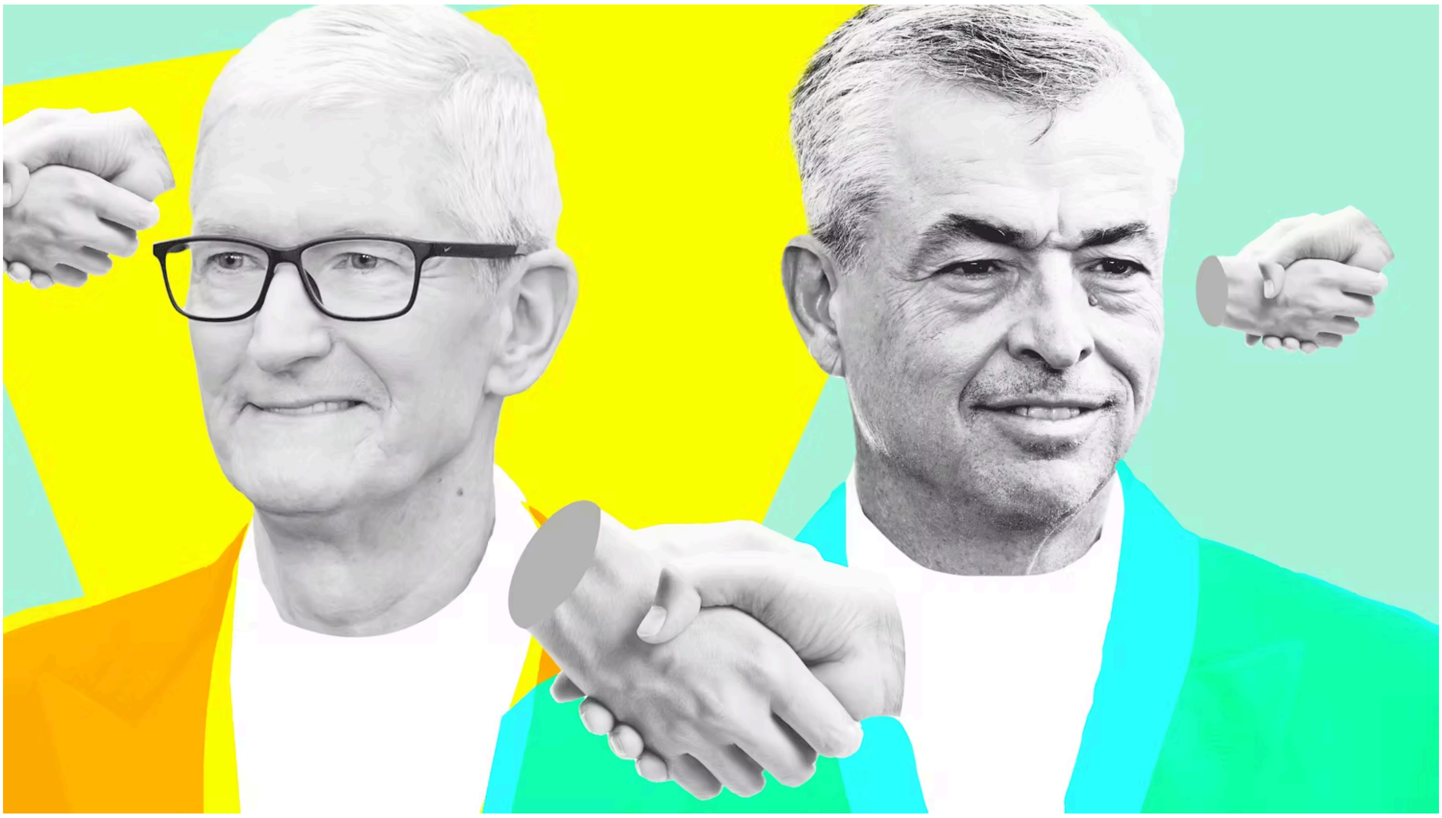
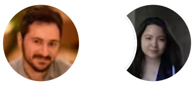


Tim Cook, left, and Eddy Cue. Photos via Getty. Art by Mike Sullivan

Exclusive

Apple's Aversion to Big Deals Could Thwart Its AI Push

Apple's competitors are spending a fortune on AI deals. As the iPhone maker struggles in AI, some executives are pushing it to be bolder.



