

Apple Inc. NasdaqGS:AAPL

FQ3 2024 Earnings Call Transcripts

Thursday, August 01, 2024 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2024-			-FQ4 2024-	-FY 2024-	-FY 2025-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.34	1.40	▲4.48	1.56	6.62	7.33
Revenue (mm)	84376.66	85777.00	▲1.66	93275.65	387922.29	416879.40

Currency: USD
Consensus as of Aug-01-2024 4:17 AM GMT

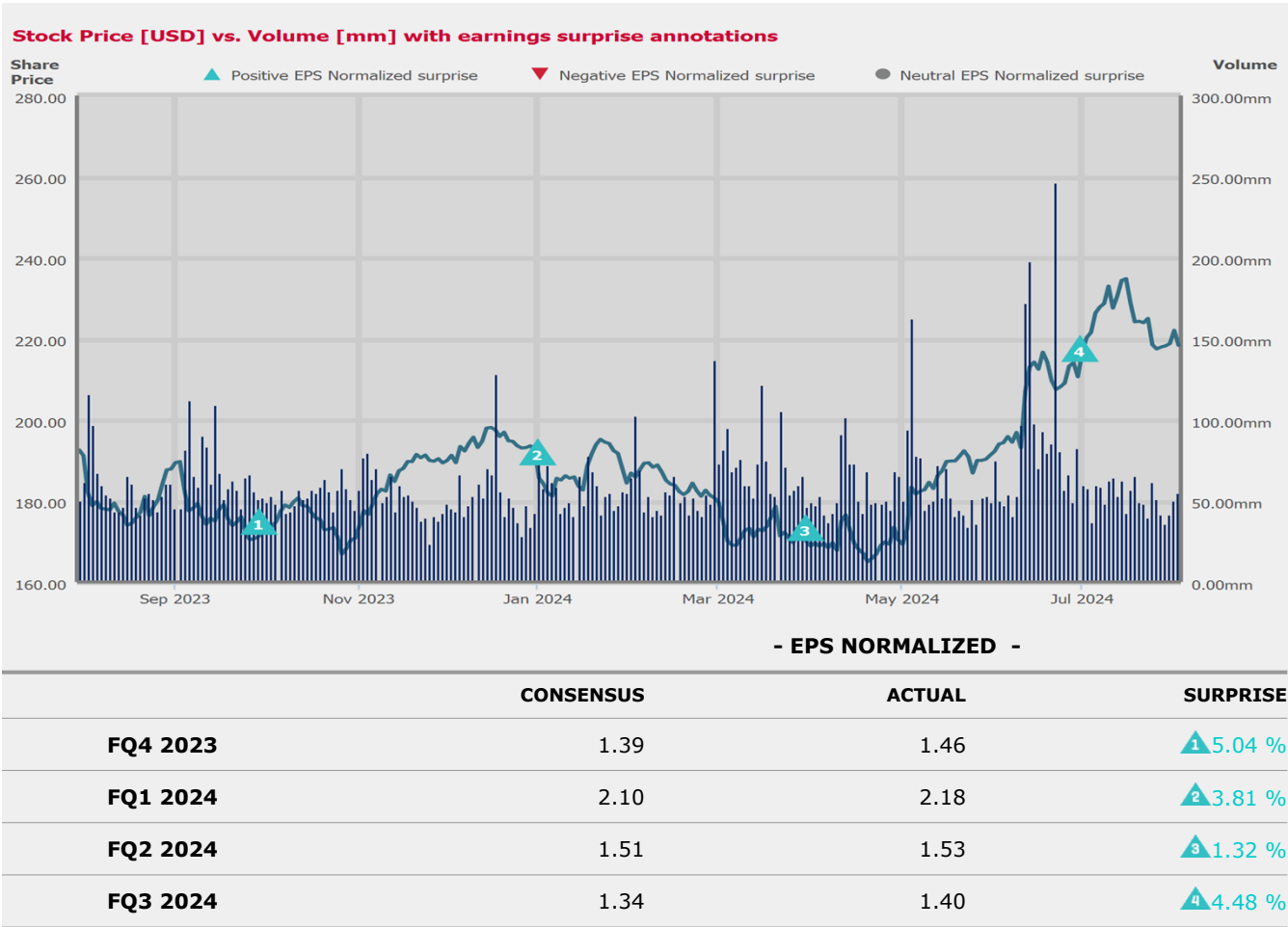


Table of Contents

Call Participants	3
Presentation	4
Question and Answer	9

Call Participants

EXECUTIVES

Luca Maestri
CFO & Senior VP

Suhasini Chandramouli
Director of Investor Relations

Timothy D. Cook
CEO & Director

ANALYSTS

Amit Jawaharlaz Daryanani
*Evercore ISI Institutional Equities,
Research Division*

Atif Malik
Citigroup Inc., Research Division

Benjamin Alexander Reitzes
Melius Research LLC

Wamsi Mohan
BofA Securities, Research Division

David Vogt
*UBS Investment Bank, Research
Division*

Erik William Richard Woodring
Morgan Stanley, Research Division

Krish Sankar
TD Cowen, Research Division

Michael Ng
*Goldman Sachs Group, Inc.,
Research Division*

Richard Alan Kramer
Arete Research Services LLP

Samik Chatterjee
*JPMorgan Chase & Co, Research
Division*

Presentation

Suhasini Chandramouli

Director of Investor Relations

Good afternoon, and welcome to the Apple Q3 Fiscal Year 2024 Earnings Conference Call. My name is Suhasini Chandramouli, Director of Investor Relations. Today's call is being recorded.

