

## **Operator**

Good day ladies and gentlemen, and welcome to the Apple Incorporated Fourth Quarter Fiscal Year 2015 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 first is Apple CEO Tim Cook, and he'll be followed by CFO Luca Maestri, after that we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including without limitation those regarding revenue, gross margin, operating expenses, other income and expense, taxes and future business outlook. Actual results or trends could differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's Form 10-K for 2014, the Form 10-Q for the first three quarters of fiscal 2015 and the form 8-K filed with the SEC today along with the associated press release.

Apple assumes no obligation to update any forward-looking statements or information which speaks as of their respective dates.

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

## **Tim Cook**

Thanks, Nancy. Good afternoon everyone, and thanks for joining us. Today, we are reporting a very strong finish to a record breaking year and I'd like to reflect on some of the highlights.

We completed our fiscal year in September, and we are proud to report revenue of \$234 billion, an increase of 28% and \$51 billion over 2014. This is our largest absolute revenue growth ever. To put that into some context, our growth in one year was greater than the full year revenue of almost 90% of the companies in the Fortune 500. We made huge inroads into emerging markets generating over \$79 billion in revenue and growing 63% despite very strong headwinds from foreign exchange rates.

These results are made possible by Apple's commitment to innovation and creating the best products on earth. In the past 12 months around the world we've sold over 300 million devices including 231 million iPhones, 55 million

iPads and 21 million Macs setting new unit records and increasing our global market share for both iPhone and Mac.

We crossed 100 billion cumulative downloads from the App Store and we added powerful new services to our ecosystem, including Apple Pay in the United States, in the United Kingdom, Apple Music in over a 100 countries, and Apple News in the U.S.

We also entered an entirely new category with Apple Watch and we are in the very early innings of this promising new part of our business. We generated over \$53 billion dollars in net income and grew earnings per share by 43%. We returned almost \$50 billion to shareholders through dividends and share repurchases while continuing to invest confidently in research and development, marketing and distribution, our retail and online stores, our supply chain and our infrastructure.

We also completed 15 acquisitions to enhance and accelerate our roadmap for products and services. We accomplished all of these things while intensifying our efforts to protect the environment to promote equality and human rights and to ensure the security and privacy we know our customers deserve.

We are ending the year on a high note with a record breaking September quarter including sales of 48 million iPhones beating our expectations and up 22% year-over-year. Momentum for iPhone 6 and iPhone 6 Plus remained very strong across the quarter and we established a new launch record for iPhone 6s and iPhone 6s Plus near the end of the quarter.

We are seeing strong interest around the world and we've been getting great feedback from customers who love the iPhone's new features including 3D touch, live photos, the new iSight camera, and the powerful new A-9 processor in the iPhone 6s and 6s Plus.

We exited the quarter with demand for our new iPhones exceeding supply but we've made good progress with our manufacturing ramp in the initial weeks of October. We sold an all time record 5.7 million Macs continuing to defy the negative trend in the global personal computer market which IDC estimates contracted by 11%.

The App Store set new all-time quarterly records for both the number of transacting customers and overall revenue. The strong performance of the App Store helped fuel \$5.1 billion in services revenue also an all-time record.

Sales of Apple Watch were also up sequentially and were ahead of our expectations. This quarter we introduced beautiful new Apple Watch cases and bands including new Gold and Rose Gold aluminum Apple Watch Sport

models. We released Watch OS 2 in September paving the way for a whole new class of native apps that are faster and can take advantage of the hardware capabilities of Apple Watch such as the microphone, speaker and the heart rate sensor.

Today, there are over 13,000 apps in the Watch App Store including over 1300 native apps such as Facebook messenger, MLB At Bat and Runkeeper and the number is growing rapidly.

Apple Watch has already had a tremendous effect on customers' health and fitness and the stories we're hearing about its impact are truly inspirational. I personally heard from people who credit Apple Watch with saving their lives and customers are finding new applications all the time in their day to day activities.

Revenue in Greater China nearly doubled year-over-year and we continue to focus and invest heavily there. I just returned from a four day visit to Hangzhou and Beijing where we announced major new initiatives to provide renewable energy for our supply chain. I also visited our retail stores in China which are among the busiest in the world.

On Saturday we opened a new store, our 25th in Greater China to a very enthusiastic crowd and we are on track to achieve our goal of 40 stores by the middle of next year. Yesterday, we started taking orders for the all new Apple TV and it was a huge first day for this exciting new product. We want to provide the same innovation in the living room that we delivered in our iOS devices. People are already watching more TV through apps today and we think apps represent the future of TV. We've built a new foundation around this vision with a new operating system called tvOS innovative ways to connect with your screen and a smart use of Siri to search for what to watch.

