

# Apple Inc. (AAPL) CEO Tim Cook on Q3 2021 Results - Earnings Call Transcript

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## Q3: 2021-07-27 Earnings Summary

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**Press Release**

**10-Q**

EPS of \$1.30 **beats by \$0.29** | Revenue of \$81.43B (36.44% Y/Y) **beats by \$8.09B**

Apple Inc. (NASDAQ:[AAPL](#)) Q3 2021 Earnings Conference Call July 27, 2021 5:00 PM ET

### Company Participants

Tejas Gala - Director of IR and Corporate Finance

Tim Cook - CEO

Luca Maestri - CFO

### Conference Call Participants

Chris Caso - Raymond James

Jim Suva - Citigroup

Shannon Cross - Cross Research

Amit Daryanani - Evercore

Harsh Kumar - Piper Sandler

Krish Sankar - Cowen & Company

David Vogt - UBS

Ben Bollin - Cleveland Research

Wamsi Mohan - Bank of America Merrill Lynch

**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'd like to turn the call over to Tejas Gala, Director, Investor Relations and Corporate Finance. Please go ahead.

**Tejas Gala**

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 expense, 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 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 now to turn the call over to Tim for introductory remarks.

## **Tim Cook**

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 tracked 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 that innovation can make possible.

But as the last 18-months had demonstrated many times before, progress made is not progress guaranteed. An uneven recovery to the pandemic and a Delta variant 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 bring 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 customer's response to the iPhone 12 lineup. We're only in the early innings of 5G, but already its 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 superfast 5G speeds, A14 Bionic chip and Adobe 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 thin design and vibrant colors have made it a favorite for users everywhere. And the iPad continues to be an incredibly versatile tool in our user's toolbox, inspiring creativity and 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 began 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, and anticipating groundbreaking films like Coda, which premieres next month. And of course, Ted Lasso kicked off season two 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 that 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 the 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 and coding translate to tomorrow's small businesses and groundbreaking new apps. 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 striving for developers to make apps that enrich people's lives.

Much like the developer community, we are diehard 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, iPad OS, Mac OS, and Watch OS 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 make iPad an 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 everyday tasks, and recommends exercises to improve stability and avoid a fall.

In the belief that privacy is a fundamental human right, we share new features in iOS 15 that continue to drive our progress forward, from mail privacy protection, which stops invisible pixels and 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 made, so the 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 lining 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 students' 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 generations' 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 1000s 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 is a 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**

Thank you, Tim. Good afternoon, everyone. We're 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 a 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 set 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, and operating cash flow of \$21.1 billion were 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 continued 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 U.S., 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 reach an all-time revenue record of \$17.5 billion with all-time records for cloud services, music, video, advertising and payment services, and June quarter records for the App Store and Apple Care. Our newest service offerings Apple TV+, Apple Arcade, Apple News+, Apple card, Apple Fitness+ as well as the Apple One bundle, continue to scale across users, 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+, and 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 redesign Siri remote and our brand new air tags, 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 set 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 lineups we've ever had, very high levels of customer satisfaction and a loyal growing installed 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 U.S. 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 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 equivalence, 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're not providing revenue guidance. But we are sharing some directional insights, assuming that the COVID-related impacts to our business do not worsen from what we're 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, as 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 our 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 dividends with \$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.

**Tim Cook**

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

**Question-and-Answer Session**

**Operator**

Thank you. Our first question comes from Katy Huberty from Morgan Stanley. Please go ahead. Katy, your line is open. Please check your mute function. We'll take our next question from Chris Caso with Raymond James.

**Chris Caso**

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

**Luca Maestri**

Well, as I explained that, first of all, we are expecting to grow very strong double digits, that's I think Chris the starting point here. We expect this very strong level of growth that we've experienced during the course of the year, to continue into the September quarter. We said that the growth rate is going to be below 36%. And I've listed three factors.

The first factor is that the dollar continues to be favorable on a year-over-year basis in the sense that it's 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 lock downs. And therefore, they're relatively easy compare in the June quarter. 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 a 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.

## **Chris Caso**

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 the supply constraints? Is that having an effect on gross margins or just product costs in general, as you perhaps pay a little more to get more supply?

