Operator

Please standby, we are about to begin. Good day, ladies and gentlemen, and welcome to this Apple Incorporated Second Quarter Fiscal Year 2013 Earnings Release Conference Call. Today's call is being recorded.

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 to everyone for joining us. Speaking today are Apple's CEO, Tim Cook; and CFO, Peter Oppenheimer; and they'll be joined by Treasurer, Gary Wipfler for the Q&A session with analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including without limitation, those regarding revenues, gross margins, operating expenses, other income and expense, stock-based compensation expense, taxes, future products and capital allocation plans. 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 2012, the Form 10-Q for the first quarter of 2013 and the Form 8-K filed with the SEC today along with the associated press releases. Apple assumes no obligation to update any forward-looking statements or information, which speak as of their respective dates.

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

Tim Cook

Thanks, Nancy. Hello everyone, and thank you for joining us. We have a lot of news to share with you today about the details of our March quarter as well as a significant increase to our capital return program.

First, I would like to talk about our business and the road ahead. We are now half way through our fiscal 2013, and we’ve accomplished a tremendous amount. We’ve introduced and ramped production of an unprecedented number of new products, and we’ve set many new sales records. Our revenue for the first half was over $98 billion and our net income was over $22 billion. During that time, we sold 85 million iPhones and 42 million iPads. These are very, very large numbers, unimaginable even to us just a few years ago.

Despite producing results that met or beat our guidance as we have done consistently, we know they didn't meet everyone's expectations, and though we've achieved incredible scale and financial success, we acknowledge that our growth rate has slowed and our margins have decreased from the exceptionally high level we experienced in 2012.

Our revenues grew about $13 billion in the first half of this fiscal year. Even though that's like adding the total first half revenue of five Fortune 500 companies, our average weekly growth slowed to 19% and our gross margins are closer to the levels of a few years ago. Our fiscal 2012 results were incredibly strong and that's making comparison very difficult this year. Last year, our business benefited from both high growth and demand for products and a corresponding growth in channel inventories along with a richer mix of higher gross margin products, a more favorable foreign currency environment, and historically low costs.

These compares are made further challenging until we anniversary the launch of the iPad mini, which as you know, we strategically priced at a lower margin. As Peter will discuss, we are guiding to flat revenues year over year for the June quarter along with a slight sequential decline in gross margins.

The decline in Apple's stock price over the last couple of quarters has been very frustrating to all of us. But Apple remains very strong and we will continue to do what we do best. We can't control items such as exchange rates and world economies and even certain cost pressures, but the most important objective for Apple will always be creating innovative products and that is directly within our control.

We will continue to focus on the long-term, and we remain very optimistic about our future. We are participating on large and growing markets. We see great opportunities in front of us, particularly given the long-term prospects of the smartphone and tablet market, the strength of our incredible ecosystem, which we plan to continue to augment with new services, our plans for expanded distribution, and the potential of exciting new product categories.

Take the smartphone market for example, IDC estimates that this market will double between 2012 and 2016 to an incredible 1.4 billion units annually, and Gartner estimates that the tablet market is growing at an even faster rate from 125 million units in 2012 to a projected 375 million by 2016.

Our teams are hard at work on some amazing new hardware, software, and services that we can't wait to introduce this fall and throughout 2014. We continue to be very confident in our future product plans.

Apple has many distinct and unique advantages as the only company in the industry with world-class skills in hardware, software, and services. We have the strongest ecosystem in the industry with App Stores in 155 countries, iTunes music stores in 119 countries, hundreds of millions of iCloud users around the world, and most importantly, the highest loyalty and customer satisfaction rates in the business. And of course, we have a tremendous culture of innovation with a relentless focus on making the world's best products that change people's lives. This is the same culture and company that brought the world the iPhone and the iPad, and we've got a lot more surprises in the works.

A little over a year ago, we announced a plan to return $45 billion to shareholders over three years. Since we began paying dividends last August and began share buybacks last October, we've already returned $10 billion under that program. We continue to generate cash in excess of our needs to operate the business, invest in our future, and maintain flexibility to take advantage of strategic opportunities.

We remain firmly committed to our objective of delivering attractive returns to shareholders through both our business performance and return of capital. So today, we are announcing an aggressive plan that more than doubles the size of the capital return program we announced last year to a total of $100 billion by the end of calendar year 2015. The vast majority of our incremental cash return will be in the form of share repurchases. As the Board and management team deliberated among the various alternatives to returning cash, we concluded that investing in Apple was the best.

In addition to the share repurchases, we are increasing our current dividend by 15% to further appeal to investors seeking yield. And as part of our updated program, we will access the debt markets. Peter will provide more details about all of this in a moment.

We appreciate the input that so many of our shareholders have provided us on how best to deploy our cash. We will review our cash allocation strategy each year, and we will continue to invest confidently in the business to bring great new products to market, strategically deploy capital in our supply chain, our retail stores and our infrastructure, and make acquisitions to expand our capabilities. We will be disciplined in what we do, but we will not underinvest.

