

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 10, 2018

In a fairly quiet Apple news week, the key Apple-related news was the factory shutdown at Apple supplier TSMC due to a computer virus. In other news, regulatory issues in India continue to plague the iPhone and the U.S. government questioned Apple about privacy and whether or not the iPhone listens to users without their consent. Also of interest, Apple rehired a former employee who had recently been at Tesla, Apple joined a smart-home mesh networking group as a potential step in expanding the capabilities of HomeKit, iOS Health Records greatly increased the number of health institutions it supports, and Verizon and Apple are partnering to oﬀer Verizon unlimited customers 6 months of Apple Music for free. Also, Apple's main high-end smartphone competitor Samsung released the latest version of its high-end Galaxy Note 9.

Apple supplier TSMC’s shuts down production due to virus

Chip supplier Taiwan Semiconductor Manufacturing Co. (TSMC) had to shut down some of its factories last weekend due to a computer virus. The virus was believed to be a variation of the WannaCry ransomware that was responsible for a widespread global attack on Windows computers in May 2017. By Monday, TSMC was fully operational again, however, TSMC’s CFO indicated that the company’s 2018 proﬁt and third quarter gross margins would be negatively impacted. Apple is a major TSMC customer for iPhone chips, and while TSMC declined to comment on the impact to speciﬁc customers, we do not expect the event to have a meaningful impact on the roll-out of the next iPhone. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2018-08-06/iphone-chipmaker-)ws/art[icles/2018-08-06/iphone-chipmaker-](http://www.bloomberg.com/news/articles/2018-08-06/iphone-chipmaker-) blames-wannacry-variant-for-plant-closures)

Apple continues to face regulatory issues in India

Apple continues to risk being kicked oﬀ mobile networks in India as it refuses to comply with the Telecom Regulatory Authority of India's (TRAI) requirement to add an anti-spam app to the App store. Apple contends that the app violates its policies as it allows third parties to track users. Last month, the Indian government told telecom companies that they have six months before they have to derecognize (remove) non-compliant devices from their networks. Reuters reports that in June, Apple wrote a letter to the Indian government asking for the "derecognition from the networks" clause to be dropped. When Reuters reached out to the TRAI, its chairman indicated that this issue would best be challenged in court and not through a letter. Apple's regulatory headwinds in India will be an important issue to monitor going forward as India is the second largest

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Companies featured

Apple Inc. (AAPL.OQ),USD207.25 Hold

2017A 2018E 2019E

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| --- | --- | --- | --- |
| 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.*

smartphone market in the world and Apple has thus far failed to gain meaningful market share in the country. [(Link)](https://www.reuters.com/article/us-apple-india/apples-mettle-in-india-tested-in-squabble-over-anti-spam-app-idUSKBN1KU0JT?feedType=RSS&amp;feedName=technologyNews&amp;utm_source=feedburner&amp;utm_medium=feed&amp;utm_campaign=Feed%3A%2Breuters%2FtechnologyNews%2B%28Reuters%2BTechnology%2BNews%29)

Apple informs U.S. lawmakers that iPhones do not listen to users

In response to a letter from the U.S. House Energy and Commerce Committee over invading users' privacy, Apple responded that its iPhones do not listen to users without their consent and the company does not allow third-party apps to access user conversations without explicit approval. However, in the letter responding to U.S. lawmakers, Apple did note that it "does not and cannot" monitor what apps do with the customer data that third parties collect. Privacy remains a key issue for lawmakers and consumers and we expect Apple to continue to face questions over how it protects users' data. (ht[tps://www.cnbc.com/2018/08/08/apple-tel](http://www.cnbc.com/2018/08/08/apple-tells-lawmakers-iphones-are-not-)ls-la[wmakers-iphones-are-not](http://www.cnbc.com/2018/08/08/apple-tells-lawmakers-iphones-are-not-)- listening-in-on-consumers.html)

Recent hire highlights potential renewed focus on Project Titan

Apple has reportedly rehired Doug Field, who most recently worked at Tesla in the development of new Tesla vehicles. Mr. Field previously worked at Apple as VP of Mac hardware engineering, and left the company in 2013 to join Tesla. During his Apple tenure, Mr. Field's worked closely on Mac hardware with Bob Mansﬁeld, who is now leading Apple's car-related initiative Project Titan. Considering his relationship with Mr. Mansﬁeld and his background at Tesla, many believe the he will be working on the Project Titan team. (https://9to5mac.com/2018/08/09/doug-ﬁeld-returns-to-apple/)

Apple joins smart home mesh networking organization

Apple has reportedly joined the Board of Directors of Thread Group as a sponsor. The group supports the smart home mesh networking solution, Thread, which is an alternative to connecting smart home devices through WiFi and allows diﬀerent devices to speak directly to each other, rather than through a router, helping extend the range and usability of smart devices. While Apple has not commented on its reasoning for joining the Thread Group, it is possible that Apple is looking to expand the capabilities of its HomeKit to work more seamlessly with a larger range of smart home devices. (https://appleinsider.com/articles/18/08/06/apple-joins-smart-home-mesh- networking-standards-group-thread)

iOS Health Records now has 77 health institutions

iOS Health Records now supports 77 diﬀerent health institutions, which is up from 12 earlier this year. By allowing consumers to access their health records on their iPhones, Apple is hoping to make it quicker and cheaper for consumers to access their critical personal health data. Healthcare provides a large opportunity for tech companies and we believe Apple's large installed base of devices positions it well to beneﬁt from the increasing use of technology in healthcare. (https://venturebeat.com/2018/08/08/apple-says-ios-health-records-has-over-75- backers-uses-open-standards/)

Verizon partners with Apple to oﬀer six months free of Apple Music

Starting August 16, both new and existing Verizon unlimited customers will be entitled to receive a free six-month subscription to Apple Music. Following the free subscription period, the service will be priced at the standard $9.99 per month rate. Apple Music continues to see strong growth, with Apple most recently disclosing that it had 40M paid subscribers, however, Apple still trails market leader Spotify with 83M users.

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Samsung unveils the Galaxy Note 9

On Thursday, Samsung released the latest version of its high-end smartphone, the Galaxy Note 9. The phone starts at $1,000 with Samsung oﬀering 128GB and 512GB storage options. The major upgrade versus the Note 8 model is the phone's stylus pen, which now oﬀers Bluetooth connectivity for additional functionality, including changing a song or switching the camera mode directly from the pen. Other key upgrades include a new AI camera feature and an upgraded processor. (ht[tps://www.cnet.com/re](http://www.cnet.com/reviews/samsung-galaxy-note-9-preview/))vie[ws/samsung-galaxy-note-9-pre](http://www.cnet.com/reviews/samsung-galaxy-note-9-preview/))vie[w/)](http://www.cnet.com/reviews/samsung-galaxy-note-9-preview/))

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.