

Deutsche Bank Research

Rating

Hold

North America

United States

Company

Apple Inc.

Date

31 July 2018

Results

TMT

IT Hardware and Supply Chain

Reuters

AAPL.OQ

Bloomberg

AAPL US

Exchange

NSM

Ticker

AAPL

Price at 31 Jul 2018 (USD)

Price target

52-week range

190.29

175.00

194.82 - 150.05

F3Q-18 results: No summer doldrums

Modest top-line beat, and higher guide

Apple reported better-than-expected F3Q-18 results with sales upside driven by iPhone, Services, and Wearables. While sales beat, iPhone unit growth of just 1% Y/Y remained lackluster, as iPhone sales upside continues to come from the reset higher in ASPs. EPS beat expectations by $0.18, but we estimate that just $0.04 of the beat came from revenue upside, while the remaining $0.14 was helped by below-the-line items like higher other income, a lower tax rate, and buybacks. Given its revenue base and size, Apple's recent growth has been impressive. However, with 80% of the company's sales exposed to secularly challenged businesses, we believe the long-term growth outlook remains limited. We continue to see support for the shares from the company's substantial share buyback, however, with positives and negatives largely balanced at current levels, we view valuation as fair and maintain our Hold.

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Key changes

TP 165.00 to ↑ 6.1%

175.00

EPS (USD) 11.35 to 11.79 ↑ 3.8%

Positives in the quarter

Sales grew an impressive 17% Y/Y, and mgmt guided F4Q-18 to be another strong growth quarter, with sales expected to be up 14-18% Y/Y. iPhone sales of $29.9B beat expectations and grew by 20% Y/Y, helped by a 20% Y/Y increase in ASPs to $724. Services growth was again impressive this quarter, with sales up 31% Y/ Y, and reﬂected double-digit growth in all geographies. Apple Music and iCloud sales grew more than 50% Y/Y, while Apple Pay, Apple Care, and App Store sales were at "record" levels. Growth in Wearables accelerated to more than 60% Y/Y, up from 50% last quarter, helped by mid-40% growth in Apple Watch and strong demand for AirPods and Beats headphones. China was also a bright spot again

Revenue (USDm)

200

*Source: Deutsche Bank*

Price/price relative

150

100

50

258,630.0 to ↑ 2.1%

264,005.0

Jan '17 Jul '17 Jan '18 Jul '18

this quarter, with sales up 19% Y/Y, the fourth consecutive quarter of double-digit growth in the region.

Items to monitor

iPhone units of 41.3M grew by just 0.7% Y/Y and were modestly below expectations. GMs of 38.3% declined by 20bps Y/Y and were ﬂat Q/Q as FX beneﬁts and cost eﬃciencies were oﬀset by seasonally slower sales. At the midpoint, F4Q-18 GM guidance suggests no improvement, as FX headwinds and product transition costs are expected to oﬀset any upside from stronger sales. While EPS beat expectations by $0.18, upside came from below-the-line items, and we estimate just $0.04 of the beat came from operational upside, while $0.09 came from other income and a lower tax rate, and the remaining $0.05 was helped by higher share buybacks versus our model.

**Apple Inc. S&P 500 INDEX (Rebased)**

Performance (%) 1m 3m 12m

Absolute 2.8 15.1 27.9

S&P 500 INDEX 3.1 5.8 13.5

*Source: Deutsche Bank*

*Please see our variance charts for F3Q-18 and F4Q-18 on p.3-4.*

Modestly raising estimates and PT to $175; maintain Hold

We have raised our estimates to reﬂect higher iPhone ASPs and stronger Services as well as more signiﬁcant share buybacks. As a result of our higher EPS, our PT increases to $175 from $165 which is based on 13x our updated FY-19E EPS of $13.30, in line with the company's historical average. Positive risks: stronger- than-expected smartphone sales, share gains, and signiﬁcantly higher margins. Negatives: slower smartphone sales, and market share losses.

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# 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.

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