I'd now like to turn the call over to Peter to discuss the details of the March quarter. Peter?

Peter Oppenheimer

Thank you, Tim. We are pleased to report the results of our second fiscal quarter. We established new March quarter records for iPhone and iPad sales and new all-time record for iTunes sales, leading to Apple's strongest March quarter revenue ever.

Revenue for the quarter was $43.6 billion compared to $39.2 billion in the year ago quarter, an increase of $4.4 billion or 11% and $600 million over the high end of our guidance range. The year-over-year revenue increase was fueled primarily by strong growth in iPad and iTunes sales as well as continued strong revenue from iPhone and Mac.

Operating margin was $12.6 billion, representing 28.8% of revenue. Net income was $9.5 billion translating to diluted earnings per share of $10.09. As for the details of the quarter, I'd like to begin with iPhone. We sold 37.4 million iPhones compared to 35.1 million in the year-ago quarter, an increase of over 2.3 million or 7%. We ended the quarter with about 11.6 million total iPhones in channel inventory, a sequential increase of about 1 million iPhones and we ended the quarter within our target range of four to six weeks of iPhone channel inventory.

Based on research published earlier this month by comScore, iPhones garnered the number one spot in the U.S. smartphone market for the three-month period ended in February with 39% share, up from 35% in the previous survey period. And in Japan, IDC Japan announced that iPhone gained the number one position for all of calendar year 2012 as well as for calendar Q4 2012 in both handsets and smartphones. This is also the first time a non-Japanese company has achieved the number one spot for an entire year.

In addition, Apple was ranked number one in Nikkei's 2013 Japan Brand Survey, achieving the top spot for the second year in a row, which is unprecedented for a non-Japanese company. Around the world, based on its latest published estimates, IDC ranked iPhone number one or two in smarphone sales in over half the countries IDC tracks.

A recent study by Kantar measured 95% loyalty rate among iPhone owners, substantially higher than the competition, and iPhone remains top in customer experience. Last month, we were very pleased to receive the number one ranking in smartphone customer satisfaction from J.D. Power and Associates for the ninth consecutive time.

Businesses around the world continue to scale iPhone across their workforces. Globally, nearly 30,000 companies are developing and distributing iOS apps for corporate use by their employees.

Cisco's Bring Your Own Device program across 80 countries has resulted in a 50% increase in the number of iPhones connecting to its corporate network in the past year.

GlaxoSmithKline has developed more than 50 in-house iOS apps to support the thousands of iPhones and iPads connecting to its corporate network. Other companies such as AXA, Nordstrom's, Eaton Corporation, and Takeda Pharmaceuticals are supporting thousands of iPhones, and are continually adding new in-house apps to better serve customers and help employees work more efficiently.

Turning to iPad, we were thrilled to sell 19.5 million iPads during the quarter compared to 11.8 million in the year ago quarter, that's an increase of 7.7 million units or 65%.

iPad experienced very strong year-over-year growth in every operating segment, particularly in Greater China and Japan where sales more than doubled year over year. Both iPad and iPad mini continue to be extremely popular, and we were pleased with sales of both.

We were able to sell significantly more iPad minis in the March quarter than in the December launch quarter and to expand availability to China. Customers love the combination of experience, performance, and size that iPad mini offers, and our early market research indicates that the overwhelming majority of iPad mini purchasers are first-time iPad customers.

We ended the quarter with about 4.8 million iPads in channel inventory, a sequential increase of about 1.4 million. All of the sequential increase was attributable to iPad mini. As we discussed previously, we were not able to meet demand for iPad mini in the December quarter and entered the March quarter below our target range of channel inventory. This sequential increase places us within our target range of four to six weeks of total iPad channel inventory.

The most recent survey published by ChangeWave indicated a 96% satisfaction rate among iPad customers. Not only is iPad a huge hit among consumers, but it also continues to be widely adopted by business customers as well. iPad and the iOS ecosystem are driving innovation across industries and in companies large and small.

We are delighted by the number of companies that are choosing iPad for their most important business tasks as well as the rapid adoption of iPad in emerging countries around the world. Doctors at the Columbia Cardiovascular Foundation in South America are using an in-house app to perform remote diagnostics for patients in inaccessible parts of the country.

First National Bank, the oldest bank in South Africa has issued iPads to wealth managers to help enhance customer relationships and interactions. And in the education market, Grupo Santillana has developed UNO Internacional and integrated educational system that uses iPads to create digital learning environment in more than 700 private K-12 schools in Latin America. UNO Internacionalhas deployed more than 60,000 iPads to schools in Mexico, Colombia, and Brazil including 17,000 iPads for teachers and students in Brazil in the March quarter alone.