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 macroeconomic conditions 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, which speak only as of the date they are made.

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

Timothy D. Cook

CEO & Director

Thank you, Suhasini. Good afternoon, everyone, and thanks for joining the call.

Today, Apple is reporting a new June quarter revenue record of \$85.8 billion, up 5% from a year ago, and better than we had expected. EPS grew double digits to \$1.40 and achieved a record for the June quarter. We also set quarterly revenue records in more than 2 dozen countries and regions, including Canada, Mexico, France, Germany, the U.K., India, Indonesia, the Philippines, and Thailand. And we set an all-time revenue record in Services, which grew 14%.

At our Worldwide Developers Conference, we were thrilled to unveil game-changing updates across our platforms, including Apple Intelligence. Apple Intelligence builds on years of innovation and investment in AI and machine learning. It will transform how users interact with technology from Writing Tools to help you express yourself to Image Playground, which gives you the ability to create fun images and communicate in new ways, to powerful tools for summarizing and prioritizing notifications. Siri also becomes more natural, more useful, and more personal than ever.

Apple Intelligence is built on a foundation of privacy, both through on-device processing that does not collect users' data and through Private Cloud Compute, a groundbreaking new approach to using the cloud while protecting users' information powered by Apple Silicon. We are also integrating ChatGPT into experiences within iPhone, Mac, and iPad, enabling users to draw on a broad base of world knowledge.

We are very excited about Apple Intelligence, and we remain incredibly optimistic about the extraordinary possibilities of AI and its ability to enrich customers' lives. We will continue to make significant investments in this technology and dedicate ourselves to the innovation that will unlock its full potential.

Recently, we've also been excited to bring Apple Vision Pro to more countries, giving customers the chance to discover the remarkable capabilities of this magical device. Vision Pro users are customizing their own workspaces, watching movies on 100-foot screens, and exploring entire worlds with just a pinch of their fingertips. With more than 2,500 native spatial apps and 1.5 million compatible apps for visionOS, the developer community continues to pioneer stunning spatial experiences that are only possible with Vision Pro.

Last month, we announced that we're bringing some amazing new immersive content to Vision Pro, including new series, concerts, films, and more. And we've seen great interest for Vision Pro in the enterprise, where it can empower companies large and small to pursue their best ideas like never before. With each innovation, we're unlocking new ways of working, new ways of learning, and new ways of tapping into the unlimited promise of human potential. We're doing that across every product and every service.

Now let me share more detail on our June quarter results, beginning with iPhone. iPhone revenue was \$39.3 billion, down 1% year-over-year. On a constant currency basis, we grew compared to last year. Customers continue to praise the iPhone 15 lineup for its incredible battery life, exceptional cameras, and unmatched power and performance. And we are excited to bring incredible new features to the iPhone with iOS 18, making it more personal, capable and intelligent than ever before. This update includes the biggest redesign of the Photos app, new customization options for the home screen, messages over satellite, and the introduction of Apple Intelligence. Apple Intelligence utilizes the power of our most advanced iPhones, the iPhone 15 Pro and Pro Max, offering a transformative set of capabilities.

Mac revenue was \$7 billion, up 2% from a year ago. Customers are loving the latest M3-powered 13- and 15-inch MacBook Air. With back-to-school season upon us, MacBook Air is the perfect companion for students on campus. And small business owners, developers, and creatives of all kinds depend on Mac to do more than they ever could before. Powered by Apple Silicon with its neural engine and privacy built in at the chip level, Macs are simply the best personal computers for AI. And every Mac we've shipped with Apple Silicon since 2020 is capable of taking advantage of Apple Intelligence with macOS Sequoia. We also know the importance of security for our users and enterprises so we continue to advance protections across our products.

Turning to iPad. Revenue was \$7.2 billion, 24% higher year-over-year. During the quarter, we had an incredible launch where we unveiled the all-new 11- and 13-inch iPad Air, the perfect device for education, entertainment, and so much more. And with the new iPad Pro, we pushed the boundaries of power-efficient performance with a remarkable M4 chip, the engine behind this incredibly thin device. By leveraging the latest in Apple Silicon, video editors and musicians can take advantage of the cutting-edge AI features in Final Cut Pro and Logic Pro. And we're very excited that iPad Pro and iPad Air models powered by the M series of Apple Silicon will be able to utilize the powerful capabilities of Apple Intelligence.

In Wearables, Home and Accessories, revenue was \$8.1 billion, down 2% from a year ago. Apple Watch is empowering users to live a healthier day with a range of tools to take charge of their wellness journeys. At the core of Apple Watch are powerful AI features that are helping users get help when they need it most from irregular heart rhythm notifications to walking steadiness to crash detection and fall detection. I've heard time and again how meaningful these features are for users and their loved ones, and their stories motivate us to keep pushing forward on this vital work.

