Bird’s Eye View of the Smartphone Industry

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Dave [00:00:00]:

All right, folks, welcome to Investing for Beginners podcast. Today we're going to do a bird's eye view. We're going to take a look at the smartphone industry. We thought this would be a fun conversation to kind of unpack the industry, maybe talk about the value chain and some other fun stuff. So without any further ado, let's go ahead and dive into the bird's eye view of the smartphone industry. Andrew, would you like to kick us off and talk about the smartphone industry?

Andrew [00:00:24]:

Happy do. I think the premise for investing in the smartphone industry is the most simple and most evident investing theme you could have today as we record this in 2023. Get ready, go outside, drive your car, see how many people are on their smartphones while they're driving, or how many people are on the streets looking at their phones. Stop at a mall, an outdoor mall, whatever. Look at how many people are buried in their phones and tell me that's not a good place to invest, period. Totally. We're obviously addicted to our phones, and it's not even funny. And I think everybody can admit that they wish that they use their phones less.

Andrew [00:01:05]:

So there's just a million ways you could invest in the smartphone industry. I mean, we could even get creative. And if I were to look at my smartphone and the apps I use, I see Metas on there with Instagram, Snapchat's on there. Technically, those are really smartphone, mobile only apps. So you could invest in that way. The obvious ones are Apple and Samsung. And if you start to unpack Apple, you got a whole came of worms of just, it's amazing how much Apple powers our economy. So maybe we could start there.

Andrew [00:01:41]:

But just from a very basic overview, assuming somebody's done zero research on Apple versus Samsung, Google, Android, how would you kind of help somebody understand that?

Dave [00:01:55]:

Well, I think to kind of defer your point of how much we're on our phones, throw out a couple of numbers here. So in 2023, the smartphone users in the world totaled 6.92 billion of us, which translates to 85.8% of the world's population. So that's kind of staggering. So to confirm what you were saying, we all have cell phones. And so I think there's no question that there's a lot of opportunity to invest in those. And I think your point about the apps is perfect. Google is the first one that pops into my mind, because it's the thing I probably use the most, is my Google search on my phone, and I'm on there all the time. So the cell phone industry is a massive industry, and like you said, there's a lot of threads we can pull to unpack, really, all the different ways that you can invest beyond just Apple or potentially Samsung or Google.

Dave [00:02:53]:

Those are probably the three most well used phones or, I guess, most users. The United States, it's dominated by Apple, but globally, it's dominated by Samsung and Google has a small, very small portion beyond that. And so there's so many different ways that we can go. I think probably the thing that I would probably want to start with is maybe start with the actual producers of the phones. Like where would you want to start? Apple. Samsung would probably be the two companies. Like you said, Apple drives so much of the economy of the United States and arguably globally. What about Samsung? I don't know, 60, 70% of the world's cell phones are Samsung's.

Andrew [00:03:33]:

Yeah, Samsung is in South Korea. And I wanted to back up and this popped in my head while you're talking. I have investments in Apple. I have TSMC, I have crowncastle. Some of these companies will be talking about today. I might own them already. So just that's going to be out there before we start. But Samsung again.

Andrew [00:03:54]:

It's in South Korea. When I think of mean, I think of memory. And that's one part of a cell phone. I don't have to state the obvious. Every smartphone we see seems to have more memory. Every single model. And so example of a company that designs those is Micron. Micron is a semiconductor company and they produce memory chips.

Andrew [00:04:19]:

And so those little boxes that are going inside your iPhone that allow you to store the thousands, tens of thousands of pictures you don't need, those are all being stored on Micron's chips. Micron's chips, Qualcomm's chips. Qualcomm does some of the RF stuff which helps your phone connect through antenna and then the chip itself, the semiconductor will help the phone kind of process all that information from the outside world and make it something that your phone can use. Another company called Skyworks, they actually drive over half of the revenue just from Apple themselves. They also make semiconductors. So it's amazing when you start to peel that onion of how many different semiconductor companies are inside your iPhone or your Samsung. It's a lot. And these stocks have done well because again, people are not afraid to spend money on their smartphones that monthly payments.

