

## **Operator**

Good day, everyone, and welcome to this Apple Incorporated First Quarter Fiscal Year 2011 Earnings Release Conference Call. [Operator Instructions] At this time for opening remarks and introductions, I would like to turn the call over to Nancy Paxton, Senior Director of Investor Relations. Please go ahead, ma'am.

## **Nancy Paxton**

Thank you. Good afternoon, and thanks 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, stock-based compensation expense, taxes, earnings per share and future products. Actual results or trends could differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's Form 10-K for 2010, and the Form 8-K filed with the SEC this afternoon along with the attached press release. Apple assumes no obligation to update any forward-looking statements or information or speak as of their respective date. And with that, I'd like to turn the call over to Apple's CFO, Peter Oppenheimer, for introductory remarks.

## **Peter Oppenheimer**

Thank you, Nancy. Thank you for joining us. We are very pleased to report the outstanding results of our December quarter. The performance of our business was extremely strong, as we sold more Macs, iPhones and iPads than in any previous quarter in Apple's history. And as a result, we're thrilled to announce all-time record quarterly revenue and earnings.

Revenue for the quarter was \$26.7 billion, an increase of more than \$11 billion over the prior December quarter's result, representing growth of 71%. The robust revenue growth was fueled by record iPhone, iPad and Mac sales. Operating margin was over \$7.8 billion, representing 29.3% of revenue. Net income was \$6 billion, which exceeded our previous quarterly earnings record set in the September quarter by \$1.7 billion, and represented 78% growth over the year-ago quarter's earnings. These results translated to earnings per share of \$6.43.

Turning to the details of the quarter, I'd like to begin with our Mac products and services. We established a new quarterly record with sales of 4.13 million Macs, representing 23% growth over the year-ago quarter. That's almost 8x IDC's most recently published estimate of 3% growth for the PC market. We experienced strong sales growth in each of our geographic segments, with over 50% growth in both the Asia-Pacific region and Japan.

The growth was fueled primarily by strong demand for the new MacBook Air, which was launched in October, as well as continued strong sales of MacBook Pro. Customers love the new thin and light unibody design of the MacBook Air, and the impressive responsiveness and reliability of its solid-state storage, while MacBook Pro continues to provide customers tremendous speed and high-performance graphics at an excellent value.

We ended the quarter with between three and four weeks of Mac channel inventory. We opened the Mac App Store in January 6, bringing what we've learned from iOS Apps to Mac users to make discovering, installing and updating apps easier than ever. The Mac App Store is available in 90 countries, and features more than 1,000 free and paid apps in categories like education, games, graphics and design, lifestyle, productivity and utility. We've been very pleased with customer response, with over 1 million downloads on the first day alone.

Moving to our music products. We sold 19.4 million iPods compared to 21 million in the year-ago quarter. We experienced continued strong sales of iPod touch, which grew 27% year-over-year and accounted for over 50% of all iPods sold during the quarter. iPod's share of the U.S. market for MP3 players remains at over 70% based on the latest monthly data published by NPD, and iPod continues to be the top-selling MP3 player in most countries we track based on the latest data published by GfK. We ended the quarter within our target range of four to six weeks of iPod channel inventory.

The iTunes Store generated another strong quarter with revenue exceeding \$1.1 billion, thanks to strong sales of music, video and apps. We were extremely pleased to bring the legendary music of the Beatles to iTunes during the quarter and to introduce movies to the iTunes Store in Japan. And as we announced a few weeks ago, iTunes users are now renting and purchasing over 400,000 TV episodes and over 150,000 movies per day.

I'd now like to turn to iPhone. We were thrilled to have sold 16.2 million iPhones compared to 8.7 million in the previous December quarter. This represents 86% year-over-year growth compared to IDC's latest published estimate of 70% growth for the global smartphone market overall in the December quarter. Recognized revenue from iPhone handset and accessory sales was \$10.47 billion during the quarter, compared to \$5.58 billion in the year-ago quarter, an increase of 88%.

The sales value of iPhones alone was over \$10.1 billion, which yields an ASP of about \$625. At the end of the December quarter, we had iPhone distributions through 185 carriers in 90 countries. We continue to experience very strong year-over-year growth in all of our segments, with sales in the Asia-Pacific region and Japan both more than doubling year-over-year.

Enterprise customers continue to embrace iPhone, with 88 of the Fortune 100 companies and almost 60% of the Financial Times Europe 100 companies now testing or deploying iPhones. Strong employee demand in custom app development are fueling deployment within the corporate sector.

Enterprise CIOs continue to add iPhone to their approved device list worldwide. Most recently, Fortune 500, like Wells Fargo, Archer Daniels Midland, DuPont, Staples, Starbucks and Genworth Financial, and Global 500 accounts such as Nissan Motor, BBVA [Banco Bilbao Vizcaya Argentaria], Standard Chartered Group and Danone, have made iPhone available to their employees.

