Q3 2019 Earnings Call

Company Participants

- Luca Maestri, Chief Financial Officer
- Nancy Paxton, Senior Director of Investor Relations
- Tim Cook, Chief Executive Officer

Other Participants

- Amit Daryanani, Analyst
- Jim Suva, Analyst
- Katy Huberty, Analyst
- Krish Sankar, Analyst
- Samik Chatterjee, Analyst
- Shannon Cross, Analyst
- Wamsi Mohan, Analyst

Presentation

Operator

Good day and welcome to the Apple Incorporated Third Quarter Fiscal Year 2019 Earnings Conference Call. Today's call is being recorded. At this time for opening remarks and introductions, I would like to turn the call over to Nancy Paxton, Senior Director of Investor Relations. Please go ahead.

Nancy Paxton {BIO 1779050 <GO>}

Thank you. Good afternoon and thanks to everyone for joining us today. Speaking first is Apple's CEO, Tim Cook, and he'll be followed by CFO, Luca Maestri. And after that we'll open the call to questions from analysts. Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook. Actual results or trends could differ materially from our forecast.

For more information, please refer to the risk factors discussed in Apple's most recently filed periodic reports on Form 10-K and Form 10-Q, and Form 8-K filed with the SEC today, along with the associated press release. Apple assumes no obligation to update any forward-looking statements or information which speak as of their respective dates.

I'd now like to turn the call over to Tim for introductory remarks.

Tim Cook {BIO 14014370 <GO>}

Thank you, Nancy. Good afternoon, and thanks to all of you for joining us today. We're thrilled to report a return to growth and a new June quarter revenue record of $53.8 billion. We saw significant improvement in year-over-year iPhone performance compared to last quarter, very strong performances for both Mac and iPad, and absolutely blow out quarter for wearables where we had accelerating our growth of well over 50%, and a new high watermark for services where we set an all-time revenue record of $11.5 billion. When you step back and consider wearables and services together, two areas where we have strategically invested in the last several years, they now approach the size of a Fortune 50 company.

Geographically, we are happy with our performance across the board including, a return to growth in Mainland China. We accomplished these results despite strong headwinds from foreign exchange, which impacted our top line growth rate by 300 basis points compared to a year ago. That's equivalent to about $1.5 billion of revenue.

Importantly, in constant currency, our revenue grew in all five of our geographic segments. For iPhone, we generated $26 billion in revenue. While this is down 12% from last year's June quarter, it is a significant improvement to the 17% year-over-year decline in Q2. We are encouraged by the results we're seeing from the initiatives that we spoke about in January, including strong customer response to our in-store trade-in and financing programs. In fact, iPhone in our retail and online stores returned to growth on a year-over-year basis in the month of June. Our active, installed base of iPhone reached a new all-time high and was up year-over-year in each of our top 20 markets, underscoring the quality of our products and the satisfaction and loyalty of iPhone customers around the world.

Revenue excluding iPhone was up 17% from last year with growth across all categories. Starting with services, we generated all-time record revenue of $11.5 billion, that's up 13% year-over-year and if we exclude the $236 million favorable one-time item from the June quarter last year, services growth was 15%, or 18% in constant currency, which is consistent with our Q2 performance.

Our strong services performance was broad-based. We set a new all-time records for AppleCare, Music, cloud services, and our App Store search ad business and we achieved a new third quarter revenue record for the App Store. What's more, we had double-digit services revenue growth in all five of our geographic segments. We surpassed 420 million paid subscriptions to services across our platform, and we remain on track to double our fiscal year 16 Services revenue in 2020.

In May, we launched our all-new Apple TV app in over 100 countries, bringing together all the ways to watch TV in a single app across iPhone, iPad, Apple TV, and select smart TVs. Monthly viewers in the Apple TV app in the United States are up over 40% year-over-year. We've seen our success being driven here by several factors. First, the fact that we have been able to integrate content from over a 150 leading content providers all in one place. Second, the same ease of use and unmatched user interface that sits Apple apart in other categories sets us apart in TV as well. And third, we're benefiting from a broader secular move to over-the-top services.

We're engaging with the third trend in five ways. Our Apple TV hardware, Apple TV channels where customers can choose to pay only for the channels they want, our massive library of over a 100,000 iTunes movies and TV shows, the App Store where users can find their favorite streaming services and later this year, our original programming service, Apple TV Plus. Apple Pay is now completing nearly 1 billion transactions per month, more than twice the volume of the year-ago. Apple Pay launched in 17 countries in the June quarter, completing our coverage in the European Union and bringing us to a total of 47 markets currently. Based on June quarter performance, Apple Pay is now adding more new users than PayPal, and monthly transaction volume is growing four times as fast. In the United States, in addition to a successful integration into Portland's transit system in May, we're beginning the rollout of New York City Transit, and we'll launch in Chicago later this year.