Andrew [00:05:16]:

Just like one of those Necessities right up there with food and rent.

Dave [00:05:19]:

That's so true. So can you maybe explain to me the connection or the correlation between Android and Google? That's something I've never really quite understood.

Andrew [00:05:32]:

So Google owns Android? Basically. Okay, Android's the I have to explain for a US audience because the percentage of Android users is smaller, the data just kind of bears that out. But it's an operating system similar to Apple's iOS. On Android phones you have the different operating system and so that operating system can go on different types of cell phones whereas the iOS can only be on an iPhone.

Dave [00:05:59]:

Right, okay. All right, that makes sense. So I guess it's always kind of puzzled me that they own the operating system, but they could never make a phone go, which is kind of interesting, right?

Andrew [00:06:10]:

When you start to untangle the supply chain of Apple and Samsung, you start to see like, this is not taking lemonade and mixing it with ice cubes and putting it in a cup. It's quite intense, it's quite global. Foxconn's. One of those suppliers that gets a lot of press sometimes. And then obviously, TSMC, who is in Taiwan, makes the chips that somebody like Qualcomm or Broadcom might design, manufactures them in their super specialized factories and then sends them to the people who put it together, sends it to Apple. Can sell at the Apple Store or T Mobile, wherever. So it is to your mean, it's not a simple, easy thing to just start up a smartphone supply chain from scratch. That's I'm just speculating.

Andrew [00:06:59]:

I don't know why those phones haven't taken off as much. Could be a million things. But you wonder if that's one major reason.

Dave [00:07:06]:

Yeah, for sure. So what would be the I guess the picks and shovels, if you will, of the cell phone industry? Like if you start kind of thinking about the value chain as kind of how they work, what would be the picks and shovels? Would it be the semiconductors that you're talking about?

Andrew [00:07:22]:

Yeah, I mean those are some picks and shovels. You could argue the software, the apps that are on there, those could be kind of like those could be their own discussion. And then you have the cell phone carriers as well, the T Mobile and the Verizon and the At T and the companies that serve those companies picks and shovels. It's hard to simplify it as picks and shovels because there's so many players, right?

Dave [00:07:45]:

Yeah, for sure. So what would be some other avenues or places you could look for value in the cell phone market or the smartphone market?

Andrew [00:07:57]:

My favorite right now is the cell phone towers and they are getting beaten up like you would not believe. It's pretty crazy. And so there's a lot of negativity, about five G and we've had this rollout where the at and T's and Verizon's and T Mobiles of the world, they've tried to market this 5G thing and for whatever reason it doesn't seem to be creating the type of financial results that maybe some of these companies thought. And so there's a lot of fear about the towers which allow these 5G networks to function that you could start to see demand kind of slip off there. The basic investment thesis for one of those is you need cell phone towers to have cell service and to be able to process data. And if I want to take a video of my dog because who wouldn't want to do that and I want to put it on Snapchat and then send it to my brother, that's got to go through the data connection, it's got to go through a cell phone tower. So those towers are essential to what's going on kind of behind the scenes of what makes your smartphone work and communicate and everything. And there's actually not that many big cell phone tower companies that help T Mobile, Verizon, and At T.

Andrew [00:09:10]:

And so they are an attractive investment thesis because their concentration makes it hard to compete against them. And their big scale kind of puts them on the same level as the customers that they serve. At T and T Mobile obviously huge companies in their own right. And so because you kind of have equal people coming to the table and having that discussion, you get good deals for all parties. And so because it's been so beaten up, because there's a lot of 5G negativity, those stocks are crazy cheap and has provided some value. But obviously through the years, there's been value in semiconductors, too. Some of the best performing stocks over the last five years have been semiconductor companies. And so I think there's a lot of ways an investor could play smartphones.

