

## **Operator**

Good day, everyone, and welcome to this Apple Incorporated Second Quarter Fiscal Year 2012 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 is Apple CFO, Peter Oppenheimer; and he'll be joined by Apple CEO, Tim Cook; and 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 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 2011, the Form 10-Q for the first quarter of fiscal 2012 and the Form 8-K filed with the SEC today along with the attached press release. 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 Peter Oppenheimer for introductory remarks.

## **Peter Oppenheimer**

Thank you, Nancy. We're very pleased to report the results of our outstanding second fiscal quarter. We established new March quarter records for iPhone, iPad and Mac sales, leading to our highest March quarter revenue and earnings ever.

Revenue for the quarter was \$39.2 billion, representing year-over-year growth of 59%. That's a new record for a March quarter and is second only to the all-time record revenue we reported in the most recent December quarter. The year-over-year increase in March quarter revenue was fueled primarily by very strong growth in iPhone and iPad sales.

Operating margin was \$15.4 billion, representing 39.3% of revenue. Net income was \$11.6 billion, increasing 94% over the prior March quarter's result. The quarter's net income translated to earnings per share of \$12.30.

Turning to the details of the quarter, I'd like to begin with our Mac products and services. We established new March quarter records for both desktops and portables, combining for a total of 4 million Macs sold. This represents growth of 7% year-over-year compared to IDC's latest published forecast of 2% growth for the global personal computer market in the March quarter. We began and ended the quarter with between 3 and 4 weeks of Mac channel inventory, which is below our target range of 4 to 5 weeks.

In February, we released the developer preview of Mountain Lion, the ninth major release of Mac OS X. Mountain Lion will bring popular apps and features from iPad to the Mac, including Messages, Notes, Reminders, Game Center, Notification Center, Share Sheets, Twitter integration and AirPlay Mirroring. We expect Mountain Lion to be available from the Mac App Store in late summer this year.

Moving to our music products. We sold 7.7 million iPods compared to 9 million in the year ago quarter. Total iPod sales were ahead of our expectations, and iPod touch continued to account for over half of all iPods sold. iPod's share of the U.S. market for MP3 players remains at over 70% based on the latest monthly data published by MPD, and iPod continued 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 4 to 6 weeks of iPod channel inventory.

The iTunes Store generated all-time record results with revenue of almost \$1.9 billion in the March quarter, an increase of 35% year-over-year, thanks to continued strong sales of music, video and apps. We now have a catalog of over 28 million songs and 45,000 movies.

I'd now like to turn to iPhone. We were thrilled to sell 35.1 million iPhones compared to 18.6 million in the previous March quarter. That represents 88% year-over-year growth compared to 42% growth for the smartphone market overall in the March quarter based on the latest published estimate from IDC. We experienced very strong iPhone sales growth in all of our segments, led by our Asia Pacific and Japan segments where sales more than doubled year-over-year. We continue to see tremendous momentum in Greater China, where iPhone sales were 5x the level of the year ago quarter, aided by the launch of the iPhone 4S in China in January and the addition of China Telecom as an iPhone carrier in March. iPhone 4S is now available in over 100 countries and is sold through over 230 carriers.

We ended the quarter with about 8.6 million iPhones in channel inventory, a sequential increase of about 2.6 million units, which placed us within our target range of 4 to 6 weeks of iPhone channel inventory.

Recognized revenue from iPhone handset and accessory sales was \$22.7 billion during the quarter compared to \$12.3 billion in the year ago quarter, an increase of 85%.

iPhone momentum in the enterprise has evolved beyond email, calendar and contacts. IT and business line managers across industries see the opportunity to leverage both company and employee-owned devices to improve productivity and efficiencies through iOS in-house app development. In fact, the majority of the Fortune 500 companies who have approved iPhone on their networks are members of the iOS Developer Enterprise Program and are actively deploying in-house applications to their employee base.

Turning to iPad. We were very pleased with sales of 11.8 million iPads during the March quarter compared to 4.7 million in the year ago quarter, an increase of 151%. Customers are loving the new iPad with its stunning Retina display, A5X chip with Quad-core graphics and the 5-megapixel iSight camera. The new iPad is now available in over 40 countries, and we saw a very strong growth in iPad sales around the world with sales more than doubling in each of our segments.

Recognized revenue from sales of iPad and iPad accessories during the quarter was \$6.6 billion compared to \$2.8 billion in the year ago quarter, an increase of 132%. We ended the quarter with about 2 million iPads in channel inventory, a sequential decrease of about 300,000 units, which placed us below our target range of 4 to 6 weeks of iPad channel inventory.

