

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 September 8, 2017

More reports of expected delays in iPhone production for the high-end OLED model surfaced this week, with the WSJ reporting a one-month delay due to technical issues with the OLED screen. Apple is reportedly oﬀering support for three outstanding bids for Toshiba's memory business, while responsibility for Siri has moved to the head of Apple's operating systems business, Craig Federighi. In other news, Apple has hired four more former TV executives and is reportedly bidding on James Bond distribution rights, LG is likely to supply iPhone OLED by 2019, and Apple will assume all production capacity from Largan's new lens module facility. Also, Apple has negotiated a new deal with Warner Bros for music content, canceled its annual London music festival, and blocked India's anti-spam app from the App Store.

More reports of production delays for new high-end iPhone

According to the WSJ, technical headwinds related to the OLED display are likely to delay production of the upcoming high-end iPhone by one month. In addition, Foxconn, the company assembling the new iPhones, is reportedly oﬀering bonuses to employees who recruit new hires. A separate TechCrunch report suggests that the new high-end iPhone will begin shipping only after the other two more basic models (expected to be named iPhone 7s and 7s plus). (ht[tps://www.wsj.com/articles/iphones-summer](http://www.wsj.com/articles/iphones-summer-production-glitches-create-)-pr[oduction-glitches-create-](http://www.wsj.com/articles/iphones-summer-production-glitches-create-) holiday-jitters-1504801636)

(https://techcrunch.com/2017/09/07/high-end-iphone-to-ship-after-standard- models/)

Apple bidding for Toshiba's memory business

Apple is reportedly participating in bids for Toshiba's chip business, according to Reuters. There are three publicly known bids for the business backed by KKR, Bain Capital, and Foxconn and Apple is thought to have agreed to ﬁnancially support each. According to a separate Reuters report, Apple has threatened to boycott Western Digital (WDC) products if the chip company takes a controlling stake in Toshiba’s memory business, as Apple fears it will lose pricing power. Toshiba has been in the process of trying to sell or spin oﬀ its memory chip business to a third party, as the company works to stabilize its remaining businesses. [(http://www.reuters.com/article/us-toshiba-accounting-apple/western-digital-](http://www.reuters.com/article/us-toshiba-accounting-apple/western-digital-) seeks-y50-billion-from-apple-to-help-ﬁnance-toshiba-chip-bid-kyodo- idUSKCN1BJ0QC?

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Companies featured

Apple Inc. (AAPL.OQ),USD161.91 Hold

2016A 2017E 2018E

EPS (USD) 8.31 9.06 9.87

P/E (x) 12.6 17.9 16.4

EV/EBITDA (x) 6.0 9.7 9.0

*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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Siri reassigned to Craig Federighi

Responsibility for Siri, Apple's voice assistant, has been moved to Craig Federighi the Head of Operating Systems, according to Reuters. Eddy Cue, Apple's Head of Content, had managed Siri since 2012. The shift in responsibility could signal plans to integrate Siri more deeply into Apple's core operating systems. (ht[tps://www.reuters.com/article/us-apple-siri/apple-shifts-responsibil](http://www.reuters.com/article/us-apple-siri/apple-shifts-responsibility-for-siri-)ity-f[or-siri-](http://www.reuters.com/article/us-apple-siri/apple-shifts-responsibility-for-siri-) to-operating-system-chief-idUSKCN1BC65B)

Additional hires to support development of video content

Apple has hired three Sony Television executives and a WGN executive to further support its video strategy, according to Variety. Kim Rozenﬁeld, a former Sony programming executive, will head Apple's documentary series development. Max Aronson, who worked in drama development at Sony, and Ali Woodruﬀ, who was a head of creative aﬀairs, will work as development executives at Apple. Rita Cooper Lee, formerly a publicity head at WGN, will be a lead commutations director of video eﬀorts at Apple. We note that in June, Apple hired two other Sony Television executives, Jamie Erlicht and Zack Van Amburg. [(http://variety.com/2017/digital/news/apple-zack-van-amburg-jamie-erlicht](http://variety.com/2017/digital/news/apple-zack-van-amburg-jamie-erlicht-)- video-1202468110/)

