Why Apple is more valuable than Google

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A look at what's behind the Mac and iPhone maker's now firm market-cap edge on the Web-search leader, and how it could one day challenge Microsoft.

While Apple's capitalization has risen above that of Google for short bursts in the past, it has remained higher since July 22. As of Aug. 11, Apple was worth $145.87 billion, compared with Google's $143.40 billion. This could be a momentary shift in Wall Street's whims—like when Cisco Systems (CSCO) briefly surpassed Microsoft (MSFT) to become the world's most valuable company in 2000.

More likely, Apple has more solidly unseated Google as tech's No. 2 powerhouse and is now on track to one day challenge Microsoft for the crown. While both Apple and Google are likely to remain highly valuable in the coming years, there's reason to believe that Apple may outshine Google in the eyes of investors.

Dedicated Apple customers

Google has an incomparably profitable Web-search operation, but it incurs losses in scores of other businesses. Apple, on the other hand, makes money on everything it does—even the music and applications sold in an effort to get people to buy the hardware devices that are its true business.

And Apple has far more room to grow based on its core businesses. While Google gets about 70% of the revenue from the $14 billion online search advertising business, Apple has well under 10% of the computer business, and about 8% of cell-phone revenue.

What's more, Apple's profit machine may be more protected from competition than Google's. As Google executives are quick to tell antitrust regulators, consumers are just clicks away from switching search engines. But Apple has its fingers all but sewn into the wallets and purses of the millions of people who have purchased billions of songs and almost 2 billion iPhone applications from the AppStore. More than 75 million people have credit cards on file with Apple, and have invested to build libraries of songs, movies, and applications. The more they spend, the less likely they are to jump ship to other products.

Apple eyeing tablet PCs

It's not hard to envision ways for Apple to grab a larger slice of consumer spending. For all of its success in digital music—it long ago passed Wal-Mart (WMT) to become the world's leading distributor of music—still only about 30% of music is sold via iTunes. And with thousands of new apps showing up in the App Store, the reasons to buy an iPhone or iPod Touch—say, to use it as a GPS navigation system, as a level, or for making bank deposits—are expanding. And if rumors pan out that future versions of iTunes will incorporate more social networking, it will be even easier for Facebook and Twitter users to recommend Apps to friends.

Apple likely will have a big leg up as it weighs entering new hardware markets—take the tablet PC for example. A raft of these computers is expected to flood the market in the coming months, thanks in part to support from Microsoft's new operating system, Windows 7, due to hit shelves Oct. 22. Analysts see little chance of a major hit emerging from any of these devices. Yet some percentage of iPhone users will undoubtedly want a device that lets them play their App Store games and watch their movies on a larger screen. "Apple's already created demand [through iTunes]" for the tablet, says Gartner (IT) analyst Paul Jackson.

As for Google, it's struggling to move beyond search. Its Google Apps unit makes money selling corporate software, but not enough to qualify as material. And analysts expect a slew of cell phones and other devices built around Google's Android software to come to market in time for the holidays. Still, there's not much traction, certainly not relative to Apple's runaway iPhone sales.

Expanding the ecosystem

Even if Apple fails to keep churning out hit new products, it has other ways to milk the ecosystem it's already created for profits. Given its huge profit margins vs. hardware rivals, it could easily lower prices for its computers. While it now has 38% of the market for laptops costing $1,000 or more, Bernstein Research analyst Toni Sacconaghi believes Apple could expand its market opportunity by 75% if it would offer an $800 device—or by 212% if it sold one for $600.

What's more, the company could easily rent out space on iTunes or the iPhone home page for ads, something it has not yet done. And the day may well come when Apple demands huge payments from Google for using its search engine and other applications on the iPhone. Former Yahoo (YHOO) Chief Product Officer Geoff Ralston speculates that as iPhone sales rise, Google could earn $500 million or more from searches carried out on the iPhone—a profit stream that Apple will certainly want a piece of.

Of course, Apple faces risks. Topping the list is the potential for a backlash from the content partners it needs to maintain that iTunes ecosystem. Having seen how little Apple has done to help the music labels profit from digital music, movie and TV studios are driving a much harder bargain. More recently, application developers have been criticizing Apple for the tight control it maintains over what can be sold via the App Store.

Bing not considered a threat

Then there's the health of CEO Steve Jobs. A recovering victim of pancreatic cancer, he's back at work on a part-time basis following a liver transplant. The company says it is not dependent on any one individual, and points to the runup in the stock during the six months Jobs was on medical leave earlier this year. But while Chief Operating Officer Tim Cook capably ran the company during that time, he also didn't mount an assault on any new or vulnerable markets.

At the same time, Google is well poised to remain the undisputed leader in Web search for the foreseeable future. Sure, Microsoft has paired with Yahoo, but few see Microsoft's Bing search tool gaining substantial share at the expense of Google any time soon.

Still, some in Silicon Valley say the question isn't whether Apple can stay ahead of Google, but which tech or telecom company it will pass next. Most likely, that will be AT&T (T), with its market cap of $149.6 billion. AT&T is currently benefiting from exclusive rights to the iPhone in the U.S.; no doubt its market cap would plummet should Apple ever announce the end of that exclusive.

Microsoft's high hurdles

That leaves only Microsoft. With a market cap of $206.1 billion, it has a healthy cushion that should last at least a few years, say analysts. Then again, Microsoft has to prove it can adapt its business in fundamental ways—to make its recent search partnership with Yahoo work, contend with lower-priced netbooks that carry versions of Windows far cheaper than regular PCs, and maintain its margins even as it introduces cheaper or even free applications such as new ad-supported versions of Word, Excel, and other programs in its Office productivity suite that will be part of a major release next year.

At the moment, those look like higher hurdles than the ones facing Apple.

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