

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 29, 2017

iPhone X production limitations were the key focus of Apple news this week, with a supply chain report suggesting only 40% of original component volumes are shipping and the WSJ reporting that there is limited supply of FaceID components. In other news, a break down of the iPhone 8 suggests a $10 increase in the BOM vs. the iPhone 7, Apple may continue to use LCD panels in next year's iPhones, Bain's Apple-supported consortium will buy Toshiba's chip business, and Apple will join an FDA pilot program. Also, Apple Music subscribers reached 30M, Google will replace Bing for Siri web searches, and Shutterﬂy is partnering with Apple Photos.

iPhone X component shipments reduced

Apple has reportedly asked suppliers to limit iPhone X component shipments while the company assesses pre-sale order levels, according to Digitimes. The article indicates that suppliers are shipping only roughly 40% of the original volumes required for the initial production run. (ht[tps://www](http://www.digitimes.com/news/a20170925PD200.html)).digit[imes.com/news/a20170925PD200.html)](http://www.digitimes.com/news/a20170925PD200.html))

Delayed FaceID components may be slowing iPhone X production

iPhone X production is reportedly being held up by a limited supply of FaceID components, according to The Wall Street Journal. Of the two key FaceID components, code-named Romeo and Juliet, Romeo modules have taken longer to assemble, resulting in a supply imbalance. (ht[tps://www.wsj.com/articles/apple-iphone-x-pr](http://www.wsj.com/articles/apple-iphone-x-production-woe-sparked-by-juliet-)oduct[ion-woe-sparked-b](http://www.wsj.com/articles/apple-iphone-x-production-woe-sparked-by-juliet-)y[-juliet-](http://www.wsj.com/articles/apple-iphone-x-production-woe-sparked-by-juliet-) and-her-romeo-1506510189)

New iPhone BOM rises 4%

The bill-of-materials (BOM) for Apple’s 64GB iPhone 8 device is estimated to be

$247.51, a rough $10 or 4% increase versus the base iPhone 7 model, according to IHS. IHS identiﬁed higher storage, a new processor, and wireless charging as key drivers of the new iPhone's higher BOM while the screen and mechanical enclosures remain among the device's most expensive components. (https://technology.ihs.com/595738/ihs-markit-teardown-reveals-what-higher- apple-iphone-8-plus-cost-actually-buys) (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2017-09-25/iphone-8-build-costs-)ws/art[icles/2017-09-25/iphone-8-build-costs-](http://www.bloomberg.com/news/articles/2017-09-25/iphone-8-build-costs-) rise-on-faster-chip-cameras-ihs-says)

Next year's iPhones could still feature LCD panels

Sherri Scribner

Research Analyst

+1-212-250-5734

Adrienne Colby Associate Analyst

+1-212-250-0948

Jeﬀrey Rand, CFA Research Associate

+1-212-250-0639

Companies featured

Apple Inc. (AAPL.OQ),USD154.23 Hold

2016A 2017E 2018E

EPS (USD) 8.31 9.05 10.20

P/E (x) 12.6 17.0 15.1

EV/EBITDA (x) 6.0 9.2 8.2

*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*

Apple has reportedly shown interest in ordering advanced LCD panels from Japan Display for some of its 2018 iPhone models, according to The Wall Street Journal. As we have noted in previous Slices, OLED supply remains limited and may be contributing to low initial production volumes of the new iPhone X. While both Samsung and LG are expanding their OLED production capacities, supply may still remain limited next year.

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Toshiba to sell memory chip business to Bain consortium

Toshiba's Board has approved the sale of its memory chip business to a consortium led by Bain Capital for 2T Yen or roughly $18B. Toshiba will maintain 60% of the chip business, while U.S. companies including Apple, Seagate, Kingston Technology, and a venture capital arm of Dell are also participating in the deal. SK Hynix and Hoya are also part of the consortium. [(http://www.toshiba.co.jp/about/ir/en/news/20170928\_1.pdf?](http://www.toshiba.co.jp/about/ir/en/news/20170928_1.pdf) fromRSS=IR2017092801)

Apple to participate in FDA pilot program

Apple has been selected to participate in the U.S. Food and Drug Administration’s (FDA) new digital health software pre-certiﬁcation pilot program, according to Bloomberg. The program will allow for accelerated approval of health software and solutions. Fitbit and Samsung also announced that they had been asked to participate.

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Apple Music subscribers reach 30M

In an interview with Billboard, Apple's Jimmy Iovine disclosed that paid subscribers to Apple's streaming music service are now over 30M. Apple Music subscribers have grown by 3M since June of this year but still trail industry leader Spotify's 60M paid subscribers. Apple remains optimistic that it can convert more of its 800M iTunes customer base to its $10 per month subscription service and continues to invest in advertising and exclusive content. [(http://www.bil](http://www.billboard.com/articles/news/magazine-feature/7980919/jimmy-)l[board.com/articles/news/magazine-feature/7980919/jimmy-](http://www.billboard.com/articles/news/magazine-feature/7980919/jimmy-) iovine-zane-lowe-larry-jackson-interview-billboard-cover-story-2017)

Siri web searches replacing Microsoft Bing with Google

Siri-initiatied web searches, as well as Search within iOS (formerly Spotlight) will now default to Google results, according to TechCrunch. Apple reportedly decided to move away from Microsoft Bing for consistency reasons since Google search is already the default search on Apple devices. (https://techcrunch.com/2017/09/25/apple-switches-from-bing-to-google-for-siri- web-search-results-on-ios-and-spotlight-on-mac/)

Shutterﬂy integrated with Apple Photos app

Shutterﬂy will be integrating its photo products and services with the Apple Photos app on macOS High Sierra. The partnership will allow users to create, customize and purchase Shutterﬂy photo books within the Photos app as well as use photos from Apple Photos on Shutterﬂy.com. [(http://www.businesswire.com/news/home/20170925006367/en/Shutterﬂy](http://www.businesswire.com/news/home/20170925006367/en/Shutter%EF%AC%82y-)- Announces-Integration-Apple-Photos-App-macOS)

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.