

COMPANY PROFILE

# Apple Inc.

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## COMPANY OVERVIEW

Apple Inc. (Apple or “the company”) designs, manufactures, and markets mobile communication and media devices, personal computers (PCs), and portable digital music players, and sells a variety of related software, services, peripherals, networking solutions, and third-party digital content and applications. The company primarily operates in the US, Europe and Asia Pacific. It is headquartered in Cupertino, California and employed 92,600 people as of September 27, 2014.

The company recorded revenues of \$182,795 million during the financial year ended September 2014 (FY2014), an increase of 7% over FY2013. The operating profit of the company was \$52,503 million in FY2014, an increase of 7.2% over FY2013. The net profit of the company was \$39,510 million in FY2014, an increase of 6.7% over FY2013.

## KEY FACTS

<b>Head Office</b>	Apple Inc. 1 Infinite Loop Cupertino California 95014 USA
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<b>Web Address</b>	<a href="http://www.apple.com/">http://www.apple.com/</a>
<b>Revenue / turnover (USD Mn)</b>	182,795.0
<b>Financial Year End</b>	September
<b>Employees</b>	92,600
<b>NASDAQ National Market Ticker</b>	AAPL

## SWOT ANALYSIS

Apple Inc. (Apple or “the company”) designs, manufactures, and markets mobile communication and media devices, personal computers (PCs), and portable digital music players, and sells a variety of related software, services, peripherals, networking solutions, and third-party digital content and applications. Through the integration model, both horizontally and vertically, the company was able to build non replicable and sustainable competitive advantages. However, operating in complex and challenging environment could have a negative impact on the market shares and growth rates of Apple.

<b>Strengths</b>	<b>Weaknesses</b>
Formidable competitive advantages through horizontal and vertical integration High average selling prices (ASPs) in an industry characterized by declining ASPs Significant growth rates and cash flows	High dependence on iPhone and iPad product lines
<b>Opportunities</b>	<b>Threats</b>
Apple Pay provides robust growth opportunity Positive outlook for smartphone and tablet markets Rising adoption of Apple products in the enterprise market Smart wearable devices market offers robust growth opportunities	Operating in complex and challenging environment could impact market position Premium pricing could limit growth in emerging markets Smartphone subsidy cuts could impact shipments

### Strengths

Formidable competitive advantages through horizontal and vertical integration

Apple has over the years followed integration both horizontally and vertically and as a result emerged as a formidable competitor. The company's multiple devices provide horizontal integration. Apple has presence across main digital media devices of computing and mobile communications. Through PCs, tablets, smartphones and other devices, Apple aimed at offering a whole range of associate products and devices. Apple through vertical integration connected the user experience across the devices. The company offers hardware, software, content, services and also retails its products creating vertical integration. In addition, the company also built strong software and content business which is equipping Apple with several competitive advantages. The company's operating system

spans across multiple devices and includes content and application. Consequently, switching to a competitor becomes difficult due to the dependence on iOS. Another key integration aspect that has enabled Apple to gain competitive advantage is the content offering. The company's content base is large and is shared across all devices through iTunes. iTunes is a storefront offering all kinds of media. In addition to the above, the company also engages in retailing. This helps Apple to have control over successfully positioning its products to the end user.

Apple has followed a vertical integration strategy to build a formidable competitive advantage. The company's business strategy leverages its unique ability to design and develop its own operating systems, hardware, application software, and services. The vertical integration provides control over the entire user experience or process from hardware to software which facilitates higher customer loyalty and provides lock-in. The vertical integration that Apple achieved is very difficult to replicate as evidenced in recent times. None of the company's competitors were able to replicate this model with resonating success as Apple. Google's sale of Motorola's mobile division indicates that this strategy and business model is difficult to replicate although the competitors have tried. This provides Apple with significant competitive advantages. Apple's customized in-house chip design, well integrated hardware, software, applications and service equips the company with an ability to create high quality products that are unmatched in the industry. According to the industry estimates, Google's Android OS accounted for 83.6% of smartphone shipments in third quarter of 2014 while Apple's iOS accounted for only 12.3% of the shipments. However, Apple's smartphone is much more lucrative as it attracted high value customer base and its smartphones accounted for 60% of mobile web usage in 2014. This data indicates that Apple's vertical integration strategy enabled it to create products which are providing the customers with what it calls a good product experience.

