

Operator

Good day, everyone, and welcome to this Apple Incorporated Fourth 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 three quarters 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.

And I'd now like to turn the call over to Peter Oppenheimer for introductory remarks.

Peter Oppenheimer

Thank you, Nancy. Thank you for joining us. We're pleased to report the results of our fourth fiscal quarter. We established a new September quarter records for iPhone, iPad and Mac unit sales, leading to our highest September quarter revenue and earnings ever.

Revenue for the quarter was \$36 billion, representing year-over-year growth of 27%. That's a \$7.7 billion increase over the prior September quarter's results and was driven primarily by strong growth in iPhone and iPad sales.

Operating margin was \$10.9 billion, representing 30.4% of revenue. Net income was \$8.2 billion, increasing 24% over the prior September quarter's result. The quarter's net income translated to diluted earnings per share of \$8.67.

Turning to the details of the quarter, I'd like to begin with our Mac products and services. We sold over 4.9 million Macs establishing a new September quarter record. This represents 1% growth year-over-year compared to IDC's latest published estimate of 8% contraction of the global personal computer market in the September quarter.

Portable sales grew 9% year-over-year and represented an all time high of 80% of Mac unit mix, thanks to strong sales of MacBook Pro and MacBook Air.

Earlier this week we unveiled the stunning new design for iMac that packed high performance technology and a brilliant new display with reduced reflection into an incredibly sleek aluminum and glass enclosure. We also introduced an even thinner and lighter version of our most popular Mac, the 13-inch MacBook Pro, featuring a retina display with over 4 million pixels in all flash storage. We began and ended the quarter with between three and four weeks of Mac channel inventory which is below our target range of four to five weeks.

Moving to our music products, we sold 5.3 million iPods compared to 6.6 million in the year ago quarter. iPod touch continue to account for over half of all iPods sold. iPod share of the U.S. market for MP3 players was over 70% in the September quarter based on the latest data published by MPD and iPod continue to be the top selling MP3 player in most countries we track based on the latest data published by GFK.

We're very excited to be shipping our newest iPods as of two weeks ago. The new iPod touch is the thinnest iPod touch yet, comes in five great colors and features of 4-inch Retina display, a 5 megapixel iSight camera, our powerful A5 chip and Siri. The new iPod Nano is the thinnest iPod ever featuring a 2.5-inch Multi-Touch display, convenient navigation buttons, and built-in Bluetooth for wireless listening. The Nano comes in seven great new colors and we think our full range of iPods will make wonderful gifts this holiday season.

The iTunes Store generated all time record results, with revenue almost \$2.1 billion thanks to continued strong sales of music, apps and video. We look forward to launching the new iTunes featuring the completely redesigned player, seamless integration with iCloud and a new look for the iTunes Store. The new iTunes has a dramatically simpler and cleaner interface, so customers' music, movie and TV purchases on any of their iOS devices or computers are conveniently displayed in their iTunes library and are available whenever they want them.

I'd now like to turn to iPhone. we're very pleased to have sold 26.9 million iPhones compared to 17.1 million in the previous September quarter. That represents 58% year-over-year growth compared to IDC's latest published estimate of 45% growth for the smartphone market overall during the quarter. We launched iPhone 5 in nine countries on September 21 and 22 more countries on September 28, and demand has been phenomenal.

Customers have responded tremendously to the iPhone 5 all-new slim and light design and beautiful new 4-inch Retina display, the powerful performance of the A6 chip and the great new ultrafast wireless technology. Demand for iPhone 5 continues to outstrip supply, and we are working very hard to get more into customer's hands as quickly as possible.

We ended the quarter with about \$9.1 million iPhones in channel inventory, a sequential increase of about 800,000 iPhones and ended the quarter below our target range of four to six weeks of iPhone channel inventory on a look-forward basis.