Turning to Mac, we sold just under 4 million Macs, which is a 2% decline from the year-ago quarter. IDC estimates that the global personal computer market contracted by 14% during the March quarter. We experienced strong year-over-year growth in desktop sales following the December quarter launch of our stunning new iMacs, offset by a decline in portable sales given a weaker personal computer market overall. We ended the quarter within our four to five-week target range in Mac channel inventory.

Moving to iPod, we sold 5.6 million iPods compared to 7.7 million in the year ago quarter. iPod Touch continued to account for over half of all iPods sold during the March quarter. iPod's share of U.S. market for MP3 players was over 70% in the March quarter based on the latest 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.

The Apple ecosystem continues to grow and thrive and we believe it's a very important driver of our incredibly strong customer satisfaction and retention, as well as developer interest and success. This Sunday marks the 10th anniversary of the introduction of the iTunes Music Store, which revolutionized the distribution of digital content.

Today, our iTunes store offer the broadest combination of geographic reach in content depth in the industry, and they surpassed quarterly billings of $4 billion for the first time ever in the March quarter, that's a $16 billion annual run rate making our digital content stores the largest in the world. The quarter's iTunes billings translated to record quarterly iTunes revenue of $2.4 billion, up 28% from the year ago March quarter with new quarterly revenue records for music, movies, and apps.

The strong iTunes sales in addition to other service revenue helped us achieve for the first time more than $4 billion in combined quarterly revenue from iTunes, software, and services. We are thrilled with the growth of these revenue streams. Today, we have music stores in 119 countries offering a combined catalog of 35 million songs. We sell movies in 109 countries offering 60,000 titles, and we have iBookstores in 155 countries offering 1.75 million iBooks for sale, and with App Stores in 155 countries that encompass almost 90% of the world's population, our developers have created more than 850,000 iOS apps, including 350,000 apps made for iPad.

Cumulative app downloads have surpassed 45 billion and app developers have made over $9 billion for their sales through the App Store, including $4.5 billion in the most recent four quarters alone. Canalys estimate the sales from our App Store accounted for 74% of all app sales worldwide in the March quarter. We believe this is in large part due to the great development environment, broad distribution, large and active user base, and seamless integration that the iOS platform offers.

Developer such as Backflip Studios have seen explosive growth in their business, thanks to the success of their apps on the iOS platform. With 70 people, this company maintains a growing suite of titles that has seen over 275 million downloads equating to nearly 5 million daily active users and 34 million monthly active users. With annual App Store sales approaching $100 million, Backflip's iOS sales comprised approximately 95% of the company's revenues in 2012.

Another tremendous success story is Supercell, founded in 2010. Based in Finland, Supercell's Hey Day and Clash of Clans titles available only on iOS have been the top most in iPad games in over 60 countries helping the company generate $8.5 million in revenue per employee in 2012. And in the enterprise, iOS devices have a strong lead over Android. In its most recently published quarterly enterprise device activations report, Good Technologies found iOS devices accounted for 77% of all activations by its corporate customers.

And thanks to careful App Store curation for the quality of apps, the iOS platform offers a much more secure environment. Recent research by McAfee Labs found that 97% of identified mobile malware was on the Android platform, with the remainder primarily on the Symbian and Java ME platforms. But perhaps the most important measure of the success of our ecosystem is how engaged our customers are with our products and services.

In its most recently published update, Chitika found that iPad accounted for 82% of all North American Tablet Web Traffic in March. Interest in apps remained very strong in the March quarter with over 800 apps downloaded per second and year-over-year iOS app revenues more than doubling in the quarter. And since launching iCloud just 18 months ago, we now have 300 million people using it every day. We will continue to invest in the ecosystem and have some great new features and capabilities in the pipeline.

I’d now like to turn to the Apple Retail Stores. Revenue for the quarter was $5.2 billion compared to $4.4 billion in the year ago quarter, an increase of 19%. This growth was fueled primarily by strong sales of iPhone and iPad. We ended the quarter with a total of 402 stores, including a 151 outside the United States. We expect to open about 30 new stores in total in fiscal 2013 and to complete at least 20 store remodels. With an average of 401 stores open in the March quarter, average revenue per store was $13.1 million, compared to $12.2 million in the year ago quarter. Retail segment income was $1.1 billion.

We hosted 91 million visitors to our stores during the quarter compared to 85 million in the year-ago quarter. That translates the 17,500 visitors per store per week. Total company gross margin was 37.5%, which was at the low end of our guidance range of 37.5% to 38.5%. Operating expenses were $3.8 billion and included $488 million in stock based compensation expense. OI&E was $347 million and the tax rate for the quarter was 26%

And turning to our cash, we ended the quarter with $144.7 billion in cash plus short-term and long-term marketable securities compared to $137.1 billion at the end of the December quarter, a sequential increase of $7.6 billion. Over $102 billion of our total cash was offshore at the end of the March quarter, and cash flow from operations was $12.5 billion. We paid $2.5 billion in dividends in the March quarter, and earlier this month, we concluded the $1.95 billion accelerated share repurchase program that we initiated in the December quarter, resulting in cumulative retirement of over 4 million shares of Apple stock.

