

Company Name: Apple  
Company Ticker: AAPL US  
Date: 2017-11-02  
Event Description: Q4 2017 Earnings Call

Market Cap: 868,326.48  
Current PX: 168.11  
YTD Change(\$): +52.29  
YTD Change(%): +45.148

Bloomberg Estimates - EPS  
Current Quarter: 3.719  
Current Year: 11.186  
Bloomberg Estimates - Sales  
Current Quarter: 84438.040  
Current Year: 266140.528

## Q4 2017 Earnings Call

### Company Participants

- Timothy D. Cook
- Luca Maestri

### Other Participants

- Kathryn Lynn Huberty
- Michael J. Olson
- Shannon S. Cross
- Steven Milunovich
- Antonio M. Sacconaghi
- Jim Suva
- Amit Daryanani
- Brian J. White

## MANAGEMENT DISCUSSION SECTION

### Timothy D. Cook

#### *Business Highlights*

##### *Opening Remarks*

- As we closed the books on a very successful FY2017, I have to say I couldn't be more excited about Apple's future
- This was our biggest year ever in most parts of the world with all-time record revenue in the United States, Western Europe, Japan, Korea, the Middle East, Africa, Central and Eastern Europe and Asia
- We had particularly strong finish this year, generating our highest September quarter revenue ever as y-over-y growth accelerated for the fourth consecutive quarter
- Revenue was \$52.6B, above the high end of our guidance range, and up 12% over last year
  - We generated revenue growth across all of our product categories and showed all-time record results for our Services business

##### *Mac Sales*

- As we expected, we returned to growth in greater China, with unit growth and market share gains for iPhone, iPad, and Mac
- In fact, it was an all-time record quarter for Mac sales in mainland China as well as an all-time high for Services revenue

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- And revenue from emerging markets outside of greater China was up 40%, with great momentum in India, where revenue doubled y-over-y
- We also had great results in enterprise and education with double digit growth in worldwide customer purchases of iPad and Mac in both markets

### ***Gross Margin***

- Gross margin for the September quarter was at the high end of our guidance range, and thanks to exceptional work by our teams, we generated record fourth quarter EPS of \$2.07, up 24% from a year ago. iPhone sales exceeded our expectations
- In the last week and a half of September, we began shipping iPhone 8 and iPhone 8 Plus to customers in more than 50 countries
  - They instantly became our two most popular iPhone models and have been every week since then

### ***iPhone X***

- As we speak, the launch of iPhone X is now underway as stores open across Australia and Asia. iPhone X is packed with innovative new technologies that chart our path for the next decade, technologies like the TrueDepth camera system, Super Retina Display, and A11 Bionic chip with neural engine, which has been in development for years with a focus on deep machine learning. iPhone X enables totally new experiences like unlocking your iPhone with Face ID, taking photos with studio-quality lighting effects, or playing immersive augmented reality games
- We can't wait for people to experience our vision of the future
- Orders have already been very strong, and we're working to get iPhone X into customers' hands as quickly as possible

### ***Services***

- Turning to Services
- Revenue reached an all-time quarterly record of \$8.5B in the September quarter
- A few quarters ago, we established a goal of doubling our FY2016 services revenue of \$24B by the year 2020, and we are well on our way to meeting that goal
- In FY2017, we reached \$30B, making our Services business already the size of a Fortune 100 company

### ***New iPad Lineup***

- We're also delighted to report our second consecutive quarter of double-digit unit growth for iPad
- Customers have responded very positively to the new iPad lineup
- And with the launch of iOS 11, the iPad experience has become more powerful than ever, with great new features for getting things done like the new dock, Files app, drag and drop, multitasking and more power than most PC notebooks

### ***iOS 11***

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- The launch of iOS 11 also made iOS the world's largest platform for augmented reality
- There are already over 1,000 apps with powerful AR features in our App Store today, with developers creating amazing new experiences in virtually every category of apps aimed at consumers, students and business users alike
- Put simply, we believe AR is going to change the way we use technology forever
  - We're already seeing things that will transform the way you work, play, connect and learn
- For example, there are AR apps that let you interact with virtual models of everything you can imagine, from the human body to the solar system
- And of course, you experience them like they're really there
  - Instantly, education becomes much more powerful when every subject comes to life in 3D
- And imagine shopping when you can place an object in your living room before you make a purchase, or attending live sporting events when you can see the stats on the field
- AR is going to change everything