Recognized revenue from iPhone handsets and accessories sales was \$17.1 billion during the quarter compared to \$11 billion in the year-ago quarter, an increase of 56%. Businesses around the world continue to make iPhone, an essential device for their employees. Virtually, every type of enterprise in the small business is using iPhone along with the business apps from the app store and custom apps developed in-house to drive efficiencies that were simply not possible before.

Canon has provided its field sales team iPhones with secure access to its customer relationship management system, sales reps can now access customer information and input meeting notes anywhere giving them more time with customers. Amtrak has deployed thousands of iPhones to train conductors, the use an in-house app that changes the entire ticketing and reporting workflow. The app enabled print-at-home ticket validation delivers a more accurate passenger manifest and makes the accounting data available to Amtrak's revenue systems in near real time, revolutionizing the paper-based process, the company used in the past.

And news organizations around the world are using iPhone to transform the way they capture and deliver news. reporters for BBC, the Wall Street Journal, Mexican newspaper, Milenio and Canada's CTV News are using their iPhone cameras to capture HD video on location and send it directly back to headquarters for broadcast on TV or streaming on the web.

Turning to iPad, we were very pleased with sales of 14 million iPads during the September quarter compared to 11.1 million in the year ago quarter and

the increase of 26%. iPad sales were ahead of our expectations and we saw a strong year-over-year growth in iPad sales in every geographic region.

Earlier this week, we introduced the iPad Mini, the thinnest, lightest, smallest iPad we've ever build. it has all the power, performance and capability, customers have come to expect from an iPad and you can hold it in one hand. We also introduced the fourth generation iPad with the beautiful 9.7-inch Retina display, an A6 chip with twice the performance of the iPad we announced earlier this year.

Together with the iPad 2, these two new iPads run more than 275,000 apps in the App Store. Recognized revenue from sales of iPad and iPad accessories during the quarter was 7.5 billion compared to 6.9 billion in the year-ago quarter and the increase of 9%. we ended the quarter with about 3.4 million iPads in channel inventory, a sequential increase of about 200,000, which left as just over our four weeks of iPad channel inventories, target on a look-back basis.

iPad is fundamentally changing work processes across industries around the world. With apps developed in-house, iPad is helping companies deliver better service; streamline manufacturing and then power workforces with critical data and information.

Volkswagen has developed more than 30 in-house apps for vital processes across the company including monitoring and tracking of vehicles on the production line, scheduling the vehicle transportation at assembly plants and greeting customers when they pick up new cars. Ping An Insurance in China has deployed thousands of iPads to their sales agents and service teams.

Apps developed in-house are used by car accident inspectors to carry out onsite inspections involve claims, which significantly shortens processing time and improves customer satisfaction. In Brazil, Banco Bradesco is using iPads to redefine the customer experience in their bank branches. Beyond completing customer transaction, employees use iPad to inform and educate customers about bank services, and Bradesco apps in the App Store.

Combining iPhones, iPads and iPod touch, we sold over 44 million iOS devices in the September quarter. The App Store now offers more than 700,000 apps, including over 275,000 apps specifically for iPad. We established a new all-time record for quarterly app sales in the September quarter, and we were very pleased to report that we have reached \$6.5 billion in cumulative payments to developers. Customers are embracing iPad in growing numbers. With over 190 million account sign ups in the first year of the service.

With iCloud, customers can access their music, photos, calendars, contacts, documents and more from whatever device they are using. And it is built into every new iOS device and every new Mac. And we launched iOS6 last month, and it's already on over 200 million devices. iOS 6 includes over 200 new features, including broader language support for Siri, Facebook integration, shared photo streams and more. We've made a number of improvements in maps over the past month, and we will work non-stop until maps lives up to our incredibly high standards.

I would now like to turn to the Apple retail stores. Revenue was \$4.2 billion, which is a new September quarter record and an increase of 18% over the year-ago quarter, with growth yield primarily by the store's best iPhone launch ever. The stores also established a new quarterly record for Mac sales, selling just over 1.1 million Macs. We opened a total of 18 new stores in 10 countries during the quarter, including our first store in Sweden. We also opened our second store at Hong Kong, at Festival Walk overwhelming response, resulting in our biggest store opening of the year.

