

Deutsche Bank 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 June 22, 2018

In a week focused on potential new Chinese tariﬀs, Apple has reportedly been assured by the Trump administration that it will not face tariﬀs on the iPhone. Also this week, reports on new iPhone models continue to surface, with a "budget" iPhone expected to be released in September with an LCD display and bezel, while a 6.5-inch iPhone X Plus is reportedly expected to be the most popular new model. In other news, the AirPower is now expected to become available in September, Apple is challenging four Qualcomm patents, a lawsuit over App Store commissions will be heard by the Supreme Court, Apple was ﬁned $6.5M for consumer law violations in Australia, and Sesame Workshop will be collaborating with Apple on video content for children.

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Companies featured

iPhone expected to be exempt from new U.S. import tariﬀs

According to the New York Times, the Trump administration has assured Apple that the U.S. government will not seek import tariﬀs on the iPhone despite the Trump administration's announcement this week that it could impose tariﬀs on an additional $200B in Chinese goods, on top of the tariﬀs on $50B in goods already announced. China remains an important geography for Apple, as the iPhone is assembled in the country and Apple generates roughly one-ﬁfth of its sales from China. Despite the assurances, Apple reportedly remains concerned over possible retaliation from the Chinese government, which could include delays in the supply chain, increased scrutiny of the iPhone in the name of national security, and legal regulations to favor Chinese brands. (ht[tps://www](http://www.nytimes.com/2018/06/18/technology/apple-tim-cook-china.html)).nyt[imes.com/2018/06/18/technology/apple-tim-cook-china.html)](http://www.nytimes.com/2018/06/18/technology/apple-tim-cook-china.html))

Low-cost version of iPhone X expected this fall

Apple is reportedly planning to release a "budget" version of the iPhone X this fall, featuring an LCD display, according to a Mac Okatara report cited by Forbes. The article suggests that the use of an LCD display, instead of an OLED panel, will result in a device that will not be bezel-less like the current iPhone X, but will shave $400 oﬀ of the cost of the device relative to the current iPhone X. In a separate article, Forbes notes that internally, Apple was disappointed by the lack of strong demand for the iPhone X, which the company attributes to the negative impact of the phone's high $999 retail price in a mature market. (ht[tps://www](http://www.forbes.com/sites/gordonkelly/2018/06/19/apple-iphone-x-x2-new-).f[orbes.com/sites/gordonk](http://www.forbes.com/sites/gordonkelly/2018/06/19/apple-iphone-x-x2-new-)el[ly/2018/06/19/apple-iphone-x-x2-ne](http://www.forbes.com/sites/gordonkelly/2018/06/19/apple-iphone-x-x2-new-)w- iphone-xplus-design-specs-release-date-cost/#2979052754c7)

Apple Inc. (AAPL.OQ),USD185.69 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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Larger form factor 2018 "iPhone X Plus" could be most popular new iPhone Production plans published on Korean website The Bell suggest Apple is expecting a larger, 6.5-inch OLED iPhone model to out-sell a 5.8-inch OLED

version this fall, according to The Inquirer. The report indicates that Apple has ordered 45M 6.5-inch OLED displays for an upcoming iPhone model that may be called "iPhone X Plus." This compares to 25M panels for a new 5.8-inch iPhone model and 30M LCD displays for a 6.04-inch device. The report conﬂicts with a Wall Street Journal article we cited in last week's Slices that suggested the upcoming 2018 LCD iPhone model was expected to be the most popular new device.

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AirPower wireless charger could be available by September

AirPower, Apple's wireless charging mat, has been delayed due to technical challenges but could be launched in September, according to Bloomberg. The device was announced in September 2017 with an expected 2018 release, and sources suggest the company was targeting a June 2018 launch. However, the complexity of integrating diﬀerent sized charging components into a single device, as well as the inclusion of a proprietary chip, have delayed the product's release until "before or in September." (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-06-21/why-apple-s-airpower-)ws/art[icles/2018-06-21/why-apple-s-airpower-](http://www.bloomberg.com/news/articles/2018-06-21/why-apple-s-airpower-) wireless-charger-is-taking-so-long-to-make)

Apple seeking to invalidate four Qualcomm patents

Apple is petitioning the U.S. Patent and Trademark Oﬃce to cancel four Qualcomm patents, according to Bloomberg. The patents in question, which relate to the automatic focusing of a digital camera, touch sensitive displays, circuit memory, and the combined functionality of a smartphone and a personal digital assistant, are at the core of Qualcomm's 2017 patent infringement lawsuit against Apple. If the Oﬃce's review board ﬁnds the claims have merit they will conduct a formal review and provide a ﬁnal decision within a year. As we noted last week, hearings related to the handful of legal cases pending between Apple and Qualcomm kicked oﬀ this week. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-06-21/apple-opens-new-front-)ws/art[icles/2018-06-21/apple-opens-new-front-](http://www.bloomberg.com/news/articles/2018-06-21/apple-opens-new-front-) in-long-qualcomm-ﬁght-the-patent-oﬃce)

U.S. supreme court to hear suit over App Store commissions

The U.S. Supreme Court has agreed to hear Apple's appeal of a lower court's ruling that the company should face charges of antitrust violations, according to Reuters. The original case was brought in 2011 and claims Apple monopolizes the market for app sales which has led to unfair pricing. (ht[tps://www.reuters.com/article/us-usa-court-apple/u-s-top-court](http://www.reuters.com/article/us-usa-court-apple/u-s-top-court-mulls-apples-)-mul[ls-apples-](http://www.reuters.com/article/us-usa-court-apple/u-s-top-court-mulls-apples-) app-store-commissions-in-antitrust-case-idUSKBN1JE1JH)

Australian court ﬁnes Apple AU$9M for consumer law violations

An Australian court has ordered Apple to pay AU$9M ($6.5M) to iPhone and iPad users after ﬁnding that the company misled customers regarding their rights to repairs, according to the BBC. In its case against Apple, the Australian Competition and Consumer Commission (ACCC) claimed that Apple refused to repair "error 53" devices, or those frozen following a software update, if the

products had previously been serviced by a third party for any reason. The court ruled Apple's actions were a breach of the company's customer guarantees. (ht[tps://www.bbc.com/ne](http://www.bbc.com/news/world-australia-44529315))ws/w[orld-australia-44529315)](http://www.bbc.com/news/world-australia-44529315))

Apple to partner with Sesame Workshop for children's content

Apple has reportedly signed an agreement with Sesame Workshop, the creators of "Sesame Street," to develop original children's live-action, animated, and puppet content for Apple's streaming video service, according to CNBC. The partnership is Apple's ﬁrst project for children's content and will not include the "Sesame Street" program.

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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 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.