Summary Apple

CORPORATE PARTICIPANTS

Luca Maestri Apple Inc. - CFO & Senior VP
Nancy Paxton Apple Inc. - Senior Director of IR and Treasury
Timothy D. Cook Apple Inc. - CEO & Director

Presentaion

Nancy Paxton Apple Inc. - Senior Director of IR and Treasury Thank you. Good afternoon, and thanks to everyone for joining us. And after that, we'll open the call to questions from analysts. For more information, please refer to the risk factors discussed in Apple's most recently filed periodic reports on Form 10-K and Form 10-Q and the Form 8-K filed with the SEC today along with the associated press release. I'd now like to turn the call over to Tim for introductory remarks.

Timothy D. Cook Apple Inc. - CEO & Director Timothy D. Cook Apple Inc. - CEO & Director, Thank you, Nancy, and thanks to everyone for joining us today. This isn't the first time you've heard from us regarding the December quarter, so the first thing I want to do is provide some final results and connect those back to the letter we shared at the beginning of the month. That's down 5% from a year ago or down 3% adjusting for foreign exchange. One of those factors, weak macro conditions in some emerging markets, was significantly more severe than we originally foresaw, especially in Greater China. We had record performance in large markets, including the United States, Canada, Mexico, Germany, Italy, Spain and Korea. But I think some of that got lost, so I want to share a bit more detail on the positives we see in China. We generated record December quarter services revenue in Greater China, fueled by an amazing ecosystem with over 2.5 million registered iOS developers. We also continued to grow our total active installed base by adding new customers. In fact, more than 2/3 of all customers in China who bought a Mac or an iPad during the December quarter were purchasing that product for the first time. Macroeconomic factors will come and go, but we see great upside in continuing to focus on the things that we can control. iPhone XR, iPhone XS and iPhone XS Max are, by far, the best iPhones we've ever shipped. These are also completely modern iPhones with stunning large full-screen displays and Face ID, the most secure authentication of any kind available in a smartphone. And the cameras are simply amazing with portrait mode and depth control to allow users to create studio-quality photos as well as stunning 4K video, opening a whole new era of photography. When you pair this with the macroeconomic factors, particularly in emerging markets, it resulted in iPhone revenue that was down 15% from last year. So what's behind this?, It's important to understand what's going on from the customer perspective at the point of purchase. We believe that it's the sum of several factors: first, foreign exchange. Second, subsidies. For various reasons, iPhone subsidies are becoming increasingly less common. In Japan, for example, iPhone purchases were traditionally subsidized by carriers and bundled with service contracts. Competitive promotional activity frequently increase the amount of subsidy during key periods. Today, local regulations have significantly restricted those subsidies as well as related competition. As a result, we estimate that less than half of iPhones sold in Japan in Q1 of this year were subsidized compared to about 3/4 a year ago and that the total value of those subsidies had come down as well. For millions of customers, we made it inexpensive and efficient to replace the battery and hold onto their existing iPhones a bit longer. Not only is our large and growing installed base a powerful testament to the satisfaction and loyalty of our customers, but it's also fueling our fast growing Services business. In fact, Services revenue set an all-time record at $10.9 billion in the December quarter, growing 19%. The App Store wrapped up its best year ever with record holiday period results propelled by the biggest Christmas Day and Christmas week ever. Customers also spent over $322 million on New Year's Day alone, setting a new single-day record for both the number of customers and purchase volume. It was also a great holiday season for Apple Pay with over 1.8 billion transactions in the quarter, well over twice the volume of the year-ago quarter. Merchant adoption continues to reach new milestones. Customers can now use Apple Pay with iPhone and Apple Watch at nearly 3,000 Speedway locations, while all Target, Taco Bell and Jack in the Box stores will be accepting Apple Pay soon. We launched Apple Pay in 3 new countries in the December quarter: Germany, Belgium and Kazakhstan and it's now live in 27 markets around the world. The rollout in Germany has been a huge success with Deutsche Bank reporting more activations for Apple Pay in 1 week than for Android in an entire year. Shoppers around the world love Apple Pay, and it has increasingly become an indispensable part of daily life. Revenue from cloud services continues to grow rapidly with year-over-year revenue up over 40% in the December quarter. And readership of Apple News set a new record with over 85 million monthly active users in the 3 countries where we've launched: the United States, the U.K. and Australia. Here in the U.S. the latest data from comScore shows that Apple News has the largest audience of all news apps. Our revenue from Services has grown from less than $8 billion in calendar 2010 to over $41 billion in calendar 2018. The largest category represents less than 30% of total Services revenue, and the new services we've launched in the last few years are all experiencing tremendous growth. We had our best quarter ever for Mac revenue, which was up 9% fueled by our new MacBook Air and Mac mini introduced in October. The MacBook Air includes a beautiful new Retina display, Touch ID and Force Touch Trackpad, while the new Mac mini provides a powerful, flexible solution for everything from home automation to giant render farms. iPad revenue was up 17%, its highest growth rate in almost 6 years, powered by the new iPad Pro released in November. With its edge-to-edge Liquid Retina display, Face ID and A12X Bionic chip, the new iPad Pro has been described by reviewers as a tablet with no equal and the most powerful mobile device ever made. Thanks to all this, our ecosystem is stronger than ever before. We have an amazingly talented team, creating hardware, software and services, optimizing each of them to create an unparalleled user experience. Apple Watch is a powerful example of that. It's humbling to read e-mails from customers around the world telling us how Apple Watch has dramatically changed their lives by motivating them to be more fit and active, by alerting them to potentially serious health conditions such as AFib and by helping them in times of crisis with features like fall detection and emergency SOS. We believe we are just beginning to see the impact we can make to improving health and are deeply inspired by the possibilities. Another example is the work we're doing with silicon. This means iPhone can recognize patterns, make predictions and learn from experience, and it does all this while keeping personal information private. Because of the quality and durability of iPhones, they maintain significant residual value, making trade-ins a great opportunity. It's not only great for the environment. It's great for the customer as their existing phone acts as a subsidy for their new phone, and it's great for developers as the phone that is traded in and redistributed can help grow our active installed base. Beginning last week, we started making it easier for people to pay for their phones over time with installment payments, and we're working on rolling out this program to more geographies as soon as we can. We'll continue to invest through near-term headwinds just as we always have, and we'll emerge stronger as a result.