As Tim discussed, we are pleased to announce that we are more than doubling our return of capital program to $100 billion by the end of calendar year 2015, which translates to an average of about $30 billion per year. We will continue to return capital to shareholders through dividends, share repurchases, and cash used to net-share-settle vesting RSUs. To facilitate our program, we will access the debt markets.

Let me provide more details regarding the three key elements of our plan. First, our Board has increased the share buyback authorization to $60 billion from the original $10 billion announced last year, that’s a $50 billion increase. This is the largest share buyback authorization of any company in history. We are very confident in Apple’s future and believe so strongly that repurchasing our shares represents an attractive use of our capital that we have dedicated a vast majority of the increase in our capital return program to share repurchases. We will buy shares under this authorization beginning this month. We will also continue to net-share-settle employee RSUs as they vest, and expect to use about $1 billion of cash annually to do this.

Second, we are increasing our quarterly dividend from $2.65 to $3.05 per share, a 15% increase. We plan to review our quarterly dividend payment annually. Our Board of Directors has declared a dividend of $3.05 per common share payable on May 16, 2013, to shareholders of record as of the close of business on May 13, 2013. We are very proud that Apple is among the largest dividend payers in the world with annual payments of about $11 billion.

Third, we will access the U.S. debt markets over time and have recently secured credit ratings from S&P and Moody's. We are continuing to generate significant cash offshore and repatriating this cash would result in significant tax consequences under current U.S. tax law.

Incorporating debt into our capital structure will provide several benefits including access to attractively priced capital, a reduction in our overall cost of capital and an efficient leverage of our very strong balance sheet. We expect to fund the capital return program from existing domestic cash, future cash generated in the U.S., and from borrowing in the U.S. We will maintain sufficient domestic liquidity to grow the business and execute capital expenditures and acquisitions. The program announced today will result in returning an average of $30 billion annually to shareholders.

To put this in perspective, the $30 billion would have represented substantially all of our fiscal year 2012 fully tax free cash flow had we repatriated our foreign earnings. Between now and the end of calendar year 2015, we would expect both our foreign cash and our domestic borrowing to grow. We will continue to review each element of our capital return program on an annual basis.

In conclusion, our capital return program is designed to facilitate our objective of delivering attractive returns to our shareholders on an efficient basis, while maintaining the flexibility to invest in the incredible opportunities that we continue to see for our business.

Now, as we move ahead into the June 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 $33.5 billion and $35.5 billion compared to $35 billion in the year-ago quarter. We expect gross margin to be between 36% and 37% reflecting approximately $90 billion related to stock-based compensation expense. We expect OpEx to be between $3.85 billion and $3.95 billion including about $500 million related to stock-based compensation. We expect OI&E to be about $300 million and we expect the tax rate to be about 26%.

In closing, we are pleased with our record March quarter revenue and record March quarter iPhone and iPad sales. We're very proud of the breadth and depth of our tremendous ecosystem and our new all-time record for iTunes sales. We are also in the fortunate position to be able to more than double our return of capital program to $100 billion with the larger share repurchase authorization in history and to be one of the largest dividend payers in the world with annual payments of about $11 billion. We remain very confident in our product pipeline.

With that, I'd like to open the call to questions.

Nancy Paxton

Thank you, Peter. 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) First we'll go to Katy Huberty with Morgan Stanley.

Katy Huberty – Morgan Stanley & Co. LLC

Thanks. Good afternoon. Peter, given gross margin did come in at the low end of guidance this quarter and you're looking for another downtick in June, can you just rank for us the biggest factors that are limiting the margin recovery even as I assume costs are coming down to the new products? And then, I have a follow-up.

Peter Oppenheimer

Sure. In the March quarter, our gross margin was 37.5%. It was at the low end of our range. We had a few items that on balance resulted in us reporting at the low end. They included mix, in particular, selling more iPads than we had planned, including getting iPad mini into our four- to six-week channel inventory range, some changes in our service policies that required us to make provisions for prior quarter sales, and we had some unfavorable adjustments. As I look forward to the June quarter, we're guiding gross margin to be down between 50 basis points and 150 basis points sequentially. We see two factors impacting gross margin sequentially. First and the largest of the two is the loss of leverage on sequentially lower revenue; and second, a different product mix. We expect both of these headwinds to be partially offset by better cost in the quarter.

Katy Huberty – Morgan Stanley & Co. LLC

Okay. Thank you, and Tim, question for you on China. Growth did slow in that market to single digits this quarter, curious of your perspective as to whether Apple is hitting a wall given you don't have the largest carrier formally selling your products? And just any thoughts around the stickiness of customers in China given you don't have an iTunes store there, and data shows that they download fewer apps than in developed countries? Thanks.