The education market's interest in iPad continues to grow. In the March quarter, we sold more than 2 iPads for every Mac to our U.S. K-12 customers while also generating a record quarter for Mac sales. The San Diego School District purchased 10,000 iPads in the March quarter and plans to purchase over 15,000 more in the June quarter for middle school and high school programs.

iPad continues to open doors to new customers with whom Apple previously had no relationship. As we enter the K-12 institution buying season, we're hopeful that iPad will be a popular choice.

iPad's momentum in business and government also continues to build. The United States Air Force Air Mobility Command is deploying thousands of iPads to serve as electronic flight bags, storing technical publications and operations information for flight crew members and trainers. Companies

such as Bechtel and Balfour Beatty are using iPads in the field for project management and viewing blueprints. And thousands of iPads are being deployed as mobile sales tools by companies such as Roche, Amgen, Bayer and Daiichi Sankyo. Combining iPhone, iPad and iPod touch, we surpassed 365 cumulative iOS device sales, selling more than 50 million in the March quarter. The iOS ecosystem continues to expand and thrive with stores in more than 120 countries.

The App Store now offers more than 600,000 apps, including over 200,000 apps specifically for iPad. We were very excited to announce the download of the 25th billionth app in March less than 4 years after the launch of the App Store.

And iCloud is off to an incredible start, currently with more than 125 million customers signed up since its launch in October.

I'd now like to turn to the Apple retail stores, which also generated record March quarter results. Revenue was \$4.4 billion, an increase of 38% over the year ago quarter and was second only to the record quarterly revenue generated in the December quarter. The stores experienced very strong year-over-year growth in iPad and iPhone sales, and they sold 826,000 Macs compared to 797,000 in the year ago quarter. And about half the Macs sold in our stores during the March quarter were to customers who had never owned a Mac before.

We opened 2 new stores in the quarter, including our first Netherlands store in Amsterdam and a beautiful new store in Houston. We exited the quarter with 363 stores, nearly 1/3 of which are outside the United States. With an average of 361 stores open, average revenue per store was \$12.2 million compared to \$9.9 million in the year ago quarter, an increase of 23%. Segment margin reached a new March quarter record of over \$1.1 billion, which was 26.1% of retail revenue. We welcomed 85 million visitors to our stores during the quarter compared to 71 million visitors in the year ago quarter, an increase of 19%. That translates to an average of 18,000 visitors per store per week.

Total company gross margin was 47.4%, which was 540 basis points higher than our guidance. About half this difference was driven by lower-than-expected commodity and other costs; about 1/4 was due to stronger-than-expected revenue and product mix, including 35 million iPhones; and the remainder was due to some onetime items that we don't expect to recur in the June quarter.

Operating expenses were \$3.2 billion and included \$361 million in stock-based compensation expense. OI&E was \$148 million.

Turning to cash. Our cash for short-term and long-term marketable securities totaled \$110.2 billion at the end of the March quarter compared to \$97.6 billion at the end of the December quarter, a sequential increase of \$12.6 billion. And about \$74 billion of the cash was offshore at the end of the March quarter. Cash flow from operations was \$14 billion.

As we indicated last month, subject to board declaration, we expect to announce a dividend of \$2.65 [ph] per share when we report our third quarter results in July. And we will provide information on the record and payment dates at that time.

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 about \$34 billion compared to \$28.6 billion in the June quarter last year. We expect gross margin to be about 41.5%, reflecting approximately \$70 million related to stock-based compensation expense. We expect OpEx to be about \$3.3 billion, including about \$385 million related to stock-based compensation. We expect OI&E to be about \$175 million. And we expect the tax rate to be about 25.25%. We are targeting EPS of about \$8.68.

In closing, we're extremely pleased with our record March quarter performance with earnings nearly doubling year-over-year. The new iPad is off to a tremendous start and is our fastest iPad rollout ever. We're thrilled with the global success of the iPhone 4S, which is now available in more than 100 countries, including China.

We remain very confident in our strategy, and we're very excited about the fabulous new products in our pipeline. With that, I'd like to open the call to questions.

## **Nancy Paxton**

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

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

### **Operator**

[Operator Instructions] And your first question will come from Katy Huberty with Morgan Stanley.

### **Katy Huberty - Morgan Stanley, Research Division**

As it relates to the June quarter revenue guidance, it implies a sequential downtick that is worse than the guidance message you provided over the last 3 years. So can you just talk about some of the headwinds sequentially you see on the top line in the June quarter relative to March?

**Peter Oppenheimer**

Sure, Katy. It's Peter. The manufacturing ramps for the iPhone 4S and the new iPad were extremely successful for us. They yielded the highest launch supply and the fastest country rollouts for these product families that we've ever had. As a result, we were able to fulfill demand in the March quarter rather than the June quarter this year, and that generated revenue of over \$39 billion. Therefore, unlike last year, we expect a sequential decline in revenue this year. I'd highlight 5 primary factors that have influenced our thinking:

The first, the iPhone channel inventory changes. As I discussed in my prepared remarks, we increased our iPhone channel inventory by about 2.6 million units in the March quarter this year, and we exited within our target inventory range of about 4 to 6 weeks. Last year, we continued to add new countries into the June quarter, and we built an additional 700,000 units of iPhone channel inventory last year in the June quarter. So the combination of these channel builds in the March quarter of this year and the June quarter of last year will impact the sequential comparisons from this year to last.