By Aaron Tilley, Wayne Ma and Valida Pau

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This summer, investment bankers came knocking on Apple's door with a pitch: Was the iPhone maker interested in doing a major acquisition or some other kind of deal in artificial intelligence? So far, the only answer it has given them is: not so much.

In the current AI frenzy, nearly all of Apple’s peers in big tech have thrown open their wallets to spend billions of dollars on AI deals, including licensing agreements that have allowed them to pluck top talent from startups in the field. But not Apple. The company has, with few exceptions, stuck to small acquisitions throughout its history (it has done around seven such deals this year alone). Some of them have played an important role in the development of its products.

The Takeaway

- Eddy Cue has emerged as the most vocal champion of dealmaking inside Apple
- Apple has internally discussed possible acquisitions of Mistral and Perplexity
- The company has avoided large acquisitions in the past and has struggled to retain talent from even small deals

Apple’s dealmaking aversion could be particularly risky given the importance of AI and the perception that Apple is lagging far behind its competitors in the technology. Investors and analysts are increasingly agitating for the company to do something big if it wants a chance to remain relevant.

Some catalysts may emerge in the near future to impel Apple into a bolder deal. As early as this week, a federal judge is expected to issue a decision in a Google antitrust trial that could end the $20 billion in annual payments the company makes to Apple to be the default search engine on Apple devices. Losing Google as a partner could prompt Apple to acquire an AI-powered search startup to fill that gap.

To be sure, the topic of acquisitions is hardly off-limits inside Apple. Among the potential targets Apple executives have discussed are Mistral AI, a Paris-based rival to OpenAI, and AI-powered search engine Perplexity, according to people familiar with the matter. Apple’s services chief, Eddy Cue, has been the most vocal champion within the company of these AI deals, according to a person familiar with his thinking.

But so far, Apple hasn't pulled the trigger on any deal. The company's hesitation to do big acquisitions isn't new. A single such deal would likely total in the billions of dollars, and over the past two decades, Apple has rarely spent more than a hundred million dollars per acquisition. The exceptions include the $3 billion it spent on Beats Electronics, which offered headphones and a streaming music service, and the $1 billion it paid for the wireless modem business owned by Intel.

"Apple likes to build everything internally," said Matt Murphy, a partner at Menlo Ventures, who was a board member at music discovery app Shazam when Apple bought it in 2018. "They worry people at other companies won't live up to Apple's standards or culture. But it is perplexing, with that market cap, that they aren't willing so far to take more risks in the AI field."

The contrast between Apple's dealmaking and that of its rivals is stark. Meta Platforms, for instance, recently invested $14.3 billion into data-labeling firm Scale AI for a 49% stake in the company, an agreement that also brought Scale's founder, Alexandr Wang, to Meta, where he oversees its new Superintelligence Labs.

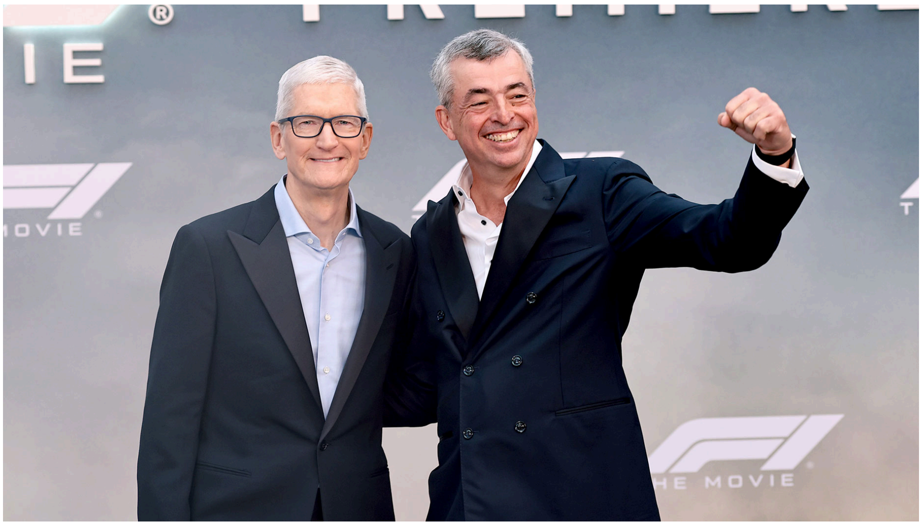
And last month, Google struck a $2.4 billion deal to license AI coding startup Windsurf's technology. The deal brought Windsurf's top talent, including its founders, to Google DeepMind, the search giant's AI division. Such arrangements have become popular at big tech companies because they avoid the regulatory scrutiny traditional acquisitions must go through.