### ***Core ML***

- iOS 11 is also allowing developers to integrate machine learning models into their apps with Core ML
- Pinterest is already using Core ML to deliver fast and powerful visual search
- PadMapper uses Core ML to provide intelligent features that make it easy to find or rent your apartment
- And VisualDx is even pioneering new health diagnostics with Core ML, automating skin image analysis to assist dermatologists with their diagnoses
- These are just a few examples
  - There's so much more to come

### ***Mac***

- Next, I'd like to talk about the Mac, which had its best year ever, with the highest annual Mac revenue in Apple's history
- It was also the best September quarter ever, with Mac revenue growth of 25% driven by the notebook refreshes we launched in June and a strong back-to-school season
- The Mac experience has become even better since the September launch of macOS High Sierra, with new technologies to make Mac more reliable, capable and responsive and lay the foundation for future innovation

### ***Apple Watch***

- Moving on now to Apple Watch
- With unit growth of over 50% for the third consecutive quarter, it continues to be the best selling and most loved smartwatch in the world
  - We began shipping Apple Watch Series 3 just six weeks ago and customers love the new freedom of cellular

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- The ability to go for a run with just your Apple Watch or go for a quick errand without your phone while staying connected is a game changer
- Now more than ever, Apple Watch is the ultimate device for a healthy life and is already making a big difference in our customers' lives
- We're very excited about the upcoming launch of the Apple Heart Study, which will use data from Apple Watch to identify irregular heart rhythms and notify users when unusual patterns are detected

### ***AirPods***

- Earlier this week, we introduced watchOS 4.1, bringing 40mm songs to your wrist through Apple Music
- The combination of music streaming on Apple Watch and AirPods is truly a magical experience for people on the go
  - We're thrilled with the momentum of these products
- In fact, our entire wearables business was up 75% y-over-y in Q4 and in FY2017, already generated the annual revenue of a Fortune 400 company

### ***Apple TV 4K***

- Late in the September quarter, we also launched Apple TV 4K, delivering a stunning cinematic experience at home
- So now users around the world can watch movies and shows in 4K HDR quality and stream live sports and news on the Apple TV app
  - There's already a great selection of 4K HDR titles available through iTunes and other popular video services with many more movies and shows on the way

### ***Apple Michigan Avenue***

- We're also very excited about the opening of Apple Michigan Avenue two weeks ago on Chicago's riverfront
- This is the first store that brings together our complete vision for the future of Apple retail, providing a welcoming place for everyone to experience our products, services and inspiring educational programs right in the heart of their city
- In addition to our very popular Today at Apple programming, which is available in all Apple Stores around the world, offering daily sessions in photography, music creation, art and design, coding and entrepreneurship, Apple Michigan Avenue is partnering with local nonprofits and creative organizations to make an ongoing positive impact in that community

### ***Free App Development***

- Also this quarter, we expanded our free App Development with Swift curriculum to more than 30 community colleges across the country
- We're very excited about this initiative, and we're thrilled by the momentum we're seeing
- The schools we've launched with this summer are just the beginning

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- Community colleges have a powerful reach into communities where education is the great equalizer, and the colleges adopting our curriculum this academic year are providing opportunity to millions of students to build apps that will prepare them for careers in software development and information technology and much more

### ***Accomplishments***

- We're incredibly enthusiastic about what our teams have accomplished this year and all the amazing products in our lineup
- As we approach the holiday season, we expect it to be our biggest quarter ever
- I'd like to thank all of our teams, our partners and our customers for their passion, commitment and loyalty
- You've helped us make 2017 a sensational year

## **Luca Maestri**

### ***Financial Highlights***

#### ***Revenue***

- Revenue for the September quarter was a record \$52.6B, up 12% over last year, and it has been great to see our growth rate accelerate in every quarter of FY2017
- Our terrific performance this quarter was very broad based, with revenue growth in all our product categories for Q2 in a row and new September quarter revenue records in the Americas, in Europe and in the rest of Asia-Pacific segments

#### ***International Performance***

- We grew double digits in the U.S., Canada, Germany, France, Italy, Spain, Korea and several other developed markets
- We were especially happy to return to growth in greater China, where revenue was up 12% from a year ago and with our momentum in India, where revenue doubled y-over-y
- We grew more than 30% in Mexico, the Middle East, Turkey and Central and Eastern Europe
  - These results have fueled overall growth of over 20% from emerging markets

