



Apple Inc., 2015

www.apple.com, AAPL

Apple is the world's largest corporation based on a market capitalization of about \$650 billion, approximately \$200 billion more than Exxon, the world's second-largest company. Apple designs, manufactures, and markets the world's single-most popular smartphone, the iPhone, even though Apple has only about 15 percent of the global market share in smartphones. Apple also produces the iPad, iPod, iCloud, Mac computers, and other accessory devices. Headquartered in Cupertino, California, Apple owns iTunes, the popular app and store where customers can download music.

New for Apple with the release of the iPhone 6 and 6 Plus is Apple Pay, where customers can pay at retail stores by scanning their phone. Apple currently operates 450 Apple stores and employs 98,000. Apple's iPhone 6 and 6+ offer larger screens to better compete with Samsung. Initial sales of the iPhone 6 and 6+ broke records, with the higher margin 6+ doing best of all. Apple's new gold smartwatch released in spring 2015 sells for \$4,000 to \$5,000. The aluminum model is priced at \$349, and the stainless steel model at \$500.

On July 21, 2015, Apple announced financial results for its fiscal 2015 third quarter that ended June 27, 2015. Specifically, the company reported quarterly revenue of \$49.6 billion and quarterly net profit of \$10.7 billion, compared to revenue of \$37.4 billion and net profit of \$7.7 billion the prior year-ago quarter. International sales accounted for 64 percent of the quarter's revenue. In that third quarter Apple's year-over-year growth rate accelerated from the first half of fiscal 2015, with revenue up 33 percent and earnings per share up 45 percent. The growth was fueled by record third quarter sales of iPhone and Mac, all-time record revenue from services, and the successful launch of Apple Watch. The company's quarterly iPhone revenue was up 59 percent over last year. Apple Music was released in July 2015 and the company plans to release iOS 9, OS X El Capitan and watchOS 2 to customers in Fall 2015.

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History

Founded in 1976 by Steve Jobs and Steve Wozniak, Apple began as a personal computer company providing desktop computers for businesses and the home. The first computer, the Apple 1, was hand built by Wozniak and did not come with a keyboard or an outer case to protect the computer. The products were considered a kit, and users had to supply extra parts themselves. The Apple 1 sold for the interesting price of \$666.66, or around \$2,800 adjusted for inflation. Apple was incorporated in 1977 after Wozniak sold his share for \$800. The Apple II was first sold in 1977 and had the first major piece of business software, VisiCalc, a spreadsheet product.

Apple went public in 1980 for \$22 a share and generated more money on its IPO than any firm since Ford Motor Company 25 years earlier. Following a dispute with the Board, Steve Jobs resigned from Apple in 1985 and started a new firm. With Jobs unaffiliated with Apple for the next 15 years, Apple experimented with various other products, including CD players, digital cameras, speakers, and others. Throughout the 1990s, Apple experimented with several different product lines of personal computers, with limited success. Apple's products were generally significantly more expensive than that of competitors, not compatible with much of the leading software or with the more popular Windows machines, and also were not able to multitask as well as Windows-based machines.

By 1996, Apple was struggling immensely and the firm acquired Steve Jobs' firm, NeXT. After the Board fired the existing CEO in 1997, Jobs was back, acting as interim CEO of Apple. In the same year, Jobs identified Jonathan Ive, and the two started working to rebuild Apple's products and brand name. Ive is currently the Senior VP of

Design. After several Mac upgrades and new software products such as iMovie, in 2001, Apple introduced the iPod and the firm sold 100 million units in 6 years. The year 2003 brought about the iTunes store, which synced \$0.99 downloads to iPods and remains an industry leader. Apple launched the iPhone in 2008 and the iPad in 2010. In 2011, Steve Jobs passed away and current CEO Tim Cook now leads Apple.