Luca Maestri Apple Inc. - CFO & Senior VP Luca Maestri Apple Inc. - CFO & Senior VP, Thank you, Tim. Good afternoon, everyone. Looking at product categories. Company gross margin was 38%. This quarter, for the first time, we're making an important new disclosure to our investors as we believe it will foster a better understanding of our business. We're now reporting, on a quarterly basis, gross margin for products in aggregate and for services in aggregate. Products gross margin was 34.3%, and services gross margin was 62.8%. On a sequential basis, products gross margin increased 60 basis points due to positive leverage from the holiday quarter partially offset by higher cost structures as we launched several new products and by headwinds from foreign exchange. Services gross margin also increased 170 basis points sequentially due to favorable mix and leverage partially offset by foreign exchange. While both products and services gross margins improved sequentially, total company gross margin was down 30 basis points due to a different mix between products and services. Net income was $20 billion, about flat to last year; and diluted earnings per share were an all-time record at $4.18, an increase of 7.5% over last year. Operating cash flow was also very strong at $26.7 billion. iPhone revenue was $52 billion. And it has surpassed 900 million devices, up year-over-year in each of our 5 geographic segments and growing almost 75 million in the last 12 months alone. Turning to Services. It was our best quarter ever with revenue of $10.9 billion, up 19% year-over-year with new December quarter records in all 5 of our geographic segments. Many Services categories set new all-time revenue records, and we are on track to achieve our goal of doubling our fiscal 2016 Services revenue by 2020. To be clear and as we've already explained 90 days ago, our 2020 goal remains unchanged, and it excludes the impact of the revenue reclassification between products and services we recorded in connection with ASC 606, the new revenue recognition accounting standard that we adopted at the beginning of fiscal '19. And we now have over 360 million paid subscriptions across our Services portfolio, an increase of 120 million versus a year ago. Our subscription business has become very large and diversified, covering many different categories from entertainment to health and fitness to lifestyle. In fact, more than 30,000 third-party subscription apps are available today on the App Store, and the largest of them accounts for only 0.3% of our total Services revenue. We also had great results for iPad with revenue up 17% from a year ago. And strong performance of both iPad and iPad Pro had generated double-digit growth in 4 of our 5 geographic segments. Wearables, Home and Accessories revenue grew 33% to a new all-time record in each of our geographic segments. Revenue from this category was up over $1.8 billion compared to a year ago, thanks to the amazing popularity of Apple Watch and AirPods, both of which were supply constrained as we exited the quarter. Our retail and online stores generated strong results from Mac and iPad and all-time record performance from Services and from Wearables. We added Thailand to our footprint with a beautiful store in Bangkok, and we opened a stunning new store on Champs-Élysées in Paris, exiting the quarter with 506 physical stores in 22 countries. In enterprise, across multiple industries, our technology continues to enable businesses to do their best work. In health care, iPhones and iOS apps continue to streamline and support clinical workflows, communications and care delivery across leading health systems, including Johns Hopkins Medicine, Massachusetts General Hospital, Stanford Health Care and St. Jude Children's Research Hospital. With custom iOS apps available to production operators across their worldwide locations, SKF has reduced production errors from 20% to 0 while saving 70% in system-related time. This new iOS app reduces wasted raw materials and helps keep building projects on time and on budget. Let me now turn to our cash position. We ended the quarter with $245 billion in cash plus marketable securities. We also had $102.8 billion in term debt and $12 billion in commercial paper outstanding for a net cash position of $130 billion. As we explained in the past, it is our plan to reach a net cash neutral position over time. We repurchased 38 million Apple shares for $8.2 billion through open market transactions, and we paid $3.6 billion in dividends and equivalents. Consistent with our historical cadence, we plan to provide an update on our overall capital return program when we report our March quarter results. As we move ahead into the March quarter, I'd like to review our outlook, which includes the types of forward-looking information that Nancy referred to at the beginning of the call. We expect revenue to be between $55 billion and $59 billion. This range reflects a negative year-over-year impact of $1.3 billion from foreign exchange, which represents about 210 basis points of last year's revenue and a more uncertain macroeconomic environment than a year ago, especially in emerging markets. We expect gross margin to be between 37% and 38%. On a sequential basis, this range reflects seasonal loss of leverage and a 60 basis point unfavorable impact from foreign exchange, partially offset by commodity cost savings. We expect OpEx to be between $8.5 billion and $8.6 billion. We expect OI&E to be about $300 million, and we expect the tax rate to be about 17%. Also, today, our Board of Directors has declared a cash dividend of $0.73 per share of common stock payable on February 14, 2019, to shareholders of record as of February 11, 2019. Nancy Paxton Apple Inc. - Senior Director of IR and Treasury Thank you, Luca. Operator Instructions

