

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 April 13, 2018

Bloomberg reported this week that production orders for HomePod have been cut, due to disappointing sales of the device. Also, Apple Music's paid subscriber base reached a new high of 40M in April, another 2M gain in a one-month period. In other news, IDC data showed Macs lost modest PC market share and saw mid- single-digit unit declines in C1Q-18, one upcoming 2019 iPhone may have three rear cameras, Apple was ordered to pay $500M in a patent infringement case that may be appealed, and Israel joined the list of countries investigating Apple's iPhone battery slowdown. Also of interest, iPhone "cracking" tools are gaining traction with local law enforcement, South Korea may sanction Apple over unfair business practices, and Apple has hired some prominent software and AI execs.

HomePod sales below company expectations

Sales of HomePod, Apple's smart speaker, have reportedly been trending below the company's internal targets, resulting in supply chain order cuts in late March, according to Bloomberg. Despite strong pre-orders, and roughly one-third share of the smart speaker market in the last week of January, the report suggests that three weeks after its launch, HomePod's weekly share had dropped to 4% of the market.

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Apple Music paid subscribers hit 40M

Paid subscribers to Apple Music reached 40M in 115 countries in April, according to Variety, and have grown by 2M per month for the past two months. The service reportedly has 8M unpaid free-trial subscribers as well. The updated subscriber ﬁgures were included in a memo circulated by Eddy Cue, Apple's head of internet software and services, announcing the promotion of Oliver Schusser to VP of Apple Music and international content. Mr. Schusser has been working with Eddy Cue at Apple for 14 years, focusing on various projects related to the App Store, iTunes movie and TV portals, iBooks, and Apple Podcasts. (ht[tps://www.reuters.com/article/us-apple-music/apple-music-appoints-ne](http://www.reuters.com/article/us-apple-music/apple-music-appoints-new-)w- head-hits-48-million-subscribers-idUSKBN1HI2RA)

Mac shipments decline and lose modest share in C1Q-18

According to preliminary IDC PC shipment data, Apple had 6.6% share of the global PC market in C1Q-18, but remained in ﬁfth place despite a 40bps decline Y/Y. Mac unit shipments fell by 4.8% Y/Y to 4.0M and underperformed the overall PC market which was ﬂat Y/Y.

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Companies featured

Apple Inc. (AAPL.OQ),USD172.44 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 | 9.4 | 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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2019 iPhones may feature a triple-lens rear camera

At least one of the new iPhone models expected to be released in 2019 may feature three rear-facing cameras, according to the Economic Daily News. The report suggests that the combination of three 12-megapixel lenses would deliver 5x zoom capabilities although it's unclear if the 5x zoom is optical or digital zoom. Both iPhone 8 Plus and iPhone X currently feature two rear 12-megapixel cameras with 2x optical zoom and 10x digital zoom. According to CNET, the Huawei P20 Pro, which was released on April 6, is the ﬁrst smartphone on the market to feature three rear-facing cameras.

(ht[tps://www.macrumors.com/2018/04/09/iphone-triple-lens-rear-camera-2019-](http://www.macrumors.com/2018/04/09/iphone-triple-lens-rear-camera-2019-) rumor/)

(ht[tps://www.cnet.com/news/apple-iphone-2019-triple-lens-camera-report/)](http://www.cnet.com/news/apple-iphone-2019-triple-lens-camera-report/))

Apple ordered to pay VirnetX $502.6M

A Federal jury in Texas ordered Apple to pay VirnetX Holding Corp. $502.6M to settle an eight-year long patent dispute, according to Bloomberg. VirnetX claimed that Apple iPhone apps FaceTime, VPN on Demand, and iMessage infringe on four patents related to secure communications. The report notes that the verdict may be overturned on appeal, as the U.S. Patent Trial and Appeal Board has said in other current Federal cases that the patents in question are invalid. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-04-10/apple-owes-502-6-)ws/art[icles/2018-04-10/apple-owes-502-6-](http://www.bloomberg.com/news/articles/2018-04-10/apple-owes-502-6-) million-to-virnetx-says-federal-jury-in-texas)

Israel joins growing list of authorities investigating deliberate iPhone slowdown Israel's Consumer Protection and Fair Trade Authority has launched an investigation into Apple’s consumer disclosures regarding the company's

deliberate slowing of older iPhones, according to Reuters. As we have noted in previous Slices, Apple is facing numerous investigations and lawsuits in the

U.S. and abroad regarding the iPhone "throttling" issue. Separately, 9to5Mac reports that unprecedented demand for iPhone battery replacements is forcing the company to shift AppleCare staﬀ and external contractors into retail store locations. The surge in replacement battery demand follows the price cut in the service in December, in the wake of the report Apple deliberately slowed the performance of older iPhones.

(ht[tps://www.reuters.com/article/us-apple-batteries-israel/israeli-agenc](http://www.reuters.com/article/us-apple-batteries-israel/israeli-agency-)y- investigating-apple-over-handling-of-iphone-slowdown-idUSKBN1HH1W8) (https://9to5mac.com/2018/04/12/apple-store-contractors-iphone-battery-repair/

#more-528891)

Report suggests iPhone "cracking" tools gaining popularity with police

GrayKey, an iPhone decryption device, is reportedly gaining in popularity with local U.S. police departments, according to Motherboard. The tool, which sells for $15-30K, can reportedly unlock iPhones, including the iPhone X, in as little as two hours or up to several days, depending on the device's passcode length. (https://motherboard.vice.com/en\_us/article/vbxxxd/unlock-iphone-ios11- graykey-grayshift-police)

South Korea considering sanctions on Apple over unfair practices

The Fair Trade Commission (FTC) of South Korea could impose sanctions on Apple Korea for unfair advertising and repair cost practices, according to the Korea Herald. The FTC recently investigated Apple Korea's reported practices of passing on advertising and repair costs to local telecom companies and has sent a report of its ﬁndings to Apple Korea for comment.

(https://business.inquirer.net/248876/apple-likely-face-sanctions-unfair-practice- south-korea)

New hires boost software and AI teams

Apple has hired Jon McCormack as a VP of software, according to Bloomberg. Mr. McCormack was most recently the head of software for HP Inc, and also served as CTO of Amazon’s devices group, and VP of Amazon's Kindle software. Separately, Apple announced that John Giannandrea, Google's reported "top artiﬁcial intelligence executive" has joined the company. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-04-06/apple-hires-former-)ws/art[icles/2018-04-06/apple-hires-former-](http://www.bloomberg.com/news/articles/2018-04-06/apple-hires-former-) amazon-devices-cto-for-software-role) (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-04-04/apple-hires-google-)ws/art[icles/2018-04-04/apple-hires-google-](http://www.bloomberg.com/news/articles/2018-04-04/apple-hires-google-) executive-to-catch-rivals-in-ai-race)

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.