We exited the quarter with 390 stores, 140 of which are outside the United States. With an average of 376 stores open, average revenue per store was \$11.2 million, compared to \$10.7 million in the year-ago quarter. Segment margin was \$848 million, compared to \$652 million in the year-ago quarter. We hosted 94 million visitors to our stores during the quarter, compared to 77.5 million visitors in the year-ago quarter, an increase of 22%. That translates to an average of 19,000 visitors per store, per week.

Total company gross margin was 40%, which was 150 basis points higher than our guidance. About half this difference was due to better than expected, commodity and other costs. Another quarterly difference was due to leverage on the higher-than-expected sales and more favorable foreign exchange. The remainder was due to some items that we do not expect to recur in the December quarter.

Operating expenses were \$3.5 billion, and included \$379 million of stock-based compensation expense. OI&E was a net expense to \$51 million. The interest income and investment gains were more than offset by higher-than-expected currency hedging expense. Under the accounting rules, foreign exchange fluctuations late in the quarter required us to accelerate recognition of premium expense related to Q1 and Q2 hedges. This will result in less premium expense being recognized in Q1 and Q2 the tax rate for the quarter was 24.5%, bringing us to a tax rate for the full fiscal year of 25.2%.

Turning to cash, our cash for short-term and long-term marketable securities totaled \$121.3 billion at the end of the September quarter,

compared to \$117.2 billion at the end of the June quarter, a sequential increase of over \$4 billion. The increase in cash was net of \$2.5 billion of dividend paid in August. About \$83 billion of our total cash was offshore at the end of the September quarter. Cash flow from operations was \$9.1 billion. Our board of directors have declared a dividend of \$2.65 per common share, payable on November 15, 2012. The shareholders of record as of the close of business on November 12, 2012.

In August, we entered into a rule 10b5-1 compliant accelerated share repurchase program, with the financial institution to purchase out the \$2 billion of Apple stock during fiscal year '13.

In addition to shares purchased through the accelerated share repurchase program, we may also purchase shares in open market transaction in compliance with our applicable securities laws. As we move ahead into the December 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. As a reminder, year-over-year comparison will be impacted by the fact that our December quarter this year will span 13 weeks, whereas the December quarter last year included a 14th week.

As we indicated previously, revenue in that 14th week last year was approximately one 14th of the quarter's total revenue. We expect revenues to be about \$52 billion compared to \$46.3 billion in the December quarter last year. We expect gross margin to be about 36% reflecting approximately \$90 million related to stock-based compensation expense.

We expect OpEx to be about \$4.05 billion including about \$485 million related to stock-based compensation expense. We expect OI&E to be about \$380 million, and we expect the tax rate to be about 26%. We are targeting EPS of about \$11.75.

In closing, we're extremely proud to conclude an amazing fiscal year 2012. We generated revenue of over \$156 billion, which is up 45% year-over-year, and reflects growth of \$48 billion in revenue. We sold over \$200 million iOS devices including 125 million iPhones reflecting 73% growth year-over-year, and 58 million iPads reflecting 80% growth.

We sold a record \$18 million Macs and shipped 35 million iPods. And we expanded the reach of iTunes music stores to 63 countries around the world. We launched stunning new versions of OS X and iOS, and time it altogether; we launched iPod with customers reaching over 190 million and growing.

And finally, we generated net income of \$41.7 billion, an increase of 61% year-over-year. We enter this holiday season with our strongest product lineup ever and remain very confident in our new product pipeline.

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

Nancy Paxton

Thank you, Peter. And we ask that you limit yourself to one question and one follow-up. Operator, may we have the first question, please?

Question-and-Answer Session

Operator

(Operator Instructions) Your first question will come from Katy Huberty with Morgan Stanley.