QnA

Question-1 : Kathryn Lynn Huberty Morgan Stanley, Research Division - MD and Research Analyst Services growth did decelerate from the growth rates in recent quarters. So can you talk about the factors that played into that slower growth? And then appreciate the new disclosure around paid subscribers. But if you compare what you added in 2018 versus what you expect to add over the next 2 years, that implies a slowdown in annual net new subscribers. So should we be thinking about Services as a lower growth segment than what you experienced in 2018? And then I have a follow-up.

Answer-1 : Luca Maestri Apple Inc. - CFO & Senior VP Yes, Katy, let me take that one. So far, we've been able to grow about 20%. In fiscal '18, we grew 22%, so we are on track to achieve our objective. As we just told you, the installed base continues to grow very nicely. The second factor for the growth of the Services business is that, within this installed base, the percentage of users who are paying for at least 1 service is growing very strongly. This is due to several factors. During the last few years, as you know, we launched Apple Music, Apple Pay and advertising service for our developers on the App Store. All these businesses are growing very strongly. Second, we are making it easier for our customers to transact on our digital stores. We accept many more payment methods today, which are very common in certain countries around the world. We are launching Apple Pay in more and more markets and so on. And this is an incredible staggering number, right, when you think about it. You should take Apple Pay as an example. It started off as the most convenient, most private and most secure way to make a payment in a store or in an app. Then, we took Apple Pay to Safari. Then, we started a peer-to-peer service, and we're launching it in new markets across the world every quarter. So we are broadening that scope. I think you're referring to the deceleration in the growth rate that we've seen in the December quarter, and I think you're referring back to the growth that we reported in September. I think an important point I need to make and I think it's helpful that you asked the question is that a portion of this deceleration is truly just a reclassification of the amortization of free services that we've made in connection with the adoption of the new revenue recognition standard. So this reclassification reduces our growth rate versus the previous classification. We talked about 27% growth in the September quarter. With the reclassification, that growth rate was about 24.5%. There are, I would say, 3 factors that explain this difference between the 24.5% to the 19%. The first one is that foreign exchange plays a role. And in general, we tend not to reprice our services for foreign exchange on a very frequent basis. The second factor is a well-known issue around the App Store in China. The App Store in China is a large business for us. But in general, we are very, very pleased with 19% growth, and we think that the business will continue to grow nicely going forward.

Question-2 : Kathryn Lynn Huberty Morgan Stanley, Research Division - MD and Research Analyst Just a quick follow-up, Luca. Share repurchases in the December quarter were well below the run rate from the June and September quarters. How much did the weaker quarter play into your ability to carry out the buyback at the same level? And what should we think about as the right run rate going forward?

Answer-2 : Luca Maestri Apple Inc. - CFO & Senior VP Well, Katy, we've always said that we're very committed to executing our program. We have done almost $250 billion of repurchases from the beginning of the program. But we've also said that we want to execute the program in an efficient, effective, I will say, disciplined manner. And that takes into account also overall market conditions. So that's what we did during the course of the December quarter. And so we will continue to execute the program. We will continue to report at the end of every quarter.

Question-3 : Steven Mark Milunovich Wolfe Research, LLC - MD of Equity Research Some have the perception that you priced the new products, the new iPhones too high. What have you learned about price elasticity? And do you feel that perhaps you pushed the envelope a little bit too far and might have to bring that down in the future?

Answer-3 : Timothy D. Cook Apple Inc. - CEO & Director Steve, it's Tim. If you look at what we did this past year, we priced the iPhone XS in the U.S. the same as we priced the iPhone X the year ago. The iPhone XS Max, which was new, was $100 more than the XS. And then we priced the XR right in the middle of where the entry iPhone 8 and entry iPhone 8 Plus have been priced. So it's actually a pretty small difference in the United States compared to last year. So yes, I do think that price is a factor. I think part of it is that, the FX piece.

Question-4 : Steven Mark Milunovich Wolfe Research, LLC - MD of Equity Research I know that you're not giving units going forward, but you said you might make qualitative comments. I was wondering if you have a comment particularly on the ASP on a year-over-year basis

Answer-4 : Luca Maestri Apple Inc. - CFO & Senior VP Well, Steve, we did mention on the call last quarter that the different timing of our phone launches would affect the year-over-year compares. If you remember, our top models, the XS and XS Max shipped during the September quarter, which plays the channel fill and the initial sales in that quarter. While last year, the iPhone X shipped in Q1 in the December quarter but is in the channel fill and the initial sales in the December quarter. It was pretty much in line with our expectations.

Question-5 : A.M. Sacconaghi Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst I have one for Luca and one for Tim. Luca, looks like the midpoint of your Q2 revenue guidance implies the steepest Q1 to Q2 sequential decline in iPhone revenues in history. It also implies a year-over-year deceleration in iPhone revenues. And I'm wondering if you can comment about whether that's conservatism, whether you're entering the quarter with a high level of channel inventory, and maybe you can comment explicitly on that, or whether you actually think the macroeconomic conditions are getting worse.