Internal Issues

Vision/Mission

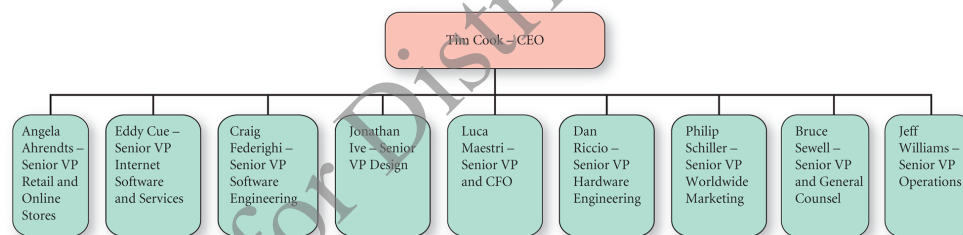
Neither at its corporate website nor in its *Form 10K* does Apple provide a written vision or mission statement labeled as such. There are statements such as the following, however, that perhaps serve as Apple's vision and/or mission:

1. "We strive to provide users of Apple products the best experience possible through innovative product designs and software."
2. "Apple designs Macs, the best personal computers in the world, along with OS X, iLife, iWork and professional software. Apple leads the digital music revolution with its iPods and iTunes online store. Apple has reinvented the mobile phone with its revolutionary iPhone and App Store, and is defining the future of mobile media and computing devices with iPad."

Organizational Structure

As indicated in [Exhibit 1](#), Apple appears to operate from a divisional-by-process design, but absent of any presidents of divisions. However, Apple does report revenues by both region and product. Some analysts suggest that titles of Apple's executives more closely mirror how the firm reports sales, and many expect to see a COO with divisional presidents reporting to that position.

Exhibit 1 Apple's Organizational Structure



Source: Based on company documents.

Strategy

Apple was late in producing a larger screen smartphone, but did so with the launch of the iPhone 6 and 6+ in October 2014. Apple prides itself on simplicity. Apple products are generally more user friendly than those of Windows, Android, and other operating systems, but at the sacrifice of the user being able to customize or tailor the device for their specific needs. Apple's overriding strategy always has been to produce elegant, easy-to-use products, often at a premium price point. In a November 2014 interview, CEO Cook reiterated this when asked if having just 15 percent of the global smartphone market share is a concern, by responding, "Not all market share is equal, and Apple has never been about the most; we are about being the best."

Apple also has a culture of not collecting every detail about its users. For example, Apple does not read or store iMessages or FaceTime. Even if a government were to ask for these data, Apple could not provide it, for the company simply does not keep it on file. The latest version of iOS 8 is more encrypted than ever. CEO Cook compares Apple to designing to an electronic Fort Knox.

With the release of the new iPhone 6 line, Apple introduced Apple Pay, a mobile app that enables Apple customers to use their existing Master Card, Visa, or American Express card to make mobile payments at retail

stores. Apple Pay's fingerprint technology is more convenient for consumers and also more secure for credit card companies such as Visa, American Express, and MasterCard. However, competitors such as Samsung currently have a similar technology on some of their phones, and all phones will likely have a similar technology moving forward. Using Apple Pay, merchants are charged the same fee as normally charged by a credit card company, which is an average of 2 percent in the United States. Transactions in the United States annually produce more credit card fees than everywhere else in the world combined, leaving open the door for Apple to possibly transition away from credit card companies in the future. Apple could offer its own in-house credit system at much lower cost to merchants, in essence becoming a financial institution.

Keeping in line with its user-friendly products strategy, Apple must approve all third-party digital content through the iTunes Store or the App Store and iBooks store. Competitors, such as Android-based phones, tend to have less control over apps offered to their customers than does Apple. Apple prides itself on well-trained and knowledgeable salespersons with excellent customer service. Apple invests heavily in R&D, over \$6 billion in 2014 alone, up nearly 100 percent from 2012. In addition, Apple is expanding its retail stores around the world.

During 2014, Apple acquired several firms, including Beats Music and Beats headphones. Apple obtained a subscription streaming music service and a headphone firm in the process. Apple's acquisitions in 2014, however, increased the firm's goodwill from \$1.5 to \$4.6 billion.

To keep costs low, almost all Apple hardware products are manufactured in Asia and many of these are manufactured at a single location, except for a few Macs that are manufactured in the United States. While able to better maintain quality control, this does put Apple at risk over strikes, poor management, or other disruptive activities at a single location facility. To counter this problem, Apple tends to stock enough supply to cover its demand for up to 150 days, but during a new issue of an iPhone, for example, there can be supply shortages, where customers must wait weeks or even months to receive their products.

