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**From:** Richard Kahn <[REDACTED]>  
**Sent:** Thursday, March 22, 2018 1:30 PM  
**To:** Jeffrey Epstein  
**Subject:** Fwd: Apple, Inc.: The Emerging Power of Apple Services

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Katy L. Huberty= CFA – Morgan Stanley

March 22, 2018 4:01 AM =GMT

As Apple's p=ospects for generating outsized iPhone growth fade as the handset market ma=ures, some investors fear Apple's best days are behind it. We disagree and s=ee increasing value in the Apple platform, particularly through Services mo=etization. Sum of the parts supports our \$203 PT.

The devices are already out there. Now investors should look to Apple Servi=es. Over the last five years, the vast majority (86%) of Apple's 8% annual r=venue growth was driven by iPhone sales. But as replacement cycles extend f=rther and device installed base growth slows to single digits (from 14% ov=r the last two years), it is through

monetization of Apple's Services business that we see the company still generating mid single digit revenue growth. In fact, Services (~60% of growth) and Other Products/Wearables (30%) will drive almost all of Apple's growth over the next five years in our updated base case model (1). Mix shift to services should also put upward pressure on gross margin, an important driver of stock performance (23). Net, next five year revenue CAGR slows (6% vs. 8% last 5 year CAGR) but EPS CAGR accelerates (16% vs. 8% last 5 year CAGR) on the back of services mix and higher share repurchases. With close to \$200 billion in excess cash and FCF available over the next 12 months, Apple can support the stock as the investment thesis evolves from one of product cycle- to services-led growth. Introducing our interactive Apple Platform Model: Base case = 5% next-five-year revenue CAGR; Bull = 11%; Bear (2)%. We have created an interactive model that allows clients to make multi-year assumptions behind Apple device replacement cycles, installed base growth, ASP trends, and services spend per device. We are modestly more negative on hardware replacement cycles in our new base case estimates (7 and 8), to reflect weaker market demand in China and US carrier comments at our TMT conference earlier this month. Our new base case demonstrates the stability of the model.

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