

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

4 March 2018

Periodical

A weekly take on Apple news

For the week ending March 2, 2018

Buzz around the potential release of the largest-yet iPhone, a 6.5" version of the refreshed iPhone X, was in focus this week. The same report suggests Apple will also launch a refreshed 5.8" iPhone X model and a lower-cost version of iPhone X with an LCD display. In other news, Apple moved into ﬁrst place in the C4Q-17 wearables market on the success of Apple Watches featuring cellular connectivity and the WSJ reported that longer smartphone refresh cycles and a growing used smartphone market are threats to future sales of iPhone and other high- end smartphones. Also, Apple is launching primary care clinics for its employees in Santa Clara County, Apple's lawyers appeared before Canada's House of Commons over the company's deliberate slowing of older iPhone models, and Apple switched from AWS (Amazon Web Services) and Microsoft Azure to GCP (Google Cloud Platform) for iCloud storage.

Three new iPhones may be coming this fall, including a 6.5" iPhone X

Apple is reportedly planning to launch three new iPhones in 2018, according to Bloomberg. The launch is expected to include a larger 6.5" version of the iPhone X , a refreshed 5.8" iPhone X model, and a lower cost version of iPhone X featuring an LCD display. All three models are expected to feature Face ID facial recognition technology and edge-to-edge display. The report also suggests Apple could oﬀer a gold color option for the larger and refreshed iPhone X devices as well as a dual- SIM card capability in the largest model. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-02-26/apple-is-said-to-plan-)ws/art[icles/2018-02-26/apple-is-said-to-plan-](http://www.bloomberg.com/news/articles/2018-02-26/apple-is-said-to-plan-) giant-high-end-iphone-lower-priced-model)

Apple moves into ﬁrst place in the C4Q-17 wearbles market

Global wearables shipments of 37.9M grew by 7.7% Y/Y in C4Q-17, according to IDC. Apple was the market leader for the ﬁrst time with 8M Apple Watch shipments in the quarter, up 57% Y/Y. Apple gained 560bps of share Y/Y, reaching 21% share, due to strong demand for smartwatches and cellular connectivity. Fitbit was the second place vendor with 14% share, followed by Xiaomi, Garmin, and Huawei.

(ht[tps://www.idc.com/getdoc.jsp?containerId=prUS43598218)](http://www.idc.com/getdoc.jsp?containerId=prUS43598218))

Report suggests elongating refresh cycles, secondary market pose threat to iPhone

Growing used smartphone sales and the extension of the consumer's average smartphone update cycle are growing threats to future high-end smartphone sales, according to the Wall Street Journal. The report references industry data indicating that the average refresh cycle is expected to increase by 10 months,

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Companies featured

Apple Inc. (AAPL.OQ),USD175.00 Hold

2017A 2018E 2019E

|  |  |  |  |
| --- | --- | --- | --- |
| EPS (USD) | 9.21 | 10.88 | 10.80 |
| P/E (x) | 14.9 | 16.1 | 16.2 |
| EV/EBITDA (x) | 7.9 | 9.6 | 10.2 |
| *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.*

next year to 33 months up from 23 months. The report also notes that used smartphone sales account for 10% of the market and that 93% of these used phones are going to U.S. buyers.

(https://9to5mac.com/2018/03/01/iphone-sales-threats/#more-522296) (ht[tps://www.wsj.com/articles/y](http://www.wsj.com/articles/your-love-of-your-old-smartphone-is-a-problem-)our-lo[ve-of-your-old-smartphone-is-a-problem-](http://www.wsj.com/articles/your-love-of-your-old-smartphone-is-a-problem-) for-apple-and-samsung-1519822801?mod=rss\_Technology)

Apple to launch a network of clinics exclusively for its employees

Apple is launching a network of primary care clinics named “AC Wellness” in Santa Clara County for its employees and their families. The network of medical clinics is expected to be launched in Spring 2018. Apple may also use the clinics to test its growing range of health services and products. (ht[tps://www.cnbc.com/2018/02/27/apple-launching-medical-clinics-f](http://www.cnbc.com/2018/02/27/apple-launching-medical-clinics-for-)or- employees.html)

Apple defends iPhone "throttling" to Canada's government

Apple faced questioning from Canada's House of Commons over its deliberate slowing of older iPhones, according to iMore. Written comments presented by Jacqueline Famulak, Manager of Legal and Government Aﬀairs at Apple Canada were reportedly "in-line" with public statements made by CEO Tim Cook. As we have noted in previous Slices, Apple is facing a wave of class action lawsuits in the U.S. and around the world around the throttling issue. (ht[tps://www.imore.com/iphone-slo](http://www.imore.com/iphone-slow))w)

iCloud drops Azure and AWS for data storage, moves to Google Cloud Platform The latest version of Apple's iOS Security Guide, a ﬁle the company periodically makes public on its website, indicates that Apple is now using Google Cloud

Platform to store iCloud services data, according to CNBC. Prior disclosures had shown that Apple was using both Amazon Web Services (AWS) and Microsoft Azure.

(ht[tps://www.cnbc.com/2018/02/26/apple-conﬁrms-it-uses-google-cloud-f](http://www.cnbc.com/2018/02/26/apple-con%EF%AC%81rms-it-uses-google-cloud-for-)or- icloud.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 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.