

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 August 3, 2018

Apple's June quarter earnings report, which helped drive Apple to a trillion dollar market cap this week, was the highlight of Apple-related news. In C2Q-18, Apple continued to see better-than-expected iPhones sales, supported by higher ASPs, and saw strong growth in Services and Wearables. Also of interest, IDC data showed iPhone moving into third place in a declining global C2Q-18 smartphone market and iPad continuing to dominate the global tablet market, while C2Q-18 CIRP data placed Apple ﬁfth in a declining Chinese smartphone market. In addition, survey data suggests HomePod has 6% share in the U.S. smart speaker market, Apple's 10Q warns of tariﬀ-related risks, Apple is looking to partner with Chinese telecoms to reduce spam, Apple has been ordered to pay WiLan $145M for a patent infringement, and South Korea plans to start taxing Apple.

F3Q-18 results: modest topline beat and higher guide

Apple reported better-than-expected F3Q-18 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. Apple Music and iCloud services grew by 50% Y/Y, while Apple Pay, Apple Care, and App Store sales were at "record" levels. Mid-40% growth in Apple Watch and robust demand for AirPods and Beats headphones contributed to an acceleration in Wearables growth to 60% Y/Y, up from 50% last quarter. The company also recorded 19% Y/Y growth in China sales, the fourth consecutive quarter of double-digit growth in the region. Guidance for F4Q-18 sales was modestly ahead of the Street. ( [Link](https://research.db.com/Research/api/1.0/file/2795-b1db71ee_94a7_11e8_96e2_df45ec77c0b4_604?fileToken=YYY122_OV9hF31drTs57SP9g1MsjrwGVrEcsoP4qefvA8XzqswqQapYETvN1%2bRWzJrBt0gTvLI8ySfc4rHk8sY4814LY%2fZvBdZ1lw5YFTpSvQjZjsU%3d) )

Apple loses second place spot in C2Q-18 worldwide smartphone market Worldwide smartphone shipments reached 342M units in C2Q-18, and declined by 2% Y/Y, according to preliminary IDC data. Apple moved from second to third

place in the market with 12% share, and was displaced by Huawei who came in second in the market with 16% share. Apple gained 30bps of share Y/Y and units grew by 1% Y/Y, while Huawei's share increased by 5ppt Y/Y and units grew by 41% Y/Y. Samsung remained the market leader with 21% market share, despite a 10% Y/Y decline in shipments. (ht[tps://www.idc.com/getdoc.jsp?containerId=prUS44188018](http://www.idc.com/getdoc.jsp?containerId=prUS44188018) )

iPad gains share in declining C2Q-18 tablet market

C2Q-18 worldwide tablet shipments of 30M fell by 14% Y/Y, according to IDC. Apple remained the market leader with 35% market share, up 5ppts Y/Y. Samsung

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Companies featured

Apple Inc. (AAPL.OQ),USD207.39 Hold

2017A 2018E 2019E

EPS (USD) 9.21 11.79 13.30

P/E (x) 14.9 17.6 15.6

EV/EBITDA (x) 7.9 11.0 11.1

*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.*

maintained its position in second place with 15% share, followed by Huawei with 10%. iPad units grew by 1% Y/Y, helped by the release of newer models, a new operating system release, and focus on the Education market. Samsung lost 50bps of share Y/Y and units declined by 16% Y/Y, reﬂecting ongoing weakness in the lower-cost slate category. (ht[tps://www.idc.com/getdoc.jsp?containerId=prUS43549518](http://www.idc.com/getdoc.jsp?containerId=prUS43549518) )

Apple remains ﬁfth in China's C2Q-18 smartphone market

Chinese smartphone shipments fell by 7% Y/Y in C2Q-18, according to Counterpoint Research, and declined for a fourth consecutive quarter. Apple maintained ﬁfth place in the market with 9% share, up 1ppt Y/Y, and unit shipments were ﬂat Y/Y. Huawei remained the market leader with 26% share, a 6ppt gain Y/Y, and shipments grew by 22% Y/Y. (ht[tps://www.counterpointresearch.com/china-smartphone-mark](http://www.counterpointresearch.com/china-smartphone-market-declined-)et[-declined-](http://www.counterpointresearch.com/china-smartphone-market-declined-) fourth-consecutive-quarter-q2-2018/ )

Survey suggests HomePod has 6% U.S. market share

According to a Consumer Intelligence Research Partners (CIRP) July survey of 500 U.S. smart speaker owners, Apple's HomePod had 6% market share. Amazon Echo reportedly led the market with 70% share followed by Google Home with 24% share. CIRP estimates that the U.S. installed smart speaker market totaled 50M units and that one-third of Amazon and Google users own multiple units. [(http://ﬁles.constantcontact.com/150f9af2201/12df3eb8-](http://ﬁles.constantcontact.com/150f9af2201/12df3eb8-)

f7ef-4258-915c-23a8c4170f79.pdf? AID=10296303&PID=6165691&SID=jke632efcc003n6p05xg3&pn=cjaﬃliate)

10-Q ﬁling warns of negative eﬀects of newly proposed tariﬀs on Chinese imports

In Apple's recent 10-Q ﬁling with the SEC, the company has expanded its risk factor section to include the negative potential impact of tariﬀs and international trade disputes. As we wrote in Slices a few weeks ago, the most recently proposed

U.S. tariﬀs on Chinese goods would include Apple Watch. (ht[tps://www.sec.gov/Archives/edgar/](http://www.sec.gov/Archives/edgar/) data/320193/000032019318000100/0000320193-18-000100-index.htm) (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-08-01/apple-warns-on-impact-)ws/art[icles/2018-08-01/apple-warns-on-impact-](http://www.bloomberg.com/news/articles/2018-08-01/apple-warns-on-impact-) of-trade-disputes-protectionism-in-ﬁling)

Apple under ﬁre to reduce iMessage spam in China

Apple is reportedly exploring methods to block or limit spam in iMessages with Chinese telecom companies, according to Reuters. The eﬀorts are in response to the Chinese government's criticism of Apple for not ﬁltering prohibited content on its iMessage service.

(ht[tps://www.reuters.com/article/us-china-apple/apple-in-touch-with-chinese-](http://www.reuters.com/article/us-china-apple/apple-in-touch-with-chinese-) telcos-on-ways-to-cut-spam-idUSKBN1KN0VB)

Apple ordered to pay WiLan $145M for patent infringement

A U.S. jury has ordered Apple to pay WiLan, a Canadian patent licensing company, $145M in damages for infringing two wireless communications technology patents, according to Reuters. Apple is reportedly planning to appeal the decision.

(ht[tps://www.reuters.com/article/us-apple-la](http://www.reuters.com/article/us-apple-lawsuit-wilan/u-s-jury-asks-apple-to-)wsuit[-wilan/u-s-jury-asks-apple-to-](http://www.reuters.com/article/us-apple-lawsuit-wilan/u-s-jury-asks-apple-to-) pay-145-million-in-damages-to-canadas-wilan-idUSKBN1KN05B)

South Korea planning to tax Apple

South Korea has accused global IT companies, including Apple, Amazon, and Google, of tax avoidance and is planning to begin taxing them, according to the Korea Times. [(http://www.koreatimes.co.kr/www/tech/2018/08/129\_253245.html)](http://www.koreatimes.co.kr/www/tech/2018/08/129_253245.html))

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.