In China, Apple Pay launched the payment card for DiDi, the world's largest ride hailing provider. As I've said before, transit integration is a major driver of a broader digital wallet adoption and we're going to keep up this push to help users leave their wallet at home in more and more instances. On a related note, thousands of Apple employees are using Apple Card every day in our beta test, and we plan to begin the rollout of Apple Card in August.

As I mentioned at the outset, it was another sensational quarter for wearables, with growth accelerating to well over 50%. We had great results for Apple Watch, which set a new June quarter revenue record and is reaching millions of new users. Over 75% of customers buying Apple Watch in the June quarter were buying their first Apple Watch. We continue to see phenomenal demand for AirPods, and when you tally up the last four quarters, our Wearables business is now bigger than 60% of the companies in the Fortune 500.

We had great performance from iPad with revenue of over $5 billion and growth driven by iPad Pro, and by strong customer response to the new iPad mini and iPad Air. This was our third consecutive quarter of growth and with revenue up 15% year-to-date, we feel great about where we're headed with iPad. With our current lineup of iPad, iPad Mini, iPad Air, and iPad Pro, we've got the perfect device for everyone from young learners to professionals.

We were also very happy with double-digit revenue growth from Mac, fueled by a strong performance of MacBook Air and MacBook Pro. Looking forward, there is an enormous amount to be excited about for Mac. On the heels of our Mac Mini and iMac updates earlier in the fiscal year, we brought significant updates to the bulk of our notebook line up in the last couple of months. We now have a $999 MacBook Air that is killer for college students, and for our pro users who push the limits of what a Mac can do, we were thrilled unveiled the most powerful Mac ever, the new Mac Pro and the all-new Pro display XDR, which will be available this fall. They're designed for maximum performance, expansion, and configurability, and at breakthrough pricing, and they are the most powerful tools Apple has ever put in the hands of Pro customers. What's more, the Mac ecosystem as a whole is about to get a big boost. At our recent Worldwide Developers Conference, we announced a game-changing tool to help developers easily adapt their iOS and iPad iOS apps for the Mac. I'll have a bit more to say on that in a moment.

I'd like to provide some color on our performance in Greater China, where we saw significant improvement compared to the first half of fiscal 2019 and return to growth in constant currency. We experienced noticeably better year-over-year comparisons for our iPhone business there than we saw in the last two quarters, and we had sequential improvement in the performance of every category. The combined effects of government stimulus, consumer response to trade-in programs, financing offers, and other sales initiatives, and growing engagement with the broader Apple ecosystem had a positive effect. We were especially pleased with a double-digit increase in services driven by strong growth from the App Store in China.

Turning to the future. Last week, we announced an agreement with Intel to acquire the majority of it smartphone modem business. This is our second-largest acquisition by dollars, and our largest ever in terms of staff. We're looking forward to welcoming all of them to Apple. We see this is a great opportunity to work with some of the leading talents in this field, to grow our portfolio of wireless technology patents to over 7,000, to expedite our development of our future products, and to further our long-term strategy of owning and controlling the primary technologies behind the products that we make.

We also had our best WWDC ever last month, packed with announcements of great new features coming this fall across our four software platforms, making them more powerful, more personal, and more private. For iPhone users, iOS 13 will take on a dramatic new look with dark mode, while delivering major updates to the apps you use every day including photos, camera, and maps. iOS 13 offers great new ways to help you manage your privacy and security, including sign-on with Apple, which uses Face ID or Touch ID to quickly sign into apps and websites without sharing your personal information. And improvements across the entire system will make iPhone even faster and more delightful to use than ever before.

For the first time, iPad is getting its own version of iOS called iPadOS, a strategic step forward that takes the iPad experience to a whole new level. The redesigned home screen, powerful new multitasking tools, and deeper integration with Apple Pencil take productivity and creativity further, including using your iPad as an extended an interactive second monitor for your Mac. For Apple TV, TvOS 13 will make the big screen experience even more personal. With a redesigned home screen and multi-user support, everyone in the family can get a more engaging and tailored experience with their favorite TV shows, movies, sports, and news, along with Apple music photos and videos in iCloud, and an App Store with thousands of great games and apps.

WatchOS 6 is a major step forward in helping Apple Watch users stay healthy, active, and connected. Apple Watch now has a dedicated App Store that users can access directly from the device, and new watch faces, Siri enhancements, and music and audio features make Apple Watch more useful than ever. And of course, we continue to innovate on Apple Watch's promise to be an intelligent guardian for your health. WatchOS 6 includes powerful new features like notifications that warned about high-decibel noise to protect your hearing, and cycle tracking to aid in women's healthcare decisions.

In the June quarter, we expanded the availability of the ECG app and irregular rhythm notifications to five additional European countries, and added Canada and Singapore just last week, making them available in 31 countries and regions around the world with more to come later this year. We're very proud of the muscle we've built in bringing regulated products like these to market. This is an important competency that creates exciting opportunities for us moving forward.

