

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 27, 2018

Negative news on iPhone X demand continued to be a key theme this week, with a report suggesting C2Q-18 iPhone X production will only reach 8M units, due to oversupply and weak demand for the high-priced phone. The report comes amid additional negative earnings reads on iPhone demand this week from suppliers and U.S. carriers. In other news, Intel is likely to supply 70% of 2018 iPhone modem chips as Qualcomm's share dwindles, the EU is investigating Apple's Shazam acquisition, Apple will begin transferring 13B Euros to an escrow account while the EU deliberates its tax case, Apple Music contributed to 39% Y/Y growth in global streaming music sales in CY-17,and Apple is replacing defective MacBook batteries for free. Lastly, a survey suggests that, given the choice, enterprise employees prefer Apple devices and the company hired a Samsung exec to head its South Korean division.

Supply chain suggests 8M iPhone X orders in C2Q-18

Excess inventory and weak demand are reportedly resulting in C2Q-18 iPhone X order volume of only 8M units, according to supply chain sources cited by Fast Company. The report suggests the company is facing a glut of iPhone X inventory due to the device's high price and lengthening smartphone refresh cycles. Separately, we note that both Verizon ([link](https://research.db.com/Research/Document?rid=505bc79c-8b1c-440a-9d8b-a8e0e57c43a2-604&amp;kid=RP0001&amp;documentType=R)) and AT&T ([link](https://research.db.com/Research/Document?rid=00fc8aa9-99bf-473a-bcce-09ff1314ee25-604&amp;kid=RP0001&amp;documentType=R)) reported below- expectation smartphone upgrade rates in C1Q-18, according to DB's Telecom analyst Matt Niknam , pointing to weak smartphone demand and a lengthening refresh cycle.

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Intel squeezing out QCOM as key iPhone modem supplier

Intel is expected to supply 70% of the LTE chips used in iPhones produced this year, with Qualcomm expected to supply the remaining 30%, according to Fast Company. Apple is reportedly looking to exclusively source its iPhone modem chips from Intel starting next year. Qualcomm was the sole iPhone modem chip supplier from 2011 until 2016 when Apple began using some Intel chips on iPhone

7. While Apple has increasingly ramped its use of Intel chips in subsequent iPhone cycles, an ongoing patent dispute between Qualcomm and Apple is believed to be fueling Apple's decisive shift away from Qualcomm chips. (ht[tps://www](http://www.fastcompany.com/40564327/intel-to-supply-70-of-iphone-).f[astcompan](http://www.fastcompany.com/40564327/intel-to-supply-70-of-iphone-)y[.com/40564327/intel-to-supply-70-of-iphone-](http://www.fastcompany.com/40564327/intel-to-supply-70-of-iphone-) modems-this-year-100-in-2019)

EU investigating Shazam acquisition

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Companies featured

Apple Inc. (AAPL.OQ),USD164.22 Hold

2017A 2018E 2019E

|  |  |  |  |
| --- | --- | --- | --- |
| EPS (USD) | 9.21 | 10.88 | 10.80 |
| P/E (x) | 14.9 | 15.1 | 15.2 |
| EV/EBITDA (x) | 7.9 | 8.9 | 9.4 |
| *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.*

The European Union's antitrust authority has launched an investigation into Apple's proposed acquisition of the music identiﬁcation app Shazam over concerns that the deal could limit consumers' music-streaming service choices and help Apple to poach customers from other providers. According to The Guardian, Shazam has been downloaded 1B times and is accessed 20M times a day by consumers, which could provide information about Apple Music's competitors and their customers. The EU plans to approve or reject the acquisition by September 4.

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Apple nearing payment of 13B Euro tax claim

Apple has ﬁnalized an agreement to transfer roughly 13B Euros to an escrow account in Dublin, in compliance with the European Commission’s tax order, according to Bloomberg. The multi-month transfer will reportedly start in June, and funds will be held in an escrow account while the European tax case is being decided. If Apple's appeal is successful, the cash will be repaid. According to Irish Finance Minister Paschal Donohoe, an appeal by Apple is likely to be heard before the end of the year.

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Apple Music helped contribute to the 8.5% Y/Y growth in recorded music sales in CY-17

Global recorded music sales of $17.4B increased by 8.5% Y/Y or $1.4B in CY-17, due to 39% growth in streaming music sales, according to MIDiA Research. Streaming music service sales, which include Spotify and Apple Music, accounted for 43% of the overall market and oﬀset the 10% decline in downloads and physical music formats.

[(http://www.riaa.com/wp-content/uploads/2017/09/RIAA-Mid-Year-2017-News-](http://www.riaa.com/wp-content/uploads/2017/09/RIAA-Mid-Year-2017-News-) and-Notes2.pdf)

Free battery replacements available for defective MacBook batteries

Apple is oﬀering free battery replacements worldwide for certain 13-inch MacBook Pros, according to Reuters. The battery defect is related to a component ﬂaw that causes the battery to expand. Apple disclosed that the aﬀected models were manufactured between October 2016 and October 2017, but did not disclose the actual number of aﬀected devices. (ht[tps://www.reuters.com/article/us-apple-batteries-macbook/apple-oﬀ](http://www.reuters.com/article/us-apple-batteries-macbook/apple-o%EF%AC%80ers-)ers- battery-replacement-for-some-macbooks-after-ﬂaws-reported- idUSKBN1HR39M)

Survey suggests employees prefer iOS devices

According to a survey conducted by Jamf, in organizations where there is a choice between IT platforms, 72% of employees picked a Mac over a PC. Similarly, 75% of respondents indicated a preference for an iPhone or iPad over a corresponding Android device. Jamf provides Apple device management software and its March 2018 survey reﬂects the views of 580 executives, managers, and IT professionals. (ht[tps://www](http://www.jamf.com/resources/e-books/survey-the-impact-of-device-choice-).jamf[.com/resources/e-books/surv](http://www.jamf.com/resources/e-books/survey-the-impact-of-device-choice-)e[y-the-impact-of-device-choice-](http://www.jamf.com/resources/e-books/survey-the-impact-of-device-choice-) on-the-employee-experience/)

Brandon Yoon, a former Samsung executive, joins Apple

Apple has hired Brandon Yoon, a former VP at Samsung, as the general manager of Apple’s South Korean operations, according to Bloomberg. The hiring comes

at an important time in Apple's relationship with the South Korean authorities; as we wrote in Slices earlier this month, the South Korean Fair Trade Commission is considering imposing sanctions on Apple over unfair business practices in the country.

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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.