

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

18 August 2017

Periodical

A weekly take on Apple news

For the week ending August 18, 2017

Apple's plans to spend $1B to develop original video content ﬁgured heavily in Apple related news this week, with Bloomberg reporting the company continues to work with movie studios for digital rentals of new releases. Also this week, TrendForce data showed double-digit C2Q-17 growth in MacBook shipments Q/ Q and modest share gains. Aetna and Apple are in discussions to oﬀer Apple Watch to Aetna’s 23M members and the new Apple Watch 3 is expected to launch by year-end. Also, Apple joined other tech companies to seek greater privacy protection from the Supreme Court of cellphone location data and the Irish government is in discussions with Apple to protect itself from losses as it helps the company with its EU tax dispute. Scribner's Slice of Apple will be oﬀ until Labor Day and will return in September. Enjoy the end of summer!

Apple to spend $1B on original content

Apple has allocated $1B for the creation of original content over the next year according to The Wall Street Journal. The company entered the original content market this year with the release of two shows, Carpool Karaoke and Planet of the Apps, and reportedly plans to add up to 10 more new shows next year. According to DB Media, Cable & Satellite analyst Bryan Kraft, Apple's planned content budget is small relative to competitors like Netﬂix who plans to spend

$7B next year, Amazon who plans to spend $4-5B, and HBO who spends around

$2B annually. We note that Apple hired two Sony Pictures Television executives in June and we view the $1B commitment as a natural, albeit relatively conservative, next step in the development of a video strategy. (ht[tps://www.wsj.com/articles/apple-readies-1-bil](http://www.wsj.com/articles/apple-readies-1-billion-war-chest-for-hollywood-)lion-w[ar-chest-for-hollywood-](http://www.wsj.com/articles/apple-readies-1-billion-war-chest-for-hollywood-) programming-1502874004)

Talks to oﬀer digital rentals of new movie releases still ongoing

Apple and Comcast continue to have discussions with movie studios to provide downloads of new movies within weeks of their theater debut, according to Bloomberg. While months of negotiations have yet to result in an agreement, talks are ongoing and a deal cold be reached by early next year. Distributors, including Apple, and studios are both interested in developing a $30-50 premium video on demand (PVOD) oﬀering. However, a PVOD product would require studios to reach an agreement with movie theaters, which they have not been able to do thus far.

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Companies featured

Apple Inc. (AAPL.OQ),USD157.86 Hold

2016A 2017E 2018E

EPS (USD) 8.31 9.06 9.87

P/E (x) 12.6 17.4 16.0

EV/EBITDA (x) 6.0 9.4 8.7

*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*

Strong C2Q-17 growth in MacBook shipments

TrendForce reported that worldwide notebook shipments reached 39.96M units in C2Q-17, up 5.7% Q/Q and 3.6% Y/Y, driven by biddings for notebook contracts in North America and the introduction of new notebook models. Apple’s MacBook unit shipments grew by 17.1% Q/Q to 3.98M, due in part to demand for the updated 12-inch MacBook. Apple maintained the ﬁfth position in the market and increased its market share by 100bps Q/Q to 10.0% during the quarter. TrendForce expects double-digit Q/Q growth for MacBook shipments in C3Q-17. [(http://press.trend](http://press.trendforce.com/press/20170815-2930.html))f[orce.com/press/20170815-2930.html)](http://press.trendforce.com/press/20170815-2930.html))

Aetna in talks to oﬀer Apple Watches to its members

Apple and Aetna have reportedly held several rounds of “secret” discussions to oﬀer free or discounted Apple Watches to Aetna’s 23M members, according to CNBC. Aetna already oﬀers the Apple Watch to its 50K employees as part of its corporate wellness program.

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Apple Watch 3 to arrive at the end of 2017 but unlikely to drive Y/Y unit growth Apple's upcoming Watch, the Apple Watch series 3, is expected to be introduced by the end of the year, according to The Economic Daily News of Taiwan.

According to the report, the next-generation Apple Watch will feature a call function, improved battery life, and LTE connectivity. Currently the device is in the ﬁnal stages of testing and is expected to enter mass production in C4Q-17. A separate report suggests Apple Watch unit shipments could reach 4.5M in C4Q-17 which would reﬂect a 2% decline Y/Y. Supply chain sources anticipate 20M Apple Watch shipments in CY-18, a 5M increase over CY-17. [(http://www.digitimes.com/news/a20170817VL203.html)](http://www.digitimes.com/news/a20170817VL203.html)) [(http://www.digitimes.com/news/a20170817PD208.html)](http://www.digitimes.com/news/a20170817PD208.html))

Technology companies seek Supreme Court protection of cellphone location data

Apple and several leading technology companies, including Facebook, Google, and Microsoft requested that the U.S. Supreme Court limit police access to smartphone location data. Speciﬁcally, the companies ﬁled a brief in an existing case, asking the court to require law enforcement to obtain a warrant in order to access a suspect's smartphone location. (ht[tps://www.recode.net/2017/8/15/16151676/apple-facebook-google-snap-](http://www.recode.net/2017/8/15/16151676/apple-facebook-google-snap-) supreme-court-privacy-carpenter-united-states)

Irish government to be protected while holding Apple tax money

The Irish government and Apple are ﬁnalizing a deal to protect the government from losses that it may incur while managing Apple’s back-taxes, according to Bloomberg. The Irish government will manage funds recovered from Apple until the company is able to appeal the European Commission’s ruling, which could take ﬁve years.

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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.