Apple has sued Samsung twice in the last couple of years for patent infringements in the hypercompetitive smartphone industry. Apple was awarded \$120 million of a \$2.2 billion claim for Samsung violating three patenting infringements. However, Apple was unable to prove that Samsung's action caused significant damage to its product line. To date, Samsung has been ordered to pay Apple over \$1 billion in damages, and both cases have been appealed, and Apple has yet to receive any compensation. More important for Apple than the \$1 billion was the desire for the legal actions to impair Samsung from being able to sell certain products. To date, this outcome does not appear likely for Apple.

Segment Data

Exhibit 2 reveals that Apple's sales increased 7 percent in 2014, following a 9 percent increase the prior year. Fiscal 2014 sales were boosted by strong iPhone 5s and 5c sales, and also account for initial sales of the iPhone 6 and iPhone 6+, released in October 2014 in the United States, one month before Apple's fiscal year ended. However, some preorder sales of iPhone 6 and 6+ are included in Apple's 2014 fiscal year. With the iPhone 6 and 6+ also comes Apple Pay, which allows customers to pay by scanning their phones at selected retail stores. As of late 2014, 83 percent of all credit card transactions in the United States were compatible with Apple Pay, with banks not offering compatible products quickly but rather coming to agreement with Apple. The company reported sales increases in all regions in fiscal 2014, except in the Rest of Asia Pacific region, which experienced a small decline. The largest percent growth came from China and Japan.

Exhibit 2 Apple Revenues by Region (in millions of USD)

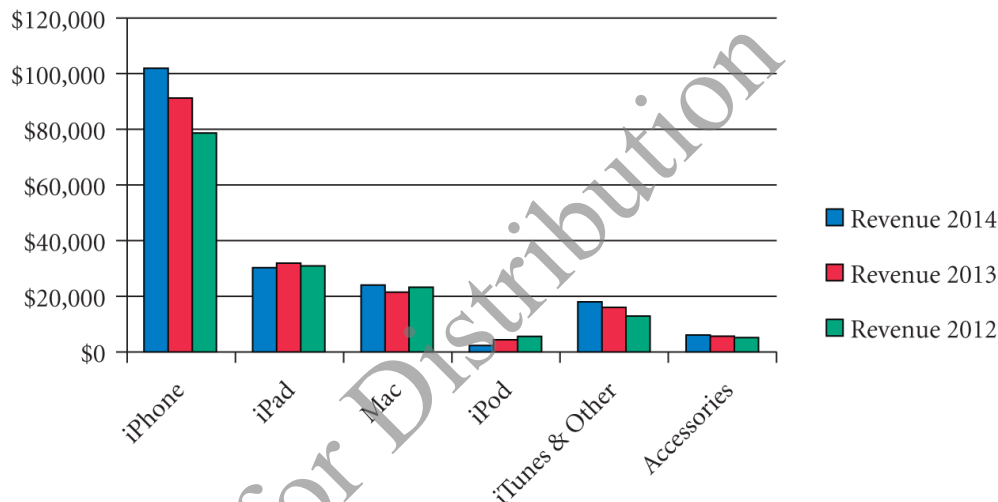
Revenues	2014	2013	2012
Americas	\$65,232	\$62,739	\$57,512
Europe	40,929	37,883	36,323
China	29,846	25,417	22,533
Japan	14,982	13,462	10,571

Rest of Asia Pacific	10,344	11,181	10,741
Retail	21,462	20,228	18,828
Net Sales	182,795	170,910	156,508

Source: Based on Apple's 2014 *Annual Report*, p. 27.

Apple's iPhone accounted for 55 percent of total 2014 revenues, up 11 percent from fiscal 2011, as indicated in [Exhibit 3](#). Apple's iPad sales have been steady but have not increased since 2012. Apple's new iPad Air 2 hopes to reverse this trend. However, with the larger iPhone displays with the 6 and 6+ products, many customers may opt only for having one device. In a bit of a surprise for analysts, Apple's Mac sales were up 12 percent in fiscal 2014, from stronger than expected back-to-school sales on Macs. The back-to-school sales were strong enough to boost Mac revenues to \$6.6 billion in Q4 of fiscal 2014, more than iPad's revenue of \$5.3 billion. Mac now owns over 6 percent of the global PC market, its largest market share since 1995. Mac has gained market share on windows machines in 33 of the last 34 quarters.

