

Q3 2021 Earnings Call

Company Participants

- Luca Maestri, Chief Financial Officer
- Tejas Gala, Director, Investor Relations and Corporate Finance
- Tim Cook, Chief Executive Officer

Other Participants

- Amit Daryanani, Analyst
- Benjamin Bollin, Analyst
- Chris Caso, Analyst
- David Vogt, Analyst
- Harsh Kumar, Analyst
- Jim Suva, Analyst
- Katy Huberty, Analyst
- Krish Sankar, Analyst
- Shannon Cross, Analyst
- Wamsi Mohan, Analyst

Presentation

Operator

Good day, and welcome to the Apple Q3 FY 2021 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 Tejas Gala, Director, Investor Relations and Corporate Finance. Please go ahead.

Tejas Gala {BIO 20432011 <GO>}

Thank you. Good afternoon, and thank you for joining us. Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. 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 expenses, taxes, capital allocation and future business outlook, including the potential impact of COVID-19 on the Company's business and results of operations. These statements involve risks and

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uncertainties that may cause actual results or trends to differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed Annual Report on Form 10-K and the 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 like to now turn the call over to Tim for introductory remarks.

Tim Cook {BIO 14014370 <GO>}

Thanks, Tejas. Good afternoon, everyone. Today, Apple is reporting a very strong quarter with double-digit revenue growth across our product and services categories and in every geographic segment. We set a new June quarter revenue record of \$81.4 billion, up 36% from last year, and the vast majority of markets we track grew double-digits with especially strong growth in emerging markets, including India, Latin America and Vietnam. Total retail sales also set a June quarter record and almost all of our retail stores have now opened their doors. This quarter saw a growing sense of optimism from consumers in the United States and around the world, driving renewed hope for a better future and for all the innovation can make possible. But as the last 18 months have demonstrated many times before progress made is not progress guaranteed, an uneven recovery to the pandemic and a delta variance surging in many countries around the world have shown us once again that the road to recovery will be a winding one.

In the midst of that enduring adversity, we are especially humbled that our technology has continued to play a key role in keeping our customers connected. Just last month, it was great to be back with our teams and customers for the opening of our newest retail store in Los Angeles, our Apple Tower Theater. It was a hopeful reminder of the energy and sense of community shared spaces brain and how appreciative we all are now of the simple privilege of talking to one another face-to-face. As we look forward to more in-person interactions in the future, we're doubling down on innovation and doing all we can to help chart a course to a healthier and more equitable world. I'll have more to say about our work in those areas a bit later on, but first let's turn to our product and services categories.

For iPhone, this quarter saw very strong double-digit growth in each geographic segment, and we continue to be heartened by our customers response to the iPhone 12 line up. We're only in the early innings of 5G, but already it's incredible performance and speed have made a significant impact on how people can get the most out of our technology. Customers love iPhone 12 for its super-fast 5G speeds, A14 Bionic chip, and a Dolby Vision Camera never seen before in a phone. Users continue to rely on iPad and Mac to work, learn, create and connect. iPad had its highest June quarter in nearly a decade, while Mac set an all-time June quarter record.

We've seen a great response to the new iMac and iPad Pro both powered by the M1 chips exceptional speed and power-efficient performance. The iMac's remarkable front design and vibrant colors have made it a favorite for users everywhere. And the iPad continues to be an incredibly versatile tool in our users toolbox, inspiring creativity in connection and keeping us entertained and productive in equal measure. It was another very strong

quarter for wearables home and accessories, which set a new June quarter record, while helping people find more ways to stay entertained, healthy and connected at home and on the go. Apple Watch remains a go-to choice for users to stay on top of their health and reach their fitness goals, and our newest accessory AirTag begin shipping to an enthusiastic response from customers making the Find My network more useful than ever, while protecting user privacy.

Turning to services, which set a new all-time revenue record as we continue to roll-out innovative new features and programming. We're proud to be the recipients of 35 Emmy nominations this year, which speaks to the quality of our programming, and an enthusiastic reception from customers and critics alike. Apple TV+ users are loving Series like Mythic Quest, an anticipating groundbreaking films like Coda, which premieres next month. And of course, Ted Lasso kicked off Season 2 just last week, and continues to win over viewers with its heartwarming message about the power of community, compassion and hope.

We also introduced Apple Podcast subscriptions, a global marketplace for users to discover exclusive content and support their favorite creators. And we launched spatial audio for Apple Music, a cinematic listening experience, their promises to change how music fans listen and musicians create even more immersive, layered and beautiful songs. Last month, we shared many exciting new features at WWDC, but more powerful than any of them was an incredible showing of developers from All Walks of Life and Around the World. The new tools we announced will help developers harness cutting-edge technologies like augmented reality, reach new users and customize their experience on the App Store or learn to update or invent an app with Swift, Apple's powerful and intuitive programming language.

Today's investments in education in coating translate to tomorrow's small businesses and groundbreaking new routes, the next app, the next act of an app economy already creating jobs and opportunity around the world. In June, a new study by the Analysis Group found that it was another record year for App Store developers, whose combined billings and sales increased by 24% to \$643 billion in 2020. The app economy continues to be an incredible engine of prosperity and opportunity fueled by the ceaseless driving our developers to make apps that enrich people's lives.