Answer-5 : Luca Maestri Apple Inc. - CFO & Senior VP Yes. I mean, 3 questions there. The first one is a question around conservatism. As we always do, when we provide a range, it's a range that we believe we're going to fall within. I mean, we've been -- we didn't miss in years and years. So that's the idea. It's -- there is that specific level of conservatism. We believe that this is the range where we're going to fall within. On channel inventory, as you know, our historical pattern for iPhone channel inventory is that, typically, we increase inventory in Q1 and we decrease in Q2. And so that obviously plays a role.

Question-6 : A.M. Sacconaghi Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst Tim, at your September event, Lisa Jackson, an Apple VP, stated the company needed to "design products to last as long as possible." And Apple's clearly doing that by helping with the battery replacement program, iOS working on an older range of products, et cetera. But I guess, the question is why doesn't that mean that replacement or upgrade cycles for iPhones should continue to extend going forward, in part, because that's almost one of your objectives. And maybe to that end, maybe you can help us understand what iPhone's average replacement cycle might be today and how that may have changed over the last 3 to 5 years. And again, why wouldn't you expect it to elongate over time given some of the aforementioned things?

Answer-6 : Timothy D. Cook Apple Inc. - CEO & Director We do design our products to last as long as possible. Some people hold onto those for the life of the product, and some people trade them in. The cycles -- the average cycle has extended. There's no doubt about that. So where it goes in the future, I don't know, but I'm convinced that making a great product that is high quality, that is the best thing for the customer and we work for the user. And so that's the way that we look at it

Question-7 : Shannon Siemsen Cross Cross Research LLC - Co-Founder, Principal & Analyst I wanted to ask about the trajectory of Services gross margin, up about 500 basis points, it appears, year-over-year. You talked a little bit about sequential. But what's driving the improvement? Or will it be volatile as we go through the year depending on quarters and mix? Just whatever color you can give us as we start to forecast this.

Answer-7 : Luca Maestri Apple Inc. - CFO & Senior VP Yes, Shannon. Let me start with sequential because I think it's probably most relevant for us. Sequentially, we increased 170 basis points. It's a business that is growing nicely, so we get good support from our scale. And also, we had favorable mix. Some of them tend to be accretive to the average gross margin for Services also because of the way we account for them. But we also have services that are very successful that are below the average for the Services business. We will report, of course, at the end of every quarter. But important to keep in mind, it's a broad portfolio with very different gross margin profiles within the portfolio. It is important for us to grow gross margin dollars.

Question-8 : Shannon Siemsen Cross Cross Research LLC - Co-Founder, Principal & Analyst And then, Tim, can you talk a bit about video? You've signed a myriad of deals. There was announcement about their TV app directly on Samsung. So perhaps when this comes out, you'll be multiplatform. I'm just curious how you view the opportunity in video. And I guess, assuming you can just leverage the costs that you've made already, it should be accretive to margin, I would think.

Answer-8 : Timothy D. Cook Apple Inc. - CEO & Director Yes. And I think that it'll likely take place at a much faster pace this year. And so we're going to participate in that in a variety of ways. One of those is through Apple TV, and you're well familiar with that product. And we're excited about that. It makes the experience in the living room with people using our products even better. We think that people are really going to like that. Another way is, of course, the -- all the third-party video subscriptions that are on the store. And I would guess that, that's going to accelerate into the future as the bundle breaks down and people begin to buy likely multiple services in place of their current cable bundle. But today, I'm not really ready to extend that conversation beyond that point.

Question-9 : Walter Paul Piecyk BTIG, LLC, Research Division - Co-Head of Research and MD I just have a question on the free services. Can you just describe how the math works on that? Is it that the free services are noncash revenue that's getting booked in the services revenue with no cost and the costs come out of products? Can you just run us through what the current state is versus how you were accounting for that before?

Answer-9 : Luca Maestri Apple Inc. - CFO & Senior VP Yes. We estimate the value that can be associated to providing free service. And so we calculate an estimated value. That value gets deferred and gets amortized over the estimated period of time that we deliver the free services. We just report that estimated value under the services category. We also reclassify the cost that we need to incur to provide those services. So the gross margin rate of each services is clearly significantly dilutive to the overall Services margin. I hope I've answered that.

Question-10 : Walter Paul Piecyk BTIG, LLC, Research Division - Co-Head of Research and MD Yes, you're right. So it's in mixed services gross margin. Got it. And then my other -- my second question is just when you think about growth in Services, you have selling more to existing paid subscription customers or it's the 300 million going to 0.5 billion. If you can just talk, at a high level, as far as when you look at growth going forward, is it about -- what is the mix in terms of selling more to existing users, getting new users or -- and maybe some of the individual services that you see the biggest growth opportunity?

Answer-10 : Luca Maestri Apple Inc. - CFO & Senior VP Yes. I mean, as I said, I mean, essentially, what -- the services -- I said services too is our installed base. So the first driver is growing the installed base. Installed base has grown nicely over the last several years. We've added 100 million in the last 12 months alone. So that's the first step. Then within that installed base, of course, we want to make sure that there are more people that are so interested in our services that, in addition to transacting on those services on a free basis, they also are interested in paying for those services. So we want to continue to do that. We want to make it easier for our customers to actually use our services, and so we are accepting more and more payment methods around the world. We provide an advertising service for developers on the App Store. The way we've added these services in the past, obviously, we're also very interested in adding new services that can provide great value to our customers in the future. Please enter confirmation code 2358120. These replays will be available by approximately 5 p.m. Pacific Time today. Members of the press with additional questions can contact Kristin Huguet at 408 974-2414. Financial analysts can contact Matt Blake or me with additional questions.