Exhibit 3 Apple Revenues by Product (in millions of USD)



Source: Based on Apple's 2014 *Annual Report*, p. 27.

iTunes, Software, and Services also continues to grow, up 12 percent from fiscal 2013. This segment includes the Apple Store, iCloud, iLife, iWork, AppleCare, and apps that many users pay to download and use on their iPhones and iPads. Apple's iPod, once the bellwether for the firm before the release of the iPhone, has been in constant decline, with sales down 61 percent from 2012 to 2014. In summer 2014, Apple discontinued making its classic iPod 160gb device on claims they could no longer get the parts. Apple's accessories segment includes headphones, Apple TV, cases, and Apple Watch. Apple Watch will be compatible only with iPhone 5 and newer products running iOS 8.0 or newer.

Finance

For years Apple had no long-term debt on its balance sheet. But in 2013, the firm, for the first time since 1994, used debt to finance operations, and reported \$17 billion in long-term debt, and then reported \$29 billion in long-term-debt in fiscal 2014, with varying maturity dates out as far as 2044. Apple is aggressively looking at financing further by debt and also for the first time with bonds backed in Euros as well. The firm reported in April 2014 that a \$90 billion stock repurchase had been authorized and also raised the dividend to \$0.47 per share for a 30 percent increase. Assuming \$100 average stock price on the repurchases, Apple will need to purchase 900 million shares back, or around 15 percent of current shares outstanding.

Apple's current income statement and balance sheet are provided in Exhibits 4 and 5, respectively. Much of the cash on Apple's balance sheet is kept in foreign banks. In this way, Apple avoids paying U.S. corporate taxes on those earnings.

Exhibit 4 Income Statement (in millions of USD)

Report Date	September 27, 2014	September 28, 2013
Revenues	\$182,795	\$170,910
Cost of revenue	112,258	106,606
Gross profit	70,537	64,304
Operating expenses	18,034	15,305
EBIT	52,503	48,999
Interest additions	980	1,156
EBT	53,483	50,155
Tax	13,973	13,118
Net income	39,510	37,037

Source: Based on company documents.

Exhibit 5 Balance Sheet (in millions of USD)

Report Date	September 27, 2014	September 28, 2013
Cash	\$13,844	\$14,259
Short-term securities	11,233	26,287
Accounts receivable	17,460	13,102
Inventories	2,111	1,764
Other current assets	23,883	17,874
Total current assets	68,531	73,286
Long-term marketable securities	130,162	106,215
Property, plant & equipment	20,624	16,597
Goodwill	4,616	1,577
Intangible assets	4,142	4,179
Other assets	3,764	5,146
Total assets	231,839	207,000

Accounts payable	30,196	22,367
Other current liabilities	33,252	21,291
Total current liabilities	63,448	43,658
Long-term debt	28,987	16,960
Deferred income taxes	20,259	16,489
Deferred revenue	3,031	2,625
Other liabilities	4,567	3,719
Total liabilities	120,292	83,451
Common stock	23,313	19,764
Retained earnings	87,152	104,256
Treasury stock	—	—
Paid in capital and other	1,082	(471)
Total equity	111,547	123,549
Total liabilities & equity	231,839	207,000

Source: Based on company documents.

Competitors

Apple competes in a highly competitive and rapidly changing industry that is often associated with strong customer loyalty. Apple and rival firms typically roll out new smartphones, computers, and tablets annually. Many of Apple's rivals have prices 50 to 70 percent lower on comparable products. However, in the tablet and phone market, top rival Samsung prices its top products in line with Apple prices. Competition for Apple should only increase in the future as rival firms are better able to duplicate Apple's products or even better able to persuade customers their products are just as good but significantly cheaper in price. Top competitors for Apple are Samsung and Lenovo in the smartphone, tablet, and PC markets. However, Apple faces significant competition from various other PC providers such as Dell, Sony, and Toshiba.

Exhibit 6 provides a comparative analysis of Apple with some of its rival firms in terms of market share. Note that Apple products trail Android products substantially in market share. Apple projects to take a 35 percent market share in watches in 2015, reducing Android's share to 42 percent. In 2014, the total watch market was less than 10 million, but is expected to expand to 35 million units by year-end 2015. **Exhibit 7** provides additional comparative competitive information for Apple and rival firms.

