

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 July 13, 2018

This week, Apple announced the release of updated 13-inch and 15-inch MacBook Pro models, featuring higher performance processors, increased memory conﬁgurations, and a range of refreshed features. Also of note this week in Apple-related news, C2Q-18 Mac shipments and market share were ﬂat Y/Y, according to PC data from IDC, Apple Music's paid U.S. subscriber base is expected to exceed Spotify's by year-end, and Apple's Photo Print Products service will be discontinued. In addition, supply chain reports suggest the upcoming 6.1-inch LCD iPhone will have a more discrete bezel, LG Display will be supplying both OLED and LCD iPhone displays in C2H-18, Siri has new leadership, Apple is starting a $300M Chinese renewable energy fund, Congress is looking into Apple's data privacy protections, the App Store turned 10, and Apple has revised contracts with Japanese carriers following an FTC inquiry.

Refreshed MacBook Pro models released

Apple has released updates to the 13-inch and 15-inch MacBook Pro devices, featuring updated core processors, more memory, and improved display technology, as well as Apple's proprietary TouchBar, Touch ID, T2 security chips, and Siri. Both versions include conﬁgurations for up to 4TB of storage and 8th generation Intel processors, which reportedly boost performance by 70-100%. The 13-inch model is priced starting at $1,799 and the 15-inch version will retail starting at $2,399.

(ht[tps://www](http://www.apple.com/newsroom/2018/07/apple-updates-macbook-pro-with-).apple[.com/newsroom/2018/07/apple-updates-macbook-pro-with-](http://www.apple.com/newsroom/2018/07/apple-updates-macbook-pro-with-) faster-performance-and-new-features-for-pros/)

Mac shipments and share essentially ﬂat in C2Q-18

According to preliminary IDC PC shipment data, Apple had 6.9% share of the global PC market in C2Q-18, up 20bps Y/Y, and remained in fourth place. Mac unit shipments were unchanged Y/Y at 4.3M and underperformed the overall PC market which saw unit shipment growth of 2.7% Y/Y. (ht[tps://www.idc.com/getdoc.jsp?containerId=prUS44118818)](http://www.idc.com/getdoc.jsp?containerId=prUS44118818))

Apple Music's U.S. subscribers expected to catch up to Spotify's by August Despite Spotify's top global share in music streaming services, its lead over Apple Music in the U.S. is rapidly narrowing, according to a Financial Times

report cited by CNBC. Of Apple Music's 40M global paid subscribers, industry executives estimate that the service now has about 21M paid U.S. subscribers. In comparison, Spotify is estimated to have 22M paid members in the U.S. out

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Companies featured

Apple Inc. (AAPL.OQ),USD191.03 Hold

2017A 2018E 2019E

EPS (USD) 9.21 11.35 12.80

P/E (x) 14.9 16.8 14.9

EV/EBITDA (x) 7.9 10.1 10.1

*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.*

of the service's total 75M paid subscribers. The gap between Apple and Spotify in the U.S. is forecast to close by next month, with Apple Music expected to surpass Spotify in paid U.S. subscribers by year-end. The report suggests that Apple Music's growing traction in the U.S. reﬂects Apple’s large iPhone customer base, which accounts for 40% of the U.S. smartphone market. In contrast, Apple's global smartphone market share is just 15%. Apple's services business remains a key diversiﬁer for the company and improved momentum in the world’s largest music market could help support services sales. (ht[tps://www.cnbc.com/2018/07/09/apple-slices-into-spotifys-lead-in-t](http://www.cnbc.com/2018/07/09/apple-slices-into-spotifys-lead-in-the-us-)he-us- music-market.html)

Photo Print Products to be discontinued

Photo Print Products, Apple's built-in service for creating prints, albums, photo books, and calendars from pictures in the Photos app, will end on September 30, 2018 according to 9to5Mac. Apple's proprietary photo printing service has been available on Macs since 2002 but has allowed for the integration of third-party photo services since 2017.

