

Deutsche Bank Markets Research

North America

United States

TMT

IT Hardware and Supply Chain

Industry

Scribner's Slice of Apple

Date

10 December 2017

Periodical

A weekly take on Apple news

For the week ending December 8, 2017

News out of Asia from suppliers suggests that demand for iPhone X is waning, with November iPhone X component orders weakening by 30% versus prior levels. Also this week, another report emerged suggesting a 6.1-inch iPhone with an LCD display is coming next year. In other Apple news, the company released a temporary ﬁx for a HomeKit security bug, the head of Apple's health team has left to form a medical records start-up, and Ireland's plans to establish a 13B euro escrow fund for Apple's back taxes are moving forward. Lastly, Apple published a paper on its machine learning blog highlighting its diﬀerential privacy policy and hired a new television executive to support the development of its series programming.

Supply chain companies report weakening iPhone X component demand November orders for iPhone X components have weakened by 30% vs. earlier expectations, following strong September and October orders, with further

weakness expected in December orders, according to DigiTimes. Key iPhone X suppliers Largan Precision, Catcher Technology, and General Interface Solution (GIS) reported ﬂat or declining sequential sales and anticipate month-over-month declines in December. Sources suggest iPhone X shipments will decline by 30% Q/Q in C1Q-18, due to seasonality and the timing of the Lunar New Year. [(http://www.digitimes.com/news/a20171208PD210.html)](http://www.digitimes.com/news/a20171208PD210.html))

Another report suggests LCD iPhone model coming 2018

Apple is reportedly planning to introduce an iPhone with an LCD (liquid crystal display) in 2018, featuring a larger 6.1-inch screen and a metal back panel, according to The Nikkei Asian Review. The report also suggests 5.8-inch and 6.3- inch iPhones with OLED displays may also be released. As we wrote in Slices in October, The Wall Street Journal suggested an LCD iPhone was in development and both articles highlight Apple's interest in lowering dependence on Samsung's supply of OLED displays as a key rationale for an LCD iPhone model. (https://asia.nikkei.com/Business/AC/Apple-planning-LCD-iPhone-with-a-metal- case-for-2018-source)

Temporary HomeKit security bug ﬁx disables remote features

Apple has released a temporary ﬁx to an iOS 11.2 security vulnerability that allowed unauthorized third-parties access to smart locks and other connected hardware via HomeKit, according to TechCrunch. However, the bug ﬁx, which is on Apple's end, has disabled some of HomeKit's remote features until Apple introduces a permanent software ﬁx next week.

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Companies featured

Apple Inc. (AAPL.OQ),USD169.32 Hold

2017A 2018E 2019E

|  |  |  |  |
| --- | --- | --- | --- |
| EPS (USD) | 9.21 | 10.45 | 9.70 |
| P/E (x) | 14.9 | 16.2 | 17.5 |
| EV/EBITDA (x) | 7.9 | 8.8 | 9.5 |
| *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.*

Deutsche Bank Securities Inc.

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(https://techcrunch.com/2017/12/07/apple-issues-ﬁx-for-homekit-vulnerability- impacting-smart-locks-and-other-devices/)

Former head of Apple health team forming medical records start-up

Anil Sethi, former Director of Apple's health technology practice, has left the company to form a medical start-up called Citizen, according CNBC. Citizen will focus on facilitating patient access to their medical records and ability to share with researchers and practitioners.

(ht[tps://www.cnbc.com/2017/12/07/apple-heal](http://www.cnbc.com/2017/12/07/apple-health-director-anil-sethi-leaves-to-)th-d[irector-anil-sethi-lea](http://www.cnbc.com/2017/12/07/apple-health-director-anil-sethi-leaves-to-)v[es-to-](http://www.cnbc.com/2017/12/07/apple-health-director-anil-sethi-leaves-to-) build-cancer-start-up.html? source=twitter%7Cmain)

Escrow fund for back taxes moves forward

Apple and Ireland have reportedly agreed to the administrative terms of an escrow account to hold funds that the European Commission (EC) ruled Apple owes in back taxes, according to Reuters. The Irish Finance Minister believes the agreement paves the way for Apple to deposit up to 13B euros in the account in C1Q-18. As we have written in previous Slices, Apple and Ireland are currently appealing the EC's August 2016 ruling that Ireland illegally provided Apple with tax beneﬁts.

(ht[tps://www.reuters.com/article/us-eu-apple-ireland-taxa](http://www.reuters.com/article/us-eu-apple-ireland-taxavoidance/ireland-)v[oidance/ireland-](http://www.reuters.com/article/us-eu-apple-ireland-taxavoidance/ireland-) expects-apple-back-tax-in-escrow-account-in-ﬁrst-quarter-2018-minister- idUSKBN1DY1M3)

Apple touts user privacy protections on its machine learning blog

Apple has published a paper on its online Machine Learning Journal describing the company's use of diﬀerential privacy. The approach, which adds random noise to a user's data before it is collected on a centralized server, purports to mine data while respecting user privacy.

(https://machinelearning.apple.com/docs/learning-with-privacy-at-scale/ applediﬀerentialprivacysystem.pdf)

Another TV veteran bolsters Apple's video team

Michelle Lee, a developer and executive producer of TV series for CBS, NBC, and Hulu, has joined Apple's Worldwide Video division as a creative executive, according to Variety. Ms. Lee, who had served as producing partner at Universal Television-based True Jack Productions since 2012, will focus on Apple's foray into series programming.

[(http://variety.com/2017/tv/news/michelle-lee-apple-1202631849/)](http://variety.com/2017/tv/news/michelle-lee-apple-1202631849/))

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.