As I mentioned earlier, in Services, we set an all-time revenue record of \$24.2 billion, with paid subscriptions climbing to an all-time high. We achieved revenue records in the majority of the Services categories with all-time revenue records in advertising, cloud, and payment services.

Apple TV+ productions are delighting audiences on screens, large and small. We're sharing powerful works of imagination with series and movies like Presumed Innocent, the upcoming Disclaimer, and The Instigator starring Matt Damon. And we can't wait for returning fan favorites with new seasons of The Morning Show, Slow Horses, and Severance. Apple TV+ productions also continue to earn accolades with nearly 2,300 nominations and 500 wins today. That includes 72 Emmy Award nominations across 16 programs, our best ever showing for the upcoming awards event.

During the quarter, we also expanded Tap to Pay on iPhone to more markets, including Japan, Canada, Italy, and Germany, enabling more businesses to use the power of iPhone to accept contactless payments.

And we announced new updates to our Services coming this fall, including U.S. national park hikes and custom walk routes in Apple Maps, the ability to pay with rewards using Apple Pay, collaborative listening

with Apple Music, and a redesigned Apple Fitness+ experience to help users make the most of our library of workouts and meditations.

Turning to retail. We continued to expand in emerging markets with our first ever location in Malaysia. Customers from all over the country came together with our team members to celebrate this special moment. Elsewhere in the world, our teams have been sharing the magic of Apple Vision Pro in demos that delight, inspire, and deeply move customers exploring the wonders of spatial computing for the first time.

At the heart of all of our innovations are the values that guide everything we do. We believe fundamentally that the best technology is technology that works for everyone. And in honor of Global Accessibility Awareness Day, we introduced all new capabilities to give users more ways to take advantage of all our products can do. These include eye tracking for users to control iPhone or iPad visually, music haptics to give those who are deaf or hard of hearing a tangible way to experience music, and vocal shortcuts that tie tasks to a user's voice.

And we are committed as ever to shipping products that offer the highest standards of privacy for our users. With everything we do, whether it's offering a browser like Safari that prevents third-parties from tracking you across the Internet, or providing new features like the ability to lock and hide apps, we are determined to keep our users in control of their own data. And we are just as dedicated to ensuring the security of our users' data. That's why we work to minimize the amount of data we collect and work to maximize how much is processed directly on people's devices, a foundational principle that is at the core of all we build, including Apple Intelligence.

And we continue to make significant progress on the environment. We are proud to say that all of our data centers, including those that will run Private Cloud Compute, operate on 100% renewable energy.

At Apple, we're constantly accelerating our pace of innovation. We are a company in relentless pursuit of big ideas. Time and again, we've seen how a spark of creativity can reach breakthrough velocity, reach across previously unexplored dimensions, and ultimately take flight in ways that can change the world. It's why we're going to keep investing in the meaningful innovation that enriches the lives of all of our customers.

We have a busy time ahead of us, and I couldn't be more excited for all the amazing things yet to come.

With that, I'll turn it over to Luca.

Luca Maestri
CFO & Senior VP

Thank you, Tim, and good afternoon, everyone.

We are very pleased to report a new June quarter revenue record of \$85.8 billion, up 5% year-over-year, despite 230 basis points of negative foreign exchange impact.

We achieved growth in the vast majority of our markets with June quarter revenue records in the Americas, Europe, and rest of Asia Pacific.

Products revenue was \$61.6 billion, up 2% year-over-year, driven by the launch of the new iPad Pro and iPad Air. Our installed base of active devices reached an all-time high across all products and geographic segments, thanks to our unmatched levels of customer satisfaction and loyalty and a large number of customers who are new to our products.

Services revenue reached an all-time record of \$24.2 billion, up 14% year-over-year, with an all-time record in developed markets and a June quarter record in emerging markets.

Company gross margin was 46.3%, near the high end of our guidance range and down 30 basis points sequentially, driven by a different mix within products, which was partially offset by a favorable mix shift towards Services and cost savings.

Products gross margin was 35.3%, down 130 basis points sequentially, primarily driven by mix partially offset by favorable costs.

Services gross margin was 74%, down 60 basis points from last quarter.

Operating expenses of \$14.3 billion were at the low end of the guidance range we provided and up 7% year-over-year.

Net income was \$21.4 billion. Diluted EPS of \$1.40 was up 11% year-over-year and set a June quarter record. And operating cash flow was very strong at \$28.9 billion, also a June quarter record.

Let me get into more detail for each of our revenue categories. iPhone revenue was \$39.3 billion, down 1% year-over-year, but grew on a constant currency basis. We set June quarter records across several countries, including the U.K., Spain, Poland, Mexico, Indonesia, and the Philippines. And the iPhone active installed base grew to a new all-time high in total and in every geographic segment.

During the June quarter, many iPhone models were among the top-selling smartphones around the world. In fact, according to a survey from Kantar, iPhone was the top-selling model in the U.S., urban China, the U.K., Germany, Australia, and Japan. Customer satisfaction on the iPhone 15 family continues to be extremely high, with 451 Research measuring it at 98% in the U.S. in their latest reports.