## **Tim Cook**

Chris, it's Tim. In terms of the cost, we're paying more for freight than 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 as you would guess we'll do everything we can to mitigate whatever set of circumstances were dealt.

### **Luca Maestri**

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 for 41.5% to 42.5% for September, which is obviously a level that we are very pleased with.

### **Chris Caso**

Right. Thank you.

### **Tejas Gala**

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.

### **Jim Suva**

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 be COVID, the Delta variant, China floods, 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?

**Tim Cook**

Jim, the company has been incredibly resilient. The employees are really doing double duty. And I could not be more pleased with the cadence that we're coming out with new things. As you can see from the software announcements that we made 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 to 18-months, it's amazing. So I'm very pleased with it.

**Tejas Gala**

Thanks, Jim. Can we please the next question please?

**Jim Suva**

Thank you. Congratulations again.

**Tim Cook**

Thank you.

**Operator**

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

**Shannon Cross**

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

### **Tim Cook**

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 Q3 ever. And so we feel really, really great about both categories.

And as Luca kind of said, during the preamble or opening comments, 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.

### **Shannon Cross**

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

### **Tim Cook**

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. But if you look at 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're seeing plenty of new customers come to the market.

For example, 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.

**Shannon Cross**

Was 85% China or overall?

**Tim Cook**

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

**Luca Maestri**

And Shannon, for the world with the Watch is 75%.

**Shannon Cross**

Right. Great. Thank you so much.

**Tejas Gala**

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.

**Amit Daryanani**

Perfect. Thanks a lot for taking my question, I have two, as well. I guess first off 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 implies down 100 basis points or so. So can you just touch on what are 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 for you folks?

## **Luca Maestri**

Yeah, I think it's important to go back to the Q3 results, 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 COVID lockdowns a year ago.

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, is 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. And so, I think it's important to take that into account, just a different mix.

## **Amit Daryanani**

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. As a follow-up on services, and I know you've 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, 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 the installed base growing and choose which one's bigger? And then over time, how do you think those two components stack up for you?

## **Luca Maestri**

It's a combination of multiple factors. Obviously, the fact that our installed base continues to grow, and it sets new all-time highs all the time, obviously, it 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 are willing to pay for some of the services. And that percentage of people that are paying for our services continues to grow nicely. I mentioned, we grew double digits again this quarter. So that obviously helps on the revenue side.

And of course, we continue to increase both 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+, Fitness+, Apple Arcade, News+, 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 the mid-20s. So I think it's obviously very nice for us to see.

## **Amit Daryanani**

Perfect. Thank you.

## **Tejas Gala**

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

## **Operator**

Thank you. We'll hear next from Katy Huberty with Morgan Stanley. Please go ahead.

## **Katy Huberty**

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

## **Luca Maestri**

Yes, we can.

## **Katy Huberty**

Okay, good. So first question, there's 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 was your business helped? Or, was it hindered by the pandemic?

## **Luca Maestri**

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 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 studying from home, we know that iPad and Mac demand was very, very strong.

On the other side we add certain services like advertising because of the reduced economic activity, Apple Care because our stores were closed, they were affected negatively. And certain products like the iPhone or the Watch that are may be 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. It's difficult for us to gauge because we've been constrained for quite a long period of time.

And the reality is that maybe 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 certainly tell you that we're all looking forward to a COVID free world, I think that would be very good for us and for our customers as well.

### **Katy Huberty**

And just to follow-up on iPhones, specifically, if you look historically, after a 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, time... [ph]

### **Tim Cook**

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 installed base. As you know with the iPhones passed a billion active devices earlier this year. Two, we have loyal and satisfied customers. The customer set we're seeing on the new iPhones are just amazing. It's just jaw dropping.

And the geographic response is pervasive across the world. In the U.S., 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 had been great.

Obviously, the product itself is amazing. The 12 lineup was a huge leap that introduced 5G and have A14 Bionic and a number of other fantastic features that customers love. The next thing I think to consider is that we're in the very early innings of 5G. If you look at our 5G penetration around the world there's 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 I would consider if I were coming up with forecast.

**Katy Huberty**

That's great color. Thank you.

**Tejas Gala**

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

**Operator**

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

**Harsh Kumar**



Yeah. Hey, guys, first of all, congratulations, fantastic execution that 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 of phones. So I was curious, if you can shed light on how the upgrades are happening and then also, how old that base is?