Next month, we'll begin shipping iPad Pro, the most powerful iPad we've ever made. iPad Pro will enable a new generation of apps for entertainment and productivity, design and illustration, engineering and medical and much more, and with the Apple Pencil and Smart keyboards users can customize their experience making iPad Pro an even more powerful tool for everyone from students to artists, to business professionals.

iOS 9 has hit the ground running on track to be downloaded by more users than any software release in Apple's history with 61% of active iOS devices already running at less than six weeks after its September the 16th release.

In late September, we also launched OS X El Capitan which has made the world most advanced desktop operating system more refined and powerful than ever before. Apple Music has set a completely new standard, redefining

and combining the best ways to enjoy music in a single immersive app. Over 15 million individual and family accounts are experiencing Apple Music including over 6.5 million paying customers. We are thrilled to bring Apple Music to China beginning this quarter along with iTunes, movies and iBooks and we are especially happy to offer such great new and diverse content to our large highly engaged and rapidly growing customer base in China.

We are also looking forward to bringing Apple Music to the new Apple TV beginning this week. Apple Pay is seeing double digit growth in transaction month after month and we continue to add major businesses including Starbucks which will roll out Apple Pay support to all its U.S. stores in 2016.

Apple Pay now supports merchant rewards programs as well and popular retailers that will be coming online in the next few weeks. We are thrilled to announce today that we are partnering with American Express to bring Apple Pay to eligible customers in key global markets so even more people can experience the easy, secure and private way to pay.

Apple Pay will be available to eligible American Express customers in Australia, in Canada this year and is expected to expand to Spain, Singapore and Hong Kong in 2016. The reach of our ecosystem continues to grow and iOS is changing more and more aspects of our customer's lives in very meaningful ways from their health, to their homes, to their cars.

In Health, there are now more than 1,600 health kit enabled solutions that are helping us live a healthier day. In the home there are over 50 brands working on home kit enabled accessories that can be privately and securely controlled from your iPad and iPhone, and in the car more than 50 automobile models have been announced with CarPlay support which provides a smarter, safer and more fun way to use iPhone in the car. And we will continue to work to make the iOS experience even more meaningful across more touch points of our daily lives.

The impact of research kit also continues to build. We recently announced new studies on autism, epilepsy and melanoma adding to the important studies already underway on conditions from asthma to diabetes to Parkinson's disease.

Our iOS news app is off to a great start. Nearly 40 million people are reading Apple News and we've been getting very positive feedback from the publishers. We have now signed more than 70 publishers representing hundreds of titles and we're happy to announce that News just launched in the United Kingdom and Australia with partners such as the BBC, NewsCorp, The Telegraph, The Guardian, Financial Times, Daily Mail and the Australian Broadcasting Service.

And finally, we are making great strides in the enterprise market, announcing a new strategic partnership with Cisco in September while furthering our progress with IBM in building our mobility partners program. We estimate that enterprise markets accounted for about \$25 billion in annual Apple revenue in the last 12 months, up 40% over the prior year and they represent a major growth vector for the future.

I'd like to thank our talented and incredibly hardworking employees, our developers and our business partners around the world and of course our very loyal customers for making 2015 Apples' most successful year yet.

With that, I'll turn the call over to Luca to go over the September quarter results in more detail.

### **Luca Maestri**

Thank you, Tim. Good afternoon, everyone. It's great to conclude our record fiscal 2015 with our strongest September quarter ever. Revenue for the quarter was \$51.5 billion, an increase of \$9.4 billion or 22% year over year. Our growth was driven by the tremendous performance of iPhone, the expanded availability of Apple Watch and all time high services revenue and Mac sales.

We achieved these outstanding results despite severe and persisting weakness in foreign exchange rates around the world that affected all our geographic segments and this makes our year-over-year growth rates even more remarkable.

In constant currency, our growth during the fourth quarter would have been 800 basis points higher. We once again reported very strong numbers in Greater China with revenue growing 99% year-over-year to \$12.5 billion. Emerging markets performance was strong overall up 65% year-over-year and representing 31% of total company revenue for the quarter.

Company gross margin was 39.9%, up sequentially better than our expectations, mainly due to lower than expected costs. Operating margin was 28.4% of revenue and net income was \$11.1 billion, a new September quarter record. Diluted earnings per share were \$1.96, a 38% year-over-year increase and cash flow from operations was \$13.5 billion, also a new fourth quarter record.