As I noted earlier, we believe Mac OS Catalina will be a breakthrough in the Mac ecosystem. A new tool included in Mac OS Catalina called Mac Catalyst gives developers a major head start in bringing their iOS apps to the Mac. Thousands of developers are already using it to bring their apps to the Mac ecosystem, and we expect to see a wave the popular apps arriving for the Mac as early as this fall.

Again as we're taking a step back and digesting the bigger picture here, these updates of the latest steps in a broader strategic effort to make the user experience across iOS, Mac OS, iPad OS, Watch OS and TvOS more effort effortless, and more intuitive. Apple is alone in offering this kind of value and ecosystem to its customers, and these devices and their platforms are unmatched in their ease of use, their seamlessness, and their privacy and security. And while providing these things, we've created a dynamic environment where a developer benefits benefit greatly from creating for, and distributing on these platforms. And our customers of course benefit greatly from access to all this creativity and innovation.

We also unveiled other exciting technologies to make it easier and faster for developers to create powerful new apps. SwiftUI provides an intuitive new framework for building sophisticated user interfaces across our software platforms using simple, easy to use, code. Core ML3 supports the acceleration of more types of advanced real-time machine learning models and Create ML lets developers build machine learning models without writing code.

We have the world's largest augmented-reality-enabled platform, and thousands of AR Kit enabled applications in the App Store. Building on this strategy, and our momentum in this area, we introduced three new AR-based technologies. ARKit 3 uses on-device, real-time machine learning to recognize the human form and integrates people seamlessly into AR experiences. Reality Kit is a new developer framework built from the ground-up to provide all the tools and technologies required to make AR objects virtually life=like. And Reality Composer brings AR content creation to tens of millions of developers who had no 3-D experience. Our developers are already running with these new technologies and we think our customers are going to love some of the apps these creators have in store in the months ahead.

On so many fronts, there is an enormous amount to look forward to over the next few months, including the launch of new services, like Apple Arcade, Apple TV Plus, and Apple Card. And without giving too much away, we have several new products that we can't wait to share with you. Until then, thanks for joining us today and for more details on the June quarter results, I'll turn the call over to Luca.

Luca Maestri {BIO 15738533 <GO>}

Thank you, Tim. Good afternoon, everyone. We are happy to report the June quarter revenue record of $53.8 billion, up 1% year-over-year. We returned to growth in spite of a difficult foreign exchange environment around the world, which impacted our year-over-year growth rate by 300 basis points. We set June quarter revenue records in the Americas, in Japan, and the rest of Asia Pacific. And as Tim mentioned earlier, all our geographic segments grew in constant currency.

Overall products revenue was $42.4 billion, down 2% year-over-year, which is significantly better than the 8% decline in product revenue that we experienced during the first half of the fiscal year. Product categories outside of iPhone grew 20%, with strong results in wearables, Mac, and iPad. Services revenue grew 13% to a new all-time record of $11.5 billion. Excluding the one-time item we highlighted a year ago in connection with the final resolution of various lawsuits, services revenue growth was 16%, and 18% in constant currency terms.

On a geographic basis, we saw a marked improvement in our year-over-year comparisons from emerging markets relative to the first half of this fiscal year, particularly in the BRIC countries where year-over-year performance went from a 25% revenue decline in the first half to 3% growth in the June quarter. We set June quarter revenue records in several major developed markets including the US, Canada, Germany, France, Japan, Australia, and Korea. In emerging markets, we returned to growth in Mainland China, grew strong double digits in India and in Brazil, and we set new Q3 records in Thailand, Vietnam, and the Philippines.

Company gross margin was 37.6%, flat sequentially, and in line with our guidance. Products gross margin was 30.4%, down about 80 basis points sequentially due to seasonal loss of leverage and product mix, partially offset by favorable cost. Services gross margin was 64.1%, up 30 basis points sequentially, primarily due to a favorable mix. Net income was $10 billion diluted earnings per share were $2.18, and operating cash flow was $11.6 billion.

Let me get into more detail for each of our revenue categories. iPhone revenue was $26 billion, down 12% compared to a year ago. This was significantly better year-over-year performance than last quarter, 17% decline with sequential improvement in year-over-year comparisons in 15 of our top 20 markets.

Our active installed base of iPhone continued to grow to a new all-time high in each of our geographic segments, and in the US, the latest survey of consumers from 451 Research indicates iPhone customer satisfaction of 99% for iPhone XR, iPhone XS, and XS Max combined. Among business buyers who plan to purchase smartphones in the September quarter, 83% plan to purchase iPhones.

