking to expand student membership base

Apple is planning to oﬀer its discounted Apple Music student membership in 82 new markets, according to TechCrunch. Eligible students will pay a discounted monthly membership fee for up to four years. The current U.S. student rate is

$4.99 per month vs. the regular $9.99 rate. We view the expansion of student memberships as another move by Apple to grow its streaming music subscriber base from its current 26M, which is well-below rival Spotify's 70M paid subscriber base.

(https://techcrunch.com/2018/02/12/apple-music-is-expanding-student- memberships-to-82-new-markets/)

HomePod less proﬁtable than competing smart speakers and leaves white rings Apple's HomePod smart speaker reportedly costs $216 per unit to manufacture, pointing to a proﬁt margin of roughly 38%, according to TechInsights. In

comparison, Google Home and Amazon Echo devices yield margins of 66% and 56%, respectively. Separately, the New York Times' Wirecutter and other media sources are reporting that the HomePod leaves white rings when placed on wood surfaces. Apple support claims the rings are caused by the interaction of the silicon base with wood oils, and suggests the rings will go away after several days once the speaker is removed.

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Apple in talks with potential Chinese NAND supplier

Apple is reportedly in discussions with China state-backed Yangtze Memory Technologies, to purchase future production of NAND ﬂash chips for Apple devices, according to The Nikkei. Yangtze would be the ﬁrst Chinese company to

manufacture memory chips and is expected to start its ﬁrst production of NAND in 2018 with production ramping through 2020. . (https://asia.nikkei.com/Business/Companies/Apple-in-talks-for-ﬁrst-order-with- a-Chinese-chipmaker)

*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 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.