#### ***Gross Margin and Diluted EPS***

- Gross margin was 37.9%, at the high end of our guidance range
- Operating margin was 25% of revenue and net income was \$10.7B
- Diluted EPS were \$2.07, up 24% over last year to a new September quarter record and cash flow from operations was strong at \$15.7B

#### ***Emerging Markets***

- During the quarter, we sold 46.7mm iPhones, up 3% over last year

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- We were very pleased to see double digit iPhone growth in many emerging markets including mainland China, the Middle East, Central and Eastern Europe, India and Mexico
- We gained share not only in those markets but also in Canada, Germany, France, Italy, Spain, Sweden and Singapore, based on the latest estimates from IDC.
- iPhone channel inventory increased by 1.3mm units sequentially to support the launch of iPhone 8 and 8 Plus, significantly less than the increase in the September quarter a year ago

### *U.S*

- Customer interest and satisfaction with iPhone are very strong with both consumers and business users
- In the U.S., the latest data from 451 Research on consumers indicates a customer satisfaction rating of 97% or higher across all iPhone models
- Among consumers planning to buy a smartphone in the next 90 days, purchase intention for iPhone was 69%, more than 5 times the rate of the closest competitor with a loyalty rate for current iPhone owners of 95% compared to 53% for the next highest brand
- For corporate smartphone buyers, iOS customer satisfaction was 95% and of those planning to purchase smartphones in the December quarter, 80% planned to purchase iPhone
  - That is the highest score for iPhone in the history of the survey

### *Services*

- Turning to Services, we set an all-time quarterly record of \$8.5B, up 34% y-over-y
- Our results included a favorable one-time revenue adjustment of \$640mm
- On a run rate basis, excluding this adjustment, services growth of 24% was terrific and the highest that we have experienced this year
- The App Store set a new all-time record, and according to App Annie's latest report, it continues to be the preferred destination for customer purchases by a wide and growing margin, generating nearly twice the revenue of Google Play
- We're getting great response to the App Store's new design in iOS 11 from both customers and developers
  - We're seeing increases in the frequency of customer visits, the amount of time they spend in the store and the number of apps they download

### *Apple Music*

- The success of Apple Music also continues to build and we're seeing our highest conversion rates from customers trying the service
- Revenue grew strongly once again in the September quarter and the number of paid subscribers was up over 75% y-over-y
  - We also saw great performance from our iCloud business with very strong double-digit growth in both monthly average users and revenue
- Across all of our Services offerings, the number of paid subscriptions reached over 210mm at the end of September quarter, an increase of 25mm in the last 90 days



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### ***Denmark, Finland, Sweden and UAE***

- Apple Pay expanded to Denmark, Finland, Sweden and the UAE last month and continues to grow rapidly
- Over the past year, active users have more than doubled and annual transactions are up 330%
- In the U.S., 70% of leading grocery chains are now accepting Apple Pay with the recent launch of Safeway and over 5mm U.S. merchant locations will be Apple Pay enabled by the end of this year

### ***Mac***

- Next, I would like to talk about the Mac, which for FY2017 set a new all-time revenue record of \$25.8B.
- We sold 5.4mm Macs during the September quarter, up 10% over last year and gained significant market share as the global market contracted by 1% based on IDC's latest estimate
  - This performance was fueled primarily by great demand for MacBook Pro and Mac revenue grew 25% to a new September quarter record
- We had outstanding results all around the world with each of our geographic segments growing Mac revenue by 20% or more
- We were also very happy with the success of Mac in the education market where customer purchases grew double digits y-over-y

### ***iPad***

- It was also another great quarter for iPad
- We sold 10.3mm units, up 11% over last year with strong demand for both iPad and iPad Pro and revenue grew 14%
- It was great to see iPad unit and revenue growth in all of our geographic segments and particularly strong results in emerging markets, including greater China, where iPad units sales were up 25% y-over-y and India, which grew 39%

### ***NPD***

- NPD indicates that iPad had 54% share of the U.S. tablet market in the September quarter, including seven of the 10 best-selling tablets
- That's up from 47% share a year ago
- Also, the most recent surveys from 451 Research measured customer satisfaction rates of 97% across iPad models
- And among people planning to buy tablets, purchase intent for iPad was over 70% for both consumers and businesses