Turning to services, we reached an all-time revenue record in spite of foreign exchange headwinds with double-digit growth from the App Store, Apple Music, cloud services, and AppleCare, and triple-digit growth from Apple Pay and our App Store search ad business. All geographic segments had double-digit growth in services revenue and set new June quarter records, with all-time records in the Americas and rest of Asia Pacific. In total, services accounted for 21% of upward revenue and 36% of gross margin dollars.

Customer engagement in our ecosystem continues to grow. The number of transacting accounts on our digital content stores reached a new all-time high in the June quarter, and the number of paid accounts grew strong double digits compared to last year. We now have over 420 million paid subscriptions across the services on our platforms, and we are well on our way to our goal of surpassing the 500 million mark during 2020. On the App Store, our growth accelerated sequentially. Our subscription business continues to grow strongly and is extremely diversified across many categories such entertainment, lifestyle, photo and video, and music. Third-party subscription revenue grew by over 40% and across all third-party subscription apps the largest accounted for only 0.25% of total services revenue.

Among our many services records, it was our best quarter ever for AppleCare. We are seeing an increase in service contract attach rates, and are expanding distribution of AppleCare through our partners. We also recently expanded our authorized service provider network, and nearly 1,000 Best Buy stores across the US are now offering expert service and repairs for Apple products. This expansion provides customers with an even more convenient access to repairs using parts certified for safety, quality, and reliability. In addition to our retail stores, that are over 1,800 third-party Apple Authorized Service Providers in the US, which is three times as many locations as three years ago.

Next I'd like to talk about the Mac. Revenue was $5.8 billion, up 11% compared to last year. Mac revenue grew in four of our five geographic segments, and set June quarter records in the US, Europe, and Japan, as our overall market performance significantly outpace the global PC industry. Nearly half of the customers purchasing Macs during the quarter were new to Mac, with revenue growing in both developed and emerging markets and the active installed base of Macs again reached a new all-time high.

We also had great results for iPad with $5 billion in revenue, up 8%. iPad revenue grew in all five of our geographic segments, with a Q3 revenue record in Mainland China and double digit growth in emerging markets. In total, over half of the customers purchasing iPads during the June quarter were new to iPad, and the iPad active installed base also reached a new all-time high.

The most recent surveys from 451 Research measured a 94% customer satisfaction rating for iPad from consumers and among business customers who plan to purchase tablets in the September quarter, 75% plan to purchase iPads. Wearables, home and accessories revenue accelerated across all our geographic segments, growing 48% to over $5.5 billion, and setting a June quarter record. This growth was fueled primarily by the strong performance of our Wearables business, which was up well over 50% and has become the size of a Fortune 200 company over the last 12 months. In addition, we generated double-digit revenue growth from Apple TV and Accessories during the quarter.

Our retail and online stores produced our best June quarter revenue ever with double-digit revenue growth across Apple Watch, iPad, Mac and Accessories our trade-in program is showing great momentum with more than five times the number of iPhones traded in compared to a year ago. We opened stunning new stores in the Carnegie Library in Washington DC and the business Shinji district in Taipei, as well as a beautiful new location in the Dallas Galleria.

We ended the quarter with 506 physical stores in 22 countries, alongside our online store presence in 35 countries. In the enterprise market, we are gaining traction with our strategy of transforming major industries by expanding our leading positions in key functional areas to grow our reach and modernize customer and employee experiences. In the financial services industry, 90 of the largest 100 banks by asset size are deploying Apple products to improve efficiency and effectiveness across their organizations.

iPhone and iPad are overwhelmingly the preferred mobile devices for bankers on the go. For example, 60% of the biggest banks are supporting iPads for wealth managers. In retail banking, two-thirds of top banks at deploying iPad for branch transformation and modernizing legacy interfaces with a unified iPad experience. One of the world's largest banks created an iPad suite that reduced customer onboarding time from more than an hour to just 12 minutes. Bank branch employees are also using Apple Watch for communication and notifications and Apple TV for customer presentations from iPads using AirPlay. Financial institutions also tell us they receive positive feedback from leveraging Apple solutions for direct customer engagement. American Express, Credit Suisse, Discover, and TD Ameritrade have launched Apple Business Chat as a dynamic way to support and interact with customers. The intuitive interface of messages on iOS enables rich communication between customers and contact center staff. TD Ameritrade as also become the first brokerage in the world to enable immediate funding of accounts using Apple Pay, eliminating the two to three business days it used to take to fund accounts by wire transfer.

Let me now turn to our cash position. We ended the quarter with almost $211 billion in cash plus marketable securities. We retired $3 billion of term debt and reduced commercial paper by $2 billion during the quarter, leaving us with total debt of $108 billion. As a result, net cash was $102 billion at the end of the quarter, and we continue on our path to reaching a net cash neutral position over time.

We returned over $21 billion to shareholders during the quarter, including $17 billion through open market repurchases of almost $88 million Apple shares and $3.6 billion in dividends and equivalents. As we move ahead into the September quarter, I'd like to review our outlook, which includes the types of forward-looking information that Nancy referred to, at the beginning of the call.