### **Tim Cook**

Yeah, what I would tell you is 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 digit, and the geographic representation of iPhone year-over-year comps looks extremely well. And so we're really pleased with it.

I would remind you that the 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 clarification. And so the net is very strong switchers, very strong upgraders, best upgrade quarter for the June quarter that we've seen. And we feel really great about the momentum. But at the same time, we recognize that the 5G penetration is quite low around the world. And, they're very, very low. We're at the front end of this.

### **Harsh Kumar**

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

### **Tim Cook**

I think that acquisition has lots of questions that people are asking, and I'll sort of leave that 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 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 a 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 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 have 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 into a market or not.

### **Harsh Kumar**

Thank you.

### **Tim Cook**

Thanks for the question.

### **Tejas Gala**

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

**Operator**

Certainly, we will take our next question from Krish Sankar with Cowen & Company. Please go ahead.

**Krish Sankar**

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 have a follow-up.

**Luca Maestri**

Well, I think, 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 in strong double digits and we feel confident around that level.

**Krish Sankar**

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?

**Tim Cook**

The majority of constraints we're seeing are of the variety that I think others are saying that are I would classify as industry shortage. We do have some shortages, in addition to that, that are where the demand has been so great and so beyond our own expectation that it's difficult to get the entire set of parts within the lead times that we try to get those. So it's a little bit of that as well.

As I said before, I think probably maybe with the basis of your question, sort of the latest nodes, which we use in several of our products have not been as much of an issue. The legacy nodes are where the supply constraints have been on the silicon.

**Krish Sankar**

Thanks, Tim.

**Tim Cook**

Yeah.

**Tejas Gala**

Thanks, Krish. Can we have the next question, please?

**Operator**

Thank you. We'll hear the next question from David Vogt with UBS.

**David Vogt**

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's less of a need for a lower priced product going forward, and 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.

## **Tim Cook**

David, 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've talked about before, Thailand, Malaysia, Vietnam, Cambodia, Indonesia, I could go on in the name a few more, it's a very long list. And so those results are for the entire line of products that we have. And keep in mind, we still do have SE in the line, we launched it a year ago, but it's still in the line today. And it's sort of our entry price point. And so, I'm pleased with how all of them are doing. And I think we need to sort of that range of price points to accommodate the types of people that we want to accommodate.

So we've 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 as good as it's true in the United States or other developed markets.

## **David Vogt**

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, we're early innings in a lot of markets, or how do we think about that over the intermediate to longer-term in terms of consumer preference for 5G in those markets, if available from an infrastructure perspective?

**Tim Cook**

In most of the markets I read, it is really, really, really early on 5G, really early. 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. So, 5G becomes an important part of their buying decision.

**David Vogt**

Great. Thank you very much.

**Tejas Gala**

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.

**Ben Bollin**

Good evening, everyone. Thanks for taking the question. I wanted to start Luca or 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?

**Tim Cook**

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 began to remind people about Apple One in a way that we probably waited a few months before doing that. And so, I'm very pleased with what we're seeing on Apple One right now. I 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 it your question is around ATT. With ATT we've been getting quite a bit of customer 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.

**Tejas Gala**

Thank you. Can we have a question, please?

**Operator**

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

**Wamsi Mohan**

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 know that 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. So what were some of the offsets there? And I've a follow-up for Tim.

## **Luca Maestri**

Yeah. On the product side, I 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're 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 were able to maintain, at least in the near-term, nothing that was abnormal during the quarter or a one-off in nature. It 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 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 we're very, very happy with where we are with the services margin trajectory.

## **Wamsi Mohan**



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 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.

### **Tim Cook**

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 world. So, we're 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 make sure that they're very satisfied with the products and services that we're showing. And we work with a lot of different companies to ensure that. So that's our focus.

### **Tejas Gala**

Thank you, Wamsi. A replay of today's call will be available for two weeks on Apple Podcasts as a webcast on [apple.com/investor](https://apple.com/investor) and via telephone. The numbers for the telephone replay are 888-203-1112 or 719-457-0820. Please enter a confirmation code 9766068. These replays will be available by approximately 5 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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