Mac generated \$7 billion in revenue, up 2% year-over-year, driven by the MacBook Air powered by the M3 chip. We saw particularly strong performance in our emerging markets with June quarter records for Mac in Latin America, India, and South Asia. The Mac installed base reached an all-time high, with half of MacBook Air customers in the quarter being new to Mac. And customer satisfaction for Mac was recently reported at 96% in the U.S.

iPad revenue was \$7.2 billion, up 24% year-over-year, driven by the launch of the new iPad Pro and iPad Air. Customers are loving the latest iPad lineup for its new design and display, unparalleled performance, AI capabilities and much more. The iPad installed base has continued to grow and is at an all-time high as half of the customers who purchased iPads during the quarter were new to the product. Also, customer satisfaction was recently measured at 97% in the U.S.

Wearables, Home and Accessories revenue was \$8.1 billion, down 2% year-over-year, a sequential acceleration from the March quarter. Watch and AirPods continue to face a difficult compare against prior year launches of the AirPods Pro second generation, the Watch SE and the first Watch Ultra. Apple Watch continues to attract new customers, with almost 2/3 of customers purchasing an Apple Watch during the quarter being new to the product, sending the Apple Watch installed base to a new all-time high. And the latest reports from 451 Research indicated customer satisfaction of 97% for Watch in the U.S.

In Services, total revenue reached an all-time record of \$24.2 billion, growing 14% year-over-year. We continue to have great momentum in Services as the growth of our installed base of active devices sets a strong foundation for the future expansion of our ecosystem. And we see increased customer engagement with our Services offerings. Both transacting accounts and paid accounts reached a new all-time high, with paid accounts growing double digits year-over-year.

Also, paid subscriptions showed strong double-digit growth. We have well over 1 billion paid subscriptions across the Services on our platform, more than double the number that we had only 4 years ago. And we are constantly focused on improving the breadth and quality of our services from critically acclaimed new content on Apple TV+ to new games on Apple Arcade and the many latest features we previewed during WWDC for iCloud, Apple Pay, Apple Cash, Apple Music, and more.

Turning to enterprise. We continue to see businesses leveraging our entire suite of products to drive productivity and creativity for their teams and customers. USAA, a leading insurance and financial services company, recently expanded beyond their existing iPhone and iPad deployments to provide their employees with the latest MacBook Air. And American Express has continued to add to their fleet of over 10,000 Macs to enhance their employees' productivity, security, and collaboration. We're also excited to see leading organizations, such as Boston Children's Hospital and Lufthansa, using Apple Vision Pro to build innovative spatial computing experiences to transform the training of their workforces.

Let me now turn to our cash position and capital return program. We ended the quarter with \$153 billion in cash and marketable securities. We repaid \$4.3 billion in maturing debt and increased commercial paper by \$1 billion, leaving us with total debt of \$101 billion. As a result, net cash was \$52 billion at the end of the quarter.

During the quarter, we returned over \$32 billion to shareholders, including \$3.9 billion in dividends and equivalents and \$26 billion through open market repurchases of 139 million Apple 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 Suhasini referred to at the beginning of the call. The color we're providing today assumes that the macroeconomic outlook doesn't worsen from what we are projecting today for the current quarter.

We expect foreign exchange to continue to be a headwind and to have a negative impact on revenue of about 1.5 percentage points on a year-over-year basis. We expect our September quarter total company revenue to grow year-over-year at a rate similar to the June quarter. We expect Services revenue to grow double digits at a rate similar to what we reported in the first 3 quarters of this fiscal year. We expect gross margin to be between 45.5% and 46.5%. We expect OpEx to be between \$14.2 billion and \$14.4 billion. We expect OI&E to be around negative \$50 million, excluding any potential impact from the mark-to-market of minority investments, and our tax rate to be around 16.5%.

Finally, today, our Board of Directors has declared a cash dividend of \$0.25 per share of common stock payable on August 15, 2024 to shareholders of record as of August 12, 2024.

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

Suhasini Chandramouli

Director of Investor Relations

Thank you, Luca. [Operator Instructions] Operator, may we have the first question, please?

Question and Answer

Operator

We will go ahead and take our first question from Erik Woodring with Morgan Stanley.

Erik William Richard Woodring
Morgan Stanley, Research Division

Maybe, Tim, if we start with you, I thought some of the color you provided before the call about iPhone 15 performing better than the iPhone 14 was interesting. So just with that context, can you maybe help us understand where you see iPhone replacement cycles today, where you think the size of the base of iPhones that have aged and likely to upgrade are? And what that translates to in potential pent-up demand as we enter a new iPhone cycle? And then I have a follow-up.

Timothy D. Cook
CEO & Director

The installed base hit an all-time high during the quarter, and so we were very happy about that. iPhone, in general, grew in constant currency. And the 15, as you point out, if you look at the same number of weeks of the 15 from launch and compare that to the 14, the 15 is doing better than the 14. And so that's kind of the state of where we currently are.

In terms of upgrade rates, it's very difficult mid-cycle to call upgrade rates. I would just say that with Apple Intelligence, we are very excited about the level of value that we're going to provide to users. And we believe that, that presents another reason for a compelling upgrade.

