

Deutsche Bank Markets 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 11, 2017

The timing and features of the upcoming new iPhone models continued to dominate Apple news this week with reports from the supply chain suggesting all three upcoming iPhones have entered mass production. Further analysis of HomePod ﬁrmware suggests the new iPhone will feature advanced facial recognition technology that can function while resting on a table and support third-party apps. In other news, ITC is investigating Qualcomm's claims against Apple, 28 app developers have ﬁled a complaint against Apple in China, upcoming Apple Watches are expected to feature direct connectivity to cellular networks, and Apple Watch was in third place in Canalys' C2Q-17 tally of global wearable bands. Also of interest, Indian company Eros is exploring the sale of its movie library to Apple for $1B and Carpool Karaoke rolled out this week on Apple Music.

[Sherri Scribner](mailto:sherri.scribner@db.com)

Research Analyst

+1-212-250-5734

[Adrienne Colby](mailto:adrienne.colby@db.com) Associate Analyst

+1-212-250-0948

[Jeﬀrey Rand, CFA](mailto:jeffrey.rand@db.com) Research Associate

+1-212-250-0639

Companies featured

iPhone production building momentum into new launch

The majority of component and services suppliers in the iPhone supply chain have reported strong July sales, signaling that iPhone production is gathering momentum, according to industry sources. Sources reported by Digitimes suggest that all three new iPhone models have entered mass production and high levels of consumer demand are expected to result in record high volumes for suppliers.

[(http://www.digitimes.com/news/a20170809PD205.html?mod=2)](http://www.digitimes.com/news/a20170809PD205.html?mod=2))

HomePod ﬁrmware points to advanced facial recognition technology in new iPhone

Further analysis of Apple’s HomePod ﬁrmware suggests that the upcoming high-end iPhone will feature facial recognition technology that can function even when the device is placed on a ﬂat surface, according to Techcrunch. The report also indicates that the device's facial recognition technology would support third-party apps. As we wrote in last week's Slices, an initial analysis of the HomePod code suggested that the upcoming iPhone would feature an infra-red face unlock function. Reports that the new iPhone will incorporate facial recognition technology furthers speculation that Apple may drop Touch ID ﬁngerprint scanning in upcoming devices. (https://techcrunch.com/2017/08/07/iphone-8-could-scan-your-face-even-if-your- phone-is-on-a-table/)

ITC initiates an investigation into Apple

Apple Inc. (AAPL.OQ),USD155.32 Hold

2016A 2017E 2018E

EPS (USD) 8.31 9.06 9.87

P/E (x) 12.6 17.2 15.7

EV/EBITDA (x) 6.0 9.2 8.5

*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.*

Qualcomm announced that the U.S. International Trade Commission (ITC) has initiated an investigation into Apple. The investigation stems from a complaint made by Qualcomm, alleging that Apple engaged in unfair trade practices by importing and selling mobile devices in the U.S. that infringe its patents. Qualcomm is seeking to block the importation and sale of iPhones and iPads in the U.S. that do not feature Qualcomm processors. (ht[tps://www.qualcomm.com/news/releases/2017/08/08/us-international-trade-](http://www.qualcomm.com/news/releases/2017/08/08/us-international-trade-) commission-pursue-investigation-apple)

Chinese app developers ﬁle oﬃcial complaint against Apple

Twenty-eight app developers have ﬁled an oﬃcial complaint against Apple with two Chinese regulators, according to the Wall Street Journal. The developers allege that Apple behaves like a monopoly, by charging "excessive" fees for in-app purchases, removing apps from the App Store without justiﬁcation, and refusing to interact with local developers in the Chinese language. It is unclear if the two regulators will investigate the complaint.

(ht[tps://www.wsj.com/articles/chinese-app-de](http://www.wsj.com/articles/chinese-app-developers-%EF%AC%81le-antitrust-complaint-)v[elopers-ﬁle-antitrust-complaint](http://www.wsj.com/articles/chinese-app-developers-%EF%AC%81le-antitrust-complaint-)- against-apple-1502347222?mod=rss\_Technology)

New Apple Watch may feature cellular technology

Apple’s next Apple Watch will feature LTE chips provided by Intel, according to Bloomberg. The chips will allow the watch to connect directly to cellular networks without requiring an iPhone, in order to stream music, send messages, or perform other tasks. Apple is reportedly in discussions with U.S. and European mobile carriers regarding the introducing of the cellular-supported Apple Watch but the launch could be postponed beyond 2017. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2017-08-04/apple-said-to-ready-)ws/art[icles/2017-08-04/apple-said-to-ready-](http://www.bloomberg.com/news/articles/2017-08-04/apple-said-to-ready-) cellular-capable-watch-to-break-iphone-ties)

Apple Watch in third place in C2Q-17 wearable band market

According to Canalys, the global wearable band market grew 8% Y/Y in C2Q-17. Xiaomi led the market with 3.5M shipments, followed by Fitbit with 3.3M units, and Apple with 2.7M. Canalys anticipates stronger growth in the market in C2H-17 due to demand for cellular-enabled smart watches. (ht[tps://www.canalys.com/ne](http://www.canalys.com/newsroom/apple-falls-third-place-q2-2017-wearable-)wsr[oom/apple-f](http://www.canalys.com/newsroom/apple-falls-third-place-q2-2017-wearable-)al[ls-third-place-q2-2017-wearable-](http://www.canalys.com/newsroom/apple-falls-third-place-q2-2017-wearable-) band-market-smartwatches-receive-boost-second-half)

Eros in discussions to sell its content library to Apple

Indian movie producer Eros Group is reportedly considering selling its music and ﬁlm content library to Apple for roughly $1B. According to The Economic Times of India, Eros is also conducting parallel discussions with Amazon and Netﬂix. Eros has a library of more than 3,000 Indian ﬁlms, while its digital platform, Eros Now, has rights to more than 10,000 ﬁlms. [(http://economictimes.indiatimes.com/industry/media/entertainment/media/](http://economictimes.indiatimes.com/industry/media/entertainment/media/) eros-group-in-talks-with-apple-to-sell-its-content-library-of-movies-and-music- for-around-1-billion/articleshow/59946497.cms)

Carpool Karaoke debuts on Apple Music

Apple debuted the ﬁrst episode of its original show Carpool Karaoke, on Apple Music, featuring host James Corden with guest Will Smith. This is Apple's second original series, after Planet of the Apps. (https://techcrunch.com/2017/08/09/carpool-karaoke-debuts-on-apple-music-

for-some-reason/)

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.