

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

27 May 2018

Periodical

A weekly take on Apple news

For the week ending May 25, 2018

Apple sent out invitations to its WWDC keynote on June 4. Also this week, news surfaced that Apple is working with Volkswagen on self-driving vans for Apple's campuses. Also of note, chip production is reportedly underway for the 7nm A12 chip expected to be used in the upcoming iPhone. In other news, Samsung was ordered to pay Apple $539M in damages in the companies' long-running patent suit, U.K. iPhone users are suing Google over privacy issues, new privacy tools were introduced in Europe to meet GDPR requirements, and a lower-priced Beats version of HomePod could be coming. Also, Apple Watch shipments were ﬂat Y/Y in C1Q-18, Apple Pay lagged market leader Starbucks in U.S. mobile payment users in 2017, app developers have banded together to lobby for App Store beneﬁts, and Apple is refunding $50 on out-of-warranty iPhone battery replacements following its battery throttling disclosure.

Apple announces WWDC keynote event on June 4

Apple sent out press invitations for its Worldwide Developers Conference scheduled for June 4-8, in San Jose, California. Similar to in past years, Apple's keynote event on June 4 is expected to focus on new software features. Apple may also introduce new devices such as a new MacBook, an updated iMac, and a smaller, less expensive version of the HomePod. (https://appleinsider.com/articles/18/05/22/apple-conﬁrms-wwdc-2018-keynote- for-june-4-at-10-am)

Apple and Volkswagen building self-driving vans

Apple and Volkswagen are reportedly partnering to create self-driving shuttle buses for Apple's campus out of Volkswagen T6 Transporter vans, according to the New York Times. The partnership began last year and was expected to go live by the end of 2018. However, work on the project is still underway at a lab managed by a Volkswagen subsidiary in Turin, Italy and is running behind schedule. The report suggests Apple was previously in discussions with several car makers, including BMW, Mercedes-Benz, and Nissan, to develop all- electric self-driving vehicles, which unraveled over Apple's demands to control the projects' design and data. As we have written in previous Slices, reports suggest Apple has scaled back its self-driving car ambitions from the construction of an actual self-driving car to the development of the systems and technology for self- driving vehicles.

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Companies featured

Apple Inc. (AAPL.OQ),USD187.16 Hold

2017A 2018E 2019E

|  |  |  |  |
| --- | --- | --- | --- |
| EPS (USD) | 9.21 | 11.35 | 12.80 |
| P/E (x) | 14.9 | 16.5 | 14.6 |
| EV/EBITDA (x) | 7.9 | 9.9 | 9.9 |
| *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.*

Mass production of 2018 iPhone chips likely underway

TSMC has started mass production of a new 7-nanometer processor, thought to be called the A12 chip, that is expected to be used in new iPhones this fall, according to Bloomberg. The chip is reportedly faster and more eﬃcient than the current 10-nanometer chips in existing Apple devices. The report suggests that Samsung also plans to manufacture and implement new 7-nanometer chips its upcoming smartphones.

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Apple awarded $539M in total damages from Samsung

Samsung has been ordered to pay Apple a total of $539M for patent infringement in the retrial of a 2012 damages verdict, according to Reuters. As Samsung already paid Apple $399M in 2015 for damages related to the patents in question, the ruling suggests Samsung owes Apple an additional $140M. As we wrote last week in Slices, Apple and Samsung's multi-year legal battle culminated in the

U.S. Supreme Court's 2016 order for a $399M damages retrial. It is unclear if Samsung will appeal the ruling.