The second factor: fabulous iPhone 4S execution. As we told you in January, we exited December with significant iPhone 4S backlog, which led to a huge January. We launched China and 20 other countries also in January, which completed the rollout of the iPhone 4S into all the countries where iPhone is currently shipping. And as I said before, we exited the quarter within a supply and demand balance.

The third factor: our new iPad execution was also fabulous. We had an incredible start with the new iPad. We launched with significant supply, leading to sales of 3 million units in the first couple of days, which was the -- and also the fastest country rollout ever. We therefore were able to satisfy much more of the demand for the new iPad in the March quarter this year compared to the iPad 2 in the March quarter of last year. This resulted in a shift of iPad volume into March this year versus last, and it will also affect the sequential compares this year to the last.

Fourth, we decreased the entry price of the entry iPad to \$399.

And finally, the last factor to point out, the U.S. dollar has strengthened recently, and we expect this to have an impact on the sequential compare,

especially versus last year when the dollar weakened against most currencies over the comparable time periods.

We -- look, we've just reported the most amazing March quarter Apple has ever had. We feel very, very good about our business and our new product pipeline.

**Katy Huberty - Morgan Stanley, Research Division**

Just as a quick follow-up to number 4, the decrease in iPad price. You already saw a 7% sequential decline in March, which suggests that the uptake of the lower-priced iPad 2 was pretty phenomenal in March. Is that the right way to read it? And what does that demand tell you about the potential to move to lower price points on the iPad over time and see significant incremental demand?

**Peter Oppenheimer**

Look, Katy, we're just learning about the elasticity of demand and the \$399 price point. It's doing well. But I have to tell you, the new iPad is on fire, and we're selling them as fast as we can make them. So we'll learn more over this quarter especially as we get through the education buying season, which looks terrific for us especially on the iPad.

**Operator**

From Citigroup, we'll go to Richard Gardner.

**Richard Gardner - Citigroup Inc, Research Division**

I recognize that you outgrew the market in Macs yet again. But I did want to get your views on the slowdown in year-over-year growth rate within the category and what factors you would attribute that to. Are we -- is it product transition related? Were the inventories down quarter-over-quarter? iPad cannibalization? Any other color that you can provide would be helpful.

**Timothy D. Cook**

Yes, Rich, it's Tim. As you said, we did outgrow the market. Macs grew at about 7% where the market grew about 2%. And so this is the 24th straight quarter that we've outgrown the market, and so we're extremely pleased with that. The compare to last year is largely affected by the fact that we changed the bulk of our portable line, or the MacBook Pros, in the February time frame of 2011. And so it's a very tough compare. Specifically, the portables last year were up 53% year-on-year. And obviously, that -- so that compare was very difficult. If you look at it sequentially, you also have to

factor in that we had 14 weeks in the December quarter. And so the 26% year-over-year growth in December quarter is probably more like 17% when you factor out that 14th week. And so yes, I think there was some cannibalization from iPad and the market is slow. But the much, much larger factor and in fact, in -- it might be the vast majority of the difference is the compare to a year ago.

## **Operator**

We'll go to -- [indiscernible] we'll go to Tony Sacconaghi with Sanford Bernstein.

## **A.M. Sacconaghi - Sanford C. Bernstein & Co., LLC., Research Division**

I was wondering if you could talk more broadly just about what you might be learning about lower priced -- price points on both the iPhone and iPad. I know it was asked earlier. But was the decrease in iPad price exclusively mix related? Or are there -- or is it a further broadening of your channel to indirect partners? But more broadly, Tim, maybe you could talk about elasticity, what you're learning about customer preferences for lower-priced offerings on both the iPhone and iPad. And I do have a follow-up, please.

## **Timothy D. Cook**

Sure. Tony, on iPad 2, we're -- with the change in the entry price to \$399, we're actually thrilled with the results that we've seen, although, as Peter said, it's only been a few weeks. And so it's too early to make a -- come to a clear conclusion. But from what we are seeing, this unlocks some education demand that is probably a more price-sensitive customer. Also, in several other countries, there was a marked change in demand at that price point. And so on the early going, we feel great about it. But I'd also point out that the new iPad is -- was current -- was supply constrained last quarter for the full 3 weeks or so it was shipping and is actually still constrained. And so the mix of the new iPad to the iPad 2, we're not certain of what that is yet. But we are certain, with what we've seen so far, that the absolute sales of iPad 2, at least in the early going, is very exciting. On the iPhone, we continue to be very happy with the moves that we made in pricing just a few months ago on the iPhone 3GS and the iPhone 4. And both of them contributed to our ability to achieve 35 million in sales, which is our second highest quarter of all time.