Katy Huberty – Morgan Stanley & Co. LLC

Hey, thanks. Good afternoon. If your guidance comes to fruition, December will be the first quarter in a very long time, but Apple EPS declined year-on-year despite what has been the broadest product refresh in the company's history over the past two months, the [bares] will point out that may be the company's price premium or supply kind of advantage is weakening, so just curious how you would respond to that? And then as a follow-up, Peter if you can comment on what's driving the significant gross margin down-tick in December given you should have decent iPhone mix? Thank you.

Peter Oppenheimer

Sure. Katy, let me begin, I'll address many of the things you asked, and then Tim can add a few points. The change year-over-year is being driven by a couple of things, so first of all, last year included a 14th week, this year's Q1 is a normal 13-week quarter. That along with a stronger U.S. dollar, and the change in gross margin, so let me talk to you about what we see for gross margin, but I'm going to go through some detail on a sequential basis, but not year-over-year.

As you pointed out, this is the most prolific product period in Apple's history. We have an unprecedented number of new product introductions over the last six weeks, and this has led to record levels of demand. New or re-priced versions of our products announced during this time frame represent over 80% of the total expected December quarter revenue.

But there are costs associated with such dramatic change and demand. The iPhone 5, iPad Mini, iMac, MacBook Pro 13-inch, iPod Touch and iPod Nano have completely new form factors with great new features, and we've never before introduced so many new form factors at once. All of these products

have higher costs than their predecessors, and therefore lower gross margins as they are at the height of the cost curve.

This has been the case with new products in the past, so nothing new. The difference this time is the sheer number of new products we are introducing in a very short period of time. Additionally, we lowered the price of the iPhone 4S and iPhone 4, delivering incredible value to our customer.

We head into this holiday quarter with the strongest iPhone line-up that we have ever had with the iPhone 4 starting at three in the subsidized markets. We also added the iPad Mini to our iPad line-up. The iPad Mini has the full iPad experience, and we priced it aggressively at \$329, delivering incredible value to our customers. Its gross margin is significantly below the corporate average.

So in summary, we expect our gross margin to decline by about 400 basis points sequentially. We expect the benefit from positive leverage on a sequentially higher revenue and a greater mix of iPhone, but we expect these benefits will be more than offset by a number of factors.

First, margins on new products are lower than their predecessors including the iPhone 5 and we have been aggressive with the iPad Mini. Second, we've lowered the price of the iPhone 4S and the iPhone 4. Third, we will experience transitional cost associated with multiple new product ramp. Fourth, the high anticipated volume of iPhone and other new products will generate significantly greater deferred revenue sequentially.

As you are aware, we defer a portion of our revenue with every device we sell, and amortize it back into revenue over the life of the device. In periods of exceptionally strong sales like the December quarter, the deferred amounts are significantly higher than the revenue amortized in from past sales. And fifth, the favorable items that benefited the gross margin in the September quarter are not expected to repeat in the December quarter.

We will work hard to try and get down the cost curves and improve our manufacturing and other efficiencies as we successfully have done in the past. We ended this holiday season with our strongest product line-up ever, and we have great choices for customers. To be in a position to anticipate over \$50 billion of demand for our products in a single quarter is a reflection of the incredible strength of our products and our business.

Timothy D. Cook

And Katy, if I could just add a couple of things to that. We are dedicated to making the very best products in the world, and we think about the smallest of details, and we are unwilling to cut corners in delivering the best

customer experience to the world. It's this relentless commitment to innovation and excellence is the reason that our customers choose buy our products, and this will always be the driving force behind Apple. We are managing the company for the long-run and will continue to make great long-term decision. We remain very, very confident in our strategy, and will use our world-class skills and hardware, software and services to delight our customers.

Katy Huberty – Morgan Stanley & Co. LLC

Thanks for the details.