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Thank you. Good afternoon, and thanks to everyone for joining us. Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook. Actual results or trends could differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed periodic reports on Form 10-K and Form 10-Q and the Form 8-K filed with the SEC today along with the associated press release. Apple assumes no obligation to update any forward-looking statements or information, which speak as of their respective dates.

Timothy D. Cook Apple Inc. - CEO & DirectorTimothy D. Cook Apple Inc. - CEO & Director

Thank you, Nancy, and thanks to everyone for joining us today. As you know, our December quarter revenue was below our original expectations coming in at $84.3 billion. That's down 5% from a year ago or down 3% adjusting for foreign exchange. We'll return to upgrades in a moment, but I first want to say a bit more about our business in Greater China. Most of the shortfall relative to our original guidance and over 100% of our worldwide year-over-year revenue decline was driven by our performance in Greater China. We had record performance in large markets, including the United States, Canada, Mexico, Germany, Italy, Spain and Korea. In the letter we shared earlier this month, we said we are proud to participate in the Chinese marketplace and that we believe our business has a bright future there over time. But I think some of that got lost, so I want to share a bit more detail on the positives we see in China. We also continued to grow our total active installed base by adding new customers. Finally, for perspective, despite the challenging December quarter, our revenue from China grew slightly for the full calendar year. Returning to iPhone, I'd like to talk about our results in the context of those lower-than-expected upgrades. iPhone XR, iPhone XS and iPhone XS Max are, by far, the best iPhones we've ever shipped. These are also completely modern iPhones with stunning large full-screen displays and Face ID, the most secure authentication of any kind available in a smartphone. We couldn't be more proud of our iPhone lineup and our industry-leading customer satisfaction. We wouldn't change our position for anyone. Now our customers are holding on to their older iPhones a bit longer than in the past. When you pair this with the macroeconomic factors, particularly in emerging markets, it resulted in iPhone revenue that was down 15% from last year. Our iPhone results accounted for significantly more than our entire year-over-year revenue decline. In fact, outside of iPhone, our business grew strongly by 19%. We believe that it's the sum of several factors: first, foreign exchange. The relative strength of the U.S. dollar has made our products more expensive in many parts of the world. In Turkey, for example, the lira depreciated by 33% over the course of calendar 2018, and in the December quarter, our revenue there was down by almost $700 million from the previous year. For various reasons, iPhone subsidies are becoming increasingly less common. In Japan, for example, iPhone purchases were traditionally subsidized by carriers and bundled with service contracts. Competitive promotional activity frequently increase the amount of subsidy during key periods. Today, local regulations have significantly restricted those subsidies as well as related competition. For millions of customers, we made it inexpensive and efficient to replace the battery and hold onto their existing iPhones a bit longer. Not only is our large and growing installed base a powerful testament to the satisfaction and loyalty of our customers, but it's also fueling our fast growing Services business. In fact, Services revenue set an all-time record at $10.9 billion in the December quarter, growing 19%. We not only generated our highest global Services revenue ever, but we also had all-time records across multiple categories of Services including the App Store, Apple Pay, cloud services and our App Store Search Ad business, and we had a December quarter record for AppleCare. The App Store wrapped up its best year ever with record holiday period results propelled by the biggest Christmas Day and Christmas week ever. It was also a great holiday season for Apple Pay with over 1.8 billion transactions in the quarter, well over twice the volume of the year-ago quarter. Merchant adoption continues to reach new milestones. We launched Apple Pay in 3 new countries in the December quarter: Germany, Belgium and Kazakhstan and it's now live in 27 markets around the world. The rollout in Germany has been a huge success with Deutsche Bank reporting more activations for Apple Pay in 1 week than for Android in an entire year. Shoppers around the world love Apple Pay, and it has increasingly become an indispensable part of daily life. And readership of Apple News set a new record with over 85 million monthly active users in the 3 countries where we've launched: the United States, the U.K. and Australia. The MacBook Air includes a beautiful new Retina display, Touch ID and Force

Touch Trackpad, while the new Mac mini provides a powerful, flexible solution for everything from home automation to giant render farms. iPad revenue was up 17%, its highest growth rate in almost 6 years, powered by the new iPad Pro released in November. We don't measure our success in 90-day increments. Thanks to all this, our ecosystem is stronger than ever before. We have an amazingly talented team, creating hardware, software and services, optimizing each of them to create an unparalleled user experience. Apple Watch is a powerful example of that. We believe we are just beginning to see the impact we can make to improving health and are deeply inspired by the possibilities. Another example is the work we're doing with silicon. We've embedded machine learning directly into the silicon with our A12 Bionic chip. This means iPhone can recognize patterns, make predictions and learn from experience, and it does all this while keeping personal information private. This is a powerful example of how innovation and privacy can go hand in hand at a time when these issues are increasingly important to our users. We are undertaking and accelerating a number of initiatives to improve our results. It's not in our DNA to just stand around and wait for macroeconomic conditions to improve. One such initiative is making it simple to trade in an iPhone in our stores and raising awareness of this opportunity. Because of the quality and durability of iPhones, they maintain significant residual value, making trade-ins a great opportunity. It's great for the customer as their existing phone acts as a subsidy for their new phone, and it's great for developers as the phone that is traded in and redistributed can help grow our active installed base. Beginning last week, we started making it easier for people to pay for their phones over time with installment payments, and we're working on rolling out this program to more geographies as soon as we can. We'll continue to invest through near-term headwinds just as we always have, and we'll emerge stronger as a result.

