

Deutsche Bank Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

22 July 2018

Periodical

A weekly take on Apple news

For the week ending July 20, 2018

This week, Digitimes reported that iPhone X component inventories remain high, suggesting weak demand for the product, while TSMC was slightly more positive on C2H-18 smartphone demand. In other Apple news, Apple Watch is expected to be subject to U.S. tariﬀs, three key Apple India executives have left the company, and C1H-18 data showed that the App Store generated twice as much revenue as Google Play, while Google Play continues to dominate in overall downloads. Also, the last of Siri's three co-founders has retired from Apple, Chinese iCloud data will be stored by China Telecom, and Apple's self-driving car ﬂeet grew to 66 vehicles.

High iPhone X component inventories suggest lower-than-expected demand iPhone suppliers have reportedly built signiﬁcant inventories of iPhone X components, according to Digitimes. Supply chain sources suggest that the

amount of iPhone X components in inventory, including ﬁnished chassis, is nearly three times the amount of previously shipped parts, due to lower-than-expected iPhone X sales.

(ht[tps://www](http://www.digitimes.com/news/a20180716PD200.html)).digit[imes.com/news/a20180716PD200.html)](http://www.digitimes.com/news/a20180716PD200.html))

TSMC's positive C2H-18 outlook suggests improving iPhone demand expectations

C2H-18 shipments of new iPhones are expected to be a meaningful contributor to TSMC's

C2H-18 sales, according to Digitimes. Sources suggest chip shipments for new iPhones and Huawei Mate smartphones will contribute to Q/Q revenue growth for TSMC in C3Q and C4Q. On TSMC's June quarter earnings call, TSMC management commented that it sees "slight improvement" in high-end smartphone demand in C2H-18 relative to its March quarter expectations. [(http://www](http://www.tsmc.com/tsmcdotcom/ExtIRListingQuarterlyAction.do).[tsmc.com/tsmcdotcom/ExtIRListingQuarterlyAction.do?](http://www.tsmc.com/tsmcdotcom/ExtIRListingQuarterlyAction.do) action=listByYearAndQuarter&year=2018&theQuarter=2&language=E#) (ht[tps://www](http://www.digitimes.com/news/a20180716PD211.html)).digit[imes.com/news/a20180716PD211.html)](http://www.digitimes.com/news/a20180716PD211.html))

Original Apple Watch subject to new Chinese import tariﬀs

The original Apple Watch is reportedly included in the list of imported "data transmission machines" from China that are subject to the current administration's proposed 10% tariﬀ, according to Reuters. Other devices included in the category include three Fitbit trackers and three models of Sonos connected speakers.

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Companies featured

Apple Inc. (AAPL.OQ),USD191.88 Hold

2017A 2018E 2019E

EPS (USD) 9.21 11.35 12.80

P/E (x) 14.9 16.9 15.0

EV/EBITDA (x) 7.9 10.2 10.2

*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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Three key Apple India executives leave

Three key Apple executives in India, the National Sales and Distribution Chief, the Head of Telecom Carrier Sales, and the Head of Commercial Channels and Mid-market Business have all recently left the company, according to Bloomberg. The article suggests that the departures are symptomatic of Apple's challenges gaining share in the Indian market where tariﬀs on imported iPhones inﬂate the price of the devices and competition from lower priced smartphones is stiﬀ. Only the iPhone SE is exempt from the import tax because it is manufactured locally. As we wrote in June, Apple has begun production in India of iPhone 6s but is still importing the devices to supplement low initial output. We continue to believe it will be diﬃcult for Apple to gain substantial share in the Indian smartphone market due to the high market share of low-cost phones. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-07-14/apple-is-said-to-lose-)ws/art[icles/2018-07-14/apple-is-said-to-lose-](http://www.bloomberg.com/news/articles/2018-07-14/apple-is-said-to-lose-) key-sales-execs-as-india-strategy-stumbles)

App Store customers spend 2X Google Play’s in C1H-18

App Store sales continue to outpace Google Play’s and totaled $22.6B in C1H-18 vs. Google Play’s $11.8B, according to SensorTower. However, Google Play spend grew at a slightly faster clip at 30% Y/Y, compared to the App Store’s 27% growth. In addition, the number of app downloads from Google Play totaled 36B and remained well in excess of the App Store’s 15B downloads. The report notes that gaming accounted for 78% of Apple and Google’s combined C1H-18 app sales or $26.6B and grew by 19% Y/Y.

(https://sensortower.com/blog/app-revenue-and-downloads-1h-2018)

Departure of last Siri co-founder and Head of Search

Tom Gruber, Head of Siri’s Advanced Development group, and Vipul Ved Prakash, Apple’s Head of Search, have left the company, according to the Information. Tom Gruber was the last remaining of Siri's three creators at Apple and is reportedly retiring. These two departures follow last week's appointment of John Giannandrea as the new head of the Siri team, suggesting the team may be undergoing a more signiﬁcant reorganization. (ht[tps://www.macrumors.com/2018/07/18/last-siri-cof](http://www.macrumors.com/2018/07/18/last-siri-cofounder-leaves-apple/))ounder[-leaves-apple/)](http://www.macrumors.com/2018/07/18/last-siri-cofounder-leaves-apple/)) (ht[tps://www](http://www.theinformation.com/articles/siris-last-remaining-cofounder-is-out-).t[heinformation.com/articles/siris-last-remaining-cofounder-is-out](http://www.theinformation.com/articles/siris-last-remaining-cofounder-is-out-)- at-apple)

China Telecom to store Chinese iCloud data

China Telecom has signed an agreement with Guizhou-Cloud Big Data (GBCD), Apple’s Chinese iCloud partner for storage of Apple’s Chinese iCloud data, according to the Verge. The move has raised concerns over the possibility of the Chinese government accessing iCloud data given China Telecom is state-run and the encryption keys to iCloud user data are also stored in China. (ht[tps://www](http://www.theverge.com/2018/7/18/17587304/apple-icloud-china-user-data-).thev[erge.com/2018/7/18/17587304/apple-icloud-china-user-data-](http://www.theverge.com/2018/7/18/17587304/apple-icloud-china-user-data-) state-run-telecom-privacy-security)

Self-driving ﬂeet grows to 66 cars from 55

Apple has reportedly added 11 additional vehicles to its self-driving car ﬂeet since May, according to MacReports. The company's California ﬂeet now totals 66 vehicles and is the third largest self driving car ﬂeet behind GM's 117 cars and Waymo's 72 vehicles, but is ahead of Tesla's 39 cars.

(https://macreports.com/apple-expands-its-ﬂeet-of-autonomous-cars-in- california/)

*Source: IDC*

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.