Much like the developer community, we are die-hard optimist about technology's potential to help people live happier, healthier and more fulfilled lives, goals that shine through with powerful new updates coming to iOS, iPadOS, macOS and watchOS, this fall. That begins with innovative new features that help users stay connected with one another, like share play and spatial audio for FaceTime or disconnect when they need a break like focus, which limits distracting notifications when you're winding down for bed or concentrating at work. And new productivity features makes iPad and even more useful tool for multitasking, helping users navigate across apps, split their screen, or use Quick Note to capture a thought, the moment inspiration strikes.

In the health space, our new health sharing feature will make it easier than ever to securely share your health data -- to share your health data with loved ones, that includes new capabilities like Walking Steadiness, which uses sensors to assess user stability doing

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everyday task and recommends exercises to improve stability and avoid a fall. In the belief that privacy is a fundamental human right, we shared new features in iOS 15, that continue to drive our progress forward, from Mail Privacy Protection, which stops invisible pixels in an email from tracking your mail activity, to App Privacy Report, which helps users check on the apps they've granted permission to use their personal data.

We also introduced some incredible next-generation technologies coming to the accessibility space. From Assistive Touch, which helps people with limb differences navigate Apple Watch, to new voiceover capabilities to help blind and low vision users, accessibility remains a bedrock principle for us in the simple belief that the best technology for the world should be the best technology for everyone. But the responsibility to be a force for good in the lives of others extends beyond the technology we make so that teachers and students shaping our future.

This quarter, as part of our Racial Equity and Justice Initiative, we awarded innovation grants to engineering schools at four historically Black colleges and universities to expand their coursework, scholarships and internship opportunities in hardware engineering and silicon chip design. We see education as a great equalizing force and we're more dedicated than ever to supporting the educators, advocates and students lighting the path and leading the way. That includes the 350 Swift Student Challenge Winners we recognized at this year's WWDC.

If you ever need a dose of hope or inspiration, I can't say enough about our student scholarship winners, whose apps bring so much good into the world, from teaching other young people to code, to helping volunteers deliver groceries to people at high risk of COVID-19. Young people's innovations remind us that our collective future is bound up in the next generation's passion for solving global challenges and of the responsibility we have to join them in building a better world.

Turning to our own backyard, we're continuing to press forward in our efforts to help bring more affordable housing to the Bay Area and across California. This month, we shared that we've contributed more than \$1 billion to help first time homeowners and construct thousands of new affordable housing units across the state. And we're continuing to stay focused on supporting the global response to the pandemic and delivering the best products and services for people.

Our greatest source of inspiration isn't [ph] technology itself, but how people use it in their own lives in ways great and small, to write a novel or to read one, to care for an ailing patient, or see a doctor virtually. To track their heart rate on a jog, or to train for the Olympics. Every day, I'm grateful for the dedication of our teams to the simple mission of creating technology that improves people's lives. And I want to thank everyone at Apple for the purpose and passion they bring to that mission.

With that, I'll hand it over to Luca for a deeper dive on our performance this quarter.

Luca Maestri {BIO 15738533 <GO>}

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Thank you, Tim. Good afternoon, everyone. We are very pleased to report record June quarter financial results, which reflect the importance of our products and services in our customers lives and our strong underlying operating performance. Our revenue reached the June quarter record of \$81.4 billion, an increase of nearly 22 billion, or 36% from a year ago. We grew double digits in each of our product categories with an all time record for services, and June quarter records for iPhone, Mac, and wearables home and accessories.

We also said new June quarter records in every geographic segment with very strong double digit growth in each one of them. Products revenue was a June quarter record of \$63.9 billion, up 37% over a year ago. This level of sales performance combined with the unmatched loyalty of our customers, drove our installed base of active devices to a new all time record. Our services set an all time revenue record of \$17.5 billion, up 33% over a year ago with June quarter records in each geographic segment.

Company gross margin was 43.3%, up 80 basis points from last quarter, driven by cost savings and a higher mix of services partially offset by seasonal loss of leverage. Products gross margin was 36%, down 10 basis points sequentially, a seasonal loss of leverage was almost entirely offset by cost savings. Services gross margin was 69.8%, down 30 basis points sequentially, mainly due to a different mix. Net income of \$21.7 billion, diluted earnings per share of \$1.30, an operating cash flow of \$21.1 billion, where all June quarter records by a wide margin.

Let me get into more detail for each of our revenue categories. iPhone revenue set a June quarter record of 39.6 billion, growing 50% year-over-year and exceeding our own expectations, as the iPhone 12 family continue to be in very high demand. Performance was consistently strong across the world and we grew very strong double digits in each geographic segment setting June quarter records in most markets we track. Our active installed base of iPhones reached a new all time high, thanks to the exceptional loyalty of our customer base and the strength of our ecosystem. In the US, the latest survey of consumers from 451 Research, indicates iPhone customer satisfaction of 97% for the iPhone 12 family.