We ended the quarter with about 3.5 million iPhones in channel inventory, a sequential increase of about 250k. We continue to have a sizable backlog, and believe we could have sold even more iPhones if we had been able to supply them. And we're thrilled to begin working with Verizon next month to offer iPhone 4 to its more than 93 million customers, as well as to new customers who want iPhone 4 on Verizon.

Turning to iPad. We continue to be thrilled with its momentum and customer interest. We sold 7.3 million iPads, a sequential increase of over 3 million, with distribution in 46 countries by the end of the December quarter. We continue to see great enthusiasm for iPads from consumer, business and education customers. Employee demand for iPad in the corporate environment remains strong, and the response to the product continues to be significant.

Enterprise CIOs are adding iPad to their approved device list at an amazing rate. Today, over 80% of the Fortune 100 are already deploying or piloting iPad, up from 65% in the September quarter. Some recent examples include JPMorgan Chase, Cardinal Health, Wells Fargo, Archer Daniels Midland, Sears Holdings and DuPont.

Recognized revenue from sales of iPad and iPad accessories during the quarter was \$4.61 billion. The sales value by iPads alone was over \$4.4 billion, which yields an ASP of about \$600. We increased the supply of iPads during the quarter and expanded both the number of countries and the number of channel partners carrying iPad.

Channel inventory increased by about 525,000 units from the beginning to the end of the quarter to support increased sales and channel expansion, and we ended the quarter within our target range of four to six weeks. Combining iPhone, iPad and iPod touch, we reached over 160 million cumulative iOS device sales through the end of the December quarter.

In November, we launched iOS 4.2, which brings over 100 new features to iPad users including multitasking, folders, unified inbox, Game Center, AirPlay and AirPrint.

The App Store continues to be incredibly successful, with over 300,000 apps available and well over 9 billion downloads to date. We continue to be very pleased with iAd, which combines the narrative quality of TV ads with the interactivity of digital to provide a new kind of advertising experience. During the quarter, we expanded iAds beyond the U.S. to Europe and Japan and provided iAd Producer to marketers.

I'd now like to turn to the Apple Retail Stores, which had a record-breaking quarter. Retail revenue almost doubled year-over-year to \$3.85 billion compared to \$1.97 billion in the year-ago quarter, an increase of 95%. iPad sales in our stores were very strong in the first holiday quarter. The stores also delivered a record Mac quarter, selling 851,000 Macs compared to 689,000 Macs in the year-ago quarter, an increase of 24%. And about half the Macs sold in our stores during the December quarter were to customers who had never owned a Mac before. International Retail Store sales were particularly strong with our average international store volume exceeding our very productive average U.S. store volume.

Additionally, our four stores in China were, on average, our highest traffic and our highest revenue stores in the world. We opened six stores during the December quarter, bringing us to a total of 323 stores worldwide at the quarter end, with 87 of them outside the United States.

With an average of 321 stores opened during the December quarter, average revenue per store was \$12 million compared to \$7.1 million in the year-ago quarter, an increase of 69%.

Retail segment margin exceeded \$1 billion for the first time and more than doubled from \$481 million in the year-ago quarter. We hosted a record 75.7 million visitors in our stores during the quarter, compared to 50.9 million visitors in the year-ago quarter, an increase of 49%.

Total company gross margin was 38.5%, which was about 250 basis points higher than our guidance. About half this difference was due to better commodity cost than we had planned. The remainder of the difference was due to the leverage on the higher revenue and lower other product costs, including freight, warranty and phone support.

Operating expenses were \$2.47 billion and included \$247 million in stock-based compensation expense. OI&E was \$136 million, ahead of our guidance primarily due to the positive impact of fluctuating foreign exchange rates from net asset. The tax rate for the quarter was 24.6%, below our guidance

of 25.5% due to the one-time benefit of the retroactive extension of the R&D tax credit from January 1, 2010. We expect our tax rate for the remaining quarters of fiscal '11 to be about 25.5%.

Turning to cash. Our cash, plus short-term and long-term marketable securities, totaled \$59.7 billion at the end of the December quarter, compared to \$51 billion at the end of the September quarter, an increase of \$8.7 billion. Cash flow from operations was \$9.8 billion, an increase of 69% year-over-year.

During the September and December quarters, we executed long-term supply agreements with three vendors through which we expect to spend a total of approximately \$3.9 billion in inventory component prepayments and capital expenditures over a two-year period. We made approximately \$650 million in payments under these agreements in the December quarter, and anticipate making \$1.05 billion in payments in the March quarter.