Tim Cook

Katy, thanks for the question. We actually had our best quarter ever in Greater China. So it was a record for us. The revenue came in at $8.8 billion. That includes our retail stores that are in that region that is up 11% year on year, again that includes the retail stores that are in that region, which is the same as Apple is growing.

The highlights for the quarter in China were that iPads grew 138% year-on-year, and we set new records for sell-through both for iPhone and iPad during the quarter. There were some significant year-over-year timing differences with regard to channel inventory relative to iPhone that affected the compares year-over-year.

In particular, in the year-ago quarter, we increased iPhone channel inventories globally by $2.6 billion, as you probably recall, $1.6 billion of $2.6 billion occurred in Greater China to support the launches that were in the March quarter of last year. And so, if you look at revenue on a sell-through basis, our Greater China revenue was actually up approximately 18%. And so it's a bit better than it first looked.

As I said, in the year-ago quarter, we launched the iPhone 4S with China Unicom in January and we launched China Telecom in March; this year, the iPhone 5 launched in December. and so it's a very different set of dynamics on a year-on-year basis.

Going forward, we still see a significant opportunity in China, it's a great market. We have 11 stores there. we expect to double those in less than two years. We have added about 8,000 iPhone point-of-sales in the indirect channel to about 19,000 today and we obviously have a plan to add more and further grow our distribution, December is obviously too low currently. We're also innovating in our online, with our online store there in adding different functionality to the store.

China has a unusually large number of potential first-time smartphone buyers, and that's not lost on us. We've seen a significant interest in iPhone 4 there and have recently made it even more affordable to make it even more attractive to those first-time buyers. and so we're hopeful that will help iPhone sales in the future.

Katy Huberty – Morgan Stanley & Co. LLC

Thank you.

Nancy Paxton

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

Operator

From Goldman Sachs, we'll go to Bill Shope.

Bill C. Shope – Goldman Sachs & Co.

Okay, thanks. Tim, you mentioned several factors that were compressing growth in gross margins in recent quarters in this year. but can you comment a bit more on the competitive landscape in 2013 versus 2012? how has it surprised you, and what do you think the company needs to do to reinvigorate your share gains across your key product categories?

Tim Cook

Bill, I think the smartphone market has always been competitive. The names have been changed. the names of competitors have changed. In the beginning, RIM was sort of the very strongest player, because the smartphone as you know really got going into the enterprise area. And of course, today, our tough competitor from a hardware point of view would be Samsung and married to Google on the operating system side.

They are obviously tough competitors, but we feel that we have the best products by far. And we are continuing to invest in innovative products and feel really, really confident about our product pipeline in both hardware, software and also our services. We have the best ecosystem by far, and we're just going to keep augmenting it, and making it better and better. and that shows up in both our royalty ratings and our customer stat and I feel very good about our competitive position.

Bill C. Shope – Goldman Sachs & Co.

One more question if I may. Can you comment on how you're thinking about the pace of your buyback program and what factors are you going to consider to determine purchase timing over the next few years?

Peter Oppenheimer

Sure, Bill, it's Peter, I'll take that. We're going to begin buying shares under the authorization beginning this month. And we expect to utilize the remaining $58 billion under the authorization by the end of calendar year 2015, which spans 32 months from now. We expect to use accelerated share repurchase programs and to buy in the open market.

Bill C. Shope – Goldman Sachs & Co.

Thank you.

Nancy Paxton

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

Operator

From UBS, we'll go to Steve Milunovich.

Steven M. Milunovich – UBS Securities LLC

Thank you very much. Tim, you alluded to fall announcements of products, is that indicating that there may not be substantial new products until literally fall late September, which means the September quarter could look a lot like the June quarter, is that part of what are implying or were you just being more general?

Tim Cook

I don't want to be more specific, but I'm just saying we've got some really great stuff coming in the fall and across all of 2014.

Steven M. Milunovich – UBS Securities LLC

Okay. And then could you talk a bit about the supply chain, there has been some concern with some of the product limitations late last year, I mean it's got to be getting so huge relatively to what you used to run. But what's your confidence level in the supply chain particularly as you're potentially moving to new types of vendors over time as the units continue to increase?

Tim Cook

I have incredible confidence. We exited the March quarter with no shortages while achieving inventory turns of over 90, which is still to this day is staggering for our industry. The December quarter that you're referring to was the largest quarter ever in the history of Apple and the technology industry as a whole. And as you know, it included for us a number of new products and unprecedented number and of new product ramps. The reality is the work we do to produce truly innovative products is very hard and there has always been challenges that I'm sure we'll face some in the future.

However, I would assure you that we are working very closely with our manufacturing partners to execute what we feel is a very exciting roadmap.

Nancy Paxton

Thanks, Steve. Can we have next question please?

Operator

From Sanford Bernstein, we'll go to Toni Sacconaghi.