Turning to services. As I mentioned, we reached an all-time revenue record of 17.5 billion with all time records for cloud services, music, video, advertising and payments services, and June quarter records for the App Store and Apple Care. Our new service offerings, Apple TV+, Apple Arcade, Apple News+, Apple Card, Apple Fitness+, as well as the Apple One bundle, continue to scale across user's content and features, and are contributing to overall services growth. The key drivers for our services business all continue to move in the right direction.

First, our installed base of devices reached an all time high across each geographic segment. Second, the number of both transacting and paid accounts on our digital content stores reached a new all time high during the June quarter in each geographic segment, and paid accounts increased double digits. Third, paid subscriptions continue to show strong growth. We now have more than 700 million paid subscriptions across the services on our platform, which is up more than 150 million from last year and nearly four times the number of paid subscriptions we had only four years ago.

And finally, we're adding new services that we think our customers will love, while also continuing to improve the breadth and quality of our current services offerings. For example, during WWDC in June, we previewed our new iCloud+, an Apple wallet features, which we believe will create a more secure and differentiated customer experience. Wearables, home, and accessories grew 36% year-over-year to 8.8 billion, setting new June quarter revenue records in every geographic segment. We continue to improve and expand our product offerings in this category. This quarter, we began shipping our new Apple TV 4K with a redesigned Siri remote, and our brand new AirTags. And the customer response to both products has been very strong.

In addition to its outstanding sales performance globally, Apple Watch continues to extend its reach with nearly 75% of the customers purchasing Apple Watch during the quarter being new to the product. For Mac, despite supply constraints, we said a June quarter record of 8.2 billion, up 16% over last year, with June quarter revenue records in most markets we track around the world. It is remarkable that the last four quarters for Mac have been its best four quarters ever. This exceptional level of sales success has been driven by the very enthusiastic customer response to our new Macs, powered by the M1 chip, which we most recently brought to our newly redesigned iMac.

iPad performance was also strong, with revenue of 7.4 billion, up 12% in spite of significant supply constraints. During the quarter, we also started shipping our new iPad Pro powered by the M1 chip and customer response has been outstanding. Both iPad and Mac have taken computing to the next level, and when you combine their performance over the last 12 months, they're now the size of a Fortune 50 business. Thanks to the best product line ups we've ever had, very high levels of customer satisfaction and a loyal growing install base. In fact, around half of the customers purchasing Mac and iPad during the quarter were new to that product. And in most recent surveys of US consumers from 451 Research, customer satisfaction was 92% for Mac and 95% for iPad.

In enterprise, our customers are excited about the superior performance, battery life, and security that, that the new M1 Macs bring. MassMutual, for example, is offering M1 MacBook Pro to all of its employees and equipping all conference rooms with M1 Mac minis in preparation for return to work. And with its incredible performance and affordable entry price, the MacBook Air with M1 is gaining rapid adoption among many leading enterprise organizations. Italgas, Italy's largest natural gas company, which will soon be using its extensive network to distribute renewable gases, is replacing every employee's Windows laptop with the new MacBook Air, powered by Apple's M1 chip, to bring the latest technology to its workforce and Grab Southeast Asia's leading super app that provides transportation, food delivery and digital payment services is adding M1 MacBook Air to its company-wide M1 Mac deployment.

Let me now turn to our cash position. We ended the quarter with \$194 billion in cash plus marketable securities. We retired \$3 billion of term debt and increased commercial paper by \$3 billion, leaving us with total debt of \$122 billion, as a result, net cash was \$72 billion at the end of the quarter. As our business continued to perform at a very high level, we were also able to return \$29 billion to shareholders during the June quarter. This included \$3.8 billion in dividends and equivalents, and \$17.5 billion through open market repurchases of \$136 million Apple shares. We also began a \$5 billion accelerated share

repurchase program in May, resulting in the initial delivery and retirement of 32 million shares.

As we move ahead into the September quarter, I'd like to review our outlook, which includes the types of forward-looking information that Tejas referred to, at the beginning of the call. Given the continued uncertainty around the world in the near term, we are not providing revenue guidance, but we are sharing some directional insights assuming that, that COVID-related impacts to our business, do not worsen from what we are projecting today for the current quarter. We expect very strong double-digit year-over-year revenue growth during the September quarter.

We expect revenue growth to be lower than our June quarter year-over-year growth of 36% for three reasons: First, we expect the foreign exchange impact on our year-over-year growth rate to be three points less favorable than it was during the June quarter. Second, we expect our services growth rate to return to a more typical level. The growth rate during the June quarter benefited from a favorable compare, a certain services were significantly impacted by the COVID lockdowns a year ago. And third, we expect supply constraints during the September quarter to be greater than what we experienced during the June quarter. The constraints will primarily impact iPhone and iPad.

We expect gross margin to be between 41.5% and 42.5%. We expect OpEx to be between \$11.3 billion and \$11.5 billion. We expect OI&E to be around zero, excluding any potential impact from the mark-to-market of minority investments and our tax rate to be around 16%. Finally, today our Board of Directors has declared a cash dividend of \$0.22 per share of common stock payable on August 12, 2021 to shareholders of record as of August 9, 2021.

With that, let's open the call to questions.