### ***Enterprise Initiatives***

- We are seeing great momentum with our enterprise initiatives

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- During the September quarter, we announced a new partnership with Accenture, who is creating a dedicated iOS practice in select locations around the world
- Experts from Apple are co-locating with this team and together they'll be launching new tools and services that help enterprise clients transform how they engage with customers using iPhone and iPad
- Examples include services to build new customer experiences and to facilitate iOS integration with enterprise systems to help businesses take greater advantage of data from Internet of Things platforms and to enable the smooth transfer of existing legacy applications and data to modern iOS apps

### ***Partnership with GE***

- And last month, we announced a partnership with GE to reinvent the way industrial companies work by bringing GE's industrial IoT platform to iOS.
- The [indiscernible] (20:37) SDK for iOS will enable developers to build native apps to drive industrial operations with more efficiency and speed than ever before
- GE is also standardizing on iPhone and iPad for its global workforce of more than 330,000 employees and working with Apple, GE is developing iOS apps for both its internal and external audiences to bring predictive data and analytics to workers across a broad range of industries
- Beyond our iOS devices, we are also seeing great traction for Mac in the enterprise market with all-time record customer purchases in FY2017

### ***New Product Launches***

- The September quarter was very strong for our retail and online stores, which welcomed 418mm visitors
- Traffic was particularly heavy during the week of our new product announcements, up 19% over last year
- Retail ran a very successful back-to-school promotion in the Americas, Europe, China and Singapore, with sales of Mac and iPad Pro up strong double digits compared to last year's program
- And around the world, our stores conducted over 200,000 Today at Apple sessions during the quarter

### ***Cash Levels***

- Let me now turn to our cash position
- We ended the quarter with \$268.9B in cash plus marketable securities, a sequential increase of \$7.4B. \$252.3B of this cash, 94% of the total, was outside the United States
- We issued \$7B in new Canadian and U.S. dollar denominated debt during the quarter, bringing us to \$104B in term debt and \$12B in commercial paper outstanding

### ***Dividend and Equivalents***

- We also returned \$11B to investors during the quarter
- We paid \$3.3B in dividends and equivalents and spent \$4.5B on repurchases of 29.1mm Apple shares through open market transactions
- We also launched a new \$3B ASR program, resulting in initial delivery and retirement of 15.1mm shares and we retire 4.5mm shares upon the completion of our 11th ASR during the quarter



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- We have now completed almost \$234B of our \$300B capital return program, including \$166B in share repurchases

## Outlook

### *Revenue, Gross Margin and OpEx*

- As we move ahead into the December quarter, I'd like to review our outlook, which includes the types of forward-looking information that Nancy referred to at the beginning of the call
- As a reminder, the December quarter in FY2017 spanned 14 weeks, whereas the December quarter this year will include the usual 13 weeks
  - We expect revenue to be between \$84B and \$87B
  - We expect gross margin to be between 38% and 38.5%
  - We expect OpEx to be between \$7.65B and \$7.75B
  - We expect OI&E to be about \$600mm and we expect the tax rate to be about 25.5%
- Also, today our Board of Directors has declared a cash dividend of \$0.63 per share of common stock, payable on November 16, 2017, to shareholders of record as of November 13, 2017

## QUESTION AND ANSWER SECTION

**<Q - Kathryn Lynn Huberty>:** Luca, when do you expect to catch up with iPhone X demand? And given it's likely to be not in the December quarter, should we think about March as a better than seasonal revenue quarter because of that iPhone X ramp? And then I have a follow-up.

**<A - Timothy D. Cook>:** I'll take that, Katy. It's Tim. The ramp for iPhone X is going well, especially considering that iPhone X is the most advanced iPhone we've ever created and it has lots of new technologies in it. And so we're really happy that we were able to increase week by week what we're outputting and we're going to get as many of them as possible to the customers as soon as possible. I can't predict, at this point, when that balance will happen. And in terms of March, we obviously don't give guidance beyond the current quarter.

**<Q - Kathryn Lynn Huberty>:** Okay. And then China growth returned to strong double digits, 12% up. You've talked historically about that region being more sensitive than others to form factor changes and the new iPhone X form factor was not available in September. And so should we assume that growth in that region only accelerates from here as that new product gets pushed into the market.