We expect revenue to be between $61 billion and $64 billion. This guidance includes almost $1 billion of the year-over-year negative impact from foreign exchange. We expect gross margin to be between 37.5% and 38.5%. We expect OpEx to be between $8.7 billion and $8.8 billion. We expect Y&E to be about $200 million and we expect our tax rate to be about 16.5%. Also today, our Board of Directors has declared a cash dividend of $0.77 per share of common stock, payable on August 15, 2019, to shareholders of record as of August 12, 2019. With that I'd like to open the call to questions.

Questions And Answers

A - Nancy Paxton {BIO 1779050 <GO>}

Thank you, Luca. And we ask that you limit yourself to two questions. Operator, may we have the first question please.

Operator

The first question will come from Amit Daryanani from Evercore.

Q - Amit Daryanani {BIO 7113568 <GO>}

Thanks a lot -- thanks for taking my question, guys. I guess two from me. First off, could you just talk about, when I think about the September quarter guide it's implied I think up 16% or so sequentially. Historically, at least, the guidance has been in the 10% or low double-digit kind of range. Just can you help us understand, what gives you the confidence for a better than seasonal guidance September. Is it from a geo-product basis? Would be helpful.

A - Luca Maestri {BIO 15738533 <GO>}

I mean to say -- it's Luca. Of course, this is our best estimate of where we think we will land. Clearly we expect to have continued strong growth from the non-iPhone categories. We have great momentum in wearables. We mentioned that we were up almost 50% in the June quarter, or actually over 50% in the June quarter. Our services business, we set an all-time record in June, and so these two categories have become really important and really large for us. And so as we continue to grow quickly, that is going to help us as we go through the year. Keep in mind that the guidance includes an estimated almost $1 billion of foreign exchange headwind for the quarter.

Q - Amit Daryanani {BIO 7113568 <GO>}

Fair enough, that's really helpful. And I guess if I just follow-up on China, I'm impressed to see the continued recovery you guys are seeing there, despite all the headlines that are out there. Just curious, what are the few things that are driving the success in China, and how sustainable do you think this changes out for Apple as you go forward?

A - Tim Cook {BIO 14014370 <GO>}

Yeah, Amit. Hi, it's Tim. And I apologize for my voice, I'm suffering from an allergy. But what happened last quarter in China was -- it's a confluence of things. The government stimulus this came in terms of a VAT reduction, a very bold one. We took some pricing action, we instituted our trade-in and financing programs in our retail stores and worked with certain channel partners on that as well, and we are seeing a growing engagement with the broader Apple ecosystem during the quarter.

And so when you look at it, each of our categories -- iPhone , iPad, Mac, wearables, services -- everything improved sequentially. So we couldn't be happier with the results, or the progress, I should say. I would point out is, I think I had mentioned in my comments, that we actually grew in constant currency for Greater China and we grew in Mainland China on a reported basis. So there's several things going on there that are quite positive.

A - Nancy Paxton {BIO 1779050 <GO>}

Thank you, Amit. Can we have the next question please?

Operator

And that question will come from Shannon Cross with Cross Research.

Q - Shannon Cross {BIO 1891806 <GO>}

Thank you very much. Can you talk a bit about what's going on within services, some of the puts and takes? I know, Luca, you gave us some color in terms of the growth rates and that, but I'm just curious -- and I know you won't talk about future products. But as you think about the opportunity, you think about what you've got now and in the future, and then some of what's been going on with China and that, is this something that could re-accelerate? Or again, the 18% on a currency rate -- constant currency basis is obviously quite strong, but how are you thinking about it?

A - Luca Maestri {BIO 15738533 <GO>}

Yeah, I think it's important to start with that 18% in constant currencies, Shannon. Our reported results are on a normalized basis, removing the one-time item from last year, was 15%. Clearly FX plays a role around the world at 300 basis points of FX impact during the June quarter. In spite of that, it was an all-time record revenue. Our installed base continues to grow. It's growing in every geography and it's growing across all our major product categories, and that is very, very important for the services -- for the services business.

I would say, I'll give you a bit more color around two offsetting factors around this performance during the June quarter. On one side, the App Store, I mentioned in my prepared remarks that growth accelerated sequentially. We had double-digit growth on the App Store in every geography. In China, we saw significant acceleration. As you know, we tend to monetize in China on the App Store through game titles, and the government has approved a few key game titles during the quarter. That has helped our performance there.