For details by product I'll start with iPhone. We sold 48 million iPhones in the quarter, up 22% year over year with strong performance around the world throughout the quarter. Total iPhone sales were up 120% in Mainland China and grew over 35% in South Asia and increased by over 20% in several markets around the world including Germany and Italy.

iPhone ASP was \$670, an increase of \$67 year-over-year, thanks to more favorable mix and in spite of the very significant negative impact from foreign exchange that I referred to earlier.

We increased iPhone channel inventory by less than 2 million units in order to support our new product launch at the very end of September quarter. We exited the quarter with demand exceeding supply and channel inventory below our target range of 5 to 7 weeks.

Next I'd like to talk about the Mac. We sold 5.7 million Macs, which is an all time quarterly record and represents 3% year-over-year growth. We extended our very long running trend of PC market share gains based on IDC's latest estimate of a 11% global market contraction. Mac growth was driven primarily by the great customer response to our new MacBook and sales of MacBook Pro also remained strong. We ended the quarter below our 4 to 5 week target range for Mac channel inventory.

Turning to iPad. We sold 9.9 million compared to 12.3 million in the year-ago quarter. iPad sell-through was 10.4 million as we reduced channel inventory by about 500,000 units. We exited the quarter below our 5 to 7 week target range of iPad channel inventory.

iPad customer metrics remain extremely positive. In August, ChangeWave measured a 97% consumer satisfaction rate for iPad Air 2 and among consumers planning to purchase a tablet within 90 days, 70% planned to purchase an iPad. Corporate buyers reported a 95% satisfaction rate for iPad and a 90 day purchase intent of 73%.

In the segments of the tablet market where we compete, we continue to be very successful. Recent data from NPD indicates that iPad has 73% share of the U.S. market for tablets priced above \$200. And the latest data published by IDC indicates that iPad has 74% share of the U.S. Commercial Tablet market.

As Tim mentioned our enterprise initiatives continue to expand. In September we announced a new strategic partnership with Cisco to optimize their networks for iOS devices with a goal of providing iOS mobile users with great performance advantage over other mobile platforms.

Also, during the September quarter, IBM released new mobile first for iOS apps in healthcare, financial services, travel and transportation and industrial sectors, including new apps leveraging iOS 9 and Watch OS 2.

There are now 55 apps in the IBM mobile first for iOS catalogue and the list of projects signings is growing rapidly. Inside IBM, Macs are gaining tremendous traction. There are currently over 30,000 Macs deployed within

the company with 1,900 more being added each week. IBM tells us that each Mac is saving \$270 compared to a traditional PC, thanks to the much reduced support cost and better residual value. This is a terrific example of the kind of opportunity our devices offer to improve user experience and create value in the enterprise world.

Our mobility partner program also continues to grow with more than 25 new partners added in the September quarter bringing the total to over 65 and we are already seeing some great success stories with this program. We are also very excited about the potential of iPad Pro and the enterprise. For example, with the Bloomberg professional app, more than 325,000 financial professionals will be able to use iPad Pro to gain instant global access to finance and business news, market data and portfolio tracking and trading tools.

Turning to services. We generated \$5.1 billion in revenue, a new all-time record, and an increase of 10% over last year mainly due to strong growth from apps. The revenue from the App Store increased 25% and the number of transacting customers grew 18%, also setting an all-time record. Services growth was particularly impressive in China, where Apple App Store revenue grew by 127% year-over-year. The momentum behind the App Store in China has been tremendous with huge interest from developers and customers alike. Our developer program in China has grown dramatically in the last year with over 1 million members in our program today.

Revenue from other products grew strongly up 61% over last year, thanks to the growing contribution from Apple Watch. We expanded Apple Watch distribution significantly over the course of the quarter and it was available at almost 5000 locations in 32 countries at quarter end.

Our retail and online stores had a very busy quarter. We opened 7 new stores, including our first store in Belgium. That brought us to a global store count of 463 of which 195 are in 15 countries outside the United States.

In fiscal 2016, we expect to open or replace between 40 and 50 stores and we continue to place particular emphasis on Greater China where we plan to have 40 stores opened by the middle of next year.

Customers have been very interested in the iPhone upgrade program offered in our U.S. retail stores. The iPhone upgrade program gives customer purchasing a connected device an easy convenient way to get a new phone every year with low monthly payments to a third party lender along with the security and protection of AppleCare Plus.

After making 12 or more installment payments, customers can upgrade to a new iPhone. Let me also quickly discuss three accounting matters. First,

relative to the iPhone upgrade program that I just mentioned, we will be reducing revenue at the time of sale for the cost associated with the program and deferring the portion of revenue related to AppleCare software upgrade rights and non software services for each iPhone sold.