Erik William Richard Woodring
Morgan Stanley, Research Division

Okay. That's very helpful. And then second to that, can you maybe dig into the China dynamics a bit? Sales down 6% this quarter, 3% in constant currency, and improvement from last quarter on a tougher compare that came on the back of some iPhone discounting. So can you maybe just share color on the China market as a whole? How much you believe promotions helped in the quarter? How sustainable this improvement is? And if this performance really changes any of your approach to the China market as we look forward?

Timothy D. Cook
CEO & Director

Yes. Erik, as you point out, we decreased by 6.5% year-over-year for the whole of Greater China. And if you look at it on a constant currency basis, we declined by less than 3%. So over 50% of the decline year-over-year is currency-related. That is an improvement from the first half of the fiscal year and so we're happy to see the acceleration.

If you look at iPhone, in particular, for Greater China, the installed base set a record. We also, in Mainland China, set a June quarter record for upgraders. And so that's a very strong signal. And in fact, the survey from Kantar this quarter showed that iPhones were the top 3 models in urban China. Also, one of the things we look at is the 15 family compared to the 14 family for the same number of weeks from launch, so this goes all the way back to the September of '23. If you look at that, the 15 is outperforming the 14. And so those are some of the color I would provide.

In addition, one of the things that we're very focused on is the level of new customers buying our products. And so if you look at this on the Mac and iPad, in Mainland China, the majority of customers buying are buying for the first time, buying that product for the first time. And the Watch, the vast, vast majority of people are buying the product for the first time. And during the quarter, I should say also that iPad returned to growth in Greater China as it did around the world.

And so we continue to be confident in the long-term opportunity in China. I don't know how every chapter of the book reads but we're very confident in the long term.

Operator

Our next question is from Ben Reitzes with Melius.

Benjamin Alexander Reitzes

Melius Research LLC

Tim, now that you've launched or announced Apple Intelligence, do you have any ideas on how it may impact Services? Do you feel like it will accelerate your Services business, augment it? And maybe folks will need to buy more storage and some other things. How are you thinking about it as a catalyst for Services into next year? And I have a follow-up.

Timothy D. Cook

CEO & Director

We started the rollout of Apple Intelligence this week with developers, so some of the features are out there as of Monday, and we couldn't be more excited about getting them out there. Obviously, this will enable developers to take their apps to the next level. And so we're taking the first step and getting the beta out there, and we can't wait to see what kind of amazing things they do with it.

Benjamin Alexander Reitzes

Melius Research LLC

Okay. And then Luca, with regard to gross margin, there's been some component price inflation and mix. Do you mind just giving us a little more color on how you're managing that sequentially and how you feel about the current component environment as an impact on margins?

Luca Maestri

CFO & Senior VP

Sure, Ben. I think I'll give you a bit of the walk for the June quarter and then get into the outlook that we provided for the September quarter. At the total company level, we've reported 46.3%. It is down 30 basis points sequentially, and it was really driven by a different mix. Within products, of course, we launched very important products like the iPad during the course of the quarter. But we had an offset from a shift in mix towards services, and we got some good cost savings. And so when you look at it on a year-over-year basis, we are up significantly on the margin front. And keep in mind that foreign exchange continues to be a bit of a headwind for us.

As we go into the September quarter, we are guiding 45.5% to 46.5%, which is kind of within the guidance that we provided last quarter. Again, similar dynamics, we expect a slightly different mix. We expect foreign exchange to have a minimal impact sequentially, although a more significant impact on a year-over-year basis.

On the commodity side, I think that's what you're referring to, yes, we have seen some increases on the memory front, but the rest of the commodities, we see a continuous decline. So in general, we feel we're well positioned. And as you know well, these are very high levels of gross margin for us and we're pleased where we are.

Operator

Our next question is from Mike Ng with Goldman Sachs.

Michael Ng

Goldman Sachs Group, Inc., Research Division

I just have two questions. First, I was wondering if you could talk about whether or not you've seen a shift in demand for iPhone 15 Pro, Pro Max models since WWDC that could potentially foreshadow consumer demand for Apple Intelligence-enabled phones?

Timothy D. Cook

CEO & Director

We just announced sort of the requirements at the system and the silicon level in June, and so we had very limited time during the quarter. So it's really too early to tell.

Michael Ng

Goldman Sachs Group, Inc., Research Division

That's fair. And then with the focus on upgrader potential over the next several years, I was just wondering if you could talk about what you're expecting from the U.S. promotional environment from your channel partners, whether that's U.S. wireless carriers, given the importance of device sales for those partners during an upgrade cycle, or any retail support on what could be a very strong smartphone upgrade period?

Timothy D. Cook

CEO & Director

We are very excited about Apple Intelligence and what it brings, and it's another compelling reason for an upgrade. I'd leave the promotional question for the sort of the carriers themselves to answer. But I believe it will be a very key time and a compelling upgrade cycle.

Operator

Our next question is from Amit Daryanani with Evercore.

Amit Jawaharlaz Daryanani

Evercore ISI Institutional Equities, Research Division

I guess, Tim, maybe back to the Apple Intelligence dynamic. There's clearly a lot of excitement from consumers around what Apple Intelligence could mean for them. Can you just touch on do you think the intent is to launch all the Apple Intelligence features at the same time to consumers? Or do you think they end up getting staggered a bit? And if they are staggered, do you think it impacts how consumers come out and buy the next-generation iPhone?