On the other side, AppleCare -- I mentioned AppleCare was an all-time record in June. So really strong performance, but our growth has decelerated in AppleCare due to factors that we fully expected because we are counting this expansion of our coverage for AppleCare that we've had. We've had significant success during the last 18 to 24 months in really broadening our coverage of AppleCare around the world with some key partners, carriers, and resellers, and obviously as we go through the year those counts become a bit more difficult. We don't -- having said all that, we've given ourselves a couple of targets and we feel very confident about reaching those targets. The first one is that we wanted to double the size of the services business from our fiscal '16 to 2020. We are on our way there. Paid subscriptions is another target that is important to us. It's an important way for us to monetize our ecosystem.

We set a target of surpassing 0.5 billion paid subscriptions on the ecosystem during 2020. We are already at 420 million now, so we feel confident there. And of course, as you mentioned, we're very excited about the fact that we're going to be launching new services soon. As Tim said, we are starting the rollout of Apple Card in August, and there's two more very important services that we're going to be adding to our portfolio during the fall. One is Apple Arcade, which is our gaming subscription service and of course, Apple TV Plus, which is our video streaming service. So obviously these services will help us carry on with the momentum that we have in services.

Q - Shannon Cross {BIO 1891806 <GO>}

Great, thank you. And then this is probably for you too as well, Luca. Can you talk about gross margin? The guidance was pretty solid. Obviously there are various things that are at play here. I know you mentioned $1 billion worth of top line impact I think from currency next quarter, but maybe if you can kind of talk about what went into your gross margin guidance? Thanks.

A - Luca Maestri {BIO 15738533 <GO>}

Yeah. So, of course, Shannon, as you've seen, our guidance for margin is 50 basis points higher than the guidance that we had given for June. I would say on the positive, we expect to benefit from leverage, as you've seen from our revenue guidance, and from cost savings because as you know, the commodity environment is fairly favorable right now. On the negative side, the headwind on gross margins on a year-over-year basis from foreign exchange is about 100 basis points. And so we need to keep that in mind, but we feel pretty good about the guidance we provided.

A - Nancy Paxton {BIO 1779050 <GO>}

Thanks, Shannon. Could we have the next question please?

Operator

Our next question will come from Katy Huberty with Morgan Stanley.

Q - Katy Huberty {BIO 6993997 <GO>}

Yes, thank you. I'd like to go back to the discussion around strength in China in the quarter, and understand what linearity looked like. I ask because there was some industry data around the smartphone market in China that seem to deteriorate in the month of June. The App Store data deteriorated a little bit in June, and just curious if that's something you saw on the business, and if it at all informs your outlook around the pace of the China business as you go into September?

A - Tim Cook {BIO 14014370 <GO>}

Katy it's Tim. We obviously took into account all of the information that we had in coming up with the guidance, including the linearity across last quarter and how this quarter has started. And so, we obviously look at that in quite much detail.

Q - Katy Huberty {BIO 6993997 <GO>}

And then just on the App Store, I appreciate there's not a lot of detail out around exact timing and even some pricing of the new services, but how should we think about the new services that launched in March impacting the overall services growth? Does that start to benefit the model in the back half of this calendar year? Or will the impact to be more longer-term in nature and really show up in 2020?

A - Luca Maestri {BIO 15738533 <GO>}

Katy, let me just talk about the new services that we've announced in March, and then also about the timing, how we get to revenue, right. We've announced Apple News Plus, and this is the service that is available for consumers right now. We've announced our channel service, which has also become available a few weeks ago. The other three services -- the card is launching in August, the gaming service and the video service are starting in the fall. Keep in mind for all these services there is a trial period upfront. It is going to be different trial periods. We'll see what they look like. So the road to monetization takes some time. Obviously all of them will add to our base and will help us with growth rates as we get into next year.

A - Nancy Paxton {BIO 1779050 <GO>}

Thank you, Katie. Could we have the next question please?

Operator

That question will come from Krish Sankar with Cowen & Company.

Q - Krish Sankar {BIO 16151788 <GO>}

Yeah, hi, thanks for taking my question, I have two of them. First one, on the iPhone trade-in program, how effective was it and what percentage of the iPhone sales came from the trade-ins? And are there any other geographies where you left to roll it out? And then I had a follow-up.

A - Tim Cook {BIO 14014370 <GO>}

Hi, it's Tim. In retail, it was quite successful. We got going in a larger way during that quarter. We were pretty much just ramping in the previous quarter. And trade-in as a percentage of their total sales is significant, and financing is a key element of it. Those two things in the aggregate led retail, the combination retail and online. We just short-formed that as retail. Apple Store led to growth in June and so we feel very, very good about the trajectory. We are obviously taking those programs and advocating those more widely, and that is that different levels of implementation throughout different geographies. We're working with our carrier partners on those, and retail partners.

Q - Krish Sankar {BIO 16151788 <GO>}

Got it. That's very helpful. Tim. And then a follow-up for you -- a much longer-term question. I understand. We are in the very early innings of the services growth story. Is there a way to think about it down the road that three or five years down the road, will the services growth be focused or would it still be tethered to the hardware of the iPhone? Or do you think at some point down the road, those services will be independent by itself not really tied to your hardware installed base?