Andrew [00:09:57]:

And I love apple, too. I mean, if you've listened to the podcast more than once, you've probably heard me rant and rave about Apple. But another great company, obviously, and it's obviously not going away. There's a lot of money being invested inside of it. Our smartphones get better. They become more integral part of our lives every day. So it's just one of those things that it wasn't around 20 years ago. And so there's really no I don't want to say there's no, but there's very few kind of parallel mental models that you can look at historically to say, like, yeah, this is similar to smartphones.

Andrew [00:10:34]:

And so I think if you don't have exposure in your portfolio to smartphones, it's maybe something you might want to consider.

Dave [00:10:40]:

Yeah, for sure. Those are all great points. One question that kind of comes up to me is how do the cell phone towers, I guess, how is that value compared to the value of the telecoms? Because a lot of us buy our phones, like, I buy my phone through Verizon, for example. So it's an Apple phone, but I'm buying it through Verizon. But the only way I can connect to you is through the cell tower with Crown Castle. So I guess how does Verizon figure into this whole value chain, if you will?

Andrew [00:11:10]:

Yeah, one of the things that was not obvious to me when I first looked at it was somebody like T Mobile, they might have their own towers, but a lot of the big T Mobile, Verizons, and at TS, they're starting to move away from owning those towers and leasing them out instead. So it's really no different than a business who has a store. Maybe they used to own the land and now they rent it. It's the same thing with the cell phone providers. They rent these towers instead of own them. And so for a tower company, it's pretty safe, long term contracted revenue. And that's what makes this period of time extremely interesting because you have fears of demand evaporating. But when some of these companies have literally contracted revenues that we can see for the next five, six, seven years makes me scrap my head a little bit.

Andrew [00:12:01]:

But it is what it is. I mean it does make a lot of sense too. Real estate in general has been terrible over the last two, three years and it's easy to lump all of that stuff into there.

Dave [00:12:10]:

Yeah, for sure. So what do you think? You mentioned earlier that the cell phone in itself has not been around real long. Are there any potential risks to looking at companies like Apple or Samsung or even any of the ones in the value chain like Skyworks that depend so much on Apple's revenue for their growth and their continued success? Are there any disruptions or there any potential risks of investing in a company like Apple versus Samsung to just a general idea, kind of like we were.

Andrew [00:12:43]:

Shooting the breeze on earlier today. They have obviously the competition to try to make something that the consumer loves is endless. And we were kind of talking about earlier how there's some of these VR sets that are being presented, apple being one of them, but also meta with its quest two and now quest three, these big VR goggles that you could argue maybe might try to disrupt the smartphones within Apple versus Samsung. You have the risk that people don't value their iPhone anymore. They go the way of Nokia, like you've mentioned many times on our show before. So there's always that risk as well. I think every company in the ecosystem is going to have its own risks. So the risk for Skyworks, which is so reliant on Apple, and the risk for Qualcomm, which also makes chips for Apple, but is not as reliant on those chips or on Apple, those risks are going to be very different depending on which company you're looking at.

Andrew [00:13:45]:

And so you can't really put a broad risk factor on it. But if you would say the obvious one would be a new consumer advice coming in and completely making me not use an iPhone and use something else. But to this point we haven't seen it, I don't see any profitable companies doing it. And so that risk seems minimal for now. But it is a good point in whenever you invest in technology you have to look out for what could potentially disrupt it. Because 20 years ago we used to all use computers for our Internet exclusively. Obviously we do now, but obviously that's changed and been disrupted by smartphones. That could happen again in 20 years.