Second, in September based on an analysis of market offerings we reduced the estimated selling price of future software upgrade rights and non software services that we defer for each iOS device and Mac sold, the reduction is between \$5 and \$10 per unit.

Third, also in September we lengthened the time period over which the deferred revenue associated to iPads will be recognized from two years to three years.

Let me now turn to our cash position. We ended the quarter with \$205.7 billion in cash plus marketable securities, a sequential increase of \$2.8 billion. \$187 billion of this cash, or 91% of the total, was outside of the United States. In the September quarter, we issued a total of \$5.8 billion of term debt, consisting of 1.25 billion British pound denominated notes, 2.25 billion Australian dollar denominated notes and 2 billion euro denominated notes.

This left us with \$56 billion of term debt outstanding at the end of the quarter.

We were very active in the market during the quarter and returned over \$17 billion to our investors. We paid \$3 billion in dividends and equivalents and we spent \$14 billion to repurchase almost 122 million Apple shares through open market transactions. We also completed our fifth accelerated share repurchase program in July and retired an additional 10 million shares at settlement.

We have now completed over \$143 billion of our \$200 billion program including \$104 billion in share repurchases of which \$36 billion was repurchased in fiscal 2015 alone. Now, as we move ahead into December quarter, I 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 \$75.5 and \$77.5 billion compared to \$74.6 billion in the year ago quarter. We expect gross margin to be between 39% and 40%. We expect OpEx to be between \$6.3 billion and \$6.4 billion. We expect OI&E to be about \$400 million and we expect the tax rate to be about 26.2%.

Also today our Board of Directors has declared a cash dividend of \$0.52 per share of common stock payable on November 12, 2015 to shareholders of record as of November 09, 2015.



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

**Nancy Paxton**

Thank you, Luca. And we ask that you limit yourself to one, one-part question and one follow-up. May we have the first question, please?

**Question-and-Answer Session**

**Operator**

[Operation Instructions] Your first question will come from Katy Huberty with Morgan Stanley.

**Katy Huberty**

Yes, thanks, good afternoon. In light of December quarter revenue guidance, firmly low single digit revenue growth and what looks like increasingly tough comps heading into the March quarter, how do you get comfortable that Apple isn't on the verge of [ex] [ph] growth for the first time in a decade? And then I have a follow up.

**Tim Cook**

Katy, it's Tim. You have to consider the constant currency growth rates. And so if you do that, our guidance is actually 8% to 11% because we have about a 700 basis point FX headwind in Q1. And so the growth is actually quite good underneath that and that's obviously a problem with everyone struggling with it.

Zooming out to the more macro question about growth, here's what I see currently. We believe that iPhone will grow in Q1 and we base that on what we are seeing from a switcher point of view, we recorded the highest rate on record for Android switches last quarter at 30%.

We also look at the number of people that have upgraded, that were in the installed base prior to iPhone 6 and 6 Plus. And that number is in the low 30 percentages. So we feel like we have a very open field in front of us. Our performance in emerging markets although it's quite good and our revenue was good our market share is low and the LTE penetration in these markets is quite low.

Also, if I zoom out and look at China, as I have said before and just to make the point once again is we see an enormous change in China over the next several years. The latest study I have seen from Mackenzie indicates if you look back five years China's middle class had about 50 million people in it. If you look ahead five years, it will have ten times that number in it. And so --

and I feel like we are reasonably well positioned in China, I'm sure we can do better, but I think we are doing fairly well there.

It's not the only market that we are working on obviously. I was really impressed last quarter with our progress in Vietnam and Indonesia and India among others. Also, from the currency point of view and the weak global economies, we don't overly focus on this. It's - my view is that it's sort of a transitional kind of thing and we invest for the long term, so we are continuing to invest for Apple's future.

In addition to those Apple TV is off to a great start. Apple Watch is just getting going. The app store hit a new record again last quarter and the growth seems to be really great there. I'm really happy with the early days of Apple Music and the people moving from the free trial to the music business. And finally, the enterprise business is not to be underestimated, I doubt very many people knew that we had \$25 billion enterprise business that we quietly built in not too many years, but our penetration is low, but we have significant actions going on to really deepen that. So sort of everywhere I look I see significant opportunity. Long answer but I thought you might be interested.