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Google sued for accessing personal information of 4.4M UK iPhone users Google is being sued by a group of iPhone users in the U.K over privacy violations, according to the Guardian. The group is seeking 3.2B British pounds from

Google for bypassing the privacy settings of Apple's Safari browser and for the "clandestine tracking and collation" of 4.4 million users' personal information. (ht[tps://www](http://www.theguardian.com/technology/2018/may/21/google-sued-).t[heguardian.com/technology/2018/may/21/google-sued-](http://www.theguardian.com/technology/2018/may/21/google-sued-)

tracking-44m-uk-iphone-users-browsing-data-apple-safari)

Apple launches new Data and Privacy website for European users

To comply with the Europe Union's General Data Protection Regulation (GDPR) deadline, Apple has launched a new Data and Privacy website. The site allows Apple users to download all data the company has retained on its servers associated with an Apple ID account, as well as change, deactivate, or delete an Apple ID. The functionality is currently only available to users in the European Union but Apple plans to roll it out to users globally later this year. (https://support.apple.com/en-us/HT208501)

Beats-branded HomePod could be ahead

Apple is reportedly considering launching a lower priced Beats-branded version of the HomePod, according to a Taiwanese supply chain source cited by The Inquirer. The device could be priced at $199, a considerable discount to the HomePod's

$349 retail price. The lower price could help improve the company's market share in the smart speaker market, which is currently only 6%. (ht[tps://www](http://www.theinquirer.net/inquirer/news/3032640/apple-might-be-planning-a-).t[heinquirer.net/inquirer/news/3032640/apple-might-be-planning-a-](http://www.theinquirer.net/inquirer/news/3032640/apple-might-be-planning-a-) cheaper-beats-branded-homepod-amid-lacklustre-sales)

Apple Watch C1Q-18 wearable band units ﬂat Y/Y

The global wearable band market grew by 35% Y/Y to 20.5M units in C1Q-18, driven by strong demand for health-centric devices, according to Canalys. Apple was the leading vendor in the market with 18% share while unit shipments of 3.8M were ﬂat Y/Y. Apple was just marginally ahead of the number two vendor, a large Chinese manufacturer, with 3.7M unit shipments, and 18% share of the

market. Fitbit came in third place with 11% share, followed by Garmin and Huawei with 7% and 6% shares, respectively. (ht[tps://www.canalys.com/ne](http://www.canalys.com/newsroom/wearables-market-up-35-in-q1-2018-as-)wsr[oom/wearables-mark](http://www.canalys.com/newsroom/wearables-market-up-35-in-q1-2018-as-)et[-up-35-in-q1-2018-as-](http://www.canalys.com/newsroom/wearables-market-up-35-in-q1-2018-as-) apple-and-xiaomi-maintain-lead) (https://appleinsider.com/articles/18/05/23/apple-watch-leads-wearable-device- market-with-estimated-38m-unit-shipments-in-ﬁrst-quarter)

Apple Pay U.S. user base lags Starbucks'

Starbucks led the U.S. mobile payment market last year and is expected to remain the leader for the next ﬁve years, based on eMarketer data reviewed by TechCruch. With 20.7M users, Starbucks' 2017 mobile payment service base exceeded Apple Pay's 19.9M , Google Pay's 9.3M, and Samsung Pay's 8.4M users. Apple Pay users are expected to grow by 11% Y/Y in 2018 to 22M but still remain behind Starbucks' 23.4M (up 13% Y/Y).

(https://techcrunch.com/2018/05/22/starbuckss-mobile-payment-service-is- slightly-outpacing-apples/)

iPhone app developers form union to demand improvements

Over 100 iPhone app developers have formed a group called "The Developers Union" to lobby Apple for App Store improvements, according to CNBC. The group's main demand is to allow every app in the App Store to oﬀer users a free trial period, versus the current policy which only permits subscription-based apps to oﬀer free trials. The group may also seek to increase developers' share of App Store revenue.

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Out-of-warranty iPhone battery replacements eligible for $50 refund

Apple will refund $50 to iPhone users who purchased out-of-warranty battery replacements for iPhone 6 or a newer models, from January 1 through December 28, 2017. However, users will receive refunds only if iPhone repairs were done by an authorized Apple service provider. The decision follows disclosures in December that Apple deliberately slowed the performance of older iPhones to manage battery consumption. As we wrote in Slices in February, the refund was contemplated to placate consumers who paid full price for replacement iPhone batteries before they were discounted to $29.

(https://support.apple.com/iphone-out-of-warranty-battery-replacement-credit)

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.