With nearly $133 billion in cash, Apple has more than enough resources to afford deals with some of the biggest and buzziest AI startups. In an earnings call last month in which investors quizzed Apple CEO Tim Cook about the company's acquisition strategy, he said the company is open to doing acquisitions of all sizes.

"We're very open to M&A that accelerates our road map," he said.

Apple has told bankers it's carrying on with its strategy of focusing on smaller deals in AI, said people with knowledge of the conversations. Adrian Perica, its vice president of corporate development, has been involved in those conversations.

Apple has good reasons to be cautious about doing blockbuster deals. Integrating big acquisitions can backfire, resulting in culture clashes between newly melded organizations.



Apple's Tim Cook (left) and Eddy Cue. Photo via Getty

According to former employees of around a dozen companies acquired by Apple, the issue is particularly acute at Apple. Most of its top executives have been at the company for decades and worked alongside Steve Jobs, its co-founder and former CEO, who died in 2011. It has proven difficult, in many cases, for outsiders to join Apple and have influence inside it, these former employees say.

That dynamic has been especially true among the founders and employees from startups Apple acquired to strengthen Siri and its AI group.

Some of them said Apple lured them with promises that their technologies would reach far more users than they ever would as part of smaller startups. But once Apple acquired their companies, they found themselves absorbed into large Apple teams that were resistant to risk-taking and ambitious ideas. In many cases, their technologies went unused.

Disillusionment can set in quickly under such circumstances. Feeling stifled at the company, one founder of an AI startup Apple acquired several years ago became so eager to leave that he placed a clock on his desk, counting down the minutes until his shares would vest and he could resign from Apple, according to a person who saw his workspace.

An Aversion to Overpaying

Apple's corporate development team—the group that is typically in charge of dealmaking at companies—is small and is led by Perica, a former officer in the U.S. Army and banker at Goldman Sachs. Perica joined Apple in 2009, after Peter Oppenheimer, former chief financial officer, recruited him to formalize its process for acquiring companies.

Under Perica, that process starts with Apple leaders identifying critical pieces of technology they lack and the outside companies that can fill those holes. Perica helps evaluate potential acquisitions of those companies and provide analysis of deal terms. The team doesn't typically hire external bankers to represent it as it hunts for deals, though it interacts with bankers who work for other companies looking to sell.

Apple has had some success with acquisitions, though many of them occurred when the company was far smaller. The most notable example is its 2008 purchase of PA Semi, which became the foundation for its now critical in-house semiconductor team. Former PA Semi employees still serve important leadership roles inside the chip group.

While some tech companies have little trouble paying handsomely to acquire startups or talent based on, say, the vision of founders, Perica's team is determined not to overpay for companies based on buzz and other elusive metrics. In 2018, for example, when Apple bought Shazam, Apple arrived at the roughly $400 million it paid for the music recognition app by calculating how much it was spending on advertising its Apple Music service on Shazam. The app had become a popular channel for people to sign up for Apple Music.

Perica's advice on deals doesn't always prevail. In 2014, Apple acquired display developer LuxVue for more than $400 million, despite objections from Perica over the price, according to a person with direct knowledge of the matter. Cook decided to buy the company on the recommendation of Al Gore. The former U.S. vice president was then an Apple board member and a partner at Kleiner Perkins, an investor in the display maker.