**Katy Huberty**

No. I appreciate that. Just as a follow-up on growth, if you look at large services companies, Facebook, Amazon, Google, they're all growing over 20% and it's largely driven by activity of Apple users on iOS devices. Do you feel like there is more that Apple can do to participate in that services growth or you relegated to fundamentals that are tied to device upgrade cycles?

**Tim Cook**

Well, the App Store is growing over 20%, it grew 25% last quarter, and so we feel very good about that. That's become a sizeable business. I would also point out that some of these upgrade programs that are in the market, they sort of began to look more like a subscription business in terms of the way they operate. And so we think that in the aggregate that they may reduce upgrade cycles and also the iPhone that has been sold to someone else hits the price point that we're not hitting today largely which could help further fuel the services revenue which we did quite well on last quarter.

**Katy Huberty**

Thank you very much.

**Tim Cook**

Yep.

**Nancy Paxton**

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

**Operator**

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

**Gene Munster**

Good afternoon and congratulations. Tim, you just briefly touched on as reducing the time between upgrades, but how do you think about the iPhone upgrade cycle compressing over the next few years, obviously the impact from carrier's changes in the iPhone upgrade program. Can you talk a little bit about when that's going to be rolled out internationally? And then lastly, Luca you mentioned some of the accounting changes related to the iPhone upgrade program. Any sense in terms of what percentage of the Plus – the s upgrades were associated with the upgrade program? Thanks.

**Tim Cook**

Gene, in terms of the upgrade program it's early, but here's what we believe our current view is that we do think that the broader upgrade program, so I'm not just talking about our program that in retail, I mean, that is relatively small compared to our total iPhone sales of the company, but the broader thing obviously is that many of the carriers are offering these plans. And that, if you look at them in the aggregate, we think that it would have a positive impact in replacement cycles. We do like the fact that it creates a market for an iPhone at a different price point as well that is a better product than that customer maybe currently buying which would further help from an ecosystem point of view and that's not to be underestimated.

It also seems like that from a rollout point of view there's a -- you will see these plans offered in a significant way in the United States already, but in fact these plans are being offered in some derivation in over dozen countries in the world. They're not as pervasive as they are in the U.S. but it seems like we're on the front end of fairly major trends in the industry.

**Luca Maestri**

From a financial perspective, Gene, the transaction on our iPhone upgrade program is a purchase, it's not a lease and so we recognize our revenue upfront, of course we deduct also upfront the cost associated with the program essentially to provide interest free financing and we need to

estimate deferred value of the upgrade option for the customer, but as Tim said, it's a popular program in our U.S. store, in the scheme of things, it's a small percentage of our worldwide iPhone sales and so we'll have really a negligible impact for example, on ASPs for the phone.

**Gene Munster**

And Tim, if we put it all together is it something that has more measurable impact on the business two, three quarters down the road, is that the right way to generally think about it?

**Tim Cook**

Yes, we think about it as being – there were some clearly that were offered in the market prior to this cycle. But they became much more pervasive and much communicated, I think much wider with the September announcements. And so, I would sort of expect to begin seeing this somewhere around a year from now.

**Gene Munster**

Thank you.

**Nancy Paxton**

Thank you, Gene. May we have the next question, please?

**Operator**

Moving on, we'll hear from Toni Sacconaghi with Bernstein.

**Toni Sacconaghi**

Yes. Thank you. Tim, I appreciated the color that you provided on the drivers of iPhone growth in Q1. I think the investor concern is that Q1 will benefit at least on a year over year basis from three extra weeks of availability in China. And it will also benefit from more of those initial launch days that only two of them were in the September quarter and the remainder will be in the December quarter.

And so I guess the investor concern is December is a structurally advantaged quarter in the sense of benefiting from both of those tailwinds on a year-over-year basis. But if we look out beyond December, wouldn't that point to notably lower seasonal growth than the March quarter. And how do we think about the factors affecting unit growth beyond the December quarter? And then I have a follow-up, please.

## **Tim Cook**

We don't guide beyond December, as you know Toni. I do think that the sort of the macro things that I spoke about earlier, the upgrade programs, the Android Switcher rate, the iPhone momentum in the emerging markets and the LTE penetration in these markets these trends are not one quarter things. These are longer term things. The same – my same response applies and I think we'll do quite good in iPhone. I do believe we'll grow this quarter as we put in our guidance that when you start with a number in the low 30s in terms of the percentage of the installed base that's upgraded that had a phone pre the iPhone 6 and 6 Plus, that number still likely to leave a lot of headroom beyond December.

So that's how I look at that. In terms of your first comment, you didn't asked me to comment on that, but just to be clear, our forecasting doesn't work like you articulated it. I recognize that people can have their own models and so forth, but just to make it clear that I'm not agreeing with your point.