## **A.M. Sacconaghi - Sanford C. Bernstein & Co., LLC., Research Division**

The -- as a second question, I was wondering if you can talk about how you think about the markets for tablet and PC devices going forward. I think you've been fairly clear about saying that you believe that tablets will eclipse



PCs in volume at some point. And I think you've also said they're somewhat discrete markets. There seems to be a lot of work, particularly on PC-based platforms, towards trying to combine the PC and tablet experience going forward in part because Windows 8 will be able to -- is a touch-based operating system as well. Can you comment about why you don't believe the PC or the Ultrabook and tablet markets or your MacBook Air and tablet markets won't converge? Isn't it realistic to think in a couple of years we're going to have a device that's under 2 pounds with great battery life that we can all carry around and open as a notebook or close up in a clever way and use as a tablet? Can you comment on why you don't think that product might not come or why you believe these markets are separate?

### **Timothy D. Cook**

I think, Tony, anything can be forced to converge. But the problem is that products are about trade-offs, and you begin to make trade-offs to the point where what you have left at the end of the day doesn't please anyone. You can converge a toaster and a refrigerator, but those things are probably not going to be pleasing to the user. And so our view is that the tablet market is huge. And we've said that since day one. We didn't wait until we had a lot of results. We were using them here, and it was already clear to us that there was so much you could do and that the reasons that people would use those would be so broad. And that's precisely what we've seen. We -- the iPad has taken off not only in consumer in a meaningful way but in education and in enterprise, and it's sort of everywhere you look now. And the applications are so easy to make very meaningful for someone, and there -- the -- there's such an abundance of those that -- and as the ecosystem gets better and better and as we continue to double down on making great products, I think that the limit here is nowhere in sight. We've now -- through the last quarter, I should say, which is just 2 years after we shipped the initial iPad, we've sold 67 million. And to put that in some context, it took us 24 years to sell that many Macs and 5 years for that many iPods and over 3 years for that many iPhones. And we were extremely happy with the trajectory on all of those products. And so I think iPad, it's a profound product. It -- the breadth of it is incredible, and the appeal of it is universal. And so I am -- I could not be happier with being in the market, and the level at which we're innovating in both the product and the ecosystem here is incredible. Now in terms of the market itself, IDC and Gartner and Forrester had some numbers out there. I think Gartner is saying there's somewhere around 375 or so by 2015. Forrester is 375, somewhere around there. And so basically, the -- they're in the mid-300s, which is about where the PC market is today. And 2015 is only 3 years from now. And so I think even the more formal predictors outside of us are beginning to see these lines cross. And so I strongly believe that they will. Now having said that, I also believe that

there is a very good market for the MacBook Air, and we continue to innovate in that product. And -- but I do think that it appeals to somewhat -- someone that has a little bit different requirements. And you wouldn't want to put these things together because you wind up compromising in both and not pleasing either user. Some people will prefer to own both, and that's great, too. But I think to make the compromises of convergence, so -- we're not going to that party. Others might. Others might from a defensive point of view, particularly. But we're going to play in both.

## **Operator**

We'll go to Bill Shope at Goldman Sachs.

## **Bill C. Shope - Goldman Sachs Group Inc., Research Division**

Tim, there's been quite a bit of concern both in the press and within the investment community around carrier subsidies. And I think the concerns are generally twofold: First, that carriers will attempt to stretch out the replacement cycle. And second, that over time, carriers across the globe will attempt to reduce subsidies significantly. I mean, how do you think about this risk? And do you think there are factors that could pressure subsidies going forward? And how would that impact Apple?

## **Timothy D. Cook**

Well, Bill, our focus is on making the very best smartphone in the world. And a phone that delivers a -- just an off-the-charts user experience that customers want to use every day of their lives. And at the end of the day, I think that carriers, the vast majority of carriers, or maybe even all carriers, want to provide what their customers want to buy. And that's what they're motivated for. And so the most important thing by far is for Apple to continue making great products that customers want. And we are deeply committed to doing this and are innovating at a rate and pace that's unbelievable in this area. For -- from a carrier's perspective, I think it's important to remember that the subsidy is not large relative to the sum of the monthly payments across a 24-month contract period. And any delta between iPhone and maybe another phone is a -- an even smaller level of difference. And the iPhone has some distinct advantages for the carrier over competing smartphones. For example, many of the carrier executives have told me that churn from iPhone customers is the lowest of any phone they sell in their whole -- in all of the phones they carry. And that has a significant direct financial benefit to the carrier. Also, our engineering teams work extremely hard to be efficient with data and differently than some others. And we believe that as a result of this, that iPhone has far better data efficiency compared to other smartphones that are using sort of an

app-rich ecosystem. Finally, we think that the -- and this is the most important, is that iPhone is the best smartphone on the planet to entice a customer who is currently using a traditional mobile phone to upgrade to a smartphone. This is by far the largest opportunity for Apple, for our carrier partners and is a great, fantastic experience to the customer. And so there's a win-win-win there. And so I think all of these factors are -- some of these factors are missed in this general discussion of subsidy.