Dave [00:14:27]:

Yeah, that's very true. I think one of the things that I know when I was doing very brief work on Apple many years ago, that one of my concerns was that they would run out of people to sell the phones to. And I think after listening to Kevin Carter on our show a few weeks ago talking about India and the long runway that India has to just getting cell phone adoption in general is they got a long ways to go. And I know Brazil does as well and definitely parts of Africa. So I think there's a long ways to go. It's interesting that Apple and Samsung have kind of two different pricing strategies where Apple seems to go for a much higher price point, where Samsung tends to go for a lower price point. And I wonder if that has some impact on their global expansion. You could argue that iOS is way better than Android, and I know that could be fighting words for some people, but it is interesting how they've kind of gone different paths.

Dave [00:15:26]:

What are your thoughts on the cell phone industry or the smartphone industry and its potential for continued growth not only now, but into the future?

Andrew [00:15:35]:

You have a daughter.

Dave [00:15:36]:

I do.

Andrew [00:15:37]:

What kind of smartphone does she have?

Dave [00:15:39]:

Well, she has an iPhone, of course. Duh.

Andrew [00:15:41]:

Has she ever talked about switching away from it?

Dave [00:15:44]:

No, but she has been talking about getting a new one because the one she has is not updated enough, right?

Andrew [00:15:53]:

Of course not.

Dave [00:15:54]:

No.

Andrew [00:15:55]:

And therein lies potential growth driver. The users of technology seem to be getting younger and younger. And I was talking to my daughter the other day and she said her friend has an Apple Watch. I was you know, I didn't think that that would be something a kid would want, because when you're that age, who wants to look at the time, that's more like a prison. Right. So I understand a lot of the arguments against Apple and its ability to continue to do what it's done. But I just wonder if sometimes that argument maybe is not looking far enough outside of the box and just not understanding and kind of the cell phone towers, I think, to an extent, deal with this too, this idea. That human progress all the way up till today 2023.

Andrew [00:16:43]:

Especially if the market's down for like, a month, then that's how we know human progress has stopped. Of course, once the market's down by 5% in a month right. That human progress has stopped today. And whatever we see today is the technology we're going to have forever.

Dave [00:16:58]:

Forever.

Andrew [00:16:59]:

And that's just not the case. So when I look at my iPhone personally, when I first used it, I maybe used it for pictures and texting. And now I use it. It's my fitness personal trainer. It's my entertainment. It's how I read the Wall Street Journal. And I only expect that to grow over time. And until that stops, the financials will show when that's stopped.

Andrew [00:17:24]:

But until that happens, I think a lot of it's just kind of Chicken Little, right?

Dave [00:17:29]:

Yeah, I would agree with that. I think one of the things that we kind of have been talking about today is a lot of people, when they think about smartphones, they think only of Apple or maybe only of Samsung. But there's so many other opportunities out there with the semiconductor field, with cell towers, and with the telecoms. And I guess if you were thinking about how you would try to maybe play the smartphone industry, is having different points in the value chain an interesting or good way to do it? What were your thoughts of kind of maybe it evolved unintentionally, but maybe how would you think about telling somebody that's just starting, hey, think about investing in this. This is why and this is kind of how you should maybe structure it?

Andrew [00:18:16]:

Well, if you want the easiest answer, you have to subscribe to Value Spotlight. Unfortunately, to me, it really depends. It depends on what time we're talking about. I know people like to listen to our podcast months later sometimes, and so whatever is interesting today might not be the same case in three months from now. So it's really tough to kind of make that determination. I would say if I was somebody starting from day one and just starting to take a look in the industry, find out what part of it is interesting and start to go down that rabbit hole. And you don't have to get whatever you want to call full exposure in your portfolio to this secular tailwind, because that's really all it is. It's a secular trend, but there's many secular trends that you can invest in.

Andrew [00:19:07]:

And if you're buying an index fund, you're getting exposure to a lot of them. But you don't have to have exposure to any and every secular trend. You don't have to be exposed to smartphones to have great returns, and you don't have to figure it all out tonight. You have a whole lifetime to learn about different investment options, if you so choose. So that would be my advice versus trying to give you the exact company right now that might change tomorrow, right?