A - Tim Cook {BIO 14014370 <GO>}

Well, there are elements today that are not necessarily tethered to iPhone, right? We have other products, where people are purchasing things, they're watching Apple TV, we offer Apple Music on Android. And so there is a series of things that are outside of that, and so we'll see what we do in the future. I don't want to really get in, get into that. But more broadly, to answer your question about growth as we go forward, the way I see it as we had the strongest hardware portfolio ever. We've got new products on the way. The pipeline is full of great new stuff both on the product and the services side. We're very fortunate and have worked very hard to have loyal customers, and to continue tracking an impressive number of switchers.

The installed base is growing -- hit a new record. That's obviously good and it hit of new record across all geographies and across all categories. And so this is a really good thing. And we've got the wearables area that is doing extremely well. We, stuck with that when others perhaps didn't and really put a lot of energy into this and a lot of R&D, and are in very good position today to keep playing out what's next there.

At the same time on the market side, we have emerging markets where we have low penetration and during the quarter tactically, emerging markets had a bit of a rebound. In fact on a constant currency basis, we actually grew slightly in emerging markets. We still declined on a reported basis. India bounced back during the quarter. We returned to growth there. We are very happy with that. We grew in Brazil as well. We are also continuing to focus on the enterprise market. Luca mentioned some of this in his comments, and we think that continues to be a big opportunity for us. And then we've got lots of what I would call core technology kinds of things like augmented reality, where we are placing big bets and I think we have a big future in addition to the health kinds of things that may fall out of the Watch.

And so hopefully that kind of gives you a view over the total. And so we're focusing on products and services, and there will be some services that aren't booked and some that -- some that we are looking at are not on current period sales. Mostly, very much, services are rarely connected on that today, or at least not a high percentage by any means. They are more correlated to the installed base, the active installed base, and also the level of transacting customers that are there and the amount per customer, which relates also to the offering that we have.

A - Nancy Paxton {BIO 1779050 <GO>}

Thank you, Chris. We have the next question please?

Operator

Next we'll go to Wamsi Mohan with Bank of America Merrill Lynch.

Q - Wamsi Mohan {BIO 15994435 <GO>}

Yes. Thank you, Tim. The China trade situation remains sort of fluid over here and recently, more recently, you asked for some tariff exceptions, were not granted those. How are you thinking about the longer-term footprint for manufacturing? And can you talk about any potential alternatives that you looked at and considered in moving parts of production potentially out of China? And I have a follow-up.

A - Tim Cook {BIO 14014370 <GO>}

Yeah, I know there's been a lot of speculation around the topic of different moves and so forth. I wouldn't put a lot of stock into those if I were you. The way that I view this is the vast majority of our products are kind of made everywhere. There is a significant level of content in the United States, and a lot from Japan to Korea to China, and the European Union also contributes a fair amount. And so that's the nature of a global supply chain. I think, largely I think that will carry the day in the future as well. In terms of the exclusions, we've been making the Mac Pro in the US, and we want to continue doing that. And so we are working and investing currently in capacity to do so, because we want to continue to be here. And so that's what's behind the exclusions. And so, we're explaining that and hope for a positive outcome.

Q - Wamsi Mohan {BIO 15994435 <GO>}

Okay. Thanks, Tim. And there is, Luca maybe for you. There has been some significant de-stocking of inventory in the first calendar half of this year and iPhone. Can you comment about the broader channel inventory levels, where you are in your typical ranges, especially given the comment around June iPhone sales being quite strong? And do you expect anything atypical in channel inventory dynamics in the September quarter? Thank you.

A - Luca Maestri {BIO 15738533 <GO>}

Yes Wamsi, as you know, we are not getting into this topic very much but I think I can give you some color here. You know that in general we decrease our inventory during the March quarter and the June quarter? That has been traditionally what we've done. This year, we reduced channel inventory for iPhone slightly more than last year and that is true in total, and it's true for Greater China as well. So we feel very good about our channel inventory ranges as we get into the September quarter. I hope that helps you with that.

A - Nancy Paxton {BIO 1779050 <GO>}

Thank you, Wamsi, can we have the next question please?

Operator

Our next question comes from Jim Suva with Citigroup.

Q - Jim Suva {BIO 6329522 <GO>}

Thanks very much. The first question is probably for Tim, and the second one for Luca, and I will offer them at the same time. So you can pick and choose whichever one wants to answer first or second. So the first question Tim, regarding the installed base comment you made, which is quite encouraging, but yet when you look at the iPhone revenue year-over-year, over the past several quarters has been down. Can you help us bridge the gap of how is the installed base is growing? Is it mostly because like secondary users are the new ones coming into the system? Are people holding their phones longer? And what does that user typically bring in with them, or is something unique relative to what we historically know?