## **Toni Sacconaghi**

Okay. And then just on the follow-up, the reported gains from currency hedging in fiscal year 2015 were significant, several billion dollar contribution to the company. And again, this is not an Apple's specific issue, Luca as you pointed out several times, but how do we think about this notion of currency hedges effectively rolling off and being replaced with hedges that are likely have less of an impact. How do we think about that impact the P&L on a go forward basis, perhaps starting with Q1, but then qualitatively or directionally over the course of the year? And what is some of kinds of things that you've undertaken or planning to undertake that could mitigate some of those concerns?

## **Luca Maestri**

Yes. I think, Toni, it's a very good point, I mean, what's going to happen in practice is that we got this portfolio of hedge comp such that over time provides protection to our margins and to our results, but that protection diminishes as we go through the year and so we should expect that in over time during the course of fiscal 2016 that protection will come off assuming that the dollar stays at current levels. Keep in mind, there are some currencies around the world that where we cannot economically hedge and so those currencies are bit excluded from what we're talking about right now.

I think my conclusion is that the guidance that we're providing for the first quarter that 39% to 40% it actually an incredible level of guidance given the

foreign exchange headwinds that we're dealing with. How do we deal with that? We continue to hedge, so our program continues on an ongoing basis and we will continue to provide some level of protection to foreign exchange movement. In some cases we have realign prices particularly when we launch new products. We tend to do that in a number of countries where the foreign exchange moves have been particularly extreme, and so we tend to recover that through pricing.

And then finally, of course we are putting in place a number of cost initiatives that would allow us to deal with the foreign exchange situation. So, overall we feel very strong guidance for the first quarter. And beyond the first quarter as you know we're not guiding and so we'll see over the course of the year.

**Toni Sacconaghi**

Thank you.

**Nancy Paxton**

Thanks, Toni. Could we have the next question, please?

**Operator**

We'll go to Shannon Cross with Cross Research.

**Shannon Cross**

Thank you very much. Tim, I wanted to go back to your commentary on the enterprise business, \$25 billion I think you said, it was up 40% year-over-year. I know you have a relatively small sales force internally and obviously you utilizing the joint ventures, but as you noted you see that's an important driver of growth. So, how do you attack that market going forward? Will there be changes? Is there something that you need to shift or focus product in a little bit of different directions to make sure you can adequately attack it. Just in general how you're thinking about it?

**Tim Cook**

From a product point of view, we'd actually been continuing to change and improve IOS for some time. With every release they are more enterprise features and so, I would describe it as sort of continuation of that cadence perhaps with little more intensity. From a go to market point of view, we will be working with or are working with IBM. With Cisco. We're already working with 75 mobility partners that are principally in the U.S. but that's expanding quickly to international as well.

And so, many of these companies have -- in some cases very large sales forces, in many cases the reasonable size sales force. And in addition to a direct sales force there is a huge worldwide indirect channel that many customers buy from and count on buying some services from. And so I do not envision Apple's having a large enterprise sales force will certainly make -- we continue adding some people more on the engineering side, but I don't envision having a large direct sales force.

## **Shannon Cross**

Okay, great. Thank you. And can you give us some more color on China, 120% year-over-year growth in iPhones, but can you talk in general about what you're seeing in the marketplace and perhaps where you think you in terms of penetration from a smartphone standpoint especially with a China Mobile which has a substantial opportunity to grow given the LTE penetration?

## **Tim Cook**

Yes. If you look at China, we grew from an iPhone point of view, Greater China, we grew 87% the market grew for. If you take iPhone out of the market number, the certain market x iPhone actually contracted slightly. And so, we've been able to grow without the market growing. iPhone 6 was the number one selling smartphone in Mainland, China last quarter and iPhone 6 Plus was number three. And so, we did fairly well. The sort of the economic question which I know there's a bit lot of attention on, frankly, if I were to shut off my web and shut off the TV and just look how many customers are coming in our stores regardless to whether they're buying, how many people are coming online, and in addition looking at our sales trend,

I wouldn't know if there was any economic issue at all in China. And so I don't know how unusual we are with that. I think that there's a misunderstanding probably particularly in the Western world about China's economy, which contributes to the confusion. That said, I don't think it's growing as fast as it was, but I also don't think that Apple's results are largely dependent on minor changes than growth. I think it's much more of contributing -- I think other things contribute to that much more. That does say, you'll never had problem there, because the economy, I'm not saying, I'm dumb enough to think that. But I just think that the area that it's currently operating within, it's hard to tell the difference of the consumer level for us. I mean, you really can't tell the difference, if you look at sort of our daily and weekly numbers.