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 about \$22 billion, compared to \$13.5 billion in the March quarter last year. We expect gross margins to be about 38.5%, reflecting approximately \$50 million related to stock-based compensation expense. We expect OpEx to be about \$2.35 billion, including about \$250 million related to stock-based compensation. We expect OI&E to be about \$50 million, and we expect the tax rate to be about 25.5%. We are targeting EPS of about \$4.90.

In closing, we're extremely pleased with our record-breaking results and customer response to our products. We look forward to expanding the reach of the iPhone in the United States with the addition of Verizon, and we remain very confident in our strategy and our new product pipeline. And with that, I'd like to open the call to questions.

## **Nancy Paxton**

Thank you, Peter. Also joining us for Q&A are Apple COO, Tim Cook; and Treasurer, Gary Wipfler. And we ask that you limit yourself to one question and one follow-up. Operator, may we have the first question please?

## **Question-and-Answer Session**

### **Operator**

[Operator Instructions] And your next question will come from Shannon Cross with Cross Research.

**Shannon Cross - Cross Research**

I have a question for you with regard to availability of iPhones, especially with the Verizon launch. I think you mentioned that there was a backlog that you weren't able to meet in the December quarter. So I don't know if, Tim and Peter, if you could talk a little bit about what you're doing to ensure that you have sufficient quantities of iPhones and any changes you've made to ensure more component availability?

**Timothy Cook**

Shannon, it's Tim. As I mentioned on the last quarter's call, we made a very bold bet, taking iPhone capacity for the September quarter with the new iPhone 4 in the lineup to 14 million. And as you may remember, we sold over 14 million in that quarter in total iPhones, so it was a fantastic quarter. And that was up from a previous number that with the 8-ish million range. We were able to step that up in this past quarter to over 16 million, as Peter said in his opening remarks. And so we were able to increase over 2 million. And we're, obviously, have continued to work on increasing this further. But as with all good things, it takes some time to do that. Relative to Verizon, we are thrilled to offer the iPhone 4 to Verizon with 93 million customers, as well as any new customers who want an iPhone 4 on Verizon. And we're going to do everything possible to get the iPhones into as many hands of those customers as possible.

**Shannon Cross - Cross Research**

And then I just had one follow up, with regard to the Mac App Store, which clearly just started, though I'm not sure how much you'll talk about it. But we've noticed your best-selling apps tend to be Apple software-based, Apple software apps. So how should we think about the Mac App Store? Any initial thoughts you have on it and initial things you've seen?

**Timothy Cook**

It's just getting going, but we are thrilled to have reported over 1 million in a very short amount of time. And so we're very happy with the start of it.

**Operator**

And next, we'll go to Katy Huberty with Morgan Stanley.

**Kathryn Huberty - Morgan Stanley**

First question for Tim, how comfortable are you right now with the availability of iPhones and iPads? And if you still see shortages, how quickly do you think they can be addressed early this year?

**Timothy Cook**

Katy, let me take each one of those separately. On iPad, we increased dramatically last quarter. We sold 7.3 million the previous quarter, we were in the low 4s as you know. That did get us into supply-demand balance and also allowed us to expand to 46 countries, or to a total of 46 by the end of the quarter, which added 20 during the quarter. And we're confident enough to add another 15 countries during the month of January that will take us over 60. And so we feel very, very good about the progress that we've made here. Relative to iPhone 4, I also feel very, very good about what we've been able to do. However, it's not enough. We do still have a significant backlog. We are working around-the-clock to build more. I feel great that the demand is so high, but at this point, I'm not going to predict when supply and demand will meet. We believe the reaction and results from the Verizon customers will be huge, and so I don't want to give a prediction right now when the supply and demand will cross.

**Kathryn Huberty - Morgan Stanley**

And then Tim, one of the most impressive metrics is the sequential on your growth of Asia-Pacific. Can you just talk about what's driving that and what plans you have in place, going forward, to sustain that growth?

**Timothy Cook**

Yes. That's a very good question. First of all, let me say that of the BRIC countries, Brazil, Russia, India, China, we, several years ago, identified China as our top priority, and we put enormous energy into China. And the results of that has been absolutely staggering. To give you some numbers there and some specifics, we look at Greater China as a region. And Greater China, just for clarity, is mainland China, Hong Kong and Taiwan. The revenue from Greater China for Apple for last quarter was \$2.6 billion, which was up 4x from the prior year quarter. And to further, just an exclamation point by that, we did a little over \$3 billion for the entire year, fiscal year 2010. And so we're very, very proud of the team and the results that we've gotten there. Korea has also been a very, very good market for us. We had an outstanding Q1 there, primarily driven by iPhone and iPads. And there are several other Asian countries doing extremely well. Japan is not in the segment that you're looking out, but Japan by itself, the revenue was up 83% year-over-year. And if you're familiar with the Japanese economy and the growth there, to grow 83% on the base that we're doing is stunning.