Apple enjoys a favorable competitive environment provided by the user dependence on iOS which enables it to earn incremental earnings by offering all associated devices. In the era of convergence this is a sustainable competitive advantage. Apple's sustainability of market share stems from the fact that it was able to successfully connect its devices with each other and one generation of devices with the next. Through these integration models, Apple built sustainable competitive advantages that are hard to replicate.

High average selling prices (ASPs) in an industry characterized by declining ASPs

Apple has launched several successful products and follows a strategy of catering to high value customer base. Apple's products ASPs continued to remain stable while rest of the industry witnessed declining ASPs. The Apple iPhone which was initially launched at \$600 remained immune to the decline in ASPs in the smartphone category. The estimates indicate that Apple's iPhones sell at an ASP of about \$649 while Android's phones ASP has dropped since launch and sell at about \$247 while the ASP of Windows phones is \$265 and that of BlackBerry phones is \$339. According to industry estimates, Apple's iPhones are expected to continue to command ASPs more than \$600 by 2018. By 2018, the Android smartphones are expected to be sold at ASPs hovering around \$200. In addition to the smartphones, the company was also able to defend its ASPs in the Macs. According to industry estimates, Macs are sold at a premium ASP of \$1,300 in a PC market where the company's competitor, Microsoft sells PCs at an average price point of \$311.

Apple's ability to command high ASPs and defend the same highlights the superiority of the company's products. Moreover, Apple's products were able to maintain high ASPs despite entry in to the developing economies where ASPs of consumer goods are usually pressurized. This once again highlights that Apple was able to gain from its product strategy which enabled it to defy many industry downtrends.

#### Significant growth rates and cash flows

Apple enjoys robust growth rates and strong cash resources. The revenue growth rates achieved by the company are a play of both increased unit sales and pricing power. While the unit growth has been derived from the appeal of its products gained in the market place, the offshoot of successful product lines has resulted in Apple gaining a dominant position, which has helped it command high pricing power.

The combination of these factors enabled Apple to attain industry leading growth rates. For instance, Apple's revenues grew at a compounded annual growth rate (CAGR) of 29.4% during FY2010-14. The company's net income grew by 29.6% annually over the same period. Moreover, despite the company's growth approaching maturity, Apple registered a 7% growth in revenues on year-over-year basis in FY2014. Furthermore, the company's cash position grew strongly in the recent times. Apple's cash from operations grew at a CAGR of 8.4% during FY2012-14 to reach \$59,713 million by the end of FY2014. The company also sits on a cash pile of over \$155 billion, which gives it more financial flexibility. The company's revenue growth and cash position provide a strong platform for it to invest in growth and expansion. The resource base is critical for remaining competitive in the technology space which is rapidly and ever changing. The company's cash base and strong growth history therefore provide competitive advantages.

#### Weaknesses

##### High dependence on iPhone and iPad product lines

The company's revenues and growth rates are largely dependent on iPhone and iPad product lines. The iPhone and iPad product lines together accounted for 72.4% of the total revenues in FY2014. Although, these product lines have been the growth drivers for the company, any future decline in the growth rates could impact the company's performance. Dependence on few product lines increases the business risk, especially in an industry characterized by fast paced technological changes. The risk is aggravated as the company has been losing market share in tablets market. According to industry estimates, in the third quarter of 2014, iPad market share stood at 22.8% compared to 29.2% in the third quarter of 2013. In addition, in the smartphone market, the company's market share declined from 12.9% in the third quarter of 2013 to 12% in the third quarter of 2014. The market share losses of a key product could have a material adverse impact on the company's growth prospects