Toni M. Sacconaghi – Sanford C. Bernstein & Co. LLC

Yes, thank you. I wanted to revisit the gross margin question. and specifically, I was hoping you could comment on whether you feel you're experiencing that the normal kinds of experience curves or declining cost curves that you do in typical product ramps. And whether you could comment on the sequential decline in iPhone ASPs, which were down nearly $30 sequentially, I presume that reflects a mix of 4 and 4S relative to the 5. But perhaps, you can confirm that in what its impact might have on gross margins and how we should think about that? and I have a follow-up please.

Peter Oppenheimer

Yeah. Toni, it's Peter, I'll take your first two. We're very pleased with the progress that we're making on getting down cost curves and this will help to partially offset the loss of leverage and the different product mix that we expect to see in the June quarter and we have factored these cost improvements into the guidance we're providing for the quarter. The iPhone ASPs were down sequentially about $28 as you noted. And this was driven primarily by mix. The largest factors were an increase in the iPhone 4 mix, which resulted from or making the iPhone 4 more affordable in many markets. And also mix within the iPhone 5 as it was in its second full quarter.

Toni M. Sacconaghi – Sanford C. Bernstein & Co. LLC

And its impact on margins, how do we think about relative margins for 4 relative to 5 on balance?

Peter Oppenheimer

Toni, we don't provide margins by product or within product line. But I talked about two factors that were impacting gross margin on a sequential basis. The first is leveraging, that's largest of the two on the lower sequential revenue. But we also expect to see a different product mix and that's primarily related to iPhone.

Toni M. Sacconaghi – Sanford C. Bernstein & Co. LLC

Okay. And then…

Tim Cook

Toni, just one other point on that is, as you get further, we see this on most of our product line, as you get further from a previous product launch, there is a general within a line, a general lower mix than where it starts. And so you'd expect, all things being equal, you'd expect to see that on most of our products.

Toni M. Sacconaghi – Sanford C. Bernstein & Co. LLC

Okay. Thank you. Tim, I wanted to follow-up with you on a statement you made in a previous response. You talked earlier about how you are excited about the large addressable markets that you have particularly, the smartphone and tablet marketplaces. And you talked about how strongly and confidently, you feel about competitive advantages in your products and ecosystems. If I step back and look at the data for this quarter on the phone side, if I adjust for inventory, the iPhone was up very low to mid single digits. I think most third-party market data would say that the smartphone market probably grew about 30%. And if I look broadly incorporating your guidance for next quarter and thinking about fiscal Q1, it appears very unlikely that Apple will grow at that market rate of 30% or more. So I am wondering if you could comment on a) whether that [extent of the] [ph] loss in market share is something that is – Apple has focused on or cares about as a principle financial objective? And if so, why do you think there is this disconnect between the very attractive products that you are offering and the market data that I just cited?

Tim Cook

So, Toni, let me try to address, you mentioned both smartphones and tablets and so let me try to address both of those. First let me start with the tablet side, the numbers that we've seen from IDC would indicate that they believe the market in March declined by 30% from December, December being obviously seasonally high quarter with a holiday. As you can see from our numbers, we declined 15%. And so if that holds, we did much better than the market and had a very nice pick up in market share.

And, obviously, on iPad, we continue to have an ecosystem story that is unparalleled, we have 350,000 apps that are optimized for iPad versus a few hundred for our competition and the overall experience in the fit and finish of the product, I think, we agree is substantially better than the options there.

On the phone side, the numbers that you talked about, the sell-in comparisons year-over –year, you really have to convert that to sell-through to look at the underlying demand. And as I've gone through before, we did grow channel inventory in the year ago quarter because we were catching up on the roll out of the iPhone 4S, in fact, we grew by 2.6 million. And so you have to factor in to get at the real sell-through.

However, I take your point if the market did grow by 30%, we still, after that normalization, we grew less than that. And so I think the question or the – this point is not lost and we do want to grow faster. We don't view it, however, as the only measure of our health. The things that are very important to us in addition to market share and unit volumes include things like customer stat, which were the highest by far winning J.D. Power's nine times consecutively and the customer loyalty and repurchase rates, which were the highest by far the 95% according to Kantar. And the ecosystem commerce, which attracts developers is incredible, Canalys says that we have 74%, so basically $3 out of $4 that are spent on apps are spent in our ecosystem.

And if you then looked at usage statistics, they are staggering at the usage of iOS versus other operating systems. And so market shares are important and unit volumes are important, but these other things for us are extremely important, because we are all about customer experience and enriching lives.

Now, that said, we see an enormous number of first time smartphone buyers coming to market, particularly, in certain countries around the world. And so what we've done with that is and we started last quarter is we've made the iPhone 4 even more affordable and which has made it more attractive to first time buyers and we caught up on the – our supply - demand towards the late in the quarter last quarter and we are continuing to do that in other markets. And we believe that the phone or the price point that we are offering is an incredible value for people, that allows them to get into the ecosystem with a really, really, phenomenal product.

Nancy Paxton

Thank you, Tony. The next question please.

Operator

From Barclays we'll go to Ben Reitzes.