Tejas Gala {BIO 20432011 <GO>}

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

Questions And Answers

Operator

Thank you. Our first question from -- comes from Katy Huberty from Morgan Stanley. Please go ahead. Hello Katy, your line is open. Please check your mute function. Having no response, we'll take our next question from Chris Caso with Raymond James.

Q - Chris Caso {BIO 4815032 <GO>}

Yes, thank you. Good morning. Just to dig into the, the commentary on guidance a little bit. Just starting with the fact that last year, obviously there was a later launch of iPhone,

that we've typically seen in other years. Could you talk us through that, and perhaps some of the other products, what may be different as compared to last year?

A - Tim Cook {BIO 14014370 <GO>}

Well, as I explained, there are -- first of all, we are expecting to grow very strong double-digits, you know that's increase the starting point here. We expect this very strong level of growth that we've experienced during the course of the year to continuing to the September quarter. We said that the growth rate is going to be below 36%, and I have listed three factors. The first factor is that, the dollar continues to be favorable on a year-over-year basis in the sense that is weakened against most currencies on a year-over-year basis, but that benefit is going to be about three points less in the September quarter than what we've experienced during the June quarter, because the dollar strengthened against most currencies in recent weeks.

Second, I mentioned that the services growth rate that we've experienced in the June quarter, 33%, that's significantly higher than what we've had in recent history, and that was due to the fact that there were a couple of services categories, namely our advertising business and Apple Care, that were significantly impacted a year ago because of the COVID lockdowns, and therefore they had a relatively easy compare in the June quarter. And so we don't expect that to continue into the September quarter. And so we expect to see significant growth in services, but not to the level that we've seen in June.

And then I mentioned that the supply constraints that we've seen in the June quarter will be higher during the September quarter, back in, when we talked here three months ago, we said that we were expecting supply constraints for the June quarter between \$3 billion and \$4 billion to affect primarily iPad and Mac. We were able to mitigate some of those constraints during the June quarter. And so we came in at the number that was slightly below the low end of that range that we accorded at the beginning of the quarter, but we expect that number to be higher for the September quarter. And so when you put all that together again very strong double-digit growth for September, with this caveat, that I just mentioned.

Q - Chris Caso {BIO 4815032 <GO>}

And thank you. If I could follow up with regard to the supply constraints, and do you expect those supply constraints to persist through the December quarter as well. What effect will that have on the holiday selling season? And then in conjunction with that, what additional costs are you absorbing because of these supply constraints? Is that having an effect on gross margins or just product cost in general as you perhaps paid a little more to get more supply?

A - Tim Cook {BIO 14014370 <GO>}

Chris, it's Tim. And in terms of the cost, we're paying more for freight that I would like to pay, but component costs continue in the aggregate to decline. In terms of supply constraints and how long they will last, I don't want to predict that today, we're going to take it sort of one quarter at a time. And we -- as you would guess, we'll do everything we can to mitigate whatever set of circumstances were dealt.

A - Luca Maestri {BIO 15738533 <GO>}

And Chris, on the cost side, as I mentioned during my comments, our results for gross margins for the June quarter 43.3%, we really saw some really nice cost savings during the quarter. And I think you've seen that, we provided guidance of 41.5% to 42.5% for September, which is obviously a level that we are very pleased with.

Q - Chris Caso {BIO 4815032 <GO>}

All right. Thank you.

A - Tejas Gala {BIO 20432011 <GO>}

Thank you, Chris. Can we have the next question, please.

Operator

Thank you. We'll take our next question from Jim Suva with Citigroup Investment Research. Please go ahead.

Q - Jim Suva {BIO 6329522 <GO>}

Thank you very much, and congratulations to you and your global team for great operations during a challenging time. Tim and Luca, I just have one question, and either of you or both of you could figure out who's best to answer it. But we look at a world of pretty unprecedented, whether it'd be COVID, the delta variant, China flood supply chain components. Just wondering for your like R&D and innovation, is it being materially impacted by that such where a normal cadence is unfair, or is it kind of happening during a slow time of year where you're able to empower people to work remotely and still have the typical innovations and product launches that you've had historically in the past?

A - Tim Cook {BIO 14014370 <GO>}

Jim, the Company has been incredibly resilient. The employees are really doing double duty. And I could not be more pleased with cadence that we're coming out with new things. As you can see from the software announcements that we made in at WWDC and the corresponding launches of the software that we plan on in the fall, and then all of the products that we've been able to bring out over the last 12 months to 18 months, it's amazing. And so, I'm very pleased with it.

A - Tejas Gala {BIO 20432011 <GO>}

Thanks, Tim. Can we have the next question, please.

Q - Jim Suva {BIO 6329522 <GO>}

Thank you. Congratulations again.

A - Tim Cook {BIO 14014370 <GO>}

Thank you.

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A - Luca Maestri {BIO 15738533 <GO>}

Thanks, Jim.

Operator

Thank you. We'll take our next question from Shannon Cross with Cross Research.

Q - Shannon Cross {BIO 1891806 <GO>}

Thank you very much. Tim, I'm curious what did you learn from this iPhone cycle regarding customer preferences and pricing and maybe subscriptions and that? And if there is a difference, if you could talk about on a geographic basis? Thanks.