Luca Maestri Apple Inc. - CFO & Senior VPLuca Maestri Apple Inc. - CFO & Senior VP

Thank you, Tim. As Tim said, revenue for the December quarter was $84.3 billion. iPhone revenue declined 15% from a year ago, while revenue from the rest of our business grew 19% to an all-time record, including our best results ever for Services, for Wearables and for Mac. This quarter, for the first time, we're making an important new disclosure to our investors as we believe it will foster a better understanding of our business. We're now reporting, on a quarterly basis, gross margin for products in aggregate and for services in aggregate. Products gross margin was 34.3%, and services gross margin was 62.8%. Services gross margin also increased 170 basis points sequentially due to favorable mix and leverage partially offset by foreign exchange. Net income was $20 billion, about flat to last year; and diluted earnings per share were an all-time record at $4.18, an increase of 7.5% over last year. Operating cash flow was also very strong at $26.7 billion. Let me provide more color for the various products categories. On a geographic basis, most of the decline from last year came from Greater China and other emerging markets, where difficult macro and foreign exchange conditions affected our results. We also believe that the reduction of carrier subsidies and our battery replacement program had an impact in a number of countries around the world. However, our global active installed base of iPhones continues to grow and has reached an all-time high at the end of December. We are disclosing that number now for the first time. And it has surpassed 900 million devices, up year-over-year in each of our 5 geographic segments and growing almost 75 million in the last 12 months alone. We plan to provide information on the iPhone installed base as well as total installed base on a periodic basis. And we now have over 360 million paid subscriptions across our Services portfolio, an increase of 120 million versus a year ago. Our subscription business has become very large and diversified, covering many different categories from entertainment to health and fitness to lifestyle. Mac revenue was up in the vast majority of countries we track with double-digit growth in many large markets such as the U.S., Western Europe, Central and Eastern Europe, Japan, Korea and South Asia. We also had great results for iPad with revenue up 17% from a year ago. And strong performance of both iPad and iPad Pro had generated double-digit growth in 4 of our 5 geographic segments. Similar to the Mac, our installed base of iPads reached a new all-time high, and among customers purchasing iPad during the quarter, half were new to iPad. The most recent consumer survey from 451 Research measured a 94% customer satisfaction rating for iPad overall with iPad Pro models scoring as high as 100%. Among business customers who plan to purchase tablets in the March quarter, 68% plan to purchase iPads. Wearables, Home and Accessories revenue grew 33% to a new all-time record in each of our geographic segments. Revenue from this category was up over $1.8 billion compared to a year ago, thanks to the amazing popularity of Apple Watch and AirPods, both of which were supply constrained as we exited the quarter. Our retail and online stores generated strong results from Mac and iPad and all-time record performance from Services and from Wearables. In enterprise, across multiple industries, our technology continues to enable businesses to do their best work. In manufacturing, SKF, the world's largest producers of bearings and seals, have transformed their manufacturing processes on iOS and iPhone with incredible success. With custom iOS apps available to production operators across their worldwide locations, SKF has reduced production errors from 20% to 0 while saving 70% in system-related time. Apple technology has made possible a simplified user experience integrating the SAP Cloud Platform, yielding better accuracy, efficiency and employee experiences across the board. For instance, Procore Technologies has introduced an app to help decrease building errors on the job site. This new iOS app reduces wasted raw materials and helps keep building projects on time and on budget. We ended the quarter with $245 billion in cash plus marketable securities. We also had $102.8 billion in term debt and $12 billion in commercial paper outstanding for a net cash position of $130 billion. As we explained in the past, it is our plan to reach a net cash neutral position over time. As part of this plan, we returned over $13 billion to our investors during the December quarter. Consistent with our historical cadence, we plan to provide an update on our overall capital return program when we report our March quarter results. We expect revenue to be between $55 billion and $59 billion. We expect gross margin to be between 37% and 38%. We expect OI&E to be about $300 million, and we expect the tax rate to be about 17%. Also, today, our Board of Directors has declared a cash dividend of $0.73 per share of common stock payable on February 14, 2019, to shareholders of record as of February 11, 2019. With that, I'd like to open the call to questions. Nancy Paxton Apple Inc. - Senior Director of

IR and Treasury Thank you, Luca. (

QnA

Question-1 : Kathryn Lynn Huberty Morgan Stanley, Research Division - MD and Research Analyst Services growth did decelerate from the growth rates in recent quarters. So can you talk about the factors that played into that slower growth? And then appreciate the new disclosure around paid subscribers. But if you compare what you added in 2018 versus what you expect to add over the next 2 years, that implies a slowdown in annual net new subscribers. So should we be thinking about Services as a lower growth segment than what you experienced in 2018? And then I have a follow-up.