And so we are placing more and more resource in these areas and continue to look for expansion possibilities throughout Asia.

## **Operator**

From Piper Jaffray, we'll hear from Gene Munster.

## **Charles Munster - Piper Jaffray Companies**

Question for Tim in terms of the long-term business planning. There's been a lot of questions in terms of how far out you guys actually planned it. I was wondering if there's any insight you can give us in terms of what your long-term business plan is in terms of a product road map. Obviously, you can't share what that road map is. But how far will you guys go in Retail Stores and so forth? Is it a one-year plan, is it a five-year plan, is it -- any sort of insight would be helpful?

## **Timothy Cook**

Well, Gene, that's part of the magic of Apple. And I don't want to let anybody know our magic because I don't want anybody copying it. What I would tell you is that in my view, Apple is doing its best work ever, that we are all very happy with the product pipeline. And the team here has an unparalleled breadth and depth of talent and a culture of innovation that Steve has driven in the company, and excellence has become a habit. And so we feel very, very confident about the future of the company. I would also note to those people that haven't thought about it is we've done outstanding in our Mac business. We've had 19 quarters straight of growing faster than the market, but we still have a relatively low share of a very large PC market despite having great momentum there. And so it would seem like there's enormous opportunity still there. We have a relatively low share in the handset market. The handset market is well over 1 billion units a year, and the smartphone market is growing faster than a weed. And so there's enormous opportunity here, and we have incredible momentum in that space. iPad just got started, it's a new category. We sold almost 15 million through the first three quarters, and we believe the market is huge. IDC, I saw this morning, is predicting it to quadruple in two years. I don't know what to predict in terms of specific numbers. However, we believe it's a huge market, as we've said before. And so we're in some great markets, some fast-moving markets, we have the best products we've ever done and an incredible product pipeline. We feel very, very confident.

## **Charles Munster - Piper Jaffray Companies**



And just a follow-up for Peter, in terms of iPhones, you mentioned that if not for production constraints, you could've sold more. Is there any way to help us kind of back into how many more?

**Peter Oppenheimer**

Gene, you can't run the experiment both ways, that's -- the demand for iPhone has just been incredible. We could not make enough in the quarter, and we would've loved to have ended with more channel inventory than we did.

**Operator**

From Citigroup, we'll hear from Richard Gardner.

**Richard Gardner - Citigroup Inc**

I was just hoping that you could talk about what components were better than you thought in terms of price during the quarter? And then Tim, if you could give us your thoughts on the commodity environment going into the March quarter, given that flat panels are below cash costs for some providers. What are you looking for going into the March quarter, please?

**Timothy Cook**

Rich, in terms of the go-forward in March quarter and what is embedded in the guidance that Peter gave earlier is that we expect a favorable pricing environment for DRAM, where supply exceeds the demand still. Some prices for raw materials such as key metals is currently increasing due to the anticipated strengthening of the worldwide economy, and it remains to be seen whether that continues. The bulk of the other commodities from NAND Flash to batteries to HDDs to ODDs to LCDs and most other commodities are generally in a supply-demand balance. And so we would expect this group of commodities to fall in prices consistent with their historical trends. In terms of what we saw last quarter, frankly speaking, in most areas, we saw a favorability and it was a key part of us overachieving our guidance gross margin.

**Richard Gardner - Citigroup Inc**

And actually, Tim, if I could follow up, can you talk about which component areas you're making long-term commitments in on supply?

**Timothy Cook**

It's something I don't want to give out, Rich, because I view it as a competitive -- something I just don't want our competition knowing. But let

me talk about it in general and hopefully, that will suffice. From our point of view on the design side, we design components where we believe we can innovate beyond what's available in the market. And the most recent example of this is the A4 chip. But with the A4 chip, we didn't feel like we had to invest in the fab itself and build the fab because we felt like they were good options in the market for doing that, but not good options in terms of buying a design, and so we really focused on design. On the operational side of the house, as you probably remember, we've historically entered into certain agreements with different people to secure supply and other benefits. And the largest one in the recent past has been we signed a deal with several Flash suppliers back at the end of 2005 that totaled over \$1 billion because we anticipated that Flash would become increasingly important across our entire product line and increasingly important to the industry. And so we wanted to secure supply for the company, and we think that, that was an absolutely fantastic use of Apple's cash. And we constantly look for more of these. And so in the past several quarters we've identified another area and come to some recent agreements that Peter talked about in his opening comments, in that these payments consist of both prepayments and capital for process equipment and tooling. And similar to the Flash agreements, they're focused in an area we feel is very strategic. And so I'd prefer not to go into more detail about what specific area it's in, but it's the same kind of thinking that led us to those deals that led us to the Flash deal.