Exhibit 6 2014 Percent Market Share of Key Global Players

	Apple	Android	Windows
Smart Phones	14%	81%	3%

Tablets	45%	51%	4%
Watches	0%	67%	0%

Source: Based on company documents and a variety of other sources.

Exhibit 7 Apple versus Rival Firms

	Apple	Samsung	Lenovo
# Employees	92,000	96,900	54,000
\$ Net Income	39.5 B	27.7 B	817 M
\$ Revenue	182.8 B	208 B	38,707 M
\$ Revenue/Employee	2 M	2 M	716,796
\$ EPS Ratio	7.39	180	7.88
Market Cap.	692.7 B	—	—

Source: Based on company documents and a variety of other sources.

Samsung

Founded in 1938 in South Korea, Samsung specializes in semiconductors and electronic appliances. The firm did not enter the mobile communications arena until the late 1990s, but by 2010 it was producing half of its mobile phones in China. Samsung has five R&D centers in China. Samsung was 2 years behind first-mover Apple into the smartphone market with its launch in 2009 using the Bada operating system. In 2010, Samsung provided an Android-powered smartphone. In 2013, Samsung smartphones were 21 percent of the global smartphone market, making Samsung the industry leader. In addition to smartphones, Samsung also today produces tablets, televisions, Blu-rays, DVD players, cameras, refrigerators, air conditioners, washing machines, ovens, PC notebooks, printers, storage devices, and more. In addition, Samsung is engaged in providing select medical equipment such as X-rays, ultrasound, and other items.

In popular products, Samsung competes with Apple directly on the Samsung Galaxy and Note smartphones, Galaxy Tablet, TVs, watches, and laptop computers. Samsung reported revenues of over \$208 billion in 2013.

Lenovo

Founded in 1984 in Beijing and headquartered in both Beijing and New York City, Lenovo acquired IBM's ThinkPad laptops and more recently IBM's lower-end servers. Lenovo did not enter the smartphone market until 2010, but its LePhone is popular in China and increasing its market share in the entry-level market space. Lenovo is also rapidly introducing the LePhone in Russia, India, Indonesia, and other neighboring Asian nations that also have developing economies. Lenovo competes with Apple primarily on PCs, since the firm has positioned itself in a lower demographic market for its smartphones.

Lenovo's 2014 revenues are expected to be in excess of \$37 billion—the same as in 2013. With Lenovo's \$2.9 billion acquisition of Motorola in 2014, the firm is now the world's third-largest smartphone maker, behind Samsung and Apple. Lenovo trades on the Hong Kong Stock Exchange and currently employs 54,000 people worldwide.

External Issues

In 2014, there were 234 million smartphone Internet connections in the United States. The growth rate was approximately 35 percent from 2009 to 2014, with a forecast of 313 million connections by 2019.

China

Most of the world's smartphones are manufactured in China, and the Chinese smartphone market itself increased nearly 55 percent from 2010 to 2014. Less than 1.5 million units were produced in 2003, increasing to over 500 million units in 2015. The top four smartphone manufacturers in China are Samsung, Lenovo, Apple, and HTC, accounting for over half of the total industry revenue in 2014. There is a growing fragmentation in the market as new entrants enter and now comprise 50+ percent overall market. Smartphone industry revenue will increase about 20 percent annually to around \$180 billion by 2020, with over 1.5 billion units produced annually. Worldwide mobile phone shipments (all phones included) were just under 2 billion in 2014 with about 70 percent of shipped phones considered smartphones. By 2018, however, 2.2 billion mobile phones will be shipped and all but 400 million are projected to be smartphones.

Computer Manufacturing and Tablets

Computer manufacturing is a \$14 billion industry in the United States alone, but sales fell over 17 percent per year between 2009 and 2014. About 62 percent of all computers manufactured in the United States are laptops, but this still leaves 38 percent of the computers manufactured being desktops. Overall projections are 5 percent declines moving forward through 2020. Tablets are projected to further make inroads into personal computers in U.S. manufacturing. However, it is important to note that at least for Apple's Q4 of 2014, Mac sales exceeded iPad sales.