A - Tim Cook {BIO 14014370 <GO>}

We've -- if you look at our results in Q3, Shannon, we had strong double-digit growth for switchers and for upgraders. And in fact, it was our largest upgrade quarter for a Q3 ever. And so we feel really great about both categories. And as Luca kind of said during the preamble, our opening comments, we -- our results are really strong for iPhone around the world. And so it's been a very, very strong cycle. And yet, we're the penetration on 5G is obviously still very, very low. And so we feel really good about the future of the iPhone.

Q - Shannon Cross {BIO 1891806 <GO>}

Okay. And maybe if you could talk a bit about China, up 58%, where are you seeing the growth? What are you hearing from customers there? How substantially 58% is not sustainable, but how sustainable is the strength? Thank you.

A - Tim Cook {BIO 14014370 <GO>}

It was an incredibly strong quarter. It set a June quarter revenue record for Greater China for us. And so we're very proud of that and doing the best job we can to serve customers there. We had a particularly strong response to the 12 Pro and the 12 Pro Max, those results were particularly strong. And it -- but if you look at our, the balance of our products, we also set June quarter records for wearables, home and accessories for Mac and for services. So it was sort of an across the board strength. And we are seeing plenty of new customers come to the market. For example, our Mac and iPad about two-thirds of the customers who bought in the last quarter were new to that product. For the Apple Watch, that number was 85%. And so we could not be happier with the results.

Q - Shannon Cross {BIO 1891806 <GO>}

Would -- was 85% China or overall?

A - Tim Cook {BIO 14014370 <GO>}

85% was China. Yeah, I was talking about specifically the numbers of reference were specifically for China.

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Q - Shannon Cross {BIO 1891806 <GO>}

Okay.

A - Luca Maestri {BIO 15738533 <GO>}

And then Shannon, it's for the world the watch is 75%.

Q - Shannon Cross {BIO 1891806 <GO>}

Right, great. Thank you so much.

A - Tejas Gala {BIO 20432011 <GO>}

Yeah. Thanks, Shannon. Can we have the next question, please.

Operator

Thank you. We'll take our next question from Amit Daryanani with Evercore. Please go ahead.

Q - Amit Daryanani {BIO 7113568 <GO>}

Perfect. Thanks a lot for taking my question, I have two as well. I guess, first of, Luca, I was hoping you could maybe talk a little bit more about the gross margins and maybe the expectations you laid out for September. I think sequentially even slightly down 100 basis points or so. So, maybe just cut in one of the puts and takes that would be helpful, because I think historically September tends to be a flattish, maybe even up a little bit gross margin number people?

A - Luca Maestri {BIO 15738533 <GO>}

Yeah. I think it's important to go back to the Q3 results, right. It's 43.3%, and one of the things that I mentioned is that, in addition to getting really good cost savings on a sequential basis, we also had a very high mix of services as part of the total and particularly with advertising, doing really, really well, because of the rebound that we saw from the COVID lockdowns a year ago. And so as we move forward sequentially, we do expect a different mix, and so that, that drives the guidance that we provided, which again as you know significantly higher than just a year ago. For example, a year ago, we were at 38.2%. So almost 400 basis points of expansion on a year-over-year basis, right. And so I think it's important to take that into account, just a different mix.

Q - Amit Daryanani {BIO 7113568 <GO>}

Got it. No, absolutely, I don't think anyone expected gross margins to be north of 40, this quickly for you folks, so that is impressive. If I could follow-up on services, and I know you called out the 33% growth this quarter as a bit of an aberration that compares easier. But if you look at your services growth rate over the last four quarters, let's just say, how -- what do you think is enabling this growth? Is it you're able to have a higher ARPU more monetization of the installed base or is your installed base going on? I'm curious which

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one is bigger and then over time, how do you think those two components stack up for you?

A - Luca Maestri {BIO 15738533 <GO>}

It's a combination of multiple factors, right. Obviously, the fact that our installed base continues to grow and it sets new all-time highs all the time, obviously gives us a larger opportunity all the time. And second, we have more and more people that are engaged in our ecosystem both transacting for free, which is a very large number, and people that I'm willing to pay for some other services, and that, that percentage of people that are paying for our services continues to grow nicely. I mentioned they grew double digits again this quarter. So that obviously helps on the revenue side.

And then of course, we continue to increase both that the quality and the quantity of the services. As you know, during the last few years, we've launched a lot of new services from Apple TV+, to Fitness+, Apple Arcade, News+. And so, and of course the Apple Card. And so these are businesses that we are scaling right now. And so all that additional revenue helps. And I think it flows through our growth rates, as you said during the last four quarters, we are well into that mid-20s, right. So I think it's obviously very nice for us to see.

Q - Amit Daryanani {BIO 7113568 <GO>}

Perfect, thank you.

A - Tejas Gala {BIO 20432011 <GO>}

Thanks, Amit. Can we have the next question, please.

Operator

Thank you. Your next from Katy Huberty with Morgan Stanley. Please go ahead.

Q - Katy Huberty {BIO 6993997 <GO>}

Thank you. Good afternoon. Can you hear me, okay?

A - Tejas Gala {BIO 20432011 <GO>}

Yes, we can.