Timothy D. Cook

CEO & Director

The rollout, as we mentioned in June, sort of we've actually started with developers this week. We started with some features of Apple Intelligence, not the complete suite. There are other features like languages beyond U.S. English that will happen over the course of the year, and there are other features that will happen over the course of the year. And ChatGPT is integrated by the end of the calendar year. And so yes, so it is a staggered launch.

Amit Jawaharlaz Daryanani

Evercore ISI Institutional Equities, Research Division

Got it. And then I guess your Services growth rates have been extremely impressive for several quarters and it seems like it's accelerated recently. Can you just talk about, when you look at this double-digit growth, how much of that do you think is coming from the installed base growth versus better ARPU or better monetization of the installed base? And how do you kind of see that mix changing as you go forward?

Luca Maestri

CFO & Senior VP

Yes, Amit, it's Luca. It's a combination of a number of factors. The installed base growth is very important, of course, because we have a larger pool of customers that uses the ecosystem and uses our Services. We are seeing, and we've seen this consistently for many, many quarters now, we see continued growth in the level of engagement that our customers have with our ecosystem. We have more transacting accounts every quarter so more people using the ecosystem, both the free elements of the ecosystem and the paid

elements. We see paid accounts growing double digits, and we've seen that for many, many quarters now. We look at our paid subscriptions on our platform, and they're growing strong double digits as well. So obviously, the growing level of engagement helps us both from an ARPU standpoint and just a volume standpoint.

Obviously, as you've seen over the last several years, we launched new services over time, and we've launched many new services fairly recently. Obviously, our payments business is relatively new, Apple TV+, Apple Arcade, Fitness+, so many other services we've added. And so we're providing more and more opportunities for our customers to interact with the ecosystem. And we believe we're doing also a very good job at improving the quality of these services and improving the amount of content that we make available. We continue to make significant investments on TV+, on Apple Arcade. We're launching new shows, new games all the time. And I think you will continue to see that as we go forward.

We're very, very happy with the 14% growth that we had this quarter because, particularly if you look at the performance that we had in Services a year ago, the compares for us tend to get a bit more challenging in the second half of our fiscal year. But in spite of that, we delivered a level of growth that was better than what we were expecting at the beginning of the quarter.

Operator

Our next question is from Wamsi Mohan with Bank of America.

Wamsi Mohan

BofA Securities, Research Division

Tim, you announced Apple Intelligence, but you also announced partnerships with OpenAI and presumably more coming down the road. How should investors think about the monetization models around these partnerships where the CapEx investments are clearly being made by these potential partners but obviously, they're leveraging your distribution to your very attractive installed base. So in the long term, do you see the Apple Intelligence part, the Services growth from Apple Intelligence being the larger contributor over time? Or do you see these partnerships becoming a larger contributor over time? And I have a follow-up.

Timothy D. Cook

CEO & Director

I think the way that I look at it is that Apple Intelligence is the on-device processing and the Private Cloud Compute. And a lot of that will be things with a personal context. And then for world knowledge, we are integrating with ChatGPT initially, and that will be focused on world knowledge as I said. And so the monetization model, I don't want to get into the terms of the commercial agreements because they're confidential between the parties, but I see both aspects as being very important. People want both.

Wamsi Mohan

BofA Securities, Research Division

Okay. As a follow-up maybe for Luca, just stepping back to the gross margin discussion again. If I look at calendar '23, you had, on average, 150 basis points increase in product gross margins on a year-on-year basis. In 2024 so far, it had been more flat year-on-year. When we think about that, is the incremental headwind, I mean, there was FX headwinds throughout the last several years. So ex FX, are there other incremental headwinds that are either temporary or structural in nature that are perhaps limiting further upside to what are obviously very strong gross margins?

Luca Maestri

CFO & Senior VP

Yes. Of course, as you said, foreign exchange continues to be, this is incremental on a year-over-year basis. And it's one of those things that is outside of our control. We try to hedge our exposures. But it is what it is. We know that when the dollar is strong, our gross margins are affected.

The other element that I think it's always important to keep in mind is that within the Products business, our products have different margin profiles. And depending on the relative success in the marketplace, our products' gross margin tends to move. And so the mix of our products has an impact on gross margins, right? And so we need to pay attention to that. Of course, we just launched an iPad and that is one of the factors.

But we want all our products to be very successful in the marketplace, and that's why we always look at gross margin dollars as the first order of priority and gross margin percentage tends to follow from that. The other factor that obviously has an impact, a significant impact is the state of the commodity markets, and they tend to go in cycles. And so we'll see how that plays out over time. But in general, we feel good about the level of gross margins that we have for our products business, and we think we're in a good position there.

Operator

Our next question is from Krish Sankar with TD Cowen.

Krish Sankar

TD Cowen, Research Division

Congrats on the strong results. The first one for Luca or Tim. We keep hearing about these increasing silicon content for AI edge devices. And also, I think, Luca, you spoke about increasing commodity costs. So I'm curious how to think about margins for these new AI devices. And Tim, do any of these Apple Intelligence features need more hardware updates than what we have today? And then I have a quick follow-up.