Over the next decade, Apple sunk more than $2 billion into a project to build displays for the Apple Watch and eventually the iPhone using LuxVue's display technology, which promised far better brightness, dynamic range, viewing angles, durability and power efficiency than existing ones.

But staffers who joined Apple from LuxVue became frustrated by, among other things, what they viewed as Apple's unrealistic focus on minimizing costs. One of LuxVue's key founders, who was also its CEO, left in 2023. Several months later, Apple canceled the effort to use LuxVue's technology for the Apple Watch.

A Deal Advocate

Over time, Eddy Cue has emerged as one of the biggest advocates inside Apple for doing more ambitious deals, including AI ones.

An employee since 1989, Cue plays a unique role within Apple. While Apple is known for its secretive and insular culture, Cue is a gregarious figure who spends a lot of time actively engaging with his extensive network of contacts outside the company, especially in the entertainment industry. He's often away from its Cupertino, Calif., headquarters, traveling for business.

Whenever Apple has gaps in its product offerings, his instinct is to look for a deal to fill it, said people who have worked closely with him. In past years, Cue championed acquisitions of both Netflix and Tesla at different times, according to people with knowledge of the matter. Cook shot him down in both cases.

In another instance, though, Cue successfully pushed Apple to do a deal that was outside its comfort zone. In 2014, at a moment when Apple was falling behind Spotify in the music business, Cue got Cook to agree to buy Beats, despite skepticism from Apple's old guard about the $3 billion deal. Cue's plan with Beats was partly to bring about a cultural shift in Apple's music business, people familiar with his thinking said.

But integrating Beats with Apple proved difficult. Apple staffers viewed the Beats engineering team responsible for a streaming music service it offered at the time as below Apple's standards, according to former employees who worked on Apple Music. Apple ended up building its own streaming music service, Apple Music, from scratch rather than relying on Beats' software. Beats' headphones business has been more successful for Apple.

Apple's Craig Federighi. Photo via Getty

Among the leaders who have questioned the need to do AI deals in the past is Apple's software chief, Craig Federighi.

For example, when Apple was looking into acquiring AI startup Turi years ago, Federighi argued against it and said his team could build similar capabilities in-house, said people familiar with the conversations. But a group of Apple executives pushed back, and Apple ended up acquiring Turi in 2016.

More recently, Cue has made the case to Federighi that Apple ought to do bolder AI deals to strengthen its position in the category, a person familiar with those discussions said.

AI Culture Clash

Doing AI deals is hardly a novel concept at Apple. For well over a decade, the company has been scooping up smaller startups in the category. Its track record of integrating them is checkered, though.

Apple’s most famous AI product, Siri, came through its acquisition of a startup by the same name in 2010, a deal Jobs was personally involved in. But Siri founders began leaving Apple after Jobs’ death in 2011 and the departure of former software head Scott Forstall a year later—events that left Siri without strong executive support inside the company.

Soon after John Giannandrea, a former Google executive, joined Apple in 2018 to lead its AI work, he got a green light to make one of his biggest acquisitions to date: AI startup Laserlike, founded by several of his former Google colleagues. Apple wanted to use Laserlike’s search engine software across Apple’s many different products.

But around the release of OpenAI’s ChatGPT in November 2022, the Laserlike team became frustrated with Apple’s hesitation to invest the billions of dollars needed to train large language models, according to a person familiar with their thinking. All of Laserlike’s founders left Apple and returned to Google in 2022, The Information previously reported.

The eye-popping valuations of AI model makers could make an acquisition of one of them particularly hard for Apple to swallow. Investors are currently in talks to value OpenAI and Anthropic at $500 billion and $170 billion, respectively, in their recent fundraising and sales of staff shares. The regulatory scrutiny of such a deal could also be a significant impediment.

An acquisition of or license-and-hire deal with Mistral—which is reportedly seeking a $10 billion valuation from investors—could be easier for Apple to stomach. The current status of its interest in Mistral couldn’t be learned.

But Cue has had discussions with people inside and outside Apple in which the other parties discouraged him from pursuing a deal with Mistral because it is not among the top AI model makers, said people familiar with the discussions.

Jessica E. Lessin also contributed to this article.

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