Answer-1 : Luca Maestri Apple Inc. - CFO & Senior VP Yes, Katy, let me take that one. And it's important to understand what is driving the growth of the business. As we just told you, the installed base continues to grow very nicely. It has reached 1.4 billion active devices at the end of December, and really, very little of our Services revenue is driven by what we sell in the last 90 days. First of all, we're offering more and more services. During the last few years, as you know, we launched Apple Music, Apple Pay and advertising service for our developers on the App Store. All these businesses are growing very strongly. We accept many more payment methods today, which are very common in certain countries around the world. We've also increased the distribution coverage for many of these services. We're bringing AppleCare to more points of sale around the world. We are launching Apple Pay in more and more markets and so on. And this is an incredible staggering number, right, when you think about it. And we're really very excited about the opportunities that we see in front of us. I think you're referring to the deceleration in the growth rate that we've seen in the December quarter, and I think you're referring back to the growth that we reported in September. I think an important point I need to make and I think it's helpful that you asked the question is that a portion of this deceleration is truly just a reclassification of the amortization of free services that we've made in connection with the adoption of the new revenue recognition standard. This factor, by itself, represents roughly 1/3 of the deceleration that you've seen. We talked about 27% growth in the September quarter. With the reclassification, that growth rate was about 24.5%. So that explains about 1/3 of that deceleration. There are, I would say, 3 factors that explain this difference between the 24.5% to the 19%. The first one is that foreign exchange plays a role. And in general, we tend not to reprice our services for foreign exchange on a very frequent basis. The second factor is a well-known issue around the App Store in China. The App Store in China is a large business for us. But in general, we are very, very pleased with 19% growth, and we think that the business will continue to grow nicely going forward.

Question-2 : Kathryn Lynn Huberty Morgan Stanley, Research Division - MD and Research Analyst Just a quick follow-up, Luca. Share repurchases in the December quarter were well below the run rate from the June and September quarters. How much did the weaker quarter play into your ability to carry out the buyback at the same level? And what should we think about as the right run rate going forward?

Answer-2 : Luca Maestri Apple Inc. - CFO & Senior VP Well, Katy, we've always said that we're very committed to executing our program. But we've also said that we want to execute the program in an efficient, effective, I will say, disciplined manner. And that takes into account also overall market conditions. We -- our fundamental view remains the same. We are optimistic about our future, and we think there is great value in our stock. We will continue to report at the end of every quarter. And by the way, when we report our March quarter results, we will also talk about the next step in our capital return program, which is something that we do traditionally in the spring.

Question-3 : Steven Mark Milunovich Wolfe Research, LLC - MD of Equity Research Some have the perception that you priced the new products, the new iPhones too high. What have you learned about price elasticity? And do you feel that perhaps you pushed the envelope a little bit too far and might have to bring that down in the future?

Answer-3 : Timothy D. Cook Apple Inc. - CEO & Director Steve, it's Tim. If you look at what we did this past year, we priced the iPhone XS in the U.S. the same as we priced the iPhone X the year ago. And then we priced the XR right in the middle of where the entry iPhone 8 and entry iPhone 8 Plus have been priced. So it's actually a pretty small difference in the United States compared to last year. And so what we have done in January and in some locations and some products is essentially absorb part or all of the foreign currency move as compared to last year and therefore, get close or perhaps right on the local price from a year ago. So yes, I do think that price is a factor. I think part of it is that, the FX piece. And then secondly, in some markets as I had talked about in my prepared remarks, the subsidy is probably the bigger of the issues in the developed markets.

Question-4 : Steven Mark Milunovich Wolfe Research, LLC - MD of Equity Research I know that you're not giving units going forward, but you said you might make qualitative comments. I was wondering if you have a comment particularly on the ASP on a year-over-year basis

Answer-4 : Luca Maestri Apple Inc. - CFO & Senior VP Well, Steve, we did mention on the call last quarter that the different timing of our phone launches would affect the year-over-year compares. If you remember, our top models, the XS and XS Max shipped during the September quarter, which plays the channel fill and the initial sales in that quarter. So we knew that this would create a difficult compare for Q1 of '19, and this is essentially what happened. It was pretty much in line with our expectations.

Question-5 : A.M. Sacconaghi Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst I have one for Luca and one for Tim. Luca, looks like the midpoint of your Q2 revenue guidance implies the steepest Q1 to Q2 sequential decline in iPhone revenues in history. It also implies a year-over-year deceleration in iPhone revenues. And I'm wondering if you can comment about whether that's conservatism, whether you're entering the quarter with a high level of channel inventory, and maybe you can comment explicitly on that, or whether you actually think the macroeconomic conditions are getting worse.

Answer-5 : Luca Maestri Apple Inc. - CFO & Senior VP Yes. The first one is a question around conservatism. As we always do, when we provide a range, it's a range that we believe we're going to fall within. We've done pretty well with that up until the December quarter, right? I mean, we've been -- we didn't miss in years and years. We believe that this is the range where we're going to fall within. On channel inventory, as you know, our historical pattern for iPhone channel inventory is that, typically, we increase inventory in Q1 and we decrease in Q2. On a year-over-year basis, the negative impact from currency is going to be about $1.3 billion, so that's about -- a bit more than 2 points versus last year's revenue. And the macroeconomic environment, particularly in emerging markets, will continue to be there.

