



IFB277: Defining Apple's Moat By Looking at the Components

[This transcript was generated by artificial intelligence. Timestamps are not 100% accurate depending on the platform used for listening].

Dave

0:00

Alright folks, welcome to Investing for Beginners Podcast. Today we have episode 277. Today we're going to talk about Moats. And we're going to talk about how you can identify a moat. And we're going to use our friend Apple, as an example, Warren Buffett talks a lot about moats and the power of them.

And it's a great analysis tool, easy for me to say, to figure out what a strong company is, it really helps you understand where the power of the business comes from. So Andrew, has a great email that he wrote a while back about this very idea. And so let's talk about the mode of Apple. So what are the, I guess? First of all, what's a moat? Like, that's probably the first place to start. Yeah,

Andrew

0:42

for sure. That's perfect. So a moat is most traditional sense is back in the day, when you had a castle and you had people come attack it, you would want to protect your family. So you would draw basically a trench and then fill it up with a bunch of water. And that would be your moat, and that keeps a bunch of enemies from getting too close to your castle too quickly. In capitalism, it's a very similar thing with businesses. If I'm a lemonade stand, and I see what the lemonade stand out in the streets doing, I'm just going to copy them and maybe undercut their price by a penny.

And then everybody's gonna come to me instead of that person. And that's just the reality of capitalism. So businesses need something better than you know, a one trick pony, in order to succeed for a long time in the business world. So when you're looking for stocks that you want to hold for a long time, you want to find these kinds of moats that keep their competitors from just blindly copying them, and stealing all the profits.

And that's why as an investor, it's important because you want to buy a business, hold it for a long time for the business to survive for a long time that needs to have a good moat.

Dave

1:54

Yeah, exactly. Exactly. So I guess what are the components of a moat? How do we I guess maybe a better way of putting it? How do we start to identify it? Like, maybe we could start working, you know, so we think Apple has a moat? How can we identify it? What are some of the things that we can start looking forward to start to kind of identify whether Apple or Microsoft or PayPal has a moat.

Andrew

2:15

Now, what's interesting is every business can have its own different moat, its own thing that makes it special. To use the apple example, one way we can identify that they have a moat is their premium pricing. So when you look at Apple versus the other phone makers that produce similar, like, technological type of phones, at least in the United States, Apple charges a much higher premium price, even though a lot of the features are similar. And so when you see a situation like that, you're like, why is this company able to charge more than its competitors?

When on the surface, this looks like a very similar product, when you see that premium pricing, that could be a good indication of a moat. I think of somebody like Nike to people will fit themselves, Nike shoes, Nike, gym bag, Nike shirt, Nike hat, and you're paying more than like an Under Armour product. Why is that? And so that's where when you start to notice those things, you can see, Alright, is there a moat?

There's a reason why these prices, why they can demand a higher price, and then you kind of look into it. So that's where I would start with apples like, okay, there is some pricing power here. Yeah, there certainly is, how would you perceive the pricing power? Why do you think they have that? So this is really on the demand side? Because you have supply and demand, this is really on the demand side of consumers are willing to pay more? Is that a source of a moat? And, you know, that would be the question to ask. So it's like, the first question is, why do they have that pricing power,

Dave

3:45

I think they have that pricing power, because they've created a product that people like and want to have, it's also a bit of a status symbol, as well. You know, there's a lot of people that, you know, insist on having, you know, the blue text boxes, you know, that it has an Illumina to it, as well, and the products are awesome, and they continue to be awesome. And you know, every iteration is a little bit better than before. And it also, I think, becomes a bit of a status symbol, it becomes a sign of I'm hip, if you will, but it also I think, because of the quality of what they put out consistently, you feel like you're getting a value when you buy it.

And so even though it is the prices do keep going up, you know, \$1,000 for a phone is a lot of money, but people will gladly Hand that over because they want that phone, they've created the demand for the phones, and there's people want them and so they're willing to pay any price or near any price to get the phone they haven't reached that ceiling where people like you know, where they start looking for alternatives. And they haven't reached that point yet.

