

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

20 October 2017

Periodical

A weekly take on Apple news

For the week ending October 20, 2017

Demand for iPhone 8 was a key focus this week with supply chain sources reporting that Apple cut orders by 50% for November and December and that Jabil laid oﬀ or reassigned some of its iPhone work force. Verizon's F3Q-17 results also point to weak iPhone 8 adoption, while Rogers Communications' CEO reported anemic iPhone 8 demand. Another supply chain report suggests iPhone X component shortages have been addressed and China's JD.com has received 1.1M pre-orders for the device. In other news, China is blocking cellular connectivity in the Apple Watch 3, Qualcomm is suing Apple in China, VirnetX won a $440M judgment against Apple, Apple and GE are partnering to develop mobile industrial apps, and Apple's self-driving cars have been spotted on the road in California.

Supply chain reports suggest iPhone 8 order cuts

Apple has reportedly lowered iPhone 8 and iPhone 8 Plus orders for November and December to 5-6M units per month from 10-12M units, according to The Economic Daily News of Taiwan. DB's Asia supply chain analyst Birdy Lu believes [the move reﬂects an expected pivot to iPhone X production, as advanced iPhone](https://ger.gm.cib.intranet.db.com/ger/document/pdf/0900b8c08db33d1b.pdf) [8 production has led to adequate iPhone 8 inventory levels](https://ger.gm.cib.intranet.db.com/ger/document/pdf/0900b8c08db33d1b.pdf). Separately, China Labor Watch reported that Jabil has laid oﬀ and re-allocated factory workers due to slowing iPhone 8 orders, which has resulted in a worker strike. (https://money.udn.com/money/story/5612/2765507?ref=tab20171019) (ht[tps://www](http://www.prnewswire.com/news-releases/china-labor-watch-as-apples-).prne[wswire.com/news-releases/china-labor-watch-as-apples-](http://www.prnewswire.com/news-releases/china-labor-watch-as-apples-) orders-decline-supplier-jabils-workers-go-on-strike-in-wuxi-300536055.html)

Second U.S. carrier results suggest weak iPhone 8 sales

During Verizon's F3Q-17 earnings call, the company disclosed a 5.5% handset upgrade rate, which was ["actually the lowest 3Q result on record" according to DB](https://ger.gm.cib.intranet.db.com/ger/document/pdf/120cb80c-1791-4a0d-819a-f38d546c8eb5_604.pdf) [Telecom analyst Matt Niknam](https://ger.gm.cib.intranet.db.com/ger/document/pdf/120cb80c-1791-4a0d-819a-f38d546c8eb5_604.pdf). Niknam also noted that Verizon's results reﬂected "a much lighter than expected promotional landscape post iPhone 8 launch in September." Verizon's weak handset upgrade rate follows AT&T's record-low upgrade rate that we reported on in last week's Slices. Also this week on the company's F3Q-17 earnings call, the CEO of Rogers Communications noted that the company was seeing "anemic appetite for the iPhone 8 right now." [(http://www.verizon.com/about/news/verizon-builds-2q-momentum-strong-3q-](http://www.verizon.com/about/news/verizon-builds-2q-momentum-strong-3q-) results)

(https://investors.rogers.com/ﬁnancials/ﬁnancial-reports/) iPhone X component yield rates stabilizing

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Companies featured

Apple Inc. (AAPL.OQ),USD155.98 Hold

2016A 2017E 2018E

EPS (USD) 8.31 9.05 10.20

P/E (x) 12.6 17.2 15.3

EV/EBITDA (x) 6.0 9.3 8.3

*Source: Deutsche Bank*

*Our price target is based on shares trading at 14x 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.*