So, we're very bullish on it, and I would point out that we're investing in China not for next or the quarter after, or the quarter after, we're investing for the decades ahead and as we look at it our own views is that China will be Apple's top market in the world. And that's not just for sales, that's also developer community is growing faster than any other country in the world. And so, the ecosystem there is very, very strong. I was very impressed with the number the developers I met last week and of course, the customers in stores are enthusiastically contagious.

## **Nancy Paxton**

Thank you, Shannon. Can we have next question, please?

## **Operator**

We'll go to Steve Milunovich with UBS

## **Steve Milunovich**

Thank you. Tim, I wanted to talk about the two sources of your iPhone demand selling to current customers and selling to new customers. In terms of selling to current customers you indicated about a third of the base is moved to the sixth line. As much as people talk about that been a huge upgrade cycle and what is the six has have incrementally, 33% not that a bigger number, I would have thought it would be bigger than that.

Does this suggest that there is maybe more of a consistency to upgrading than the street perceives. And then on the other side in terms of new customers, just wanted clarity on the switcher number, are you saying that 30% of iPhone shipments in the quarter went to android switchers to IOS. And do you believe that you could actually have more new customers to Apple in fiscal 2016 than you had fiscal 2015.

## **Tim Cook**

There's a lot there. Let me start with the Android Switcher. What this means is that for customers to purchase an iPhone last quarter and replace the smartphone that 30% of those switched from an android device. And so there would have been some switchers on top of that from other operating systems, but obviously android is the largest one by far. And so that's what that means, and that number is the largest that we've ever recorded since we began measuring it three or so years ago.

And so, it's a huge number, we're very, very proud of that number. In terms of 2016 versus 2015 new customers, it's hard to predict. I'm very happy with how we're doing. We're doing better than we've ever been doing.



People -- I know there's a fixation on the upgrade rate. When I look at the upgrade rate, Steve, what I see is I feel good that it's a low number because that's low number means that there is 69% of the people that are out there prior to the iPhone 6 and 6 plus that haven't bother to upgrade this year. That's a large number.

And so, I'd see that is opportunity. Do I think it has anything, does to length to consistency? I think part of it is and I believe that the iPhone upgrade plans that are out there as I've mentioned before it seems to me on the future. We'll tell it's true or not, but it seems to me it's going to act as a catalyst to accelerate some of this upgrades. And I think that's not something that we're going to see this quarter or next quarter, but it seems like it's going to happen beginning a year for now or so.

It have begins to be – you've seen the plan. They look more and active like a subscription than they do like a purchase. And that's great for the customer because many of them want to upgrade on a frequent basis and they can do this very, very simply. In terms of new, I don't know, whether we'll more new or not. I can tell you that that's always our objective. We want to add a lot more people to the ecosystem and certainly if you look in the emerging markets, even like, nobody is asking about iPad on the call. But if you look at iPad as just an example, in China, 68% of the people that purchased an iPad it was the first tablet they've owned and 40% of those have never owned any Apple product.

Just to go through one product with one set of number. I don't want to get through a bunch of numbers because it does contain the data than I don't want to share. But these are things that we're very focused on. And the first time buyer number is surprisingly strong. And keep in mind that we have a good history of bunch of people buy one Apple product, they have a great experience. They begin to look at other Apple products. And of course we makes they all work well together.

**Steve Milunovich**

Thank you.

**Nancy Paxton**

Thank you, Steve. Could we have next question, please?

**Operator**

From Goldman Sachs, we'll go to Simona Jankowski.

**Simona Jankowski**

Hi. Thank you very much. Just is a follow-up to that last question and to put that in context, roughly what percent of the iPhone shipments come from shipments for the installed base versus from your user shipment?

**Tim Cook**

I don't know the answer of your question.

**Simona Jankowski**

Okay. And then just a follow-up, as Luca mentioned, you had to make some adjustments to the pricing in various regions given the currency move we've had. What had been the response in terms of demand, I guess both in terms of units and revenues in some of these regions like Japan or India, parts of Europe where the local prices has to go up?

**Luca Maestri**

Simona, we've made a number of price changes during the course of fiscal 2015. What we've seen in a normal of these markets, we've seen that iPhone sales have been very resilient and that shown in our growth rates. Most recently we've adjusted some prices around the world for the launch of iPhone 6s and 6s Plus. We are very positive about the safest trends around the world. It's a bit early to tell, because the phones have out there just for four weeks, so its bit early to tell there. Obviously when we increase prices around the world, it's normal to see some impact on sales rates, but so far we were encouraged by the response.