## **Operator**

From Goldman Sachs, we'll hear from Bill Shope.

## **Bill Shope - J.P. Morgan**

Guys, in the past, your build materials for key devices has generally come down at a rate that allowed for fairly healthy gross margin expansion over time. And I'd say this has generally been true for iPod refreshes in the past, iPhone refreshes. Is there anything different about the iPad that we should consider going forward, that would make it difficult for margins to follow this historical pattern? And did you see some of this in the most recent quarter as well?

## **Timothy Cook**

Bill, margins consist of a number different factors like which direction the commodity markets are going? Where the product is within the product life cycle, as well as the value engineering that we do and the negotiating and so forth we do. And so I don't think that you can take a single product kind of out by itself and speak about it with any accuracy. And as you know, we

don't guide at the product level on margin. We're confident with the guidance that Peter provided on gross margin in his opening comments.

### **Peter Oppenheimer**

And I would ask of that, that we have always aggressively worked to lower our costs. I think we have a good track record in this regard, and we shipped a lot of iPads in the December quarter, and have very strong gross margins. So I think we were quite happy with our progress.

### **Bill Shope - J.P. Morgan**

On the iPad side again. Now that you've had the opportunity over the past few weeks to see more detail specs and in some cases, the price points for all the countless tablet devices coming into 2011. Can you comment on how you're currently dealing with competitive landscape for the iPad and how, if that's changed, if at all, over the past few months?

### **Timothy Cook**

Well, and if you're look at what's shipping today, there's not much out there as you know. And generally speaking, there's two kinds of groups today, that are at least on the market today. The ones that are using a Windows-based operating system are generally fairly big and heavy and expensive. They have very weak battery life, they require a keyboard or a stylus as an input device. And from our point of view and what we've seen, customers, frankly, just are not interested in them. Then you have the Android tablet, and the variety that are out shipping today, the operating system wasn't really designed for a tablet. And Google has said this, and so this is not just an Apple view by any means. And so you wind up having a size of a tablet that is less than what we believe is reasonable or even one that would provide what we feel is a real tablet experience. And so basically, you wind up with kind of a scaled-up smartphone, which is a bizarre product in our view. Then you've got kind of a third group -- and so those are the two that are shipping today. And frankly speaking, it's hard for me to understand if somebody does a side-by-side with an iPad, I think some enormous percentage of people are going to select an iPad there. Those are not tablets that we have any concern on. The next-generation Android tablets, which are primarily what you mentioned in terms of the CES, there's nothing shipping yet, and so I don't know. Generally, they lack performance specs, they lack prices, they lack timing. And so today, they're vapor. We'll assess them as they come out. However, we're not sitting still. And we have a huge first-mover advantage. And we have an incredible user experience from iTunes to the App Store, and an enormous number of apps and a huge

ecosystem. And so we're very, very confident with entering into a fight with anyone.

## **Operator**

From Sanford Bernstein, we'll hear from Toni Sacconaghi.

## **Toni Sacconaghi - Bernstein Research**

You've said on previous earnings calls that the move to iPhone non-exclusivity in regions of the world has had no impact on your ASPs. Can you comment on whether that is still the case today and whether we should expect any impact in the migration away from U.S. exclusivity? And related to that, there are several large carriers globally that the iPhone is still not offered in. Can you talk about some of the reasons why that isn't the case? Many of them are CDMA-based. And given that you now have a CDMA-based offering, is it unreasonable to expect that we should see more CDMA carriers going forward?

## **Timothy Cook**

Toni, it's Tim. Relative to the ASP, I generally would not do this. And I want to be specific, that this comment isn't related to the U.S. or any specific carrier or any specific region. But to specifically answer your question, I don't envision the overall iPhone ASP decreasing from the December quarter that we just completed to the March quarter that we're currently in. And as you know, as our long-standing practice has been, we don't comment on after, after that period of time. Relative to other carriers, yes, we're always looking and assessing in every country who we should be doing business with and exploring different deals and arrangements, et cetera. And so we'll continue to do that. What I've said before and we have seen this in every case, literally, that we've done, is where we've moved from a exclusive carrier arrangement to a dual- or multi-carrier arrangement, our growth has changed significantly and our market share has increased. And so that doesn't mean that would happen in every country nor does it mean that we're just out doing that in every country. We look at each one individual because each market has its own individual characteristics and parameters and technology. On the CDMA phone, specifically, I don't have any specific thing to announce today other than we're truly thrilled to be working with the Verizon team. They have built quite a company and earned a great deal of respect from the customers, and some of them have waited a long time to get iPhone. And we're very, very happy to give them iPhone, and any other customers that are non-Verizon customers who wish to buy an iPhone. We're also very happy that we've signed a multi-year non-inclusive deal with AT&T.