Nancy Paxton

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

Operator

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

Bill C. Shope – Goldman Sachs & Co.

Okay, great. Thanks. Can you walk through how you're thinking about the supply ramp for the iPhone 5 in the holiday quarter? And how does some of the challenges you're facing relative to the strong demand compared to the past iOS product launches?

Timothy D. Cook

Hi Bill, it's Tim. The demand for iPhone is extremely robust, we are thrilled with what we see; we are in a significant state of backlog right now. In terms of the production, our output has improved significantly since earlier this month. And I'm very, very pleased with the progress that we've made there; I'm pleased with the current level of output in what is the largest volume ramp in Apple's history. It's difficult to predict when supply and demand will balance, but I'm feeling very confident on our ability to supply quite a few iPhones.

Bill C. Shope – Goldman Sachs & Co.

Great, thank you.

Nancy Paxton

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

Operator

Next we'll go to Toni Sacconaghi with Sanford Bernstein.

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

Yes, thank you. I just wanted to first follow-up on that previous question around the ramp of iPhone. Do you continue to anticipate rolling out to all 100 countries this quarter as you had announced at the time of the iPhone 5 announcement. And related to that can you comment on whether the supply constraints that you've had, have had a material impact on your cost of goods sold relative. So as your supply improves, do you actually expect your cost of goods sold to decline?

Timothy D. Cook

Tony, it's Tim. In regard to your first question, we still continue to anticipate rolling out to the 100 countries as we announced before, it is our fastest rollout ever; there will be some large countries in month of December. But we anticipate still achieving the 100. In terms of costs, with each new product we see learning curves associated with ramping production.

And the new products we have now are no exception to that, the difference is the number of new products that we having moving in line. As Peter said, and as you can talk, the announcements we've had the last couple of months, this is the most prolific period in our history in terms of the new product introduction and innovation; the past six weeks have been phenomenal in terms of new product introduction.

And so we do see all of these costs associated with each of these. But I don't see those costs accelerating on a per unit basis. As we got through the quarter, I see it very much being a production ramp across many, many new products.

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

Okay, thank you for that color. If I could just follow-up, you've talked before about how you believe that the iPad will be, and the tablet market will be an enormous market, bigger than the PC market. Clearly, you've made a move to expand that market and make it more accessible by introducing the iPad Mini. I'm wondering if over time you could see this market evolving to larger tablets going forward that would address different needs in the marketplace, take on incremental PC functionality, and I'm wondering when you talk about the iPad market being bigger than the PC market going forward, do you see larger form factors in the marketplace evolving, and I guess the question, is why not?

Timothy D. Cook

Tony, as you know we don't comment on our future views on products and roadmaps etcetera. But let me make some comments on your question. We continue to be very confident that the tablet market will surpass the PC market, there is incredible development in both ecosystems and product going on in the tablet space. It is already extremely compelling for many, many customers to choose the tablet, in particular an iPad over a PC. And when you look at the size of the PC market, there is an enormous opportunity for Apple there. Pretty much each quarter you see 80 to 90 million PCs being sold.

And so we do think that the iPad and the iPad Mini, and the iPad 2 will all be extremely attractive offering for people in lieu of PC. And we are going to continue to very much focus on the future of iPad, and we are very, very confident with what we have in the pipeline. And we are extremely pleased to have launched iPad Mini; and can't wait until next Friday, when we begin selling the very first unit.

Nancy Paxton

Thanks, Tony.

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

Thank you.

Nancy Paxton

Can we have the next question, please?

Operator

From Cross Research, Shannon Cross.

Shannon S. Cross – Cross Research LLC

Thank you very much. Tim or Peter could you talk a little bit about China, and what you're seeing in China fairly with your revenue guidance, it sounds like it remained strong, but obviously there's been some mixed signal from an economic standpoint?

