



The Powerful SaaS Platform No One Is Talking About — and It's Made by Apple

Description

Expectations were low going into the **Apple** (NASDAQ: AAPL) [product event](#) on Tuesday. Investors believed the annual iPhone-focused keynote would reveal smartphones with form factors similar to their predecessors. The iPhones were rumored to have received some internal upgrades, camera improvements, and other incremental changes — but no major new features were expected.

That's almost exactly how things played out.

The new iPhone 11, iPhone 11 Pro, and iPhone 11 Pro Max are unlikely to kick Apple's important smartphone segment back into growth mode. The iPhone peak — in terms of annual unit sales — seems to be in the rearview mirror. Indeed, the company doesn't even report unit sales anymore, highlighting how growth in that figure is no longer a priority for the company.

But there's another catalyst brewing under the surface — one that can take over where Apple's hardware left off: its consumer-facing software-as-a-service (SaaS) platform, better known as the operating systems its devices run on. This includes iOS, MacOS, WatchOS, and tvOS.

Craig Federighi, Apple's senior vice president for software engineering, unveils iOS 13 for the iPhone at its developers conference in June. The company's software platform is becoming its new growth driver. Image source: Apple.

Apple's next growth driver

While the iPhone may no longer be the big growth driver it was for Apple stock in years past, the company has slowly but surely been building and fortifying what may be its most powerful and durable growth driver yet: the software platform all Apple customers use. It is monetizing its iOS, macOS, WatchOS, and tvOS users with sales of content and subscriptions better than it ever has.

It may be time for investors to start shifting their view of the company: It's morphing into a provider of one of the most powerful consumer-facing SaaS platforms in the world.

Here are three reasons these operating systems should be viewed as a compelling SaaS platform and not just the free software included on Apple devices.

1. Apple has an installed base of 1.4 billion active devices

Perhaps the best way to grasp the importance of Apple's software platform is the massive number of users who are active on it. In January, the company said it had 1.4 billion active devices. Every one of them uses an Apple operating system and has direct access to the company's services and the third-party services Apple gets a cut from. Of these devices, 900 million were iPhones and 500 million were made up of the rest of Apple's devices.

According to data geek Horace Dediu of Asymco, trend lines suggest Apple will surpass 1.5 billion active devices by the end of this month and 1 billion iPhones by the end of 2019.

2. Paid subscriptions are soaring

Highlighting one key way it is monetizing its installed base of active devices, the [tech company](#) surpassed 420 million paid subscriptions by the end of its most recent quarter. This is up from 300 million in the same period last year.

That's a 40% year-over-year increase in paid subscriptions on its operating systems.

The company makes money from subscriptions to its own services and from third-party subscriptions. It gets 30% of third-party subscription payments in the first year and 15% beyond year one.

3. Apple is aggressively launching new services

In an effort to better monetize its active devices, Apple announced four new services this year. Two have already launched, one launches later this month, and the other one debuts on Nov. 1. They are:

- Apple News+, which has a monthly subscription fee of \$9.99.
- An Apple-branded credit card.
- A video game subscription service called Apple Arcade for \$4.99 per month.
- Apple TV+, a streaming TV service for \$4.99 a month.

These build on an already robust suite of services, including the App Store, Apple Care, iCloud, and Apple Music.

It's no surprise to see the company doubling down on services. With the help of strength in its own services and growth in subscriptions to third-party apps in its App Store, services revenue is rising rapidly. For the trailing-12-month period ending June 29, 2019, it increased 16% year over year.

Apple is still a hardware company

While it is more of a SaaS company today than it was five years ago, hardware is still its main business. For instance, of Apple's trailing-nine-month revenue of \$196.1 billion, \$33.8 billion was from services.

Still, investors should start giving more weight to Apple's services in their analysis, as they now provide 29% of gross profit. That outsize contribution is because the segment carries a higher gross profit margin — 64%, versus 32% for the products segment.

As services revenue grows, fueled by the company's SaaS operating systems platform, the segment will quickly become even more important to the company. Indeed, in just a few years, services gross profit could be close to rivaling its hardware gross profit.

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