And so we're very happy that we'll have shortly a dual-carrier setup in the United States.

**Toni Sacconaghi - Bernstein Research**

Tim, if I could follow-up on that, given your previous comments on China and the importance of that country strategically for you and the investments that you're making in stores, et cetera, can you may be use that as a case study for why you're only in one carrier there? I think you've said that there are no longer any exclusive conditions that you have in place globally with any carriers. So can you talk about other either impediments or hindrances beyond technology, of which CDMA is one, that may be limiting your ability to sign important carrier agreements in potentially very important and strategic areas for the company?

**Timothy Cook**

Toni, I generally found people really want to do business with us, and their customers are very much desiring to have the iPhone. And so I don't really see a lack of desire. I don't want to comment about any specific country because I view any conversations that we have going confidential in nature. It is true, as you said, that we are not under a contractual exclusivity now in any country in the world. The last one was the United States. We have moved away from those. I can guarantee you that we always are looking at opportunities to grow. Of course, in the very short-term, I would also remind you that we're constrained on iPhone 4, and we're working around the clock to get as many of these out to our existing partners as we can.

**Operator**

We'll go to Brian Blair with Wedge Partners.

**Brian Blair - Wedge Partners**

Can you maybe give us your updated thoughts on the Mac side and maybe specifically address the impact of iPads? With the tremendous iPad unit this quarter, the cannibalization question is going to come up. And I just want to get your latest thoughts on that, if we could?

**Timothy Cook**

That's a good question. What we saw in the Mac this quarter was we grew 23% at the worldwide level, and that is compared to a market growth of only 3%. And so we grew almost 8x the market rate of growth, which is, I think, stunning. And every region outgrew the market, so it wasn't just one region. Asia-Pacific led the growth with a whopping 67% year-over-year

increase, and that's almost 10x what market did there, to put it in context. Japan grew at 56%, which is about 6x the market, and Europe and the United States both grew in double-digits despite both markets contracting overall. And so we did significantly better than the market in every major region, and we're very proud of that. Now was there any cannibalization by iPad? Honestly, I don't know for sure. But yes, I think there is some cannibalization. But I also think there's a halo effect. As we've seen on the Mac by the iPod some years ago, I think there is a halo effect from Apple product to Apple product. And of course, we have introduced millions of people in Asia to Apple through the iPhone. And we're now introducing many more through the iPad, and I think some of those decide to buy a Mac. And so when you look at the Mac growth in Asia at 67%, and you look at the Japan growth at 56%, and you look at the U.S. and Europe growing in double-digits against shrinking markets, if this is cannibalization, it feels pretty good. The other point I would make is that if the iPad or tablets do cannibalize the PC market, keep in mind that we have low share of the PC market. And so the other guys lose a lot more, and we have a lot more to win because of that. And so honestly, cannibalization is not something that we are spending one minute on here. The iPad team are building the best iPad for the future, and the Mac teams are building the best Mac, and I can tell you that both groups believe that they can continue to grow and do great stuff, and I believe that.

### **Brian Blair - Wedge Partners**

And that's a great way to look at it. One of the things that's interesting to me is I see this trend of your bringing a lot more of the functionality from the tablet side, you're bringing it on to the Mac side. It was talked about earlier, the Mac App Store that's now on Mac OS X. And then as we're getting kind of teaser shots of Lion, it looks like the next OS is also taking even more kind of design and UI elements from the iPad side. So maybe if you could just talk about that a little bit, are these two platforms really merging into one? And is this the future of computing as you see it? Or is it just -- are you just kind of grabbing one or two aspects of tablets and bringing it into the OS X?

### **Timothy Cook**

I think one of the -- part of the magic of Apple is that there's not high walls between these product groups. They like each other, talk to each other, they're of the same DNA, they want to build the best products in the world. And so if one has a great idea, there's not a "not invented here" in the other group. And so one of the key learnings from the iPad was that people love instant on, they really love that. And so the MacBook Air incorporated that, and that's just one simple example. But there are tons of examples

throughout all of our products, where something started on one and went to a different one. And it's not always in the same direction either. It could start on the phone, and then flow forward, it could start on the iPad and flow, and so on and so forth. And so just the part of the way we run the company. And I think Steve said it great when he said, "If the Mac company were a separate company, and the iPad company were a separate company, what would the Mac company build to compete with the iPad? And I think the answer is the MacBook Air." And I think that's a phenomenal insight, and I think a great way to look at it. And it's not that the groups are competing, they are sharing and coming up with these incredible products that people really want.

### **Operator**

From Bank of Montreal, we'll hear from Keith Bachman.