**Bill C. Shope - Goldman Sachs Group Inc., Research Division**

That's helpful. I had one other follow-up question, if I could. I appreciate the user stats you gave us on iCloud. But can you give us any color, now it's been out for a few months, on how consumers are actually using iCloud? And in particular, are you seeing a big uptake in iTunes Match and paid storage additions? And how should we think about that?

**Peter Oppenheimer**

Bill, it's Peter. Customers are using all the features of iCloud. Response has been terrific. Feedback has been terrific. Pickup on storage is occurring, but it's growing because we've just launched iCloud in October. And we've now got over 125 million users that have come on to the service since then and they're building up documents in music and other things that they want to store. And so I think storage growth will come more over time. Our real desire here was not about selling more storage. We think Match is a great product, and we recommend that everybody use it. But it's a paid for service. We just really wanted to increase the customer delight from the entire ecosystem and platform of our iOS devices and the Mac, and that's why we've done iCloud. And we just -- we couldn't be happier that just a couple months into this, there's more than 125 million users around the world on iCloud.

**Operator**

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

**Charles Eugene Munster - Piper Jaffray Companies, Research Division**

If you could dig a little bit more into what's going on in China. I know you gave some high-level numbers. But is this increased distribution points, is it just price elasticity of lower-priced 3GS? Is it more people in China having money? All of the above? Anything that you can tell us to explain this vertical growth?

**Timothy D. Cook**

Gene, it was an incredible quarter in China. We -- the revenue was record -- was a record at \$7.9 billion in Greater China, which is up over 3x year-over-year and brings the first half revenue for Greater China to \$12.4 billion. That compares to a full year last year of \$13.3 billion. So it is mind-boggling that we can do this well. A part of this was the pent-up demand for iPhone 4S. As you know, we launched mainland China in January of this year, and so China was not able to get into the Q1 period. So all of that is in Q2. We also have very strong demand for iPad 2. We have not shipped in mainland China yet the new iPad, although we are shipping in Hong Kong. And so it's a combination of these things. And the halo that both of these products have produced for the Mac is also incredible. Mac was up over 60% year-over-year. And that compares to a market rate of growth of about 6%. We have expanded point of sales. On a year-over-year basis, Mac is up 70% but still only 1,800 for all of Greater China. And so there's obviously a lot more opportunity there. iPhone, we're up over 11,000, which is 138%. But 11,000 is a much smaller number than we have in the U.S., and obviously, China will, in the next few years, be a bigger opportunity. iPad is only in 2,500 points of sale. And so yes, we've expanded. We've expanded a lot. However, there's a lot of headroom here in our view.

**Charles Eugene Munster - Piper Jaffray Companies, Research Division**

Was the iPhone mix in China different than the rest of the world? Or how was it different?

**Timothy D. Cook**

I don't have that in front of me, but my recollection is that it wasn't materially different. But keep in mind that iPhone 4S just launched in -- within the quarter. And so usually, when a new product launches within the quarter, you would expect it to mix fairly much toward the new product.

**Charles Eugene Munster - Piper Jaffray Companies, Research Division**

And just one final quick question on iTunes content. It seems that there's kind of this logjam to getting more TV shows and movies and the rentals, and it's been a little bit of a slow pace of improvement. How important is getting better content on iTunes? And what's going to break that logjam?

**Peter Oppenheimer**

Gene, it's Peter. We're actually thrilled with the rate that we're adding content into iTunes. This is something that we have to do country by country, so it takes a bit of time to put in place. We have the largest catalog

of songs and movies available anywhere, over 28 million songs. And this led to almost \$1.9 billion of revenue in the March quarter, which was up 35% year-over-year. So we're thrilled with the progress that we're making in iTunes and customers love it.

### **Operator**

And that will come from Ben Reitzes with Barclays.

### **Benjamin A. Reitzes - Barclays Capital, Research Division**

Tim, the other big issue outside of the subsidy question that you just answered a couple of calls ago was regarding shortages. There's talk about potential Qualcomm shortages into the next couple of quarters and potential constraints even at year end for some pretty neat products that might be good for you to have in some products down the road. I know you don't comment on future products, but this is a big concern. And I guess can you just talk directionally about whether you expect long term to get your -- more than your fair share of product and what you need? And do you see any bottlenecks on the horizon that are major in that department or in any component down the line over the long term?

### **Timothy D. Cook**

Tough question to answer, Ben. Obviously, we're aware of the lithography transition issue that you mentioned with 28 nanometer. We currently do not use 28-nanometer parts. But as you also know, we don't comment about future products, and so I can't talk about the future part. Generally, outside of this, we work very closely with our supplier partners and do everything that we can do to get supply. And sometimes, we're successful with that, and sometimes we're not. And so you can bet that we are focused on anything that we think may impact us and trying to push every button within our disposal to work on it.

