

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

4 August 2017

Periodical

A weekly take on Apple news

For the week ending August 4, 2017

The big Apple news this week was the company's June quarter earnings, where results beat expectations driven by very strong iPad sales and higher Services revenue. Also this week, IDC data showed modest iPhone share gains in C2Q-17 in a modestly declining smartphone market, Apple removed VPNs from its China App Store, and a judge is allowing a class action suit regarding FaceTime to proceed. HomePod code for developers suggests the upcoming iPhone could feature face unlock technology, Apple is looking for tax breaks for suppliers in India, and Apple's beta testing platform for apps has been expanded to support 10,000 users.

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Apple F3Q-17 results unlikely to change views

Apple reported better-than-expected results for the June quarter, with units and sales in all three of Apple's hardware categories growing Y/Y for the ﬁrst time since F1Q-14. iPad was the standout in the Q with 15% Y/Y unit growth and 2% Y/Y sales growth driven by recent new device launches and strength in U.S. education. Services growth accelerated to 22% Y/Y, up from 18% Y/Y last quarter. iPhone unit shipments of 41M were modestly ahead of expectations, but ASPs and sales missed expectations. On the negative side, China sales declined 10% Y/ Y, the sixth consecutive quarter of declines in this region. Mgmt delivered a good quarter, in our view, but we continue to believe the market is overly optimistic on future iPhone sales. Given a saturated smartphone market, elongating refresh cycles, increased competition in China, and a growing secondary market, we think Apple may have a hard time delivering on Street expectations.

(<http://pull.db-gmresearch.com/cgi-bin/pull/DocPull/1428-15E9/283166755/> eaba5596-ad22-497e-a974-4ea17e52b7a4\_604.pdf)

IDC C2Q-17 smartphone data shows market declined; modest iPhone share gains Y/Y

Global smartphone unit sales fell 1.3% Y/Y and 0.8% sequentially in C2Q-17 to 341.6M units, according to preliminary data released by IDC. Samsung maintained the top market position with 23.3% share, with share up 60bps Y/Y, while Apple continues to hold the second spot with 12.0% share, up 30bps Y/Y. The big winners, however, were Chinese vendors, who each gained 150-200bps of share Y/Y. Huawei remained the third largest provider with 11.3% share, followed by OPPO at 8.1%, and vivo with 6.2% share.

Deutsche Bank Securities Inc.

Top picks

Apple Inc. (AAPL.OQ),USD157.14 Hold

*Source: Deutsche Bank*

Companies featured

Apple Inc. (AAPL.OQ),USD157.14 Hold

2016A 2017E 2018E

|  |  |  |  |
| --- | --- | --- | --- |
| EPS (USD) | 8.31 | 9.06 | 9.87 |
| P/E (x) | 12.6 | 17.4 | 15.9 |
| EV/EBITDA (x) | 6.0 | 9.4 | 8.6 |
| *Source: Deutsche Bank* |  |  |  |

*Our price target is based on shares trading at 14x our FY-19E EPS. 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. Negative risks include slower smartphone sales, market share losses in smartphones, and weaker growth in Services sales.*

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(<http://www.businesswire.com/news/home/20170427005931/en/Worldwide-> Smartphone-Market-Gains-Steam-Quarter-2017)

VPNs pulled from Chinese App Store

Apple has removed all virtual private network (VPN) apps from its Chinese App Store, due to new government rules requiring VPNs to receive state approval before doing business. VPNs allow users in China to access the internet without any limitations. Other large companies operating in the region, like Amazon, are also informing customers that they cannot use VPNs due to the ruling. (https://techcrunch.com/2017/07/29/apple-removes-vpn-apps-from-the-app- store-in-china)

FaceTime class action suit moving forward

A U.S district judge ruled that older iPhone users can proceed with a nationwide class action lawsuit against Apple regarding the video conferencing app, FaceTime. The suit claims Apple intentionally disabled the FaceTime feature on older iOS devices in order to cut costs.

(https://[www.reuters.com/article/us-apple-lawsuit-facetime-idUSKBN1AG1PJ)](http://www.reuters.com/article/us-apple-lawsuit-facetime-idUSKBN1AG1PJ))

HomePod ﬁrmware suggests iPhone 8 may feature facial recognition

With the introduction of Apple 's HomePod ﬁrmware, developers have been analyzing the code for insights on the smart speaker. The HomePod is expected to run on a version of iOS, and its ﬁrmware is believed to be very similar to that of the upcoming iPhone 8. According to developer Steve Troughton-Smith, the code also suggests the next-generation iPhone will feature an infra-red face unlock function.

(https://9to5mac.com/2017/07/30/iphone-8-design-and-face-unlock-homepod- code/)

Apple looking for wider tax beneﬁts in India

Apple is seeking tax concessions for its suppliers in India, according to Reuters. The move is motivated by Apple's interest in creating a production hub for iPhones and related components in the country. Indian government oﬃcials noted that the extension of tax beneﬁts to suppliers could require new policy to be adopted in order to provide a level playing ﬁeld for all smartphone manufacturers. (<http://www.reuters.com/article/us-apple-india-idUSKBN1AH499)>

TestFlight beta testing platform expanding to support up to 10,000 users Apple's TestFlight platform, which allows developers to trial their apps before release to the App Store, is now able to support a maximum of 10,000 users,

up from 2,000 users previously. Apple has also recently extended the evaluation period of beta apps on the platform to 90 days, from 60 days, in order to help developers concurrently assess diﬀerent app versions. ([http://appleinsider.com/articles/17/07/31/apples-testﬂight-beta-testing-platform-](http://appleinsider.com/articles/17/07/31/apples-test%EF%AC%82ight-beta-testing-platform-) now-supports-up-to-10000-users)

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 15x. 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 14x 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.