Timothy D. Cook

CEO & Director

Maybe I'll take the second 1 first and then pass it over to Luca. In terms of the requirements to run Apple Intelligence, there are system requirements and there are silicon requirements. And so from an iPhone point of view, the iPhone 15 Pro and Pro Max will run Apple Intelligence and the successor products, obviously. If you look at the Mac, it starts with the M series of silicon that started in 2020. And the iPad is the same, and so it starts with the M series of silicon. And so there are system requirements and silicon requirements that go with each of those.

Luca Maestri

CFO & Senior VP

And from a gross margin standpoint, as you know, we don't provide any color past the current quarter, and we just provided guidance for the quarter, 45.5% to 46.5%. It is essentially broadly in line with what we reported for the June quarter. So we'll take it quarter by quarter and we will report as the time goes by.

Krish Sankar

TD Cowen, Research Division

Got it. Very helpful. And then a quick follow-up for Tim. Thanks for the color on China. We also see many other consumer discretionary and luxury brands talk about a weak China. And I think Tim, you said half the details was FX-related. I'm curious, the other half of the weakness, was that more China macro-related or do you think it is kind of like specific to Apple with domestic competitors? Any other color you could give would be very helpful.

Timothy D. Cook

CEO & Director

Well, certainly, the competitive environment there is the most competitive in the world. I've said that before and that remains to be the case. The macroeconomic factors have been in the press, too, and I'm not an expert on those. I can only tell you what we're seeing. And we were pleased that the business showed improvement from the first half of the year.

Operator

Our next question is from David Vogt with UBS.

David Vogt

UBS Investment Bank, Research Division

Two, if I may also. Tim, first one for you. I know it's early days, and you talked about the developers just getting their hands on Apple Intelligence. But when you think about the categories that are currently in the App Store and kind of what you think app developers could do with this new technology, what's your instinct say in terms of, are these going to be iterative applications to currently available applications? Is there any sort of category that you think lends itself more naturally to Apple Intelligence? Is it games? Is it more creative? I'm just trying to get a sense of how you're thinking about it. And then I have a follow-up for Luca.

Timothy D. Cook

CEO & Director

If you look at how we've deployed Apple Intelligence or are deploying Apple Intelligence, we've really thought about it at pretty much all of the apps that you use every day. And so we've thought about it from Notes to Mail to Messages and all the rest. And so there's been a deep level of thinking about how it affects those apps. And that's going to surface Apple Intelligence in a way that is natural to the user, in a way that will, I think, get them very excited about it and get usage. Similarly, I think the developers will do that on a broad basis with their apps as well. And so I think it's profound and we'll see what the developers do. But we're very excited to get the initial seed out there this week and see what they do. I think it will be amazing, yes.

David Vogt

UBS Investment Bank, Research Division

Yes. No, that's helpful. I appreciate it. And Luca, I know you didn't give a full rundown of product categories in your prepared remarks. But if I kind of take your comments at face value, I guess what I'm trying to think about is for the next quarter, it sounds like with Services being relatively strong and FX easing a little bit, you're effectively saying that product revenue in the September quarter is going to basically be flat with the September quarter last year ahead of a product launch. And so I'm just trying to get a sense for, what are the puts and takes in that sort of outlook, particularly as you have Apple Intelligence hopefully stoking the fire for demand going forward?

Luca Maestri

CFO & Senior VP

Well, we have provided, let me repeat what we provided. We think that we're going to be growing total company revenue at a rate that is similar to what we reported, so the plus 5%, right? In spite of the fact that we're going to have some foreign exchange headwinds, and we said about 150 basis points in the December quarter. And we said that we will grow Services double digits at a rate that is similar to what we've reported for the first 3 quarters of the fiscal year.

We are not going into the other categories. I think there's a lot of good math that you can do from what we've given you here. Keep in mind on the Mac that we will have a challenging compare from a year ago, given the fact that we launched and we had the full quarter impact of the launch of the MacBook Air 15-inch a year ago. And also on the iPad, we reported 24% growth in the June quarter. Clearly, we had the benefit from the launch in the June quarter of the new products, the iPad Air and the iPad Pro. So important to keep that in mind on a sequential basis.

Operator

Our next question is from Atif Malik with Citi.

Atif Malik

Citigroup Inc., Research Division

The first 1 is for Tim. I know it's early days. The feedback on Apple Intelligence software features like notification summary and reduced interruption focus from the developers who have tried the iOS 18.1 beta version this week is very positive. My question is in response to an earlier question, you talked about a staggered launch on some of these software features. So are you expecting most of the features that you announced at WWDC to be part of iOS 18? Or we should be thinking that some of these features could potentially be part of iOS 19 next year?

Timothy D. Cook

CEO & Director

Our objective that we said in June is to roll out U.S. English starting in the fall and that's to users and then proceed with more functionality, more features, if you will, and more languages and regions coverage as we proceed across the next year. And so we sort of gave a time frame and we're tracking to that.

Atif Malik

Citigroup Inc., Research Division

Understand. And the next 1 for Luca. Luca, the Services growth momentum seems very strong. Are you seeing any impact from changes made to comply with the DMA rules?