### **Benjamin A. Reitzes - Barclays Capital, Research Division**

Okay. Well, I appreciate that. And then my follow-up is regarding Walmart. They were actually just in our building in a conference here talking about how they're moving from one store in Arkansas now to 25 stores. And they seem really pleased with the "store within a store" concept. How is it going? And when can you be in all 10,000 stores?

### **Timothy D. Cook**

There's no plan to be in 10,000. And so we're trying some things. And as you know, that doesn't include the Mac. And so we're trying some things and

seeing how it goes. And they've been a very good partner for us on iPod and have been selling iPods for a while and are an increasingly more substantial partner in the iPad space as well and an evolving partner on iPhone. And so we're working with them and enjoy working with them and hope to continue expanding.

### **Operator**

That will come from Keith Bachman with Bank of Montréal.

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

Tim, for you, I think. Could you add some more specifics on iPhones in Asia Pacific, including China? Is supply-demand in balance there? Or that -- can that be a help? And then more broadly, with iPhones getting increased inventory of 2.6 million units, will that be a -- will that, in fact, go down in the June quarter? Is there any comments, you could provide there? And then I have a follow-up, please.

### **Timothy D. Cook**

Yes, let me start with the -- your last question. On the 2.6 million, our desire, just to be very clear on this, our desire was to increase inventory -- channel inventory across the quarter. As you might recall, we ended with only 6 million units in the channel coming out of December because we were extremely backlogged. And this is on particularly -- this is on 4S specifically. Our target is to be between 4 million and 6 million. The addition of the 2.6 million allowed us to get within that range by the end of the quarter. And so we feel that we exited the quarter as supply and demand balanced. Because our execution, the ops team was so good, the vast majority of the supply-demand in the different countries was reached by the end of January. And so we had the mother of all Januarys with the -- with really getting out of the vast majority of the iPhone 4S backlog and launching China as well. And so it was an incredible, incredible start of the quarter for us. Your other question was?

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

On China specifically. It sounds like China can still be a help. Or it sounds like China is still supply-demand imbalanced. But I wanted to see if you could add some thoughts [ph] there in terms of iPhones.

### **Timothy D. Cook**

No. China is not supply-demand imbalanced on iPhone. On iPad, worldwide, we're supply constrained on the new iPad, both coming out of last quarter.

And to give you a current view, we're still supply constrained on the new iPad. Demand has been incredibly robust, and we are selling them as fast as we can make them, as Peter mentioned earlier. In China, I believe on a macro basis, China has an enormous number of people moving into the higher income groups, middle class, if you will. And this is creating a demand for goods, not just Apple's but other companies' goods as well. And so I think there's a tremendous opportunity for companies that understand China, and we're doing everything we can to understand it and serve the market as good as we can.

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

It certainly seems so. Tim, for my follow-up from Bill Shope's question, there have been some changes in Spain in particular on the behavior of their carriers and the economics. And Vodafone has actually changed some of their subsidy levels. It's only been about 30 days or 35 days, but have you seen any changes in demand levels in the Spanish market as a consequence of some of the activities of the carriers? And that's it for me.

**Timothy D. Cook**

Yes. Keith, Spain has been weak for us and probably more broadly for many companies. We -- our revenues grew in Spain last quarter but materially less than we grew in Europe or worldwide. However, that wasn't cause and effect related to the issue you're on, that Spain is just in a, I think, terrible economic situation. And so I sort of look at that as an unusual case. To be clear about what was done, is that -- I think there's also some noise in the pike on this one. What the carriers did was they still have subsidies for their existing customers. And I don't want to talk about what the -- their existing customer-to-new customer ratio is, but you can find out numbers from different parts of the world and model that. They pulled subsidies on new customers. And so it wasn't a pull of all subsidies, it was a pull of subsidies from new. And it -- all carriers in that market did not do that. A couple of the carriers did. So I wouldn't necessarily use that as a proxy for the world, I guess, is my point.

**Operator**

From JPMorgan, we'll go to Mark Moskowitz.

**Mark A Moskowitz - JP Morgan Chase & Co, Research Division**

A question for Peter. Peter, can you provide a little more framework or context for us in terms of understanding how the segments dovetail with the 13% sequential revenue decline in the guidance? In terms of that bogey,

what product segments could be higher in terms of decline or less than the decline?

**Peter Oppenheimer**

Go ahead, Tim.

**Mark A Moskowitz - JP Morgan Chase & Co, Research Division**

Oh, sorry. Go ahead.