**<A - Timothy D. Cook>:** Let me talk a little bit about Q4 in China to give you a little bit of color on the results. We increased market share for iPhone, Mac and iPad during the quarter. We hit all-time revenue records for Services and for Mac for the PRC during the quarter. We've had very strong iPad revenue growth. We had double digit unit growth in iPhone and both the upgraders and Android switchers were both up on a y-over-y basis during the quarter, and so the results were broad based. They were pretty much across the board, as I indicated.

The other thing that's happened is that the decline that we've been experiencing in Hong Kong moderated. And so it's still down y-over-y but less so than it was and part of that is the compare is an easier compare.

And then finally, in terms of another headwind that is a little less than it was, currency has been affecting us more significantly. Last quarter in China, it affected us 1 percentage point. And so the sum of all that, I feel great about the results. We don't obviously provide geographic-specific guidance but you can see from our overall guidance, we think we're going to have a really strong quarter.

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**<Q - Michael J. Olson>**: Is there any information you can provide on how iPhone X pre-orders compared to what you saw with iPhone 8 pre-orders? And then I have a follow-up as well.

**<A - Timothy D. Cook>**: Michael, we never go through mix, but I would share with you that the iPhone X orders are very strong for both direct customers and for our channel partners, which as you know, are lots of carriers throughout the world. And we couldn't be more excited to get underway. And I think as of a few minutes ago, the first sales started in Australia. And I'm told we had several hundred people waiting at the store in Sydney and I'm getting similar reports from across that region.

**<Q - Michael J. Olson>**: All right. Thanks. And we're excited about augmented reality and from your perspective, and maybe from our perspective on the outside looking in, how do we gauge the success of AR and what are some of the applications of the technology that you're most excited about today? Thanks.

**<A - Timothy D. Cook>**: Yes, it's a great question. The reason I'm so excited about AR is I view that it amplifies human performance instead of isolates humans. And so as you know, it's the mix of the virtual and the physical world and so it should be a help for humanity, not an isolation kind of thing for humanity.

As I go through different countries as I've been traveling lately, and looking at some things in the market, other things that are coming, the very cool thing is they're all over the place. I see things that the consumer's going to love because it's going to change shopping. I see things that consumers will love on the gaming side and the entertainment side. I see business-related AR apps as well. They're going to be great for productivity and between small and large business. And I see apps that makes me want to go back to K-12 again and repeat my schooling because I think it changes the game in the classroom a lot.

And so the real beauty here is that it's mainstream. And of course, Apple is the only company that could have brought this because it requires both hardware and software integration, and it requires sort of making a lot of – or giving the operating system update to many people at once. And the software team worked really hard to make that go back several versions of iPhone so that we sort of have hundreds of millions of enabled devices overnight. And so there's 1,000-plus in the App Store right now. I think this is very much like in 2008, when we fired the gun in the overall App Store. And so that's what it feels like to me, and I think it will just get bigger from here.

**<Q - Shannon S. Cross>**: A couple questions. The first, Tim, can you talk a bit about how you're thinking in terms of the lineup? You go from \$340 – this is for iPhone – you go from \$349 to above \$1,000. And it appears that you probably sold a fair amount at the lower end. Perhaps that was just some of the switchers in China and maybe drove some of the growth in China in terms of market share. But how are you sort of thinking about what went into the guidance for the December quarter? Are you seeing really strong demand at the low end and obviously expected benefit from the X at the high end? I'm just trying to understand because you have such a broader lineup than you've had in prior years.

**<A - Timothy D. Cook>**: Yes. In terms of what we saw in Q4, you can probably tell from the ASP we had good success, I would say, through the different iPhones. And we've tried hard to have an iPhone that is as affordable as possible for people that really want an iPhone but may have a more limited budget. And we've got some iPhones that are really great for that market. And then we've got three new iPhones and people will look at these and decide which one they want. And this is the first time we've ever been in the position that we've had three new iPhones at once like this at the top end of the line. And it's the first time we've had a staggered launch. And so we're going to see what happens, but we put our absolutely best thinking that we have here in the guidance that Luca presented, and you can tell from that, that we're bullish.

**<Q - Shannon S. Cross>**: Great. Thank you. And then in terms of Services, \$8.5B, up 34%, can you talk about some of the portions of that that outperformed, how sustainable? You mentioned China in terms of significant growth in Services, but I'm just curious. That's a pretty remarkable number, so I'm curious what the drivers were. Thank you.