Timothy D. Cook

Yeah Shannon, it's Tim. In terms of what we saw in China for Q4, revenue was \$5.7 billion, that's up 26% year-on-year, Mac was up extremely strong, up 44%. As you recall, we launched portables for the first time in July or the portables that we have previously announced in U.S. in June, we announced that in China in July. iPad was up 45% in Greater China, iPhone was up

38%. And so all in all, a fantastic quarter that brings us to a full year fiscal year revenue number of \$23.8 billion for China which is really phenomenal, when you think about it, that's up over \$10 billion year-on-year up 78% and Greater China now represents about 15% of Apple for the fiscal year and so we're extremely happy with how we've done in China as Peter alluded to in his opening remarks, we are continuing to invest in our own retail stores there, we continue to expand distribution in with channel partners as well, and we continue to see it as a extremely exciting market with more and more people wanting Apple product.

Shannon S. Cross – Cross Research LLC

Great, and then I just had a follow-up question on the Tablet market, with the launch of Surface today and obviously the Win 8 Tablet of Mac, could you talk a little bit about what are you seeing, from a competitive standpoint and how you think about it? Thank you.

Timothy D. Cook

Yeah, I haven't personally played with the Surface yet, but what we're reading about it is that it's a fairly compromised confusing product, and so I think one of the toughest things you do with deciding which product is to make hard trade off and decide what a product should be and we've really done that with the iPad, and so the user experience is absolutely incredible, I suppose you could design a car that flies and floats, but I don't think it would do all of those things very well, and so I think people when they look at the iPad versus competitive offerings are going to conclude, they really want an iPad and I think people have done that to-date and I think they will continue to do that.

Shannon S. Cross – Cross Research LLC

Thank you.

Nancy Paxton

Thanks, Shannon, can we have the next question please?

Operator

From Barclays, we'll go to Ben Reitzes.

Benjamin Reitzes – Barclays Capital

Thanks a lot, appreciate it. Can you just go through a little bit more on tablets, the iPad Mini, how do you think that will sell versus the original iPad form factor and how do you want to differentiate that is there more of an

eBook focus with and education focus with the Mini and do you think it will sell more than the regular or the original iPad and how do you want us to just think about the cannibalization factor as well of the older product or the older form factor?

Timothy D. Cook

We don't really have an old product, then we have only new product, we just announced the fourth generation iPad as well and...

Benjamin Reitzes – Barclays Capital

Yeah, I knew, I do, I'd messed up in my speech there sorry.

Timothy D. Cook

So, no, but the way that we look at this is that we provide a fantastic iPad Touch, we provide an incredible fourth generation iPad and iPad Mini and then iPad 2. Customers will decide which one or two or three or all four that they would like and will buy those and so we've learned over the years not to worry about cannibalization of our own products, it's much better for us to do that than somebody else to do it and the far, far bigger opportunity here are the 80 million to 90 million PCs that are being sold per quarter, there's still over 300 million PCs being bought per year, and I think a great number of those people would be much better off buying an iPad or a Mac, and so that's a much bigger opportunity for Apple, and so instead of being focused on cannibalizing ourselves, and I look at it in much more that it's an enormous incremental opportunity for us and so that's how I look at it.

Benjamin Reitzes – Barclays Capital

Okay, and then just my quick follow-up is on Apple TV we haven't heard about your hobby in [Vaio] how many did you sell in the quarter and what's the strategy there for the living room to-date and I'm intrigued to hear the answer or not an answer?

Timothy D. Cook

Or not you might guess, for Q4 we sold 1.3 million that is up over a 100% year-on-year that means that we sold up more than 5 million Apple TVs during the fiscal year, which is almost double the previous year, we have sold 2.8 the previous year and so the business continues to do very well, but if you look at the size of revenue of this business versus our other businesses, it's quite small and so it still has the (inaudible) label, however it's below Toby and we continue to focus on it and continue to believe there

is something more there and continue to pull the string to see where it takes us.

Benjamin Reitzes – Barclays Capital

Thanks a lot, Tim.