**Peter Oppenheimer**

Sure. iPhone, well, we would expect to have a year-over-year increase and a sequential decrease for the reasons that both Tim and I discussed. We built channel inventory in the March quarter, and we are exiting March in supply and demand balance. And we had a huge January. And for iPad, we would have a significant -- expect to have a significant year-over-year and sequential increase in sales. And I've got a -- I want to put something out just so it gets out on the call in case it's not asked and talk a little bit about the gross margin guidance that we provided for the June quarter. We're pleased to be providing a gross margin guidance of 41.5% for the quarter. We expect about 2/3 of the sequential decline to be primarily driven by a higher mix of iPads and Macs, a full quarter of selling the current iPad lineup and lots of leverage on the sequentially lower revenue. And we would expect the remainder of the difference to be primarily driven by the items benefiting the March quarter gross margin that we don't expect to recur in June.

**Nancy Paxton**

And Mark, did you have a second question?

**Mark A Moskowitz - JP Morgan Chase & Co, Research Division**

Yes. Tim, Tim, can you hear me?

**Timothy D. Cook**

Yes, I can now.

**Mark A Moskowitz - JP Morgan Chase & Co, Research Division**

Okay, great. Sorry about that. So just in terms of the -- your flexibility or versatility, you've been flexible here recently in terms of your cash usage as well as just providing more color or commentary during your earnings call. I was just wondering how we should think about opportunities for incremental flexibility as it relates to patent disputes. Is there a point where Apple



maybe feels it reasonable to settle and just continue out-innovating and outgunning the competition rather than wage an ongoing litigation? Are there opportunities for that?

**Timothy D. Cook**

I've always hated litigation, and I continue to hate it. We just want people to invent their own stuff. And so if we could get to some kind of arrangement where we could be assured that's the case and a fair settlement on the stuff that's occurred, I would highly prefer to settle versus battle. But it -- the key thing is that it's very important that Apple not become the developer for the world. We need people to invent their own stuff.

**Operator**

Next, we'll go to Shannon Cross with Cross Research Group.

**Shannon S. Cross - Cross Research LLC**

My first question is just going back to iCloud. Perhaps Tim, if you can talk a little bit more about feedback from customers? Curious sort of average number of devices of customers that customers are putting up or maybe percent of users attaching more than one device. Just sort of what's the initial feedback? And then I have a follow-up.

**Peter Oppenheimer**

Shannon, it's Peter. I don't want to frustrate you, but, well, we have, of course, the data that you're asking for, but we don't want to help our competitors. And so it's not something that we're going to provide probably. The feedback that we're getting from customers on iCloud is just it's off the charts. They're loving it. And the fact that we could be here on the conference call with you in April just 5 or 6 months after introducing the service and have 125 million people around the world using it every day, I think, speaks for itself.

**Shannon S. Cross - Cross Research LLC**

Okay. And then my follow-up question is just on R&D. I mean, it was up 45%. It's over \$800 million now. I'm curious. So was a chunk of the growth from the acquisitions you've made? Or is there anything you can tell us in terms of your thoughts on R&D and investment levels? Because it's definitely been ramping, which, I guess, bodes for good products coming for -- in the future.

**Peter Oppenheimer**

Well, we view this as a good thing. We are investing in engineering to continue to bring out the most innovative products in the world to delight customers. We are making investments in our hardware and software engineering teams. We're shipping the best products that Apple has ever shipped today. And we've got some fabulous new products in the pipeline. So I'm very confident in the return that we're going to see on these investments.

**Shannon S. Cross - Cross Research LLC**

You used to give sort of an idea of percentage to software, percentage of hardware. Is there anything you can give there?

**Peter Oppenheimer**

Shannon, I'm sorry. I don't have that in front of me.

**Operator**

From Sterne Agee, we'll go to Shaw Wu.

**Shaw Wu - Sterne Agee & Leach Inc., Research Division**

Just a quick clarification. I understand you disclosed China in terms of the 4S shipping along with 21 countries early in January. What about China Telecom specifically? When did that launch?

**Timothy D. Cook**

Shaw, it's Tim. We launched with China Telecom in March. And in early part of March, we were at a supply-demand balance with them prior to the end of the quarter. We're very happy to be working with them.

**Operator**

From Bank of America Merrill Lynch, we'll go to Scott Craig.

**Scott D. Craig - BofA Merrill Lynch, Research Division**

Peter, on the OpEx side, that's an area where you guys have been getting a fair amount of leverage. If you look year-over-year, it's down pretty significantly as a percentage of sales. So I'm just curious on your thoughts going forward, maybe not just next quarter but sort of how do you think about the OpEx leverage longer term? And then, Tim, can you just kind of take us through the components like you do on most quarter calls and where you're seeing some pricing better than expected and maybe worse than expected and put that in the context of going forward as well?

