

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

27 October 2017

Periodical

A weekly take on Apple news

For the week ending October 27, 2017

Pre-orders for the iPhone X began this week with initial supply selling out within 10 minutes and average deliveries delayed until early-to-mid December. Supply chain reports suggest that iPhone X shipments will total just 20M units in 2017 and that Apple's COO and Foxconn's chairman plan to meet to discuss production issues. Also, Apple has rejected Bloomberg's claims it downgraded the accuracy of Face ID to improve iPhone X production yields. In other news, CIRP data suggests iPhone 8 adoption is well-below an "S" model and both the iPhone 7 and 6, Sprint's C3Q-17 results point to relatively stronger iPhone 8 upgrade rates than peers, App Annie data shows ongoing growth in app spending, Samsung and Apple head back to court in May 2018, a former BBC executive joins Apple, and Apple acquired wireless charging tech ﬁrm PowerbyProxi.

iPhone X pre-orders exhaust supply after minutes

Supply of the iPhone X reportedly ran out within 10 minutes of going on sale, according to the Financial Times. As of 3:10 a.m. ET on Friday morning, the ship date for the iPhone X slipped from November 3 to early-to-mid December. Our checks on Apple's website on Friday afternoon quoted a wait time of 5-6 weeks for iPhone X prior to checkout.

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Initial iPhone X shipments may be 50% below original volumes

Apple is expected to ship only 20M units of the iPhone X in 2017, according to the Nikkei. Shipments in 2017 are reportedly 50% lower than the originally planned volumes, due to ongoing production issues related to the face recognition components. Separately, the Nikkei reported that Terry Gou, Foxconn’s Chairman and Apple COO Jeﬀ Williams will meet in Taiwan later this month to discuss ongoing iPhone X production issues. (https://asia.nikkei.com/Business/Companies/Apple-to-settle-for-half-its-planned- iPhone-X-shipments-this-year)

(https://asia.nikkei.com/Business/AC/Apple-Foxconn-executives-to-meet-amid- iPhone-X-production-strain)

Claims of watered-down Face ID accuracy levels refuted

According to Bloomberg, Apple reportedly allowed suppliers to reduce the technical accuracy of the face recognition components in the iPhone X, in order to facilitate volume production. Production of the 3D sensors used in the iPhone X's Face ID feature has been hampered by complexity, which has resulted in

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Companies featured

Apple Inc. (AAPL.OQ),USD156.41 Hold

2016A 2017E 2018E

EPS (USD) 8.31 9.05 10.20

P/E (x) 12.6 17.3 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.*

constrained supply of the iPhone X. Apple refuted the Bloomberg article, stating that Face ID's accuracy is unchanged with a "one in a million probability of a random person unlocking [an] iPhone with Face ID." (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2017-10-25/inside-apple-s-struggle-)ws/art[icles/2017-10-25/inside-apple-s-struggle-](http://www.bloomberg.com/news/articles/2017-10-25/inside-apple-s-struggle-) to-get-the-iphone-x-to-market-on-time)

Survey data suggests iPhone 8 underperforming an "S" model

Purchases of iPhone 8 and 8 Plus reﬂected a lower mix of total iPhone sales than an "S" model in C3Q-17. According to Consumer Intelligence Research Partners (CIRP), iPhone 8 and 8 Plus accounted for only 16% of all iPhone units sold in the quarter vs. 24% for the iPhone 6s and 6s Plus. Sales of iPhone 8 and 8 Plus are also well-below sales of the iPhone 7 and 7 Plus and the iPhone 6 and 6 Plus over the same time frame, with these models accounting for 43% and 46% of sales, respectively.

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Sprint results point to better iPhone 8 sales than other U.S. carriers

Sprint's C3Q-17 results reﬂected a modest increase in customer handset upgrade rates to 6.7% from 6.4% in C3Q-16. [According to DB's telecom analyst, Matt](http://pull.db-gmresearch.com/cgi-bin/pull/DocPull/225-0E3E/233383278/89192aa0-0eb1-411d-9ff6-dda8660edc48_604.pdf) [Niknam](http://pull.db-gmresearch.com/cgi-bin/pull/DocPull/225-0E3E/233383278/89192aa0-0eb1-411d-9ff6-dda8660edc48_604.pdf), Sprint's upgrade trends "bucked the industry trend" and were due to the carrier's Samsung and iPhone "Forever" programs as well as a higher number of subscribers that were eligible for upgrades.

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App downloads and spend continue to rise

Worldwide app downloads and consumer spending on apps reached record levels in C3Q-17, according to App Annie. Combined app downloads on the App Store and Google Play reached roughly 26B, up 8% Y/Y, while combined consumer spending reached $17B, up 28% Y/Y. We view growing app demand and downloads as a positive trend for Apple's App Store sales, although the business currently represents less than 10% of Apple’s sales by our estimates. (ht[tps://www.appannie.com/en/insights/mark](http://www.appannie.com/en/insights/market-data/global-app-downloads-)et[-data/global-app-downloads-](http://www.appannie.com/en/insights/market-data/global-app-downloads-) consumer-spend-hit-q3-2017-recap/)

Patent infringement lawsuit with Samsung drags on

A U.S. district judge in California ordered a new trial to determine damages owed to Apple in a patent infringement suit with Samsung. The trial is set to begin on May 14, 2018 and is the next step in a 6.5 year legal dispute between Apple and Samsung involving three of Apple's iPhone design patents. Most recently in December 2016, the U.S. Supreme Court overturned a court ruling that required Samsung to pay Apple $399M in damages and sent the trial back to an appeals court to reassess the amount of damages awarded. (ht[tps://www.reuters.com/article/us-samsung-apple-iphone/apple-samsung-](http://www.reuters.com/article/us-samsung-apple-iphone/apple-samsung-) face-new-iphone-damages-trial-u-s-judge-idUSKBN1CS1VF)

Broadcasting hire to support advance of video strategy

Jay Hunt, former BBC executive, will begin working at Apple in January 2018, according to the Financial Times. The report notes that Ms. Hunt is the company's ﬁrst "high-proﬁle" broadcasting executive recruit from outside the U.S. and will join a team at Apple with a $1B annual budget for developing original video content.

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Wireless charging specialist acquired

Apple has acquired PowerbyProxi, a New Zealand-based wireless charging technology developer, for an undisclosed fee, according to New Zealand website Stuﬀ. PowerbyProxi currently has 55 employees and holds over 300 wireless charging related patents.

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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.