**<A - Luca Maestri>**: Yes, Shannon. It's Luca. As I mentioned in the prepared remarks, there was \$640mm adjustment and there was a one-off change. And it's important to call it out because of course it's a one-off. And so the underlying growth rate for service in the quarter was fantastic. It was 24%. It's the highest growth rate that we've had for services

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during FY2017. So the business is going incredibly well. I would highlight maybe three of these businesses within Services at the App Store set a new all-time record. It's going incredibly well.

The number of paying accounts continues to grow very strongly, and that's very, very important to us for the App Store business. Apple Music was up, subscriptions were up 75% y-over-y. We're getting the highest conversion rates that we've had since the launch of the service. And so we turned the corner in Music. You remember that a few years ago, we were actually declining in Music; now with the streaming service in addition to the download business, the business is growing again. And that really helps the growth rate for the entire Services business.

iCloud is a service that continues to grow very strong double digits, and that's also helping. So we already become the size of a Fortune 100 company. We set a goal for ourselves to double what we did in FY2016, and the trajectory is actually quite positive.

**<Q - Steven Milunovich>**: I wanted to try to push a little bit more on the mix. Could you comment whether the 8 Plus outsold the 8 in the quarter? There seems to be some data that suggests that. And the 451 Research survey that you're alluding to also finds that over the next 90 days, those buying an iPhone, 43% are planning on buying the X. Could you comment upon your expectations in terms of the mix going forward? And if you won't do that, perhaps you could comment a bit about your thinking in terms of pushing price elasticity. I think a couple years ago, nobody would've imagined selling a phone at this price and obviously, you're pretty confident that you can do it.

**<A - Timothy D. Cook>**: Obviously, I'm not going to talk about mix. That's something that we've done in the past. If you look at the 8 and 8 Plus, when we launched them, they instantly became our top two selling products. If you look at 8 Plus in particular, to provide a little color there, 8 Plus for the period of time that we can measure to date, has gotten off to the fastest start of any Plus model. That for us was a bit of a surprise, and a positive surprise, obviously. And so we'll see what happens next. As I've mentioned before, we've never had three products and it's only today that the first customers can sort of look at all three of those and I'm sure there's been some people that wanted to do that before deciding even which one. And so we'll see what happens there.

But in terms of price elasticity, I think it's important to remember that a large number of people pay for the phone by month. And so if you were to go out on just the U.S., since that tends to be more of the focus of this call, you look at the U.S. carriers, I think you would find you could buy an iPhone X for \$33 a month. And so if you think about that, that's a few coffees a week. It's let's say less than a coffee a day at one of these nice coffee places.

The other thing to keep in mind is that many people are now trading in their current iPhone on the next iPhone. And the residual value for iPhone tends to be the highest in the industry and many people pick up \$300, \$350 or so for their iPhone and so that even reduces the monthly payment less. And then obviously, some carriers also have promotional things going on. And so I do think it's important to try to place it in that context.

In terms of the way we price, we price to sort of the value that we're providing. We're not trying to charge the highest price we could get or anything like that. We're just trying to price it for what we're delivering. And iPhone X has a lot of great new technologies in there that are leading the industry, and it is a fabulous product and we can't wait for people to start getting it in their hands.

**<Q - Steven Milunovich>**: And then I wanted ask, the Street historically has been a little skeptical about continued innovation and you've suggested there is more to go. Historically, you weren't first to large screens, you weren't first to OLED. Now though, you're leading in AR, you're leading with face ID, which the all-in a year ago, as some of your guys have suggested, was kind of very reminiscent of the aggressive Apple. Is it possible going forward that you could accelerate share gains from Android because you're now in a stronger competitive position?

**<A - Timothy D. Cook>**: I think, Steve, we've been in a competitive position. And so I probably maybe have a different view than you do or the folks that you're quoting. There's always doubting Thomases out there. And I've been hearing those for the 20 years I've been here and suspect I'll hear about them until I retire, right. So I don't really listen to that too much. There's lots of fantastic people here and they're doing unbelievable things. And yes, I view AR as profound. Not today, not the app that you'll see on the App Store today, but what it will be, what it can be. I think it's profound and I think Apple is in a really unique position to lead in this area.