Amazon and Apple pitching for James Bond distribution rights

Amazon and Apple are reportedly competing with Warner Bros. to secure ﬁlm distribution rights for the James Bond franchise, according to the Hollywood Reporter. Ex-Sony executives Erlicht and Van Amburg are reportedly spearheading Apple's negotiations. Sources suggest the franchise, which is universally well-known, could be valued in the $2-$5B range. [(http://www.hollywoodreporter.com/heat-vision/apple-amazon-join-race-james-](http://www.hollywoodreporter.com/heat-vision/apple-amazon-join-race-james-) bond-ﬁlm-rights-1035539)

LG Display to supply OLED for iPhones from 2019

LG Display is planning to supply OLED displays for iPhones starting in 2019, according to Bloomberg. While some OLED supply from LG may be available in late 2018, Samsung is expected to initially provide the bulk of Apple's OLED screen supply. LG Display has reportedly found it diﬃcult to acquire the necessary evaporation machines for OLED manufacturing, since Samsung had already booked "years of orders" for the machines from a key supplier. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2017-09-07/apple-lg-said-to-)ws/art[icles/2017-09-07/apple-lg-said-to-](http://www.bloomberg.com/news/articles/2017-09-07/apple-lg-said-to-) discuss-oled-deal-for-supplies-starting-2019)

Apple to use all of Largan's new facility capacity

Apple has reportedly reserved the entire production capacity for above 12- megapixel lens modules at Largan Precision's new manufacturing facility, according to Digitimes. The central Taiwanese factory is expected to begin production in October 2017. [(http://www.digitimes.com/news/a20170905PD200.html)](http://www.digitimes.com/news/a20170905PD200.html))

New deal ﬁnalized with Warner Music

Apple has secured a new music deal with Warner Music Group and is ﬁnalizing a new deal with Sony Music Entertainment, according to Bloomberg. Through the new agreements, Apple is expected to pay record labels lower royalty fees for music content sold through iTunes and Apple Music services.

(ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2017-09-06/apple-is-said-to-reach-)ws/art[icles/2017-09-06/apple-is-said-to-reach-](http://www.bloomberg.com/news/articles/2017-09-06/apple-is-said-to-reach-) music-deal-with-warner-sony-pact-next)

Apple Music festival discontinued

Apple has canceled its annual Apple Music festival in London. The event debuted in 2007 as the iTunes festival, but was renamed in 2015 as the Apple Music festival, and has hosted many A-list artists such as Alicia Keys, Ed Sheeran, Elton John, and Foo Fighters. In reaction, streaming music industry leader Spotify, is reportedly sponsoring its ﬁrst live music event in London. (ht[tps://www](http://www.theguardian.com/music/2017/sep/05/apple-cancels-its-london-).t[heguardian.com/music/2017/sep/05/apple-cancels-its-london-](http://www.theguardian.com/music/2017/sep/05/apple-cancels-its-london-) music-festival-itunes-festival)

(https://9to5mac.com/2017/09/08/apple-music-festival-spotify-who-we-be/

#more-497953)

India's anti-spam app rejected from App Store

Apple has blocked the Telecom Regulatory Authority of India's anti-spam app from the App Store over privacy concerns, according to Bloomberg. The iPhone app, "Do Not Disturb," enables users to ﬂag spam calls and text messages to authorities, who can then forward these details to mobile operators for necessary action. Apple's refusal to include the app has reportedly angered the regulator, potentially negatively aﬀecting Apple's relationship with the Indian government and its ambitions to expand its business in the country. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2017-09-06/apple-refusal-to-)ws/art[icles/2017-09-06/apple-refusal-to-](http://www.bloomberg.com/news/articles/2017-09-06/apple-refusal-to-) approve-india-spam-app-antagonizes-regulator)

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.