Ben A. Reitzes – Barclays Capital, Inc.

Thanks a lot. I appreciate it. Tim and Peter, can you comment on gross margin beyond next quarter maybe what does it say about long-term gross margins if 36 to 37 is the margin that you are calling for when your highest margin product, let's hope is that a trough for the year and I think you are implying that when you say all these new products are coming in the fall.

So is there an implied margin philosophy here with this 2Q guide that 36 is as low as you wanted to get and then maybe it gets better from there or is there nothing that we should imply in terms of how the company views gross margins?

Peter Oppenheimer

Ben, it's Peter. I'll start on that one. It's been our long-term practice, we're not providing specific gross margin guidance beyond the June quarter. We don't do this, because there are many factors that can influence gross margins and a specific quarter and cause them to vary widely over time, including product cycles, commodity markets, product mix, and currencies.

So while we don't want to make a forecast beyond June, let me tell you how we think about gross margin and hopefully this will help. We are managing the business for the long-term and are willing to trade off short-term profit where we see long-term potential. The iPod is a great example of this. When we launched it in 2001, its margins were significantly below the margins of Apple at that time.

Four years later, the iPod and the iTunes Music Store comprised half of Apple's revenues and inspired us to build the iPhone. The iPad mini is another great example. We have priced it aggressively and its margins are significantly below the corporate average. However, we believe deeply in the long-term potential of the tablet market and think that we've made a great strategic decision. We'll only make great products and this precludes us from making cheap products that don't deliver a great experience.

We believe deeply that there are people in every part of the world that want great products. Looking back over the last several years, we've made very good business decisions balancing units, revenues, and the bottom line. We think about all three and as I said, we're willing to make short-term trade-offs and profits, where we see long-term potential.

And we're managing Apple with a very long-term horizon. Some of our revenues and profits occur after we ship our products. We were thrilled to exceed this quarter $4 billion in revenue for our services for the first time. And as Tim mentioned, we will augment our very strong ecosystem with new services and make the current ones even, even better. So we remain very confident in our strategy and we will use our world-class skills in engineering and operations to manage our business well in the future.

Ben A. Reitzes – Barclays Capital, Inc.

All right, thanks. And Tim, my follow-up just for you, just maybe asking you this every quarter in different ways. But I just wanted to get your reaction to what you thought of the 5-inch phone market at this time versus three months ago? And if anything has changed in your view as to that market and its place in the smartphone world versus your 4-inch product? And that's it from me.

Tim Cook

Yeah Ben, that's a good question. My view continues to be that iPhone 5 has the absolute best display in the industry. And we always strive to create the very best display for our customers. And some customers value large screen size, others value also other factors such as resolution, color quality, white balance, brightness, reflectivity, screen longevity, power consumption, portability, compatibility with apps and many things.

Our competitors had made some significant trade-offs in many of these areas in order to ship a larger display, we would not ship a larger display iPhone while these trade-offs exist.

Ben A. Reitzes – Barclays Capital, Inc.

Got it.

Tim Cook

Does that answer?

Ben A. Reitzes – Barclays Capital, Inc.

Yes.

Tim Cook

Thank you.

Ben A. Reitzes – Barclays Capital, Inc.

Yes, got it.

Nancy Paxton

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

Operator

We'll go to Gene Munster with Piper Jaffray.

Gene E. Munster – Piper Jaffray, Inc.

Hey, good afternoon. Tim, I just wanted to confirm, did you mention in your prepared remarks that something about new product categories or did I not hear you correctly?

Tim Cook

I did, Gene. I said that one of our areas for growth are potential new categories, and we're very excited about those.

Gene E. Munster – Piper Jaffray, Inc.

And that would presumably be kind of in the next year?

Tim Cook

Well, I didn't announce the specific timeframe, but…

Gene E. Munster – Piper Jaffray, Inc.

Okay. And Peter, you mentioned new services in that you can kind of build and kind of improve on existing services, and I guess, beyond just the natural evolution of maybe Maps and iCloud, are there any other kind of key assets that you guys have which you can leverage in the new services?

Peter Oppenheimer

Well, nothing specific, Gene, but we are very fortunate to have the largest and broadest ecosystem in the world. We have App Stores in 155 countries and iTunes Stores in over 110 countries. We have hundreds of millions of users. we've just crossed a $16 billion run rate on the iTunes Stores in terms of billings, and just achieved for the first time $4 billion in revenue for our services. So we're really thrilled with what we've just reported this quarter, but we see opportunity that we're going to invest in tremendously to delight our customers and continue to grow our business in those areas.

Tim Cook

And I would just add to that, because we are not fragmented like our competition, we can update an iOS with a major release and a substantial percentage of our customers will update to the – to our latest offer. We've made that very elegant and very easy. Also because the usage for iOS is so much higher, when we integrate things well, people use them a lot more and so just those concepts by itself are huge advantages from a customer experience point of view and from a more of the metrics that you're thinking about point of view.