### **Keith Bachman - BMO Capital Markets U.S.**

Tim, do you have data that you've gathered on the Phone and/or the iPad on new to the brand. You typically talk about Macs in the stores, you're getting 50% new to the brand. Do you have any data related to the newness of the brand? I would assume it's substantially higher to that, but I want to hear a little bit about that. And depending on that outcome, if you talk a little bit about how you think these products, in particular, the Pad in emerging markets may help to continue drive share opportunities for you?

### **Timothy Cook**

I don't want to share -- do we collect it? Yes, of course, we do. The numbers for iPhone are -- there's many such numbers, they're now big because we've been shipping iPhones for a while. Any product that you ship for a while looks a little different at the prime end or in the early adopter cycle versus when you get to the mainstream. The iPad went through that cycle quickly, and moved to mainstream and enterprise and all the rest in record time. But nevertheless, that data needs to settle some, even before internally, we put a lot of weight in it. But the bulk of your question doesn't need specific numbers. To make a point, if you look at our Asia-Pacific business, the revenue growth was 175% or so. And so this is incredible. And the size of business in Asia that we've now built is massive. To do \$2.6 billion in China in three months, where just two years ago, we did less than \$1 billion in the whole year, it is phenomenal, or actually for the year before. And so I think we are -- it's clear that we're introducing a lot of people to Apple who previously had not been introduced to the company, and I think that helps across the product line.

### **Keith Bachman - BMO Capital Markets U.S.**

In the U.S., I'm just trying to understand how you see the tablet market more broadly having greater penetration rates, say in established markets versus emerging markets. But typically, the notion is that tablets in many cases are more about consumption versus creation. And just want to hear your thoughts, not on growth rate, but on absolute unit opportunities between the established markets and the emerging markets?

### **Timothy Cook**

I think that the tablet market is, the opportunity is so large, it's large everywhere, honestly. I think it's huge.

### **Operator**

And we'll move on to Barclays Capital, Ben Reitzes.

### **Benjamin Reitzes - Barclays Capital**

A question for Peter, I just wanted to cash out the revenue outlook. Your sequential decline of, I guess, 17% is a little more than last year's, but you have Verizon now for the iPhone. So what components, I guess, other than iPod, are expected to have to contribute to the big decline, if intuitively, maybe iPhone has some support from Verizon?

### **Peter Oppenheimer**

Ben, I'll answer your question in a couple of ways. First of all, we're working hard to increase supply of iPhones. Tim has talked about that, but that will come over a period of time and not necessarily, overnight, as we said. In terms of the sequential guidance this year, let me start by saying we are thrilled to be giving you guidance for 63% revenue growth year-over-year, which will translate to a 50% earnings growth. So the business is performing extremely well. We're shipping the best products in Apple history and customer response has been tremendous. But as I said in my prepared remarks, we increased the iPhone and the iPad channel inventory by about 775,000 units, and this will have a bit of impact on the sequential compare that you referred to. In terms of the products, for Mac, we've just reported the highest Mac sales ever, and we've outgrown the market for 19 consecutive quarters. We would expect to see a sequential unit decline, which is typical for us after the holiday season. For iPod, we would also expect to see a large sequential decline, which is also typical for us after the holiday season. For iPhone, we'd expect to see a significant year-over-year increase. And for iPad, this will be our first experience, going from the December to March quarter, so we'll see. However, it was clear to us that the iPad was a hot holiday gift item, which fueled the 75% sequential growth that we saw in the December quarter. And given this, we would expect a



sequential decline in the March quarter. So that's what's gone into our thinking, Ben.

### **Benjamin Reitzes - Barclays Capital**

And then just a follow up for Tim, the last call, maybe, or one of the last calls, Steve had a lot of comments around Android and perhaps, some of its disadvantages versus your platform. Is there any other observations you'd like to make now that, we had a few more months, to see the market develop further and with Verizon, and even more tablet sales on the horizon, feedback you're getting from developers, or anything else you'd like to add on the battle with Android, kind of updating Steve's recent comments from last quarter?