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 Company Ticker: AAPL US  
 Date: 2017-11-02  
 Event Description: Q4 2017 Earnings Call

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Bloomberg Estimates - EPS  
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**<Q - Antonio M. Sacconaghi>**: Just following up a little bit on that question, Tim. You talked a bit about providing a lot of value and that Apple sets its prices according to value. And I think given the uniqueness of the product you have with the iPhone X in particular, that makes a lot of sense. I guess the question is given the uniqueness of the value that you have in the marketplace, why shouldn't we – should we, or why shouldn't we expect gross margins to improve this cycle vs. previous ones? And perhaps you can talk a little bit about how you think about pricing in the context of gross margin. And I have a follow-up, please.

**<A - Luca Maestri>**: Toni, I'll take that one. When – you said we price our products for the value that we deliver. We also said that every time we launch new products, the cost structures of the new products tend to be higher than the products that they replace. It's inevitable. We are adding new technologies, new features, and therefore the cost structures go up. We have a very good track record of taking those cost structures and over the life cycle of the product, we are able to bring them down.

There are a lot of elements in the gross margin line that we have good control over and there are also elements that we don't control. Take for example foreign exchange, which has been a significant headwind for the company for the last three years now. Also, the mix of products that we sell into the market tends to change over time, and that also has an impact on the overall gross margin for the company. There are situations where the commodities markets are in good shape. There are situations where commodity markets can be a bit out of balance.

We have a case right now around memory pricing, which is a headwind for the time being. So there's many puts and takes. The fact that our Services business is growing, it should be a positive because our Services margins tend to be accretive to company margins. So there's many puts and takes. We tend to think about maximizing gross margin dollars because we think that's the most important thing for investors at the end of the day. When we look at our track record over years, I think we've found a good balance between unit grow and gross margins and revenue, and we will continue to do that as we go forward.

**<Q - Antonio M. Sacconaghi>**: Okay. Thank you for that. And then I wanted to revisit this notion of supply and demand, and I realize it's very early and you can't make predictions. I think a common investor question is, the iPhone X was made available for sale. It quickly had pushed out availability levels to unprecedented levels vs. history. And so I think the really significant question is, is that initial push-out really a function of uniquely strong demand vs. history or is that push-out in availability really a function of much weaker supply vs. history?

So it'd be really helpful. You have in the past commented on first 24-hour orders, for which there were 4mm plus for the iPhone 6 and 6 Plus. You have very often on this call talked about targeting when you think you could reach supply/demand balance. So it'd be really helpful if you could provide some context in terms of what you know, either about initial orders or about a supplies vs. history that can help investors try and better understand the little data points that they're seeing in terms of availability of the device. Thank you.

**<A - Timothy D. Cook>**: The truth is we don't know. We've put our best estimate into the guidance, and you can see from the guidance that we are very bullish. And so, and we feel really great about the product lineup. We just sold the first units minutes ago. And so we'll see how things go. Until you get all of them out there where customers have the ability to demo and support, I think any kind of mix discussion is very much estimating. And so we put our best estimates in, but grantedly, we've never done this before. So there's no comparison here, with either the three iPhones nor the staggered launch. So we're going to learn something.

**<Q - Jim Suva>**: And I'll ask my original question and follow-up at the same time because they're slightly different topics. But you'd mentioned great success in India. I believe, Tim, in your prepared comments you mentioned, I think, India doubled y-over-y. Based upon market analysis, it looks like Apple's still just a relatively small sliver of the pie there. So Tim, what would it take to be even more successful in India? Is it a manufacturing footprint there? Is it partners? Is it more physical stores? Is it lower price points? Is it the bandwidth that has now caught up to many other countries, or how should we think about that?

And then the follow-up question is on the AR/VR, where will it really show up in your income statement? Are you hoping more for hardware sales or services through the apps or where the excitement will then monetize it within



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Apple? Thank you.

**<A - Timothy D. Cook>**: In terms of India, many of the things that you mentioned are correct. Growing a market like India is a result of all of those things and doing them all well. And so it's analogous to the many years that we put into China. It's building stores. It's building channels. It's building markets. It's building the developer ecosystem. It's having the right product lineup for the market. And I feel like we're making good progress there and are gaining understanding of the market, but we still have a long way to go, which I sort of see as an opportunity instead of a problem. And I do feel great about the growth rate. And so that's India. I think it's all of those things.

As you know, as I think we talked about before, we started manufacturing the iPhone SE there six, nine months ago so. And the majority of the iPhone SEs that we sold in the domestic market last quarter were manufactured there. And so we also have that going and are hoping that that winds up saving some amount of money over time and avoiding some of the compounding of taxes, et cetera.