#### Opportunities

#### Apple Pay provides robust growth opportunity

The launch of Apple Pay is expected to provide incremental growth opportunities for the company. In September 2014, the company launched Apple Pay, a new mobile payment service. Apple Pay works with iPhone 6 and iPhone 6 Plus through a Near Field Communications (NFC) antenna design, a dedicated chip called the secure element, and the Touch ID. Apple Pay allows users to add their credit or debit card on file from their iTunes Store account. Apple Pay also works with the Apple Watch. Moreover, Apple Pay supports credit and debit cards from the three major payment networks, American Express, MasterCard and Visa, issued by most banks, including Bank of America, Capital One Bank, Chase, Citi and Wells Fargo, representing 83% of credit card purchase volume in the US. Furthermore, Apple Pay is supported by 258 Apple retail stores in the US as well as other leading retailers, including Bloomingdale's, Disney Store and Walt Disney World Resort, Duane Reade, Macy's, McDonald's, Sephora, Staples, Subway, Walgreens and Whole Foods Market. Apple Watch will also work at over 220,000 merchant locations across the US that have contactless payment enabled. Apple Pay can also be used to make purchases through apps in the App Store.

The launch of Apple Pay is expected to provide new growth opportunities for the company in the medium to long term. According to industry estimates, the global mobile payment transaction value reached approximately \$235 billion in 2013 with approximately 245 million mobile payment users. The global mobile transaction volume is expected to grow at a CAGR of 32.3% during 2013-17 to reach a value of \$721 billion in 2017. Moreover, the number of mobile payment users is expected to grow at a CAGR of 16.4% during the same period to reach 450 million users by 2017. Apple Pay is an extension of the company's iOS ecosystem, which makes it a disruptive player in the fast growing mobile payments industry. The strong outlook for the end market coupled with Apple's robust smartphone market share and iTunes accounts provides incremental growth opportunities to enhance revenues and market share.

#### Positive outlook for smartphone and tablet markets

The smartphones and tablets market is expected to grow at a robust pace in the medium term. According to industry estimates, the global shipments for smartphones are expected to reach 1,250 million units in 2014 as compared to 1,004 million units in 2013. Furthermore, smartphone shipments are expected to grow at a CAGR of 13% between 2013 and 2018. Moreover, emerging markets are expected to lead smartphone shipments with a CAGR of 16% for the 2013-18 periods as compared to a CAGR of 3.6% for the mature markets during the same period. Furthermore, the demand for tablets is also increasing. The shipment of tablet PCs is estimated to grow from 233 million units in 2014 to more than 304 million units by 2018, growing at a CAGR of 6.9% for the 2014-18 periods.

The company is one of the leading smartphone players with a market share of approximately 12% in the third quarter of 2014. The company's iPhone is one of the leading smartphone products globally. In FY2014, Apple sold approximately 169.2 million iPhones. Its tablet product line includes iPad and iPad mini. Apple sold approximately 67.9 million iPads in FY2014. Robust outlook for the smartphone market and tablet market will increase the company's sales in the coming years.

#### Rising adoption of Apple products in the enterprise market

The company has been focusing on the enterprise markets over the past few years as part of its strategy to enhance its revenues in the wake of the growing adoption of bring your own device (BYOD) across enterprises. Adoption of BYOD has been robust in the recent times. Firms are using smartphones, laptops, and wireless to save on building a dedicated network. According to industry estimates, the global market for BYOD and enterprise mobility market generated total revenues of \$72 billion in 2013. Moreover, the market is expected to grow at a CAGR of 26% during 2013–19 to reach a value of \$284 billion by 2019.

As BYOD trends starts making inroads in the enterprise sector, Apple will be able to effectively sell into this space. The popularity of the iPhone and iPad with consumers is spilling over into the business world, as mobile users increasingly use their personal devices for business purposes. In recent times, companies are opening up their mobility strategies to allow for more choice, which has benefitted Apple. In addition, to further enhance its enterprise adoption, the company announced an exclusive partnership with IBM to launch business apps, to bring IBM's big data and analytics capabilities to iPhone and iPad. The partnership aims to launch more than 100 industry-specific enterprise solutions including native apps, developed exclusively from the ground up, for iPhone and iPad. As part of the partnership, IBM will also offer cloud services optimized for iOS, including device management, security, analytics and mobile integration. IBM will offer new AppleCare for Enterprise service and support offering tailored to the needs of the enterprise. Furthermore, IBM will also sell iPhones and iPads with the industry-specific solutions to business clients worldwide. The partnership will also see IBM offering Device Supply, Activate and Manage, a suite of value-added reselling services for iPhone, iPad and Mac.

The positive outlook for the BYOD and enterprise mobility market provides a robust growth opportunity for the company to increase its revenues and market share in the coming years.