Question-6 : A.M. Sacconaghi Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst Tim, at your September event, Lisa Jackson, an Apple VP, stated the company needed to "design products to last as long as possible." And Apple's clearly doing that by helping with the battery replacement program, iOS working on an older range of products, et cetera. But I guess, the question is why doesn't that mean that replacement or upgrade cycles for iPhones should continue to extend going forward, in part, because that's almost one of your objectives. And maybe to that end, maybe you can help us understand what iPhone's average replacement cycle might be today and how that may have changed over the last 3 to 5 years. And again, why wouldn't you expect it to elongate over time given some of the aforementioned things?

Answer-6 : Timothy D. Cook Apple Inc. - CEO & Director We do design our products to last as long as possible. And then that phone is then redistributed to someone else. The cycles -- the average cycle has extended. We've said several times, I think, on this call and before that the upgrades for the quarter were less than we anticipated due to the -- all the reasons that we had mentioned. So where it goes in the future, I don't know, but I'm convinced that making a great product that is high quality, that is the best thing for the customer and we work for the user.

Question-7 : Shannon Siemsen Cross Cross Research LLC - Co-Founder, Principal & Analyst I wanted to ask about the trajectory of Services gross margin, up about 500 basis points, it appears, year-over-year. You talked a little bit about sequential. But what's driving the improvement? Or will it be volatile as we go through the year depending on quarters and mix? Just whatever color you can give us as we start to forecast this.

Answer-7 : Luca Maestri Apple Inc. - CFO & Senior VP Yes, Shannon. Let me start with sequential because I think it's probably most relevant for us. Sequentially, we increased 170 basis points. It's a business that is growing nicely, so we get good support from our scale. Some of these services are scaling quickly, and so we tend to expand gross margins there. As you probably know, we have a very broad portfolio of services. Some of them tend to be accretive to the average gross margin for Services also because of the way we account for them. But I wouldn't draw necessarily a conclusion on how this Services gross margin is going to move over time. We will report, of course, at the end of every quarter. It is important for us to grow gross margin dollars.

Question-8 : Shannon Siemsen Cross Cross Research LLC - Co-Founder, Principal & Analyst And then, Tim, can you talk a bit about video? You've signed a myriad of deals. There was announcement about their TV app directly on Samsung. So perhaps when this comes out, you'll be multiplatform. I'm just curious how you view the opportunity in video. And I guess, assuming you can just leverage the costs that you've made already, it should be accretive to margin, I would think.

Answer-8 : Timothy D. Cook Apple Inc. - CEO & Director Yes. And I think that it'll likely take place at a much faster pace this year. And so we're going to participate in that in a variety of ways. The second way is the -- is AirPlay 2, which we have -- as you just pointed out, we have support on a number of different third-party TVs. It makes the experience in the living room with people using our products even better. And I would guess that, that's going to accelerate into the future as the bundle breaks down and people begin to buy likely multiple services in place of their current cable bundle. We have signed a multiyear partnership with Oprah. But today, I'm not really ready to extend that conversation beyond that point. We've hired some great people that I have a super amount of confidence in, and they're working really hard. And we'll have something to say more on that later.

Question-9 : Walter Paul Piecyk BTIG, LLC, Research Division - Co-Head of Research and MD I just have a question on the free services. Can you just describe how the math works on that? Is it that the free services are noncash revenue that's getting booked in the services revenue with no cost and the costs come out of products? Can you just run us through what the current state is versus how you were accounting for that before?

Answer-9 : Luca Maestri Apple Inc. - CFO & Senior VP Yes. In essence, when we sell a product at a certain price, we make an assumption. We estimate the value that can be associated to providing free service. That value gets deferred and gets amortized over the estimated period of time that we deliver the free services. Now in connection with the new revenue recognition standard, we are reclassifying essentially that amortization from products revenue to services revenue. We just report that estimated value under the services category. We also reclassify the cost that we need to incur to provide those services.

Question-10 : Walter Paul Piecyk BTIG, LLC, Research Division - Co-Head of Research and MD Yes, you're right. So it's in mixed services gross margin. Got it. And then my other -- my second question is just when you think about growth in Services, you have selling more to existing paid subscription customers or it's the 300 million going to 0.5 billion. If you can just talk, at a high level, as far as when you look at growth going forward, is it about -- what is the mix in terms of selling more to existing users, getting new users or -- and maybe some of the individual services that you see the biggest growth opportunity?

Answer-10 : Luca Maestri Apple Inc. - CFO & Senior VP Yes. I mean, as I said, I mean, essentially, what -- the services -- I said services too is our installed base. So the first driver is growing the installed base. Installed base has grown nicely over the last several years. We've added 100 million in the last 12 months alone. Then within that installed base, of course, we want to make sure that there are more people that are so interested in our services that, in addition to transacting on those services on a free basis, they also are interested in paying for those services. And I mentioned that the percentage of paid accounts has increased strong double digits. And we've added a very useful service to our developers. We provide an advertising service for developers on the App Store. The way we've added these services in the past, obviously, we're also very interested in adding new services that can provide great value to our customers in the future. Nancy Paxton Apple Inc. - Senior Director of IR and Treasury Thank you all. And the numbers for the telephone replay are 888 203-1112 or 719 457-0820. Financial analysts can contact Matt Blake or me with additional questions. Matt is at 408 974-7406, and I'm at 408 974-5420.