And so because they keep raising the prices on every couple years They're raising their prices, that indicates to me that they have pricing power. And that's a very, very huge indication of a company with a moat. Because companies that don't have that those pricing power, they can't do that.

Andrew

5:12

This one's admittedly pretty hard to quantify. We can't say, yeah, there's specific numbers here that show, you know that this is where this comes from, or anything is very unscientific. But he looked at the way that there's a attention to detail with every little thing that you can think of like when you bought when you got the air pods for the first time, and saw like how easy that was to use, where if you try to hook up a Bluetooth was something else, it's you'd have to click a few things. But apples gone through the hassle of making it really that simple, and that easy.

And that's really something they've done ever since Steve Jobs was really involved with the company. And how can we make this so simple, so easy, make people's lives so much better. So to your point, like it's just a better product in a lot of ways. And people see the value in that. And so they pay up for the better convenience, the better user experience, the better product and with the ecosystem now, I feel like it makes it even harder between the watches and the AirPods. And all of that too.

Dave

6:15

Right, exactly. Well, I think that really leads to the next idea that when you're trying to identify a mode is this idea of a network effect or user stickiness. And I think you just kind of alluded to that. So do you want to do we want to kind of pull that thread a little bit?

Andrew

6:29

Yeah, I'll talk about stickiness, since I was kind of zooming in on that. And then you can look at maybe explaining the network effect. But this the stickiness is, again, when we have something that we've ingrained in our lives, a lot of us are creatures of habit. And so sometimes the switching costs of going through the hassle of changing disrupting your life. Sometimes, if there's not a big reason to well just kind of stick with the status quo. So banks are a great example of this, where we talked several times, people have bank accounts longer than they have some relationships or marriages, as because it's a big hassle to go change your bank account, what's the benefit to doing that if you're getting just as good of service here as it would somewhere else.

So, you know, companies can kind of abuse that and get away with a lot of were customer experience, just because they have high switching costs. So even though you might not like that bank that you're with, they annoy you with all their little mail or papers that come in your address. And every week, you might not be annoyed enough to go through the hassle of switching and that stickiness, and switching costs. So that can be a moat in itself. And switching costs can come from so many different things like banks would be one example where it's just a big hassle to uproot your life. I look at like to go back to the Apple example. If you're a big user in there, let's say iCloud or you know, their photos, all your contacts are on there is it really worth switching all of that to save 100 bucks, which ends up being like five bucks a month on a payment plan.

So with it, there's another example of like when your entire company's infrastructure is built a certain way, it can take 1000s of man hours to switch it out. Right. And so that switching costs there to go across the map with how the switching costs work. But every company has, if they have switching costs, they probably have a unique reason why they do and Apple certainly does.

Dave

8:27

Yeah, they certainly do. It's they're very sticky. Very, very sticky. So network effect kind of comes into play with the stickiness in that the more of the people are on the network, the more powerful the network gets,

because the more people interact with the network, the more you want to be in the network, to take advantage of what your friends are doing, what your family is doing what other people are doing.

And it also creates this idea of these different products that pull you into the network and make you engage with the network. And all those things just kind of build upon themselves. And the network effect is one of those things that helps continue to build the brand because the more people want to watch Apple TV and talk about Ted lasso, for example, that creates a network effect because then other people want to go watch that show. And you subscribe to Apple TV, and you watch it on your phone or your Apple TV, listen to it on your headphones, all those things just create more of an effect for you to be in the ecosystem for Apple.

And that's really one of the things that they've done a fantastic job of building out this kind of whole network of things that you can use, you know, Apple podcasts, iTunes, you know, there's so many different things that kind of build upon itself. And it becomes this network that you really want to be involved in. And there's a lot of companies out there that really have taken advantage of this VISA is one that always kind of springs to mind when I think of network effect because they have what's called a two sided network effect where the customer as well as the merchant are all taking advantage of visa is brand power. And the more people that have a Visa card in their wallet, they're going to want to go use that Visa card to spend in the merchant wants to have that money. And so if they don't accept Visa, then they can't take that customers money. And so it just becomes this network effect.