Smart wearable devices market offers robust growth opportunities

The market for wearable devices has been growing strongly over the past few years. According to industry estimates, the global wearable devices market recorded shipment volume of 19 million units in 2014. The shipment volume is expected to grow at a CAGR of 78.4% for the 2014-18 periods to reach a volume of 112 million units by 2018. Furthermore, sale of smart wearable devices is expected to generate \$22.9 billion in revenue by 2020.

Apple is keen to benefit from the growth opportunities offered by these end markets. In September 2014, the company announced Apple Watch, which is expected to be available in early calendar year 2015. Apple Watch is a personal electronic device that combines a watch technology with an iOS-based user interface created specifically for a smaller device. Apple Watch features Digital Crown, a navigation tool that allows users to scroll, zoom and navigate. Apple Watch enables customers to communicate in new ways from their wrist and features. It also includes Force Touch, a technology that senses the difference between a tap and a press and allows users to access controls within apps.

The company is well positioned to tap the growing markets and enable revenue growth in the future.



## Threats

Operating in complex and challenging environment could impact market position

The markets for the company's products and services are highly competitive and complex, and the company is confronted by aggressive competition and challenges in all areas of its business. These markets are characterized by frequent product introductions and rapid technological advances that have substantially increased the capabilities and use of mobile communication and media devices, PCs, and other digital electronic devices. Apple faces intense competition from well-funded and experienced peers such as Microsoft, Google and Samsung, among others. Google's Android platform is one of the largest mobile operating systems and the Windows is also estimated to capture increased market shares.

In addition to Microsoft and Google, the company competes intensively with Samsung, which has approximately twice the market share of Apple. The company's other competitor includes Lenovo that offers a strong line of ThinkPad tablets and IdeaPad Yoga. Lenovo is well positioned to dent the market share of Apple in China. In addition, freely available music and videos and easier-to-use subscription service such as Spotify or Netflix could also dent the company's market share, as Apple sells this content through iTunes.

Also, Apple is facing challenges in its overseas markets. In China, the government has announced plans to build its own Linux-based processor to reduce reliance on Apple's computers. In India, which is one of the largest addressable consumer markets in the world, Apple has been facing trouble to establish its stores because of stringent local market laws. Further, the company is shrouded by legal battles across the world. Operating in such complex and challenging environment could have a negative impact on the market shares and growth rates at Apple.

Premium pricing could limit growth in emerging markets

Price can be one of the key competitive disadvantages of Apple that the competitors can effectively use to gain market share. This will prove to be a challenge while addressing the emerging markets, which become important as the advanced economies' smartphone markets attain maturity. The emerging markets lack carrier subsidies and the customer base in these markets is highly price sensitive and therefore competing with lower priced Android products could be a challenge. The revenues from emerging market for Apple products will come from a higher mix of older models. This indicates that as the smartphone markets move towards emerging countries, the average prices will start to fall, impacting the margins. The company has been facing marginal declines in average price per product. Apple has not been able to effectively gain market share in emerging markets where historically, lower priced phones are popular. Apple's premium pricing strategy will prove to be challenging and could have a negative impact on the company's gross margins.

Smartphone subsidy cuts could impact shipments

The company's shipments could be threatened as carriers move to cut smartphone subsidies affecting profitability. Carrier subsidies have been significantly responsible for Apple's strong position in the US smartphone market. In the US Market, players such as AT&T and T-Mobile are changing the dynamics of the market by doing away with the subsidies, thus, posing a threat to Apple's business. For instance, in December 2013, AT&T introduced a new pricing plan, which enables consumers to save \$15 on service charges per bill if they keep their old phones. This plan may impact the consumer's handset refresh cycle, thus affecting the demand for new launches. Similarly, the Chinese government has asked its leading carriers, including China Unicom, China Telecom, and China Mobile to reduce their subsidy costs. According to industry estimates, these three carriers spend approximately \$3.2 billion per year on subsidizing gadgets, primarily made by Apple and Samsung. Carrier subsidies allow companies such as Apple to target the majority income groups in China. If the subsidy is withdrawn then price conscious consumers may opt for other models, thus impacting on its sales. This evolving business model where the telecom carriers will do away with subsidies has the potential to harm Apple's market share.

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