

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

11 March 2018

Periodical

A weekly take on Apple news

For the week ending March 9, 2018

Apple's potential launch of a high-end, over-the-ear style of headphones was a key Apple news highlight this week. Also, a report suggests that iOS smartphone brand loyalty, while high, has trailed Android by 3-4 ppts since January 2016. In other news, Apple is looking to drive subscriptions to Apple Music by sponsoring its ﬁrst major public music concert in two years and oﬀering free 6-month subscriptions to VW and FIAT Chrysler car buyers, also, UnitedHealthcare is oﬀering free Apple Watches to digital wellness program members, and Apple’s supplier report highlights an expanding number of suppliers although labor violations versus Apple’s policies have also moved higher.

Apple developing high-end headphones

Apple is reportedly working on premium over-the-ear noise-cancelling headphones that would compete with Bose and Apple's own Beats by Dre, according to Bloomberg. The new headphones are expected to feature wireless paring, like the company's current AirPod earphones, and could launch before year end, although development headwinds could delay the project. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-03-05/apple-is-said-to-turn-up-)ws/art[icles/2018-03-05/apple-is-said-to-turn-up-](http://www.bloomberg.com/news/articles/2018-03-05/apple-is-said-to-turn-up-) audio-ambition-with-high-end-headphones)

Report suggests iOS smartphone loyalty trails Android

Android operating system brand-loyalty in smartphones exceeds iOS in 2017, according to Consumer Intelligence Research Partners (CIRP). The company's research suggests Android had a 91% loyalty rate among U.S. consumers upgrading their smartphones in 2017, compared to an 86% loyalty rate for iOS. Since January 2016, Android loyalty has been in the 89 to 91% range versus a range of 85 to 88% loyalty for iOS. iOS loyalty last exceeded Android's back in 2013. CIRP suggests Android's higher brand loyalty may reﬂect consumers having chosen from several smartphone brands and models. [(http://ﬁles.constantcontact.com/150f9af2201/4bca9a19-](http://ﬁles.constantcontact.com/150f9af2201/4bca9a19-)

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Eﬀorts to drive Apple Music subscriptions with free London concert, FIAT Chrysler and VW partnerships

Apple has announced a free, Apple Music sponsored Anderson.Paak concert in London on March 13, according to the company's Apple Music Twitter feed. 9to5Mac reported that the event, to be presented by Dr. Dre, is the company's ﬁrst public concert since its last Apple Music Festival in 2016. Separately, TechCrunch reported that new European buyers of certain Volkswagen vehicles and U.S. buyers of certain Chrysler, Dodge, FIAT, Jeep, and Ram cars will get free six-

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Companies featured

Apple Inc. (AAPL.OQ),USD176.94 Hold

2017A 2018E 2019E

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| --- | --- | --- | --- |
| EPS (USD) | 9.21 | 10.88 | 10.80 |
| P/E (x) | 14.9 | 16.3 | 16.4 |
| EV/EBITDA (x) | 7.9 | 9.7 | 10.3 |
| *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.*

month subscriptions to Apple Music. In our view, both promotions reﬂect Apple's eﬀorts to increase its 36M paid Apple Music subscriber base, which trails market leader Spotify's 70M paid subscribers.

(https://9to5mac.com/2018/03/08/apple-music-ﬁrst-free-concert-anderson-paak/

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(https://techcrunch.com/2018/03/06/new-cars-from-ﬁat-chrysler-and-vw-will- come-with-up-to-6-months-of-free-apple-music/)

UnitedHealthcare wellness program members can 'earn' a free Apple Watch Starting in July, UnitedHealthcare will include Apple Watch in the company's Motion digital wellness program, according to statements made at the HIMSS

health information and technology conference in Las Vegas. The program allows members to earn up to $1,000 annually by meeting daily walking goals. The funds can be used to oﬀset the cost of the Apple Watch, excluding shipping and tax, with the remainder accumulating in a health savings or health reimbursement account.

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Annual supplier report reﬂects growing number of new suppliers and violations Apple's 12th annual Supplier Responsibility Progress Report reﬂected the company's audit of 756 suppliers, an 18% increase Y/Y, and included 197 new

suppliers vs. 140 in the year ago period. According to the report, the number of labor rule violations increased from 22 to 44 and included work hour falsiﬁcations and poor working conditions. Apple believes the large number of new suppliers joining the Apple ecosystem is the reason for the step-up in violations. (ht[tps://www](http://www.apple.com/supplier-responsibility/pdf/).apple[.com/supplier-responsibility/pdf/](http://www.apple.com/supplier-responsibility/pdf/) Apple\_SR\_2017\_Progress\_Report.pdf) (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-03-08/apple-s-push-to-clean-)ws/art[icles/2018-03-08/apple-s-push-to-clean-](http://www.bloomberg.com/news/articles/2018-03-08/apple-s-push-to-clean-) up-supply-chain-gained-momentum-in-2017)

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.