And it builds upon itself. And that's one of the things that Apple has done a fantastic job of and as they build out more of these services, and ancillary kinds of products and stuff that just builds on the network effect and the ecosystem that we all live in, and anybody that's in the Apple ecosystem, that's just part of the network effect. And Samsung has the same idea. And so that's as part of the ecosystem. And to Andrew's point, to switch from Apple to Samsung would be a headache, and especially if you're involved in all the services, and then you go to Samsung, and you don't have the same access to those things. And if your family is not there, your friends aren't there. And it just becomes this, you know, it becomes a stickiness to stay a network effect to stay with the Apple products. And that's, for me, that's one another reason why they it appears they have a moat that kind of allows them to be successful.

Andrew

11:14

Yeah, is it worth getting kicked out of a family group chats, you make that decision,

Dave

11:18

a bad decision, bad life choice.

Andrew

11:21

So we got two left. So let's let's run through these. The third one economies of scale and low cost producer. Economies of Scale is something where, you know, the bigger a business is, the cheaper it is to, for them to manufacture something. So you know, if I'm trying to make 1000 toilet, if I'm trying to manufacture 1000, toilet rolls, it's going to be cheaper on a per toilet roll basis, if I buy 1000, than if I tried to just buy one, not to mention that no one will probably custom make me a toilet roll.

So in the same token, when Apple is for example, they design their own chips that go in the iPhone. So because they order such a huge batch of chips from TSMC, they're able to get a better deal on those chips than a smaller cell phone maker might have. So to compete against Samsung, or Apple as a new cell phone startup, that's really tough today, because of the network effect, and also economies of scale. And they've also become a low cost producer. Part of that's because of economies of scale. But also, because in a way, this kind of sounds a little maybe out there.

But in a way, a lot of developers that work on the apps that go in the App Store, and they go on the Android store, a lot of those, we're using them on our iPhones and almost like buying a better iPhone because there are better apps out there to use. And so in a way, it's like these developers are advancing the product in a very low cost way. So that can be a competitive advantage if you have a good ecosystem of developers that are used to developing stuff on your app store.

Dave

13:03

Yeah, exactly. That's perfectly the perfect example for me always have economies of scale is Walmart, you think about the pieing power that they have, that's one of the ways that they can sell everything so cheap, is because they can go out buy so much. And they'll move it, they can get low prices, Costco does the same thing. And then they pass those savings on to the customers.

And that's kind of their business model. And so whenever I think of economies of scale, that's always what I think of but Apple certainly has economies of scale, like you were saying. So that's a great example. All right,

so let's move on to the last one. So we have proprietary technology and its protection. So how would Apple how does that play.

Andrew

13:41

So now I'm starting to drift in a fanboy territory. And, you know, longtime listeners, I own this stock, I'm a big fan of Apple as a stock. And I just wish I bought it a long time ago, they are on the leading edge of designing the technology that goes on inside the iPhone. And so they actually, you know, a lot of other, let's take on the want to pick on a technology company.

But let's pick on someone like Dell or something they're not in, they're designing the chips that go inside their computers, they're buying chips from other people who are designing the chips, and then putting those on their computers. Apple's designing that all in house. So that gives them a lot of different advantages in that they can make these things super custom to exactly what they want to do. And it's a trend that we're seeing in the semiconductor industry not to get too into the weeds of instead of everything being about scaling costs, designing the software to interface with the hardware.

And I know that sounds kind of techie. But the best way I can describe it is if if you look at the newest iPhones, and they have this screen that at the top of the screen, you have the little bar that's on the top and then the screen itself kind of goes around it. Now I realize it weren't a podcast so if you don't know I'm talking about you like what is the visualizing this idea that you can wrap the display around a piece of hardware, and everything still works fine.

That's an example of being able to manipulate your hardware in order to make a better user experience. And that's hard for other companies to replicate if they can't design their own chips, or have the technological know how to be able to basically integrate hardware with software to make these things other kind of unique and just make apple more like apple.