Gene E. Munster – Piper Jaffray, Inc.

Okay. Let met ask you this way in terms of just the payment market specifically, I mean, do you feel that that market is well addressed today with the offerings out there?

Tim Cook

I think it's in its infancy, Gene. I think it's just getting started and just out of the starting block.

Nancy Paxton

Thanks, Gene**.** Can we have the next question please?

Operator

From Cross Research, we'll go to Shannon Cross

Shannon S. Cross – Cross Research LLC

Thank you very much. Tim, I was wondering if you could talk a bit about what you're thinking about within the Mac market and PC market because obviously you outperformed substantially the competition but we're still down about 2%. So I am curious as to whether or not you think elasticity of demand with lower prices or what you are hearing from your customers in terms of their reluctance to buy a new Mac and then also how you're thinking about the cannibalization potential that's coming out of the iPad?

Tim Cook

I think the, Shannon, I think the reason that we were down last quarter, we were down 2% as you had mentioned. The market for PCs are incredibly weak. IDC said that the market for the March quarter was down 14% year-on-year, which is the largest decline that I remember from being in this industry for a long time. At the same time, we sold almost 20 million iPads and it's certainly true that some of those iPads cannibalized some Macs. I personally don't think it was a huge number, but do I think it's some, and I think probably the larger thing at least for the, maybe not so much on the Macs side, but on the PC side, it's cheaper, probably extending their upgrade cycles.

That said, I don't think this market is a dead market or bad market by any means. I think it has a lot of life to it. We are going to continue to innovate in it. We believe that if anything the huge growth in tablets may wind up benefiting the Mac, because it pushes people to think about the product they're buying in a different manner and people maybe even more willing to buy a Mac where today than may be buying a PC. And so we're going to continue making the best personal computers. our strategy is not changing. And we feel really good about it. We delivered some incredible innovation last year with Retina display with the MacBook Pro, an incredible thin and light package and we've got some more great stuff plan. So this is an area we're continuing to invest in.

Shannon S. Cross – Cross Research LLC

Okay. And just a follow-up question with regard to the tablet market. We've met with some of your competitors recently and they're starting to talk about wins in the enterprise, and touting the benefits of Microsoft and some of the other OS's that are out there in terms of security and interoperability in some of the enterprise companies. So I'm curious what you've heard from your customers, have you seen much displacement and what are sort of the discussions that you have with enterprise customers with regard to iPads and fitting into their systems? Thanks.

Tim Cook

We seem to be doing really well and Peter had referenced earlier, the Good Technology's data that says that iOS accounted for 77% of all their activations by their corporate customers. Now that would not include BlackBerry, but it would include all the other guys. and so we seem to be doing really well and honestly, I don't see the recent announcements changing that at all. I've seen more and more people developing more and more custom apps for their businesses on iOS to be used on iPad and we're very, very bullish on it. As a matter of fact, just to quote you some numbers, iPad now is being used in 95% of the Fortune 500 and what's even more impressive probably is on the global 500 companies, we're now in 89%.

Shannon S. Cross – Cross Research LLC

Okay. Thank you.

Tim Cook

Yeah.

Nancy Paxton

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

Operator

We'll go to Mark Moskowitz with JPMorgan.

Mark A. Moskowitz – JPMorgan Securities LLC

Thank you. Tim, earlier you talked about how the December quarter had a very big and broad product refresh, were there any learning points from that experience in terms of maybe it's better to stage or kind of stagger out launches over multi-quarters versus one quarter. How should we think about that going forward?

Tim Cook

It's a good question. I don't spend a lot of time looking back except to learn from it, and if we could run it over frankly, I would have announced the iMac after the turn of the year, because we felt our customers had to wait too long for that specific product; or the iPad mini was in shortage in the December quarter I would not have done that differently, because we were able to get the iPad mini out to many millions of customers who really wanted that product for their holiday. And so, yes, we did do a lot, our teams fortunately can do a lot, but in retrospect that one, yeah, I sort of wish it were after the turn of the year, because our customers would not have had to wait as long as they did.

Mark A. Moskowitz – JPMorgan Securities LLC

Okay. And then my follow-up question is back to the ecosystem. Are there other metrics or milepost you can share with us, you acknowledged earlier that the growth of revenue at Apple have slowed for some of your key products. But how about the ecosystem in terms of usage rates, are you seeing slowing there or are you actually seeing the opposite where there's maybe acceleration within each user?

Tim Cook

We see incredible usage in every study that we see. These aren't just done by us, as a matter of fact the vast majority of them come from other people. The usage of iOS devices are staggering compared to others. It's a phenomenal difference. And I think that shows the strength of the ecosystem.

Mark A. Moskowitz – JPMorgan Securities LLC

Thank you.

Peter Oppenheimer

And Mark this is Peter. I will add that, we are now paying very happily our developers more than $1 billion every quarter.

Mark A. Moskowitz – JPMorgan Securities LLC

Thank you.