Dave [00:19:39]:

Yeah, for sure. But technology, like you said earlier, it changes constantly. And so what could be pertinent today could be obsolete in two years.

Andrew [00:19:48]:

Well, that's what's important, I think, and I'm glad you brought that up, is each company in this chain is going to have varying levels of that. And if you're not considering that as you think about the risks of these companies, I don't think you're really analyzing them.

Dave [00:20:03]:

Okay, well, maybe let's pull on that thread just a little bit of the, I guess, four subsections that we've kind of talked about today. What would be the least risky to the riskiest as far as, like, maybe tech obsolescence or just overall potential for.

Andrew [00:20:19]:

Going out of style, if you will, purely from obsolescence? With my crystal ball stepping off, I would say the semiconductors have the most risk of obsolescence. And I think the reason why I say that is because you've seen it happen already where intel used to sell a lot into Apple. And what Apple figured out was, oh, you guys don't manufacture these chips, you only design them. Oh, we can hire engineers and do that too. So Apple's actually they've built a really strong team of engineers who know how to design semiconductors and so they've already displaced some of the purchases from that. I don't see why they can't continue to do that and

I don't see why Samsung and some of the other device manufacturers can't do that as well. Not to say all semiconductors are bad companies, but to say I think the risk of obsolescence is highest in that space because like you're saying, the tech moves so fast and in semiconductors, if you're not first, you're last.

Dave [00:21:25]:

Yeah, for sure. And I think that's a really great way to think about it. And when you think about Apple's ability to maybe take on the manufacturing of the phones and the semiconductors gives them a bit more of a control and also gives them a bit of more of a competitive advantage because they can do it all in house. When you think about them trying to take over the rest of the value chain, then it becomes, I think, a little more difficult, I would hypothesize, because there's a lot more capital do you have to put out there to create the cell phone tower network like a Crown Castle has. And likewise, to be able to distribute the phones like Verizon does takes a much bigger effort than I don't know that Apple would want to do. So it's kind of interesting, kind of how the value chain all feeds on each other and is necessary for each other, but some parts are stronger by themselves than others.

Andrew [00:22:20]:

Yeah, that's very well said.

Dave [00:22:22]:

I think it's a fascinating industry and it's not something I think a lot of people consider beyond just investing in Apple.

Andrew [00:22:30]:

Right. And the world really is your oyster. I mean, do you have kind of a preferred pocket in you? Has that changed for you over time?

Dave [00:22:42]:

I don't know that it's necessarily changed. I feel like I missed out on Apple a little bit and I could still buy it today. I just have chosen not to. I have invested in TSMC, I have invested in Crown Castle and I don't own any of the telecoms at this time. But I have looked at them hard, especially Verizon, just have found reasons not to buy them, for whatever reason. So I feel like those two have been I think they are going to be good investments and I think they serve the thing I like about them is they serve the cell phone, the smartphone industry, really well, but they also have a lot of other options as well. And it gives them, I think, not so much reliance on the smartphone industry, but enough that they can partake in the gains that that industry is going to continue to see.

Andrew [00:23:30]:

Yeah, that's good insight. I feel like we'd be remiss if we didn't spend a little more time on the cell phone providers. I know you've done some work, maybe it was two, three years ago, you kind of looked at Verizon. How would you kind of summarize that part of all of it? Because I haven't talked too in depth about it.

Dave [00:23:51]:

Right. Well, I can't speak to T Mobile because I don't frankly, know much about them. I have done a little bit of digging on At T and I spent more time in the Verizon world, and they are unquestionably strong big companies, and they pay dividends, but the growth has been kind of stunted. And I think five years ago, even maybe ten years ago, you would have thought of Verizon in particular as kind of a growth company, and to a certain extent, maybe a portion of at and T. But more recently, they both have tried. I think they saw the writing on the wall that they were going to become more mature than I think they wanted to be. And so they tried getting into media. At T bought Discover and HBO and Verizon bought AOL and some other things, and they all kind of fell flat on their face.