Most tablets are manufactured in China, with Apple holding 27 percent of the market share, followed by Samsung and Lenovo with 12 and 8 percent, respectively, on tablets made in China. The largest players in the U.S. computer manufacturing business, which also includes servers, are HP, Dell, and IBM, with 25, 19, and 18 percent market shares, respectively. Two relative new areas that may help boost laptop sales are the new ultrabooks, extra thin laptops with no battery sacrifice, and laptops with touch glass where the user can touch the screen much like on a smartphone or tablet. Worldwide PC sales are expected to be \$190 billion in 2015, tapering down to \$160 billion by 2018. In 2014, PC shipments alone accounted for 56 percent of the device (PC and Tablets) shipments, but this number is expected to be reduced to 45 percent by 2018, as tablets make further inroads on PCs. (Tablets are expected to grow 9 percent a year through 2018.) Currently, Android-based phones account for just over 60 percent of smartphone operating systems, with iOS picking up much of the balance. Through 2018, the outlook is projected to remain the same.

Operating Systems

Operating systems are another large market in the United States with 2013 revenues of \$45 billion expected to grow to \$57 billion by 2019. Major firms by market share include Microsoft and Apple, with 62 and 20 percent of the total market. Microsoft's prominent product continues to be Windows, while Apple is the owner of iOS.

Geographic Outlook

Most smartphone markets in developed countries are expected to see growth rates subside moving forward. However, with the current culture of customers being trained to update their phones at least every 2 years, the long-term outlook for smartphone providers looks promising. The real exponential growth, though, moving forward should come from developing markets such as Brazil, India, and China. Tablet sales in the United States are projected to increase from \$55 billion in 2014 to 63 billion in 2018, or a 15 percent total increase. In the Asia Pacific (not including Japan) region, tablet sales are expected to increase from \$65 to \$93 billion over the same time frame, or 43 percent. Sales for smartphones are expected to show similar results with respect to the major growth being in China, India, and Brazil.

During its first month in operation (July 2015), Apple Music obtained 11 million trial members, giving the App store a record-breaking month. The streaming service costs users \$9.99 per month with the first 3 months free.

store a record-breaking month. The streaming service costs users \$7.99 per month with the first 3 months free. But 2 million of those subscribers opted for the more expensive family plan costing \$14.99 per month. Despite some bugs and glitches in the service, which Apple is scrambling to fix, Apple Music is a popular hit so far. If all the trial users convert to paying monthly customers, Apple will surpass most competitors. For example, 10-year-old Spotify only has 20 million paying customers, but boasts 75 million active users, Pandora has 3.3 million paid subscribers from its 79 million active user base, and Deezer has 6 million paid subscribers out of its 16 million active users. During July 2015, Apple's App store did a record-breaking \$1.7 billion in transactions. Interestingly, 23 percent of the digital music market is made up of paid subscribers, who generated a collective \$1.6 billion in calendar year 2014.

Future

Apple announced record financial results for 2015 fiscal first quarter that ended in December 2014. Total revenues and profits were \$74.6 and \$18 billion, respectively, up from \$57.6 and \$13.1 billion in first quarter 2014. In addition, international sales accounted for 65 percent of total revenue as the iPhone is now the most popular phone in China. International sales would have been significantly higher if not for a significant rally in the U.S. dollar against other foreign currencies over much of 2014.

Apple began shipping its Apple watch in April 2015. iPhone and Mac revenues were \$51 and \$7 billion, respectively, for the first quarter 2015, up 57 and 9 percent from first quarter 2014. However, iPad sales were down 22 percent over the same time frame due to people not updating their tablets as frequently, less demand than for phones, and also the new iPhone 6+ has cannibalized iPad sales.

Develop a 3-year strategic plan for CEO Tim Cook that will enable Apple to continue to compete with rivals Samsung and Lenovo. Use the template at the www.strategyclub.com website to prepare matrices and analyses. Impress Mr. Cook with your work because, according to *Financial Times*, CEO Cook was the business "Person of the Year" for 2014. In 2015, at Apple's shareholder meeting, when someone questioned the profitability of Apple's environmental initiatives, Mr. Cook responded: "We do things for other reasons than a profit motive, we do things because they are right and just. If that's a hard line for you . . . then you should get out of the stock."

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