

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

13 May 2018

Periodical

A weekly take on Apple news

For the week ending May 11, 2018

In key Apple news this week, Apple TV users could soon purchase video subscriptions directly through the Apple TV app. Also, Apple plans to invest $10M in a new aluminum production JV with Alcoa and Rio Tinto. In other Apple news, an Apple Pay branded credit card with Goldman Sachs may be coming, Apple outperformed the European smartphone market in C1Q-18 but trailed market leader Samsung by 11ppts, and Apple will be participating in a drone testing program to improve Apple Maps. Also, the company is removing privacy violating apps from the App Store and has abandoned plans to build a new Irish data center.

Apple looking to sell video subscriptions through Apple TV

Apple is reportedly planning to sell video subscriptions directly to consumers through the Apple TV app, according to Bloomberg. Currently, Apple TV users must pay for content or subscribe to other video services through third-party apps, forcing subscribers to jump back and forth between apps. Under the new service, users will be able to subscribe and pay for third-party content directly through the Apple TV app.

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Apple investing $10M in Alcoa-Rio Tinto joint venture

Apple will invest CAD $13M or roughly $10M in a new joint venture (JV) with Alcoa and Rio Tinto. The JV is focused on developing a new, more environmentally friendly aluminum-making process. The technology is expected to be marketable by 2024 and will reﬂect a CAD $188M ($147M) investment by the companies, the Canadian government, and the Quebec government. (ht[tps://www](http://www.apple.com/newsroom/2018/05/apple-paves-the-way-for-).apple[.com/newsroom/2018/05/apple-paves-the-way-for-](http://www.apple.com/newsroom/2018/05/apple-paves-the-way-for-) breakthrough-carbon-free-aluminum-smelting-method/) (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-05-10/apple-backs-alcoa-rio-)ws/art[icles/2018-05-10/apple-backs-alcoa-rio-](http://www.bloomberg.com/news/articles/2018-05-10/apple-backs-alcoa-rio-) tinto-to-develop-carbon-free-metal-making)

Apple Pay branded credit card could be coming

Goldman Sachs and Apple are reportedly discussing an Apple Pay branded credit card to launch in 2019, according to the New York Times. Discussions have been ongoing for months and would represent a new foray into the consumer credit card market for Goldman Sachs. Apple partnered with Barclay's in November 2014 to launch a card that earns points towards the purchase of new Apple products or Apple gift cards. According to the Wall Street Journal, the Goldman Sachs credit card would replace Apple's current card with Barclay's.

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Companies featured

Apple Inc. (AAPL.OQ),USD186.05 Hold

2017A 2018E 2019E

|  |  |  |  |
| --- | --- | --- | --- |
| EPS (USD) | 9.21 | 11.35 | 12.80 |
| P/E (x) | 14.9 | 16.4 | 14.5 |
| EV/EBITDA (x) | 7.9 | 9.8 | 9.8 |
| *Source: Deutsche Bank* |  |  |  |

*Our price target is based on shares trading at 13x 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.*

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Apple outperforms European smartphone market in C1Q-18

Smartphone shipments in Europe fell by 6.3% Y/Y in C1Q-18, according to Canalys. Western Europe declined by 13.9% to 30.1M units and accounted for the biggest decline, while Central/ Eastern Europe was up 12.3% to 15.9M units, driven by strength in Russia. Samsung remained the top vendor with 33.1% share, but units fell by 15.4% Y/Y. Apple remained in second place with 22.2% market share with 10M units, a 5.4% decline Y/Y. Huawei rounded out the top three with 16.1% share and 7.4M units, up 38.6% Y/Y. (ht[tps://www.canalys.com/ne](http://www.canalys.com/newsroom/smartphone-shipments-fall-63-europe-)wsr[oom/smartphone-shipments-f](http://www.canalys.com/newsroom/smartphone-shipments-fall-63-europe-)al[l-63-europe-](http://www.canalys.com/newsroom/smartphone-shipments-fall-63-europe-)

q1-2018)

Apple to participate in U.S. drone test program

Apple was among a group of 10 companies to receive permission from the U.S. Department of Transportation to use drones, according to Reuters. As part of the government's eﬀorts to evaluate drone safety and regulation, the department will allow a select group of companies to ﬂy drones over people at night, operations that are currently prohibited in the U.S. Apple is expected to use drones to take aerial photos to improve Apple Maps.

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(https://9to5mac.com/2018/05/09/apple-use-drones-to-improve-apple-maps/

#more-532602)

Stricter stance adopted for privacy in App Store apps

Apps sold in the App Store that share user location data with third parties without permission are starting to be removed, according to 9to5Mac. Apple is requiring developers to ensure that any code or SDKs involved in privacy violations be removed before an app can be resubmitted to the App Store. (https://9to5mac.com/2018/05/08/apple-location-apps-third-parties/)

Plans for Ireland data center dropped

Apple has canceled plans to build a data center in Athenry, Ireland due to a three- year delay in the approval process, according to Reuters. As a result, the company reportedly plans to expand its European headquarters, which are currently located in County Cork, where it employs over 6,000 people. (ht[tps://www.reuters.com/article/us-apple-ireland/apple-drops-plans-f](http://www.reuters.com/article/us-apple-ireland/apple-drops-plans-for-data-)or[-data-](http://www.reuters.com/article/us-apple-ireland/apple-drops-plans-for-data-) center-in-ireland-due-to-planning-delays-rte-idUSKBN1IB0XT)

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 13x 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.