

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

10 November 2017

Periodical

A weekly take on Apple news

For the week ending November 10, 2017

New products were an area of interest in Apple news this week, with a redesigned iPad with FaceID and an augmented reality headset being two products expected to be launched in the next two years. Also this week, Apple reportedly won an original-content morning show starring Jennifer Aniston and Reese Whitherspoon. In other news, Apple's smartphone share was ﬂat Y/Y in C3Q-17, while its tablet share grew, some iPhone X models are experiencing cold issues and a mysterious green line, and the New York Times reported that Apple is using a small island to avoid paying taxes. Also, a beta version of its peer-to-peer payment system has been launched in the U.S., a Samsung appeal was denied, Apple is expected to expand its Watch supply chain, and the company acquired camera sensor designer InVisage Technologies.

Redesigned iPad could be coming in 2018

Apple is planning to launch a redesigned high-end iPad in 2018, featuring Face ID technology and slimmer edges, according to Bloomberg. Similar to the iPhone X, the new iPad will not feature a home button due to the Face ID feature, but the devices are not expected to use OLED screens. (ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2017-11-08/apple-is-said-to-)ws/art[icles/2017-11-08/apple-is-said-to-](http://www.bloomberg.com/news/articles/2017-11-08/apple-is-said-to-)

plan-2018-ipad-redesign-with-facial-recognition)

AR headset may be in development

Apple is reportedly working on developing a production-ready augmented reality (AR) headset by 2019, according to Bloomberg. The headset, which could start shipping in early 2020, is not expected to be tethered to a smartphone, and is thought to feature its own display. The device will also be powered by a new chip and have its own operating system (OS). Apple is reportedly designing the new chip in-house, while the new OS, code-named "reality operating system (rOS)," will be based on iOS.

(ht[tps://www.bloomberg.com/ne](http://www.bloomberg.com/news/articles/2017-11-08/apple-is-said-to-ramp-)ws/art[icles/2017-11-08/apple-is-said-to-ramp-](http://www.bloomberg.com/news/articles/2017-11-08/apple-is-said-to-ramp-) up-work-on-augmented-reality-headset)

Apple to produce an original new morning show series

Apple reportedly beat competition from multiple networks to win an original morning show drama series, according to Deadline. The two-season, straight- to-series project will be produced by and star Jennifer Aniston and Reese Witherspoon. We would note that this is Apple's second original series following the company's sci-ﬁ series remake “Amazing Stories" with Steven Spielberg, which was announced in October.

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Companies featured

Apple Inc. (AAPL.OQ),USD176.24 Hold

2017A 2018E 2019E

EPS (USD) 9.21 10.45 9.70

P/E (x) 14.9 16.9 18.2

EV/EBITDA (x) 7.9 9.2 10.0

*Source: Deutsche Bank*

*Our price target is based on shares trading at 16x 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.*

[(http://dead](http://deadline.com/2017/11/apple-reese-witherspoon-jennifer-aniston-)l[ine.com/2017/11/apple-reese-witherspoon-jennifer-aniston-](http://deadline.com/2017/11/apple-reese-witherspoon-jennifer-aniston-) morning-show-series-2-season-order-amazing-stories-reboot-1202204293/)

Smartphone market grew modestly in C3Q-17; Apple share unchanged Y/Y Global smartphone unit sales grew 3% Y/Y and 7% Q/Q in C3Q-17 to 373M units, according to preliminary IDC data. Samsung remained the market leader with

22% share, up 140 bps Y/Y, while Apple maintained its second place position with 12.5% share, which was ﬂat Y/Y. Huawei continued to hold the third place in the market with 10.5% share, up 120 bps Y/Y, followed by OPPO at 8%, up 110 bps Y/Y, and vivo with 7% share, up 370 bps Y/Y. (ht[tps://www.wiﬁhiﬁ.ca/LatestNe](http://www.wiﬁhiﬁ.ca/LatestNewsHeadlines/)wsHead[lines/](http://www.wiﬁhiﬁ.ca/LatestNewsHeadlines/) WorldwideSmartphoneShipmentsRiseinQ3.html)

iPad market share grows in C3Q-17

IDC reported that worldwide tablet shipments were 40M in C3Q-17, a decline of 5% Y/Y. Apple remained the market leader with 26% share, followed by Samsung with 15% share. Apple’s share increased by 390 bps Y/Y and unit shipments grew by 11% Y/Y, helped by the roll out of a lower-priced iPad and the release of iOS 11, which allows iPads to be more competitive with traditional PCs. Samsung’s was the only top ﬁve vendor to lose some modest share, with its share declining 40 bps Y/Y. Vendors outside of the top 5 lost 9.5 ppts of share compared to C3Q-16. (ht[tps://www.idc.com/getdoc.jsp?containerId=prUS43193717)](http://www.idc.com/getdoc.jsp?containerId=prUS43193717))