## **Peter Oppenheimer**

Yes, Scott, it's Peter. We are, as I discussed in Shannon's question, investing in R&D to introduce the most innovative products in the market. We are also spending on marketing, advertising, opening more of our own retail stores and expanding our indirect channels around the world to increase sales. And we're investing in infrastructure to support our growth and also stock-based comp for our employees. We are very confident in the investments that we're making. We're thinking about the long term, and we're confident in the returns that we're going to get in -- on these investments.

## **Timothy D. Cook**

Scott, in terms of component costs for the quarter we just finished, Q2 component costs were better than we had planned, and this assisted us in exceeding our gross margin guidance, as Peter talked about earlier. Displays and NAND flash drove the majority of the favorable commodity cost benefit. In terms of the June quarter and the -- what we factored into our guidance, NAND and mobile DRAM supply continued to exceed demand. And because of that, we expect pricing will continue to be favorable. For most LCDs, we expect pricing to stabilize as the market moves to a supply-demand balance. The hard drive market has moved to a supply-demand balance, and we expect marketing -- market pricing to decline but will still be higher than the pre-flood level from the tragedy in Thailand. Most other components are expected to fall in line with or somewhat faster than historical trends.

## **Operator**

And we'll go to Kulbinder Garcha with Credit Suisse.

## **Kulbinder Garcha - Crédit Suisse AG, Research Division**

Just a clarification, Pete. Did you say that 2/3 of the sequential gross margin decline was basically due to products? And did I hear that right? Can you clarify that? Because it seems like quite a rapid drop, and I'm just wondering how much conservatism is in your gross margin guidance. And then I have a follow-up for Tim afterwards.

## **Peter Oppenheimer**

Sure, Kulbinder, the 2/3 that I talked about, the sequential decline, we see as being driven by a higher mix of iPads and Macs, a full quarter of selling the current lineup of the iPad or the current iPad lineup, and then a loss of leverage on the sequentially lower revenue. So those 3 factors we see driving 2/3 of the sequential decline.

**Kulbinder Garcha - Crédit Suisse AG, Research Division**

Okay, great. And then, Tim, just a question on the enterprise side. You mentioned a couple of times how the iPad is being taken into new markets, new verticals, whether it's because of the price point of the innovation. I'm just wondering specifically what resources is Apple dedicating to have a much more direct relationship with the enterprise? Can you speak on what's changed in the last 6 or 12 months and what you think you need to do to become a more credible or significant enterprise player?

**Timothy D. Cook**

Initially, our focus was on working with the Fortune 500 and the Global 500 to get the iPad certified for their particular enterprise. And I'm pleased to report that 94% of the Fortune 500 are testing or deploying iPads and 75% of the Global 500 are testing or deploying the iPad. So these numbers are just off the charts for a product that's only 24 months old. And so we are moving our focus away from this and focusing on penetration within these accounts. Peter alluded to some of the wins that we have had in the -- his opening comments. The incredible things about these are that they span across many verticals, through government, through education, and many different functions within the enterprise. It's absolutely the most broad-based product I have ever seen in my whole career in terms of adoption rate into the enterprise. And so yes, this means that we're applying more resources in Fes [ph] and salespeople to interact directly with these customers. We also work with our carrier partners and our reseller partners in delivering both the products and services that are wrapped around that to these customers.

**Operator**

We'll go to Chris Whitmore with Deutsche Bank.

**Nancy Paxton**

Chris, are you there?

**Chris Whitmore - Deutsche Bank AG, Research Division**

Hello? Can you hear me?

**Nancy Paxton**

Yes, we can.

**Chris Whitmore - Deutsche Bank AG, Research Division**

Okay, sorry about that. If I take your revenue guidance and the comments you made around gross margin at face value, it seems to imply that you expect iPhone unit sales to be down about 10 million units quarter-on-quarter. First, is that in the right ballpark? And secondly, are you just being conservative with respect to the outlook? Or have you seen a change in the end demand environment for the phone?

**Peter Oppenheimer**

Chris, let me sort of go in reverse order. We are incredibly confident in our business, our strategy and what we're doing. When we give you guidance, we give you guidance that we have reasonable confidence in achieving. And finally, we do expect a sequential decline in iPhone sales driven by the fact that we built 2.6 million units of channel inventory in the March quarter, which we needed to do. We're now within our target range of 4 to 6 weeks, and we entered the March quarter with significant backlog, as we talked about, in January. And we're able to fulfill that and launch 20 countries in the month of January. So -- we have immense confidence in what we're doing and are very pleased with the way our business is performing.

**Chris Whitmore - Deutsche Bank AG, Research Division**

A follow-up, if I could, on iPad. It is supply constrained across many geos, as you talked about. Is there a specific component issue? Do you have visibility on resolution? When do you expect to be able to meet demand in the iPad?

**Timothy D. Cook**

It's hard to answer meet the demand. What I'm confident about, however, is that we will be able to supply a significant number of iPads during the quarter, and I feel very, very confident about that. It's tough to know precisely that it will balance until you get there, but I'm very confident with the improving supply and that the total number will be very significant.