Insight: Apple's grip on carriers, suppliers loosens

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(Reuters) - Apple Inc's shareholders have been hit by one of the bloodiest weeks in the history of the stock, but wider fallout from such weakness might be more important to the long-term value of their investments.

While Apple's iPhones, iPads and Macs remain gold standards, signs the company is losing some of its edge in the smartphone market suggest its clout with business [1] partners could wane.

Recent comments from executives at phone carriers and component suppliers show they see room for at least some shift in the balance of power.

In particular, a move by No. 4 US mobile service provider T-Mobile USA to stop subsidizing smartphones around the time it starts selling the iPhone in three months time may put pressure on Apple, especially if other carriers follow the example.

U.S. phone companies mostly subsidize handsets in return for two-year contracts. If customers start paying the full price for an iPhone they might look for cheaper alternatives.

Asked whether carriers are now in a better position to negotiate lower prices with smartphone makers such as Apple, Fran Shammo, chief financial officer of Verizon Communications, said having four strong platforms - Apple, Android, Windows and BlackBerry - is leading to more competitive pricing.

"The more operating systems we have to compete in this area the better the competition," he told Reuters.

Verizon Communications Inc is the majority owner of Verizon Wireless, the biggest U.S. mobile provider.

LOWER GROSS MARGINS

Apple sold a record 48 million iPhones in the December quarter, but its share of the overall market is expected to peak this year at 22 percent and become dependent on repeat business [1] from loyal customers unless it accepts lower margins by making low-cost iPhones, according to ABI Research.

Meanwhile, arch-rival Samsung Electronics [2] Co Ltd, with a range of handsets has overtaken Apple as the world's top smartphone seller.

If Apple's customers and suppliers, let alone rivals, smell blood and take a much harder line in negotiations, it could erode Apple's gross margins, which slipped to 38.6 percent in the last quarter from 44.7 percent a year ago.

Apple declined to comment on its business with partners, although when CEO Tim Cook was asked on an earnings [3] conference call last July about subsidies potentially being reduced, he said the total subsidy carriers pay is fairly small compared with revenues over a two-year contract. He also said carriers told him the iPhone has many advantages, including lower churn rates and the ability to sell shared data plans for other Apple products such as the iPad [4].

Certainly, Apple's astounding run over the past decade and ever rising volume of iPhone sales have given it unrivaled power to negotiate with wireless carriers and component suppliers.

Last week's results fell short of Wall Street's estimates, sending Apple's share price down more than 14 percent. That underscored signs Apple is coming back down to earth, transforming from undisputed Wall Street darling to a more normal - if enormous and hugely profitable - company.

A less powerful Apple could be welcomed by telecommunications carriers and component suppliers that have grown accustomed to the tough terms Apple was able to exact thanks to its massive scale and leadership in the market.

Wireless carriers that once agreed to unfavorable contracts and hefty subsidies still cannot live without Apple, but experts say they could have more leeway in the future if Samsung and other device makers continue to grab market share.

HAS BEENS

Subsidies have been a major driver of the iPhone's success and in boosting Apple's earnings [5]. Analysts estimate operators pay a roughly $400 subsidy for each iPhone they sell in comparison with subsidies of $250 to $300 for other smartphones.

But that may already be changing. T-Mobile USA, a unit of Deutsche Telekom AG, has not disclosed the details of its deal with Apple, but CEO John Legere said it will not be as onerous as Sprint Nextel's commitment to pay $15.5 billion over four years. Instead of subsidizing smartphones, T-Mobile USA will let consumers pay the full price in monthly installments.

Randall Stephenson, CEO of AT&T, Apple's first partner for the iPhone, applauds T-Mobile USA's idea.

"That's something we've looked at on several occasions. I kind of like that idea," Stephenson said. "It's something we're going to be watching."

Verizon CEO Lowell McAdam told Reuters T-Mobile USA's strategy is "very intriguing," but wondered if consumers are ready to pay full price. An iPhone 5 with 16 gigabytes of storage that is not tied to a contract costs $649 on Walmart.com.

If subsidies are removed and payment plans widely adopted, some experts say consumers might opt for cheaper devices.

"The illogical love affair is over. Now it's just a great company," said a former top executive for a rival in the handset business. "The AT&Ts of the world will start to try to get themselves weaned off of paying such great subsidies to Apple."

In content, there are already signs of resistance. The company is meeting media executives in a potential effort to transform the living room with some kind of new Apple TV product, sources have said.

Its efforts are hindered, however, by the reluctance of movie and TV program makers to make content deals favorable to Apple. They saw how Apple's iTunes service helped decimate recording industry profits some years ago and they are very wary as a result, sources and analysts say.

Samsung led the global smartphone market with 29 percent market share in the fourth quarter, up from 22.5 percent a year ago. Apple was No. 2, but its share fell to 21.8 percent from 23 percent a year ago, according research firm IDC.

Apple's ability to extract low prices from the makers of chips and other components is one of the reasons it preserves margins in the 40 percent range on average.

But given increasing competition in the United States and its relatively weak position (sixth in smartphone sales) in the rapidly growing China [6] market, that power might be hard to keep.

Supplier stock prices surge or plummet as result of being chosen or rejected by Apple. Chipmaker Audience Inc went public last year on the back of its Apple business, but the stock plummeted when Apple stopped using its chips. Audience's largest customer is now Samsung and its stock is recovering.

An executive at one chipmaker welcomed the prospect that one day his company might depend less on Apple.

Selling to Apple is "a double-edged sword," said the executive, who was not authorized to discuss his company's relationship with Apple. Having Apple as a customer guarantees huge volumes, but comes at the cost of accepting rock bottom prices that can cripple profit margins, the executive said.

Meanwhile, a few component makers are staking out territory in smartphones and tablets without Apple.

InvenSense Inc reported a 58 percent jump in quarterly earnings last Wednesday and its stock leaped 11 percent, partly because its gyroscope chips are used in hot-selling Android devices, including the Google Nexus 7, Samsung Galaxy S3 and Amazon Kindle Fire HD.

To be sure, InvenSense is trying to win Cupertino, California-based Apple's business. But even without Apple, it has become a key supplier in the smartphone and tablet market.

But as Samsung's share of the smartphone market grows further, it too is forcing suppliers to accept lower and lower prices, said Evercore Partners analyst Mark McKechnie.

"Samsung beats the heck out of people too. Be careful what you wish for," McKechnie said.

CULT STATUS

For now, Apple is still a mega player, even if it ships fewer phones than Samsung. For many consumers, its cult-like status remains unchallenged.

Despite recent stock market losses - more than $230 billion has been wiped off Apple's value since its September peak - the iPhone alone pulled in $30.66 billion in revenue last quarter, 43 percent more than Microsoft's entire sales for the period.

"Even though they're not gaining share, they're such a large piece of the market and such a driver of customer volume into their stores that people can't walk away yet," said David Yoffie, a professor who specializes in competitive strategy at Harvard Business School.

"Over the longer term, clearly there will be more and more pressure on Apple if they don't find new ways to innovate."

Even with slower growth, Apple is still widely seen as a highly successful company with a bright future and plenty of potential to produce another revolutionary product.

"What rabbit will Apple pull out of its hat to once again transform the industry?" asked Joseph Doyle, who co-manages wealth management firm Morris Capital Advisors' large cap strategy. "And if they can't do it, does that make it an awful investment? No, that will make it more like everything else."

(This story corrects paragraph one to add dropped word "be", corrects paragraph 32 to "makers" instead of maker)

(Additional reporting by Sinead Carew in New York and Sarah McBride in San Francisco; Editing by Martin Howell and Andre Grenon in New York)

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