Luca Maestri

CFO & Senior VP

Well, as you know, we've introduced some changes to the way we run the App Store in Europe already in March. And we are seeing a good level of adoption from developers on those changes. We are, on an ongoing basis, discussing with the European Commission how to ensure full compliance with the DMA. It's obviously early stage, but in general, our results for the Services business and for the App Store have been pretty good until now. Again, to just provide you a frame of reference, the percentage of revenue that we generate from the European Union on the App Store is about 7% of the total.

Operator

Our next question is from Samik Chatterjee with JPMorgan.

Samik Chatterjee

JPMorgan Chase & Co, Research Division

I guess, Tim, if I can just ask you about Apple Intelligence as well. There's a regulatory aspect as well in certain geographies. You mentioned the staggered launch that you're aiming for and the time lines you're thinking. How are you thinking about the complexity of the regulatory process, in particular, like EU and maybe China? And in terms of your time lines of the rollout, are you sort of embedding in the regulatory aspect here? And how should we think about timing then including that? And I have a follow-up.

Timothy D. Cook

CEO & Director

We're engaged, as you would guess, with both regulatory bodies that you mentioned. And our objective is to move as fast as we can, obviously, because our objective is always to get features out there for everyone. We have to understand the regulatory requirements before we can commit to doing that and commit a schedule to doing that. But we're very constructively engaged with both.

Samik Chatterjee

JPMorgan Chase & Co, Research Division

Okay, got it. And a quick 1 on the Wearables category, Luca. I know you mentioned the acceleration there on a sequential basis. Maybe you can just sort of parse that out in terms of which categories drove the acceleration because that's been a category that has been lagging a bit in terms of revenue trends for the past couple of quarters. So just curious what is starting to sort of drive it to accelerate on a sequential basis?

Timothy D. Cook

CEO & Director

Yes, I'll take that one. I think the important thing to remember when you look at the Wearables, Home and Accessories categories is that we have a difficult launch compare. And we've been running that for a few quarters and we still have that because last year had the continued benefit from the AirPods Pro second generation, the Watch SE and the very first Watch Ultra. And so it's important to keep that in mind. If you sort of take a step back, however, and look at the business across the trailing 12 months, it's grown. The Wearables, Home and Accessories business has grown to almost \$40 billion, which is double what it was 5 years ago.

Operator

Our last question is from Richard Kramer with Arete Research.

Richard Alan Kramer
Arete Research Services LLP

Tim, you referenced the investment in innovation, and your R&D sales ratio reached what I think was a June quarter record even before launching Apple Intelligence. Do you see the rollout of these features requiring further increases in R&D or increases in OpEx or CapEx for cloud compute capacity? And is it even possible to forecast the Services usage as they roll out, given that they're so new for consumers?

Timothy D. Cook
CEO & Director

Clearly, we have increased R&D over time. We've been investing in AI and ML for years. And in addition to investing more, we've also redeployed certain skills onto AI and ML. And so the growth in sort of embedded in our numbers that we've shared here, it's increasing year-over-year.

On the CapEx part, it's important to remember that we employ a hybrid kind of approach, where we do things internally and we have certain partners that we do business with externally where the CapEx would appear in their respective businesses. But yes, I mean, you can expect that we will continue to invest and increase it year-on-year.

Richard Alan Kramer
Arete Research Services LLP

Okay. And maybe a quick follow-up for Luca. When we look at the free cash flow margins for the first 9 months, they're up materially. And given this year's product mix, can you describe to us what exactly in the Services mix or cost control is driving what seems to be structurally higher free cash flow margins across the business?

Luca Maestri
CFO & Senior VP

Yes, I'm glad you noticed that. We are pretty pleased with that fact. And I think you probably also noticed that we've increased our return of capital to shareholders this quarter. This one was a record quarter for us. Well, it's a combination of a number of things. Of course, an improvement in the top line helps the margin expansion that we've had over the last several years and several quarters obviously has helped. And so that is driving better operating cash flow.

On the CapEx front, as Tim said, we employ a hybrid model. Some of the investments show up on our balance sheet and some other investments show up somewhere else and we pay as we go. But in general, we try to run the company efficiently. We continue to think that capital efficiency is a good thing. And therefore, we're pleased with the fact that our free cash flow is doing well this year.

Suhasini Chandramouli
Director of Investor Relations

Thank you, Richard. A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor, and via telephone. The number for the telephone replay is (866) 583-1035.

Please enter confirmation code 1969407 followed by the pound sign. These replays will be available by approximately 5 p.m. Pacific Time today.

Members of the press with additional questions can contact Josh Rosenstock at (408) 862-1142. And financial analysts can contact me, Suhasini Chandramouli with additional questions at (408) 974-3123. Thank you again for joining us today.

Operator

Once again, this does conclude today's conference. We do appreciate your participation.

Copyright © 2024 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

These materials have been prepared solely for information purposes based upon information generally available to the public and from sources believed to be reliable. No content (including index data, ratings, credit-related analyses and data, research, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON "AS IS" BASIS. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages. S&P Global Market Intelligence's opinions, quotes and credit-related and other analyses are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P Global Market Intelligence may provide index data. Direct investment in an index is not possible. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Global Market Intelligence assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P Global Market Intelligence does not act as a fiduciary or an investment advisor except where registered as such. S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

© 2024 S&P Global Market Intelligence.