Q - Katy Huberty {BIO 6993997 <GO>}

Okay, good. So, first question, there is a debate in the market around how much Apple benefited from the pandemic, given increased spend in areas like Mac and App Store. But of course, you've mentioned over the past several quarters that there are other areas that were limited by the pandemic and store closures and less foot traffic. When you net out all the puts and takes with your business helped or was it hindered by the pandemic?

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A - Luca Maestri {BIO 15738533 <GO>}

Well, of course, Katy, we don't have the crystal ball that tells us exactly what these different variables, how they impacted our business. We do know that on the -- I would say on the positive side of the ledger, obviously, especially during the periods of extreme lockdowns, digital services did very well, because entertainment options were limited. And so obviously, our digital services did really, really well. Obviously with more people working from home, more people starting from home, we know that iPad and Mac demand was very, very strong.

On the other side, we had certain services like advertising because of the reduced economic activity, Apple Care, because our stores were closed, that were affected negatively. And certain products like the iPhone or the Watch, that are maybe more complex types of sales because of the complexity of the transaction. They were also affected because so many points of sale were closed all around the world, not only our stores, but also our partner stores, right. So we had that dynamic during throughout COVID. And now some of these businesses are rebounding, I mentioned advertising and Apple Care, iPad and Mac, it's difficult for us to gauge, because we've been constrained for quite a long period of time. And the reality is that may be the new normal after we exit COVID may be different from the past, for example, maybe there's going to be hybrid models around work for example. And so it's difficult to tell you on a net basis, what that is. Clearly, and this is very fluid, because it tends to change over time. I can tell you that we're all looking forward to a COVID free world. I think that would be very good for us and for the entire -- for our customers as well.

Q - Katy Huberty {BIO 6993997 <GO>}

And just a follow-up on iPhone, specifically, if you look historically after really strong product cycle, which you've experienced this year with iPhone 12, iPhone revenues come under pressure because the upgrade rate slows the mix often shifts to the lower end of the portfolio. Is it fair to assume a similar trend will play out over the next year, or if not, what do you think is different this time?

A - Tim Cook {BIO 14014370 <GO>}

Katy, it's Tim. We're not predicting the next cycle, but I would point out a few things: One is, we have a very large and growing install base. As you know, we had the iPhones passed a billion active devices earlier this year. Two, we have loyal and satisfied customers. The customers that we're seeing on the new iPhones is just amazing, it's just jaw dropping. And the geographic response is pervasive across the world. In the US, we have the top three selling models. In the UK, we have four out of the top five. In Australia, we have the top two. In Japan, we have the top three. In urban China, we have the top two. And so the response from customers all around have been great. Obviously, the product itself is amazing. The 12 lineup was a huge leap that introduced 5G and had A14 Bionic, and a number of other fantastic features that customers love.

The next thing I think to consider is that, that we're in the very early innings of 5G. If you look at our 5G penetration around the world, there is only a couple of countries that are in the double digits yet. And so that's an amazing thing nine months or so into this. And the last thing is, we're going to continue to deliver great products. We're going to continue to

do what we do best, is integrate hardware, software and services together into an amazing experience. And so those are the things that, that I would consider, if I were coming up the forecast.

Q - Katy Huberty {BIO 6993997 <GO>}

That's great color. Thank you.

A - Tejas Gala {BIO 20432011 <GO>}

Thanks, Katy. Can we have the next question, please.

Operator

Thank you. We'll take our next question from Harsh Kumar with Piper Sandler.

Q - Harsh Kumar {BIO 3235392 <GO>}

Yeah. Hey, guys. First of all, congratulations, fantastic execution, which resulted in consistency for your results. Tim, this is actually perfect timing for this question. You talked about your installed base of a billion odd units. I was curious, if you could help us understand how all of that installed base is? And the reason that I'm asking this question is, we're clearly seeing people upgrade to 5G phones, that's the case and that continues. That could be a larger force than most other forces for your revenues to continue to grow as people migrate to the 5G family phone. So I was curious, if you can shed light on how the upgrades are happening and then also how that basis?

A - Tim Cook {BIO 14014370 <GO>}

Yeah. What I would tell you is, it's -- first of all, it's difficult to answer your question precisely, but what I would tell you is on both switchers and upgraders, we did extremely well in Q3. Both were up strong double digits, and the geographic representation of iPhone year-over-year comps were -- looks extremely well.

And so we are really pleased with it. I would remind you that the 1 billion number that I quoted also was iPhone, where we quoted a number earlier in the year, in the January call, I believe, of 1.65 billion devices is the total active devices just for -- just for clarification. And so the net is very strong switchers, very strong upgraders, best upgrade quarter for June -- for the June quarter that we've seen, and we feel really great about the momentum. But at the same time, we've recognize that the 5G penetration is quite low around the world, and they're very, very low. We're at the front end of those.

Q - Harsh Kumar {BIO 3235392 <GO>}

Fair enough. So my follow up, Apple's probably one of the largest semiconductor companies in the world. How do you -- how does Apple determine? What strategic and something that Apple wants to make itself versus non-strategic? And also I was curious, there's a lot of, well, it's public news, now that ARM is getting acquired by Nvidia. And I was curious how Apple views that? Is that something that's beneficial to Apple, or not meaningful or negative?