iPhone X users encountering cold issues and a mysterious green line

New iPhone X owners are reporting a few issues with their new phones as the devices come to market. Many users have reported that their screens are becoming unresponsive in cold weather, an issue that Apple has acknowledged and plans to ﬁx with a software update at some point in the future. Other users are reporting a mysterious green line that is appearing on their displays, which does not go away after a restart. It is not uncommon for issues to be discovered with new technology products once they are brought to market. [(http://appleinsider.com/articles/17/11/09/apple-acknowledges-iphone-x-](http://appleinsider.com/articles/17/11/09/apple-acknowledges-iphone-x-) becoming-unresponsive-in-cold-weather-promises-software-ﬁx) [(http://appleinsider.com/articles/17/11/10/some-iphone-x-owners-report](http://appleinsider.com/articles/17/11/10/some-iphone-x-owners-report-)- mystery-green-lines-appearing-on-displays)

Apple denies using island of Jersey as a tax haven

To avoid paying corporate taxes, Apple has reportedly recorded over $128B in earnings in Jersey, a small island in the English Channel, according to the New York Times. The report suggests that Apple changed its corporate strategy and moved proﬁts from Ireland to Jersey following pressure from Irish and European tax authorities. An Apple spokesperson responded to the allegations by stating that the company "follow[s] the laws" and that "the changes we made did not reduce our tax payments in any country." Following the NYT's report, The Washington Post reported that EU authorities have asked Apple for details on the company's tax arrangements. (ht[tps://www](http://www.nytimes.com/2017/11/06/world/apple-taxes-jersey.html?_r=1)).nyt[imes.com/2017/11/06/world/apple-taxes-jer](http://www.nytimes.com/2017/11/06/world/apple-taxes-jersey.html?_r=1))se[y.html?\_r=1)](http://www.nytimes.com/2017/11/06/world/apple-taxes-jersey.html?_r=1)) (ht[tps://www](http://www.washingtonpost.com/news/the-switch/wp/2017/11/07/e-u-).w[ashingtonpost.com/ne](http://www.washingtonpost.com/news/the-switch/wp/2017/11/07/e-u-)ws/t[he-switch/wp/2017/11/07/e-u-](http://www.washingtonpost.com/news/the-switch/wp/2017/11/07/e-u-) competition-chief-asks-apple-for-details-on-tax-arrangements/? utm\_term=.c49b7dc7c065)

Beta version of peer-to-peer payment service launched

Apple rolled out a beta version of Apple Pay Cash in the U.S. this week. The service, which is a peer-to-peer payment system accessible in the Messages App, was announced in June during the company's developer conference. Users are

able to fund payments via debit or credit cards, while payment recipients will be issued a virtual Apple Pay Cash card that stores receipts. (https://techcrunch.com/2017/11/07/apple-pay-cash-launches-in-beta-today- letting-you-send-and-receive-cash-in-messages/)

Samsung's appeal of 2014 patent ruling rejected

The U.S. Supreme Court will not hear Samsung's appeal of a May 2014 judgement against the company in favor of Apple, according to Reuters. The 2014 ruling determined that Samsung had infringed on a handful of Apple's iPhone patents, including slide-to-unlock, autocorrect, and quick links features, and awarded Apple $120M in damages. The 2014 case is separate from another ongoing patent infringement suit between Apple and Samsung over iPhone design patents. As we wrote in Slices in October, a district judge in California has ordered a new trial to reassess the $399M in damages awarded to Apple in the design infringement case.

[(http://www.reuters.com/article/us-usa-court-samsung-elec/supreme-court](http://www.reuters.com/article/us-usa-court-samsung-elec/supreme-court-)- rejects-samsung-appeal-of-patent-loss-to-apple-idUSKBN1D61W4)

Apple Watch supply chain may expand

Apple’s Watch Series 3 unit sales grew by more than 50% Q/Q in C3Q-17, according to Digitimes. Supply chain sources suggest that strong demand for the device may push Apple to expand its upstream supply chain footprint to boost margins and diversify production risks. The report suggests that demand from ﬁrst-time buyers is expected to contribute to at least 25M in Apple Watch shipments in CY-18. Apple does not disclose its Watch shipments. [(http://www.digitimes.com/news/a20171106PD207.html)](http://www.digitimes.com/news/a20171106PD207.html))

Camera sensor company acquired

Apple has acquired InVisage Technologies, a startup that has developed a thin camera module featuring a specialized light capturing sensor called QuantumFilm Image Sensor, according to TechCrunch. Financial terms of the acquisition were not disclosed. According to 9to5Mac, Apple currently uses third-party suppliers for cameras, but proprietary software for signal processing. With the acquisition, Apple may work on developing its own camera modules. https://techcrunch.com/2017/11/09/apple-has-acquired-imaging-sensor-startup- invisage-technologies/)

(https://9to5mac.com/2017/11/09/apple-invisage-acquisition/#more-507750)

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 16x. 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 16x 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.