And then for Luca, you been investing a lot, a lot, lot, lot. And a lot of these services are now coming to pass, whether it be AppleCare, Apple Cloud, all these wearables, and soon Apple Pay and Arcade. Are we we at a point where now a lot of harvesting is going to happen? Or do you kind of continue this is relatively same investment that you've been doing for the future strategy? Thank you.

A - Tim Cook {BIO 14014370 <GO>}

Hey, Jim, it's Tim. I'll start with your installed base question. Installed base is a function of upgrades and the time between those. It's a function of the number of switchers coming into the iOS, Mac OS, and so forth tense. It's a function of the robustness of the secondary market, which we think overwhelmingly hits incremental customer and it's a function is still in the emerging markets, and somewhat developed markets to a lesser degree, of people new -- they're buying their first smartphone. There are still quite a few people in the world in that category. And so, the reason that the installed base doesn't correlate to the 90-day clock, is that what's happening underneath the numbers is switchers are still a very key piece of what's going on. The secondary market is very key and we are doing programs, et cetera, to try to increased up because we think we wind up hitting a customer that we don't hit in another way. And the upgrades, where people are holding onto the device a bit longer than they were, they're staying in the ecosystem. And then you have the people in the new category as well, and so that's sort of the equation. I don't want to go into the specific numbers, but I think you can see readily mathematically how the installed base is growing in an environment where the iPhone revenue is declining within a 90-day kind of window.

A - Luca Maestri {BIO 15738533 <GO>}

And, Jim, on OpEx. Obviously it's very important for us to continue to invest in the business, particularly on the R&D side because we were always want to bring more innovation into the market. We want to improve the user experience and differentiate our products and services in the marketplace. So we will continue to do that. There are some type types of investments, of course, that are very strategic for us and they will have long-term implications. You've seen the announcement that we made around the Intel acquisition, very important strategically for us. It requires upfront investment, of course. As you've seen from this quarter and also from the past, we will continue to run our SG&A portion of OpEx tightly. We will of course, will continue to invest in marketing and advertising.

We talked about a lot of new services, that we are launching during the fall and Apple Card, that next month -- obviously they will require the appropriate level of marketing and advertising as we launch into the general public. When you look in total at where we are in terms of our expense-to-revenue ratio for operating expenses, you know quite well that we are extremely competitive relative to other tech companies, so we want to continue to to be competitive and at the same time, we will not under invest in the business.

A - Nancy Paxton {BIO 1779050 <GO>}

Thank you, Jim, could we have the next question please?

Operator

The next question will come from Samik Chatterjee with JP Morgan.

Q - Samik Chatterjee {BIO 15496543 <GO>}

Hi, thanks for taking the question. I just wanted to start off with the announcement of the WWDC around the independent App Stores for the Watch and the iPads. What level of interest have you seen from developers and how are they thinking about the ability to monetize services independently on those App Stores? And how does it help you position Wearables more firmly into the health and fitness category?

A - Tim Cook {BIO 14014370 <GO>}

We're seeing good interest across virtually everything that we announced at WWDC. I couldn't be happier with it. The developer tools around ARKit and AR in general that I went through earlier, lots of interest there. Lots of interest from the Watch App Store, to the Catalyst that will be released with Mac OS Catalina, which allows developers quickly to port a iOS app to the Mac. We think, this is huge and so great for the user experience. And so you look at all of these and all the things that I talked about earlier, and I couldn't be happier with the reception that we're getting, and the work that is going on behind the scenes right now to ready -- for the developers readying their apps for the fall.

Q - Samik Chatterjee {BIO 15496543 <GO>}

Got it. If I can just follow-up on the China market. One of the things that we're looking at is with the going into the new year into 2020 there'll be a lot of 5G phones launching in that market from the Android players. How you think about the competitive landscape there as you enter next year?

A - Tim Cook {BIO 14014370 <GO>}

We don't comment on future products. With respect to 5G, it's -- I think most people will tell you, it's, we're in sort of the extremely early, early innings of it, and even moreso on a global basis. So we couldn't be more proud of what our lineup is and we're excited about the great pipeline of both hardware and software, and we wouldn't trade our position for anyone's.

A - Nancy Paxton {BIO 1779050 <GO>}

Thank you. Samik. A replay of today's call will be available for two weeks on Apple Podcasts, as a webcast on apple.com/investor, and by telephone. And the numbers to the telephone replay are 888-203-1112, or 719-457-0820. Please enter confirmation code 305-7347. These replays will be available by approximately 5:00 PM Pacific Time today.

Members of the press with additional questions can contact Kristin Huguet at 408-974-2414, and financial analysts can contact Tejas Gala or me with additional questions. Tejas is at 669-227-2402, and I'm at 408-974-5420. Thanks again for joining us.

Operator

That does conclude our conference for today. Thank you for your participation.