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A - Tim Cook {BIO 14014370 <GO>}

Well, I think that, that acquisition has lots of questions that people are asking, and I'll certainly leave that to up to everyone else. And in terms of us, and how we decide to make silicon, we ask ourselves, if we can do something better, if we can deliver a better product, if we can buy something in the market and, and it's great, and it's as good as what we could do. We're going to buy it. We will only enter where we believe, we have ability to do something better and therefore make a better product for the user. And so the M1 is a great example of that. We have the ability within our silicon team to deliver a product that we feel is appreciably better than we could buy. And so we've taken our great hardware and software expertise and combine those and brought the M1 out. And the response to the M1 has been unbelievable. It's powering Mac sales that are constrained. It's powering now iPad, which also has constraints on it. And so that's how we look at, whether we should enter a market or not.

Q - Harsh Kumar {BIO 3235392 <GO>}

Thank you.

A - Tim Cook {BIO 14014370 <GO>}

Thanks for the question.

A - Tejas Gala {BIO 20432011 <GO>}

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

Operator

So we will take our next question from Krish Sankar with Cowen and Company. Please go ahead.

Q - Krish Sankar {BIO 16151788 <GO>}

Yeah. Hi, thanks for taking my question, and congrats on the strong results. First one for Luca. You mentioned services growth should normalize in the September quarter. And I understand the last few quarters, services business was strong driven by work from home, et cetera. So what is the normalized growth rate for the services business as folks return back to the office in this post-COVID world? And then I had a follow-up.

A - Luca Maestri {BIO 15738533 <GO>}

Well, I think you know, you can go back several quarters and try to do a bit of an average, and that's what we were talking about. Of course, there's always a bit of variability around results, right, but certainly, we haven't done 33% in years. And so that was a bit of an anomaly. And again I explained it's around a couple of the businesses that had a relatively easy compare during the June quarter. So our services growth has been for many, many quarters and strong double digits, and we feel confident around that level.

Q - Krish Sankar {BIO 16151788 <GO>}

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Got it, got it. And then just a follow-up for Tim or Luca. I think Tim, you mentioned in your prepared comments that in September quarter there's going to be greater impact on supply constraints on the iPhone and iPad. So I'm kind of curious, this is the first time I heard you talk about component shortages impacting the iPhone. Can you be more specific, is it display drivers, or what exactly is the choke point on the supply?

A - Tim Cook {BIO 14014370 <GO>}

The majority of constraints we're seeing are of the variety that I think others are seeing, that I would classify as industry shortage. We do have some shortages. In addition to that, where the demand has been so great and so beyond our own expectation, that is difficult to get the entire set of parts within the lead times that, that we try to get those. And so it's a little bit of that as well. As I said before, I think probably maybe with the basis of your question, the sort of the latest nodes, which we used in several of our products have not been as much of an issue, the legacy nodes are where those supply constraints have been on silicon.

Q - Krish Sankar {BIO 16151788 <GO>}

Thanks, Tim.

A - Tim Cook {BIO 14014370 <GO>}

Yeah.

A - Tejas Gala {BIO 20432011 <GO>}

Thanks, Krish. Next question, please.

Operator

Thank you. We will hear our next question from David Vogt with UBS.

Q - David Vogt {BIO 21761779 <GO>}

Great. Thank you guys for the question. So maybe just a point of clarification. So based on the data and the comments about upgraders and switchers being strong, as well as emerging markets were relatively strong in the quarter, what does that specific set of data points strength mean for the iPhone portfolio? And I guess my question around that is, when you think about switchers and price points, I think last year you launched the SE2 to really address, maybe some of the lower price point markets like the emerging markets. So does that mean thinking about the portfolio going forward, there is less of a need for a lower priced product going forward? And that the current portfolio and the new cycle going forward would be more high-end in nature as we currently have today? And then I have a follow-up.

A - Tim Cook {BIO 14014370 <GO>}

David, we did, we had an incredible quarter for the emerging markets. In Q3, we set June quarter records in Mexico and Brazil and Chile, in Turkey and UAE and Poland and Czech

Republic, India, obviously in China, as I talked about before, Thailand, Malaysia, Vietnam, Cambodia, Indonesia, I could go on in the name of few more. It's a very long list. And so we are -- those results are for the entire line of products that we have. And keep in mind, we still do have SE in the long. We launched it a year ago, but it's still in the line today, and is sort of our entry price point. And so I'm pleased with how all of them are doing, and I think we need sort of that range of price points to accommodate the types of people that we want to accommodate. And so we want to put something for the entry buyer who really wants to get into an iPhone, and then something for the Pro buyer who wants the very best iPhone that they can buy. And I think that's true in the emerging markets is as good as it's true in the United States or other developed markets.

Q - David Vogt {BIO 21761779 <GO>}

No, that's helpful. I appreciate that. Tim, so does that mean sort of the emerging market buyer that wants to get into the iPhone, is looking for a device that has 5G capability as well, obviously, where early innings and a lot of markets, or how do we think about that over the intermediate to longer-term in terms of consumer preference or 5G in those markets, if available from an infrastructure perspective?