Yield rates for certain key iPhone X components are stabilizing, according to Digitimes. As a result, iPhone X shipments are expected to pick up signiﬁcantly starting in November. Supply chain sources indicated that the ﬁrst shipments of iPhone X have left Foxconn Electronics' facility and this supply is expected to be adequate to meet demand before the holidays. Separately, JD.com Inc., the oﬃcial authorized online channel for iPhone sales in China, has reported more than 1.1 million iPhone X pre-orders and commented that it will have plenty of inventory when the device is released on November 3. [(http://www.digitimes.com/news/a20171017PD204.html)](http://www.digitimes.com/news/a20171017PD204.html)) (ht[tps://www.yicaiglobal.com/news/jdcom-receiv](http://www.yicaiglobal.com/news/jdcom-receives-over-11-million-pre-orders-)es-ov[er-11-mil](http://www.yicaiglobal.com/news/jdcom-receives-over-11-million-pre-orders-)l[ion-pre-orders-](http://www.yicaiglobal.com/news/jdcom-receives-over-11-million-pre-orders-) apple%E2%80%99s-iphone-x-ahead-nov-3-release)

China blocks Apple Watch cellular connectivity

Chinese regulators are blocking the cellular connectivity in Apple Watch Series 3, according to the Wall Street Journal. The device's embedded SIM card (eSIM), which is installed by Apple and necessary for LTE connectivity, does not allow Chinese carriers and regulators to track user identities, which is speculated to be the reason for the move.

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Qualcomm suing Apple in China

Qualcomm ﬁled a patent infringement lawsuit against Apple in China, seeking to prevent the sale and manufacturing of iPhones in the country. The lawsuit, as reported by Bloomberg, was ﬁled in Beijing's Intellectual Property Court, and is based on a dispute over certain non-standard essential patents related to power management and touchscreen technology. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2017-10-13/qualcomm-seeks-china-)ws/art[icles/2017-10-13/qualcomm-seeks-china-](http://www.bloomberg.com/news/articles/2017-10-13/qualcomm-seeks-china-) iphone-ban-escalating-apple-legal-ﬁght)

Apple ordered to pay $440M in damages to VirnetX

A U.S. District Court in Texas is ordering Apple to pay $439.7M in damages to VirnetX in a patent infringement lawsuit. The suit began in 2012 and concerns technology used in FaceTime and other iOS apps, according to The Verge. Apple reportedly plans to appeal the verdict, and the company's case may be strengthened by the U.S. Patent and Trademark Oﬃce's recent invalidation of the four patents in question. (ht[tps://www](http://www.theverge.com/2017/10/16/16482568/apple-virnetx-facetime-).thev[erge.com/2017/10/16/16482568/apple-virnetx-facetime-](http://www.theverge.com/2017/10/16/16482568/apple-virnetx-facetime-) patent-battle-loss-appeal-planned)

iPhone and iPad to feature GE's industrial apps

General Electric (GE) is partnering with Apple to introduce GE’s Predix industrial applications for the iPhone and iPad. As part of the collaboration, the two companies released a Predix software development kit (SDK) for iOS. The Predix iOS apps are expected to provide industrial operators with better insights and visibility into equipment performance. (ht[tps://www.apple.com/ne](http://www.apple.com/newsroom/2017/10/apple-and-ge-partner-to-bring-)wsr[oom/2017/10/apple-and-ge-partner-to-bring-](http://www.apple.com/newsroom/2017/10/apple-and-ge-partner-to-bring-) predix-industrial-apps-to-iphone-and-ipad/)

Video of Apple's self-driving car shows large sensor array

Video footage of Apple’s self-driving SUV on the road in Silicon Valley, shows a new, bulky roof-top sensor array, according to The Verge. The video shows that the Apple vehicle has six Velodyne-made LIDAR sensors, several radar units, and cameras, which are assembled and covered in white plastic on the roof. As we noted in June, Apple has indicated that it is focusing its autonomous car

project on the development of an autonomous driving system and self-driving car technology instead of on building self-driving cars. (ht[tps://www](http://www.theverge.com/2017/10/18/16496182/apple-self-driving-car-project-).thev[erge.com/2017/10/18/16496182/apple-self-driving-car-project](http://www.theverge.com/2017/10/18/16496182/apple-self-driving-car-project-)- titan-sensor-lidar)

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.