### **Timothy Cook**

Well, if you look at the iPhone portion, we had record sales on iPhone with 16.2 million units sold in the quarter. And Peter said we believe we could've sold more if we had more supply. From the market estimates that we've seen, it suggests that we grew faster than the market. Obviously, we're working around the clock on increasing supply. We're continuing to expand countries and carriers. And I've talked a little bit of that with Toni's question. We're getting enormous enterprise traction, with 88% of the Fortune 100, which is mind-blowing, I believe. 83% of the Fortune 500, 60% of the FT 100. So the enterprise traction is gaining. We have the highest customer sat [satisfaction] ratings in the industry versus Android or RIM or any -- we have the largest App Store with over 300,000 apps. We have now sold over 160 million iOS devices. And I mean, this is huge. And we fundamentally believe that our integrated approach delivers a far superior customer experience than the fragmented approach. And you can see this in a variety of ways from the fragmentation of the number of App Stores out there that people are going to pull their hair out, because they're going to have a variety of updating methodologies, and a variety of payment methods, and slightly different derivatives. You can see from surveys, people are doing to see who is on the latest OS, and you'll notice that the iOS is always off the charts on the percentage of people that have the latest version versus the other guys. We are launching with Verizon next month. We believe there's a huge pent-up demand there, and we think that, that will help us in the U.S. And so I think I'd probably just repeat it, much of what he said before. But the net-net is we think that our integrated approach is much better for the end user because it takes out all the complexity for the end user instead of making the end user a systems integrator themselves. I don't know about you, but I don't know very many people that want to be system integrators as a consumer or somebody in the enterprise. And so I think that the more iPhones that we can get out there into people's hands, the more people love

them. And I think we've got a very bright future. I think the same thing about iPad. It's the same set of issues at the end of the day. The differences on iPad, of course, is that we have a -- we've been running three quarters without any significant competition of any type. And I think that the customer sat ratings on the iPad are also off the charts. So I don't know if any of that is new, I doubt that it is. But I think we're in a very good position.

## **Operator**

We'll go to Mark Moskowitz with JPMorgan.

## **Mark Moskowitz - JP Morgan Chase & Co**

Peter, I want to see if you can give us a little more insight on the iPad gross margins going forward. Just given Tim's comments earlier about the bounty of underachievers out there, at least, nearly going, should we assume then that Apple can really improve the future set with the next generation and kind of hold pricing stable?

## **Peter Oppenheimer**

I'm sorry, Mark, that's not a question I can answer. We don't talk about future products. But I can tell you that in terms of what we're shipping today, we're always aggressively working to lower our costs. And I think we have a good track record in doing so, and our gross margins were stronger than we thought for the December quarter. And I've provided guidance for the March quarter at 38.5%. And we feel very, very good about the performance of our products and our cost of products.

## **Mark Moskowitz - JP Morgan Chase & Co**

And then my follow-up, Tim, I apologize if this question has been asked, I fell off for a moment, I want to come back to the MacBook Air. Just given the initial success here and momentum, can you give us any sort of insight in terms of how you're looking at that platform now? Is it kind of a premium tablet? Is this kind of more of a notebook still? I'm trying to get a sense of just kind of a one-two punch in terms of the iPad, with the MacBook Air, kind of giving you a kind of a double coverage, if you will, in both notebooks and tablets?

## **Timothy Cook**

The way that we look at it is it's the Mac of the future shipping today, and it was a phenomenal part of our growth on the Mac last quarter. It has gotten off to a unbelievable start. The customers love it. They love the precision of

it, they love the thinness, the weight, the instant on and the list is long, I think. And so we're really happy with how it's doing out of the starting blocks. And as you know, we've only been shipping it for less than 90 days, and so we've just gotten going.

## **Operator**

We'll go to Jason Maynard with Wells Fargo.

## **Jason Maynard - Wells Fargo Securities, LLC**

There's been a lot of talk about this consumerization of enterprise technology, and obviously, it's being driven by folks bringing their iPhones and iPads to work. I know you said it's some big share gains within your statistics. But I was curious if you think there still are some barriers around maybe developer training at the corporate level or security or things that just sort of naturally need to get worked through before you start to see those penetration numbers even increase further or start to see a wider swathe of employees use iPhones and iPads in business?

## **Timothy Cook**

I think that the consumerization that you speak of, of the enterprise, is one of the megatrends that are occurring. I think the most forward-looking CIOs are coming to the realization that the productivity of the person, the creativity of the employees is materially more important than everyone using the same thing. And the ability to write apps in a simple and straightforward manner for the iPhone or the iPad through the SDK is an incredible thing. And you can wind up, literally, running your whole business off of an iPad or an iPhone. And so I think the list of ideas and places that people can go there are -- were unimaginable just a few months ago. And so I see an enormous potential there. The numbers are already incredible. And think about this, the iPad started shipping in April, and we're already up to 80% of the largest companies deploying or piloting the product. This is unheard of, at least, in my dealings with the enterprise over the years. Generally, enterprise is much slower and much more cautious and uses things that have been in the market for a long time. And I think to everyone's credit, they've seen the value of this from a productivity and creativity point of view, and they're really moving fast. And so I think we're just scratching the surface right now. In terms of inhibitors, the iPad has a huge advantage because as you probably remember, as we went to various different iOS releases, we always put in a huge chunk of enterprise features. And so this isn't something that we just started focusing on. We started focusing on this before we shipped the first phone. And with the synergy that exists with the iOS between the different products, other products get

the advantage of it, not just the product that it ships on initially. And so I think there's a huge play here for us.