(https://9to5mac.com/2018/07/12/photo-print-products-discontinued/)

Supply chain suggests narrowing edges on upcoming 6.1-inch LCD iPhone Nichia, a Japanese supplier, will reportedly be the exclusive provider 0.3t LED chips for the upcoming 6.1-inch iPhone, according to DigiTimes. The chip, which

will be used for backlighting the LCD panels, will allow for a more narrow 2.0-2.5mm bottom edge and bezel on the device, vs the prior model's use of 0.4t LED chips which led to a 4.0-4.5mm bezel. (ht[tps://www](http://www.digitimes.com/news/a20180709PD206.html)).digit[imes.com/news/a20180709PD206.html)](http://www.digitimes.com/news/a20180709PD206.html))

LG expected to supply OLED and LCD displays for upcoming iPhones

Supply chain sources suggest LG Display will be shipping OLED and LCD displays in C2H-18 for iPhones, according to a Newspim report cited by DigiTimes. The report suggests LG will supply 3-4M OLED panels, which is a modest increase from a prior Bloomberg report that the company would supply 2-4M OLED panels. In addition, LG is expected to supply 20M LCD display panels. With improving OLED yields, the company could provide 10M panels in 2019. (ht[tps://www](http://www.digitimes.com/news/a20180713PD204.html?mod=2)).digit[imes.com/news/a20180713PD204.html?mod=2)](http://www.digitimes.com/news/a20180713PD204.html?mod=2))

Siri team gets third new leader in the span of one year

Former Google AI executive John Giannandrea, who joined Apple in April, has been named the head of a new combined AI and machine learning team, which includes oversight of Siri, according to Apple's website. According to the Wall Street Journal, Mr. Giannandrea is the third executive to lead Apple's Siri team in the past year, following software head Craig Federighi and SVP Eddy Cue. (ht[tps://www](http://www.apple.com/leadership/john-giannandrea/)).apple[.com/leadership/john-giannandrea/)](http://www.apple.com/leadership/john-giannandrea/)) (ht[tps://www.wsj.com/articles/apple-hands-siri-responsibil](http://www.wsj.com/articles/apple-hands-siri-responsibilities-to-executive-)it[ies-to-e](http://www.wsj.com/articles/apple-hands-siri-responsibilities-to-executive-)x[ecut](http://www.wsj.com/articles/apple-hands-siri-responsibilities-to-executive-)iv[e-](http://www.wsj.com/articles/apple-hands-siri-responsibilities-to-executive-) poached-from-google-1531261759)

China Clean Energy Fund launched

Apple and 10 of its suppliers plan to invest $300M over the next four years to create the China Clean Energy Fund. The fund will invest in green energy projects in China with the goal of increasing the use of renewable energy within Apple's supply chain.

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Congressional inquiry launched on privacy and data practices

U.S. House members have asked Alphabet and Apple to provide information on their privacy practices and handling of customer data, according to Reuters. The lawmakers' written request focused on the collection and use of audio recording data, and location data collected from Google Android or Apple iPhones, as well as third-party access to customer data.

(ht[tps://www.reuters.com/article/us-congress-priv](http://www.reuters.com/article/us-congress-privacy-tech/house-republicans-)acy[-tech/house-republicans-](http://www.reuters.com/article/us-congress-privacy-tech/house-republicans-) demand-answers-from-apple-alphabet-on-privacy-data-practices- idUSKBN1JZ2KG)

App Store marks its 10th anniversary

To help commemorate the App Store's 10-year anniversary, Apple released details about the platform, including its average 500M weekly visitors from 155 countries. Key to the App Store’s success is the variety of content from developers worldwide, with Apple noting that developers have earned over $100B from the App Store to date. Subscriptions continue to grow and as of June 2018 were up 95% Y/Y. While games and education remain important categories, health and ﬁtness have seen a “surge in popularity,” helped by the launch of Apple Watch. Downloads for Apple Watch apps and HealthKit have increased by 75% since Apple Watch's launch, and more than 500 doctors and medical researchers have used ResearchKit and CareKit in clinical trials involving more than 3M participants. The App Store remains an important component of the success of Apple’s iOS platforms, and trends in these metrics are key to evaluating the platform’s continued popularity. (ht[tps://www](http://www.apple.com/newsroom/2018/07/app-store-turns-10/)).apple[.com/newsroom/2018/07/app-store-turns-10/)](http://www.apple.com/newsroom/2018/07/app-store-turns-10/))

Japanese FTC antitrust inquiry results in contract revisions with carriers

Apple has revised its contracts with mobile carriers in Japan following the Japanese Fair Trade Commission's (FTC) investigation of Apple for the potential violation of antitrust rules, according to Reuters. The FTC, which has been looking into Apple's business practices since 2016, alleged that Apple forced Japanese wireless carriers to oﬀer discounted iPhones and to charge higher monthly subscription fees for two or four-year periods. Japanese carriers now have the option of oﬀering unsubsidized iPhones and charging lower monthly fees. (ht[tps://www.reuters.com/article/us-apple-japan-antitrust/japan-watchdog-](http://www.reuters.com/article/us-apple-japan-antitrust/japan-watchdog-) apple-may-have-breached-antitrust-rules-with-iphone-idUSKBN1K10MI)

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.