Dave [00:24:47]:

And so that was not their core competency. And so they kind of had to move away. And I would think of them now as more like, in essence a bond replacement in an equity, where you're going to get some capital appreciation and you're going to get a good dividend from them, but to expect big returns from them, I think those days might be behind them. But the one, I guess, Shining Light is the 5G rollout. And I don't think that that's because it's been going on for like it feels like 17 years that it doesn't get. I don't think the recognition for how groundbreaking this is really going to be once it's fully rolled out across the country, and particularly the big cities of how much it's going to make our lives easier, even easier, with those cell phones in our hands that we will be able to basically instantly look at anything and everything that we want, whenever we want. Right now, you sometimes can have a lag, and maybe if you're out in the country, you can have even more lag. But I think once it's fully up and optimized, it's going to be blazing fast.

Dave [00:26:02]:

And I think that could be really a game changer for Verizon, at T, T Mobile, and Crumbcastle and American Tower as well. And I don't think that's really been talked about enough. I think of the telecoms, really, they used to be like our phone distributor, but now I think of it as basically a subsidiary of Know that's where I go to get my Apple products is I go to Verizon because they're my cell phone provider, and that's just how I look at them. And think of them, but I think they're interesting companies, and especially At T, they have a very long history. It can be a fascinating thread to pull on, but I don't know that they're necessarily, depending on what you want them for in your portfolio, they could be a greater investment or they could not be. So it kind of depends on that.

Andrew [00:26:49]:

I think the history tells a lot and you wonder if they could shed some of that and really focus on core competencies and not just to pick on At T, but just the whole industry. In would I would hazard you guess you would see a lot higher growth than what they've seen historically if they start to really laser in on what they do best.

Dave [00:27:11]:

Right, I agree with that. I think the last thing I'd like to throw out there about them is they have the potential to upseat or upend the streaming digital transfer of information like a. Comcast or some of the other streaming industries. These companies could become the distributors of that, and I know that they've kind of been dabbling in that. But as the 5G rollout becomes a bigger thing, they could become a bigger player in that industry, which could drive some growth for them as well, and it could upend some of the more. A lot of this is all legacy, if you will. So Comcast and Charter and some of those all kind of sit in that same realm. But Verizon and At T, they could be players in that industry going forward.

Andrew [00:28:04]:

Yeah, it's a fun industry to watch, for sure, in so many levels.

Dave [00:28:08]:

Yeah. There's so many different onion peels that you can kind of peel away as you kind of start looking beyond just Apple and the value chain and all the different kind of categories and interconnections the whole thing. It's kind of fascinating.

Andrew [00:28:22]:

Or you could just buy Apple and go sit on the beach, right?

Dave [00:28:25]:

Yeah. That's probably your best option to be. Exactly. Exactly. I will say this. I tried to read through Samsung's financial report, and that is, I'm going to tell you, is gargantuan because they have so many different businesses. It's a little bit overwhelming for me. At some point, I may try to go back at that.

Dave [00:28:47]:

It's kind of like trying to read The Ulysses by Joyce. It's one of those things you just got to go through at one point to try to figure it out. And if somebody has better insights into that, I'd love to know. All right, folks. Well, with that, we will go ahead and wrap up our show for this week. Don't forget to subscribe to the show on your preferred podcast app. If you enjoyed our little show, and if you would kindly consider giving us a review, a five star would be fantastic. It greatly helps our show.

Dave [00:29:12]:

And don't forget to browse the incredible materials we've created for you@einvestingforbeganners.com. Lastly, continue growing your. Knowledge as an investing for Beginners insider with insights and educational tips delivered right to your inbox for free. Sign up today. Do not delay. All right. With that, we will go ahead and sign us off. You guys go out there and invest with a margin of safety.

Dave [00:29:30]:

Emphasis on the safety. Have a great week and we'll talk to you all next week.