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**From:** Richard Kahn [REDACTED]  
**Sent:** Sunday, January 8, 2017 10:46 PM  
**To:** Jeffrey Epstein  
**Subject:** Fwd: Apple, Inc.: 2017 Top Pick with Growing List of Catalysts

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Apple, Inc.: 2017 Top Pick with Growing List of Catalysts

Katy L. Huberty, CFA – Morgan Stanley

January 11, 2017 10:00 PM GMT

The market is focusing too much on near-term supply chain noise and not enough on three potential catalysts: 1) iPhone supercycle led by China, 2) cash repatriation, and 3) US tax reform. Apple is a top US IT Hardware pick in 2017 with 26% upside to our PT, 61% upside to bull case.

Apple is a top pick in US IT Hardware in 2017 with several potential catalysts. First, recent iPhone weakness signals pent-up demand, especially in China, head of a major form factor change with significant technology enhancements, including improved battery technology. Second, Apple is the largest potential beneficiary of cash repatriation, with \$216B trapped overseas. Third, while border adjustment provisions could limit upside, Apple could see as much as an 11 point reduction in tax rate. Of the three catalysts, we believe the iPhone supercycle is most debated by investors who see China as a risk, not an opportunity, after weak demand in recent quarters. Our view is that China consumer loyalty to Apple remains high, evidenced by stable market share of 80% at the high-end of the market, and that weak demand is a function of the lack of a form factor change during the iPhone 6S/7 cycles which will be addressed with the AMOLED iPhone launch later this year. In fact, our analysis of China upgraders suggests that even a flat China upgrade rate next cycle will result in at least 20% iPhone unit growth, compared to current consensus of 10%. We expect supply chain data points and repatriation discussions to positively impact valuation beginning in late C1Q. At 11x our FY18 (supercycle) base case EPS, Apple trades at a discount to the 14.5x P/E multiple when iPhone 6 launched. We view a return to double digit iPhone unit growth, larger base of high margin, recurring services revenue, and increased access to international cash as multiple enhancers. Net, our 148 PT assumes a 14x multiple on base case FY18 EPS of \$10.60. Higher iPhone unit growth (20%+ vs. our 12% base case)

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