A - Tim Cook {BIO 14014370 <GO>}

In most of the markets I read, it is really, really, really early on 5G, really early. And so I -- but I think the top end buyer is buying for the future as well, because they may hold their phone for two years or longer in some cases. And so 5G becomes an important part of their buying decision.

Q - David Vogt {BIO 21761779 <GO>}

Great. Thank you very much.

A - Tejas Gala {BIO 20432011 <GO>}

Yeah. Thank you. Can we have the next question please.

Operator

Thank you. We'll take our next question from Ben Bollin with Cleveland Research Company.

Q - Benjamin Bollin

Good evening, everyone. Thanks for taking the question. I wanted to start Luca, Tim. Could you walk us through a little bit about how you think Apple One bundles are influencing the trajectory of services and the economics. And then a second part on services, I'm curious how you think IDFA is developing and influencing the trajectory of the advertising business within services?

A - Tim Cook {BIO 14014370 <GO>}

And in terms of Apple One, as you know, we're offering Apple One, because it makes enjoying our subscription services easier than ever before, including Apple Music and Apple TV+ and Apple Arcade and iCloud and more. And so we really put the customer at the center of that and have recently begun to remind people about Apple One in a way that we probably weighted a few months before -- before doing that. And so I'm very pleased with what we're seeing on Apple One right now, and think it's a great ramp for the future services. And more importantly, it's a great customer benefit because many of our customers like to try out more than one of these services, and it allows them to do that with one easy bundle and subscription service.

In terms of IDFA or the advertising in general, I take your question is about ATT. With ATT, we've been getting quite a bit of customer reaction, positive reaction to being able to make the decision on a transparent basis about whether to be tracked or not. And it seems to be going very well from a user point of view.

A - Tejas Gala {BIO 20432011 <GO>}

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

Operator

Thank you. We'll take our next question from Wamsi Mohan with Bank of America.

Q - Wamsi Mohan {BIO 15994435 <GO>}

Yes, thank you. I have two as well. To begin with, Luca, you noted significant product revenue deleverage, but yet your product gross margins were roughly flat. You noted cost savings, can you maybe talk about whether these are tactical in nature, or more structural like vertical integration that will continue to drive benefits to product gross margins? And on services side, you noted several times about the strength in ad growth, which is obviously very high margin contributor, but the sequential trajectory on services margins was flat to what were some of the offsets there? And I have a follow-up for Tim.

A - Luca Maestri {BIO 15738533 <GO>}

Yeah. On the product side, it talked about cost savings. Tim mentioned that, maybe on the freight side we're seeing some level of cost pressure that is a bit out of the norm, at this point in the cycle. For everything else, for all the major commodities and components, we continue to see a very typical cycle, where we are getting good cost savings on a sequential basis. And so far it's been very good, as you can tell from the absolute level of gross margins, because on the product side, we are up more than 600 basis points on a year-over-year basis. So it feels something that we've been able to accomplish and we're able to maintain at least in the near term, nothing that was abnormal during the quarter or a one-off in nature was pretty structural.

On the services side, again, up a lot, on a year-over-year basis. So the baseline has gone up a lot. The sequential decline, as you said, it was very, very small. And as I mentioned several times in the past, we have a very large services portfolio with very different margin profiles in our services, and so even a slight change in mix can drive some sequential

differences, and this was the case, this quarter, just a different mix. I mentioned for example that, Apple Care has rebounded. And so those -- the relative success of our services in the marketplace can drive some slight changes in gross margins. Again, step back for a second, 69.8% gross margin were very, very, very happy with where we are with the services margin trajectory.

Q - Wamsi Mohan {BIO 15994435 <GO>}

Okay. Thanks, Luca. And Tim, there is increasing regulatory focus in China, in particular on some of the Chinese companies. It's not a direct impact of the Apple, but how should investors handicap the indirect impact given some of these companies are pretty large contributors to Apple's App store revenues, and also is there, are you seeing any impact at all from these, and is the limiting of the usage of some of these apps influencing how people are either interacting with your devices, or is there any other ancillary impact that you're seeing? Thank you.

A - Tim Cook {BIO 14014370 <GO>}

For the quarter, as you can see, we grew 58%. So it was a strong quarter and embedded in that was a quarterly record for services, which includes the App Store. And so we are seeing strength in China. The economy has really bounced back there fairly quickly from COVID. In terms of the regulatory focus, what we are focusing on from our angle is to serve users there and try to make sure that they're very satisfied with the products and services that we are -- that we're showing. And we work with a lot of different companies to ensure that. And so that's our focus.

Q - Wamsi Mohan {BIO 15994435 <GO>}

Thank you.

A - Tejas Gala {BIO 20432011 <GO>}

Thank you, Wamsi. A replay of today's call will be available for two weeks on Apple Podcast as a webcast on apple.com/investor and via telephone. The numbers for the telephone replay are 888-203-1112 or 719-457-0820. Please enter confirmation code 976-6068. These replays will be available by approximately 5:00 PM Pacific Time today. Members of the press with additional questions can contact Josh Rosenstock at 408-862-1142, financial analysts can contact me with additional questions at 669-227-2402. Thank you again for joining us.

Operator

Thank you. That does conclude today's conference. Thank you for your participation.

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