**Tim Cook**

Let me go back to your question. And this is an exactly what you're asking that what your view, I think some color is. The reason I can't answer this is, we don't look at any aggregate, we actually look at the detailed because it's much more important for to us to look at, buy iPhone model by country, what percentage going to our first iPhone buyers. Somebody that's never owned an iPhone before. And so if you look at China as an example, it's over 50% of people that bought 6 and 6 Plus were buying their first iPhone.

As you move down the line, that numbers goes up. And so a 5s generally speaking is higher in most countries. And so, that gives a feel for very important market and we cannot where the numbers are.

**Simona Jankowski**

Great. Thank you very much.

**Nancy Paxton**

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

**Operator**

Next we'll go to Amit Daryanani with RBC Capital Markets.

**Amit Daryanani**

Thanks a lot. Good afternoon guys. Two questions from me as well. I guess, first could you talk about the gross margin dynamic as you go from September to December, the midpoint implies on 20 basis points. I think the last five years that's only happen once the gross margin is going down in fiscal Q1. Can you just talk about what the FX dynamic or what area the other headwinds that you think that implies gross margins being done in December?

**Tim Cook**

Yes. Let me give you puts and takes for margins for the December quarter. On the positive side, of course as you mentioned that we would have positive leverage from the higher seasonal volumes. Also what we've seen over the last several quarters is a commodity environment that has been quite favorable and we expect it to remain favorable during the December quarter.

On the other hand, of course we are launching a lot of new products. We've launched some during September. We are launching some now and everything we launch new products, we make them better. We had features and new technology and these products when we launch and tend to have higher cost structures than the products what they replaced. We have a very good track record overtime to reduce those cost structures, but every time we introduce a new product that is a headwind at the beginning of the cycle for gross margin.

While it's different from a year ago very significantly with the foreign exchange impact that we have mentioned before it remains a very significant headwind as I mentioned earlier to Tony I believe we are dealing with that to a combination of hedging, price realignments [ph] cost initiatives, but on a net basis foreign exchange we will clearly by a sequential headwind.

**Amit Daryanani**

Got it. And then Tim when you talk about seeing iPhone growth in fiscal Q1, I'm curious is that statement more reflective of iPhone units or iPhone revenues so that the ASPs could hardly get growth even if units are not

there. And then would you expect to exit within the 5 to 7 week optimal inventory range in fiscal Q1?

**Tim Cook**

I don't know that we will exit. We make that call late in the quarter as we see what the demand is because we are actually trying to position the inventory for the following quarter instead of the current quarter. And it's very difficult to predict. What was your other question?

**Amit Daryanani**

I was just curious to your statement on iPhone growth in fiscal Q1, is that a reflection of....

**Tim Cook**

Is it revenue? I was making a revenue statement but units are also, yes we expect units to be up as well.

**Amit Daryanani**

Thank you.

**Tim Cook**

Yes.

**Nancy Paxton**

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

**Operator**

From JPMorgan we'll go to Rod Hall.

**Rod Hall**

Yes thanks for taking my question. I just wanted to ask Tim maybe if you could comment on the mix between iPhone 6 and iPhone 6s. And whether the mix of demand is any different than what you say for instance that the iPhone 5, 5s point whether there is more say iPhone 6, I know you highlighted that the iPhone 6 is a number one phone in China for example and then I have a follow up?

**Tim Cook**

The statement I made in China was about Q4 and the 6s was only available in China for two days last quarter. The iPhone 6s is the most popular iPhone that we currently sell. In terms of has there been a change. If you look at iPhone 6 today, and add iPhone 6 Plus and compare that to last year's 5s we are doing better, at that price point than we were previously.

**Rod Hall**

Okay, thank you. And then there's follow up for what you were doing on the upgrade program. I am wondering if can you envision a time ever made in the U.S. or elsewhere where you would not have to come into an Apple store to activate it or to take advantage of the upgrade you might be able to do that somewhere else, do you start now what your....

**Tim Cook**

That's a really good question. We actually solved that problem back in 2007. But then quickly had to change it in order to scale in a major way. And so that is something that we would always -- sort of always in our mind that one day from a customer experience point of view we would like to make things as easy as possible for the customer.

And to some degree you can already do that with buying online. But there are many different plans and search what the people buy, that they have to come in for several times we would love to have that automated and working with our partners, with service providers.

**Rod Hall**

Great. Thank you very much.

**Tim Cook**

Yes.