Dave

15:27

Yeah, that totally makes sense. And I think that's one of the probably the more under the radar, if you will, aspects of their moat is the technology that they've created and are creating, to build the brand that they've built. I mean, the simplicity of the phone itself, to me is one of the things that makes it so amazing, it's so easy that a five year old can use it. And it's easy enough that a five year old can use it.

So it's one of those things in if you look under the hood, so to speak of what you were talking about, that kind of stuff, I think really is one of the things that does set them apart. And it's also going to give them a lot of optionality to be able to do different things and be you know, as Andrew was saying, custom, custom build certain products for a certain sector of people. And that's going to give them a lot of ability to continue to innovate going forward. And that's kind of an unsung aspect of the Moto, the company for sure.

Andrew

16:17

A lot of the things that you say, make the easy user experience, we don't realize how there's a moat and like a technology behind it, because to us, it's just Oh, that was easy. But actually behind that could be a patent that Samsung can't replicate. And so they can never make it as easy as Apple did. In this instance, that instance.

And that's all unique to all of us, because there's so many apps and so many use cases, basically. Right? So my question for you would be, you know, sounds great. And we fanboy about a company for a whole an entire episode. So the question becomes, do you buy the stock? When do you buy a stock like this? Do you just always buy a stock like this? Like, how do you think of that, for me, it's

Dave

16:57

always part of the equation of trying to determine whether I buy or not, it comes back to the price that you're paying, because it's that still matters, you know, the greatest company in the history of the world, whichever one you want to insert, company A they're the you still have to buy it at a price that makes sense. And if you don't, then it doesn't matter how great the moat is, you won't get the return that you could have, if you had bought it at a better price.

And it all goes back to you don't have to swing at every pitch, you're going to come across companies that may be the most fantastic companies in the world, that just for the moment, for whatever reason, they're just not at the right price for you to buy to get a good return. It doesn't mean that it's not a great company, it doesn't mean it doesn't have a huge moat just means that it's too expensive at this particular time. I guess what about you?

Andrew

17:43

Yeah, that's 100%. That's 100%? Correct. I feel like it's so easy. And that's kind of what makes investing fun is you can get really excited about some of these companies and your potential returns. But you do have to counterbalance it with some cold, hard facts, right, the cold, the harsh truth, some numbers to the ground. You know, that's where learning how to do evaluation and the basics of how that works can really help you in that regard. Because to your point, we've seen too many companies.

I live on the list of all too many stocks where they were fantastic companies, they had great Moats. They were terrible stocks to own because the share prices were too high when the investors bought them. So I won't comment on the current price of any stock right now. That's what the weather is for. But I will say yes, the MO is a big part, but also so it's evaluation. Yep,

Dave

18:34

I totally agree. All right. Well, with that, we will go ahead and wrap up our conversation on moats, and how you can go up how you can start to go about assessing those. If you have any questions about anything that we talked about today, please check out our website investing for beginners.com. We have articles there concerning moats, pricing, power, and competitive advantages.

So those could be some good resources for you to learn a little more in depth about what we are talking about today. And taking those ideas and trying to discover moats or determine whether the company you're looking at has a moat doesn't have a moat. And that can be very helpful as you try to learn more about stock market and find great companies to invest in. So without any further ado, I'll go ahead and sign us off you guys go out there and invest with a margin of safety. Emphasis on the safety. Have a great week, and we'll talk to y'all next week.

Contact sales@advertisecast.com to advertise on Investing for Beginners podcast. The Investing for Beginners podcast is part of the Airwave Media podcast network.

We hope you enjoyed this content. Seven steps to understanding the stock market shows you precisely how to break down the numbers in an engaging and readable way with real-life examples. Get access today@stockmarketpdf.com until next time have a prosperous day. The information contained just for general information and educational purposes. Only it is not intended as a

substitute for legal, commercial, and or financial advice from a licensed professional review, our full disclaimer@einvestingforbeginners.com.