The bandwidth issue has also been an issue, but as you point out, it is being addressed and between the large carriers there with Bharti and now Jio investing the way they are, the service in India is materially better than it was just 12 months ago. So there's been a sea change there in a short period of time. So I feel good about all that, but we have a long way to go.

In terms of the monetization question on AR/VR, we tend to focus first and foremost on customer experience. And so we're all about making sure the experience is great. And we think that if we get the experience right, that revenues and profits will be a result of getting that right. And so we're very much focused on the experience right now.

**<Q - Amit Daryanani>**: I have two as well. I guess maybe to start with on gross margins. Luca, y-over-y revenues are going to be up high single digits at the midpoint, gross margin will be down a little. Could you just tell us what are the puts and takes on that? And are yield inefficiencies broadly much more severe this time vs. what you've seen historically?

**<A - Luca Maestri>**: Yes. Amit, so we're guiding 38% to 38.5%. That's up 35BPS sequentially. Obviously we're getting the leverage from the larger volumes. As I mentioned, I think to Toni, we have higher cost structures every time we launch new products. So that is going to be the offset, and I mentioned particularly the impact from the memory pricing environment which is a headwind at this point. Just to size it for you, the impact of memory on our gross margin is 40BPS sequentially and 110BPS on a y-over-y basis. So they are meaningful impacts, and I think that is what I think probably you're referring to.

**<Q - Amit Daryanani>**: Got it. That's really helpful. And I guess if I could just follow up on the Services line. I mean you guys talked about it a fair amount earlier, but even if you exclude the one-time gain, it looks like the back half of 2017 accelerated by 500BPS in FY2017 vs. H1 2017. Qualitatively or quantitatively, is there a way to think about how much of this is from expanding of the installed base, which is one of the three things you mentioned I think, vs. more dollar per iOS device that you see?

**<A - Luca Maestri>**: Yes. I think it's both. As I mentioned, particularly on the App Store, which is very important to us, the number of paying accounts has grown a lot. It's grown a lot because, as you said, the installed base has grown, but also because we have made a number of changes that have made it easier for our customers around the world to participate on the App Store and be able to transact on the App Store. We are accepting, for example, more forms of payment today than we were 12 months ago or even 6 months ago. So that's been very important.

We also see that there is a typical spending curve for our customers. When they start transacting on the Store, they start at a certain level and they tend over time to get more familiar with the Store and they start to spend more. We're also now, very recently, made some changes, as you probably have seen, to the design of the App Store. And I was mentioning to you in the prepared remarks that these changes have been received very favorably. And so people now are spending more time on the Store, they download more apps, and that over time translates into monetization.

But we also have other businesses that are growing very, very fast and actually accelerating. I mentioned Music. I mentioned iCloud, and so it all adds up. And as you correctly point out, our growth rate is accelerating.

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**<Q - Brian J. White>**: Yeah, Tim, I'm wondering if we take a look at mainland China and we think about iPhone 8 and iPhone 8 Plus, they've been on sale for a while now. What has been the just general response to those two new iPhones and also preorders around the iPhone X in mainland China?

**<A - Timothy D. Cook>**: Brian, I hate to repeat this, but we don't really disclose mix. We view it as competitive information that we want to hold tightly ourselves. In terms of the way the preorder process works in China in the channel, so not in our direct channel, but in the broader carrier channel and channel, they generally take indications of interest vs. something that I would label a preorder. And so I would hesitate to even quote a number for fear it could be misconstrued. And we'll find out what the demand and where the supply and demand meet sometime in the future. I don't know when yet, but we're really excited to get going to find out.

**<Q - Brian J. White>**: And, Tim, it's interesting that sales grew 16% sequentially. If you look at the past five years, sales were up 7% in the September quarter, so that's an average. Yet you didn't have all your iPhones in the market. So if you had to, what would you attribute that to? It's a pretty big disconnect, 16% vs. an average of 7%.

**<A - Timothy D. Cook>**: Our emerging market performance during the quarter was very strong. And if you take China out, it's even stronger. But you can see that China rebounded. And as I'd indicated before, the China rebound was broad based across the products. And so we just had a phenomenal quarter on iPad, on the Mac, on Services, on Apple Watch, on iPhone. I mean we're literally, we're firing on all cylinders. And so that's what, that and our new products give us great confidence headed into this holiday season that this is going to be the best holiday season yet.

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