Timothy D. Cook

Yeah.

Nancy Paxton

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

Operator

Moving on we'll hear from Gene Munster with Piper Jaffray.

Charles Eugene Munster – Piper Jaffray

Hey good afternoon. Tim, can you talk a little bit about the iPad we saw a deceleration in September quarter. Was there anything in particular that might have been, as do you think about that business might have been driving that?

Timothy D. Cook

The June to September was 17 million to 14 million Gene and the first thing to know there is that as we had talked about in the July call, the June quarter contained 1.2 million increase in channel inventory and so the actual sell through sequentially looks, the comparison looks very different than the our reported sell in numbers do, the second thing is that the \$14 million exceeded what we had expected to do in iPad and the reason we had expected it to decline is that we believe based on the two or three years of results that we've got is that normally, we would see a seasonal reduction in the September quarter versus the June quarter, a part of this reason is because K-12 heavily buys in the June quarter, K-12 doesn't buy very much in the September quarter, it becomes the Higher Ed kind of move and Higher Ed is still buying notebooks for the most part, and so there is some kind of normal seasonal that's exaggerated further when we announced the new product in March and have an enormous full quarter of demand in the June quarter and then when you compare that to the September quarter there would be natural phase down.

In addition to all of that, people it's clear that customers delayed purchases of tablets due to new product rumors and this intensified in August and

September. Some of that was anticipated and some of it I wish wouldn't occur. But it did occur.

And so that's how we would explain the sequential difference. On a year-over-year basis because of the year ago quarter having also a channel inventory build as we stock the channel to the profit level the sell through year-over-year actually grew 44% and so the underlying sell through was extremely strong.

And so we continue to feel great about how iPad has done and with announcing the fourth generation iPads just as we are adding iPad Mini to the family, we think it's going to be an incredible holiday season.

Charles Eugene Munster – Piper Jaffray

Okay, great, thank you, and then my follow-up question is given what we're seeing in margins that some of these products get more expensive to produce to be competitive, would you be open to passing some of those cost on to customers and obviously historically you've announced new products and maintain a lot of those price points?

Timothy D. Cook

It's a hypothetical question, hence so we think, we've made great choices on the product and the prices and as you know our customary practice, long-standing customary practice is just to guide for the current quarter, and so I would want to talk about what we might do post that.

Charles Eugene Munster – Piper Jaffray

Great, thank you.

Timothy D. Cook

Thanks, Gene.

Nancy Paxton

Thank you, Gene. We have the next question please?

Operator

From JPMorgan, we'll go to Mark Moskowitz.

Mark A. Moskowitz – JPMorgan Securities LLC

Yeah, thank you, good afternoon. Peter or Tim my first question is around the sequential guidance for revenue of around 44% quarter-on-quarter for

December. Can you provide us some context about how we should think about the iPad and the iPhone families in particular? How their revenue growth could [down tail] of that 44%?

Peter Oppenheimer

Hi, Mark. It's Peter. You're asking the sequential question, but I do want just to remind everybody that if you are looking at this year-over-year and comparing the sequential year-over-year, don't forget about the 14th week, last year in Q1, you need to adjust for that. And I think it would give you a different answer, if you were comparing anything year-over-year. Specifically, your question about iPhone and iPad sequentially, we have just announced amazing new products in both lineups and we expect large sequential increases, going from the September to December quarter. And as a result, what's real to be providing guidance tonight for \$52 billion of revenue.

Mark A. Moskowitz – JPMorgan Securities LLC

Okay. And then Tim, question on the iPhone 5, as far as just the global rollout, what is the approach, the approach is the first touch all 100 countries and have supply constraints, impacting all 100 countries first and then go back and back still all those different outlets or will there be certain markets where you decide to kind of reach the supply-demand equilibrium first, and then keep similar sort of 100 countries kind of at constrained levels. I'm just kind of curious about the efforts there in terms of. In terms of (inaudible) first sprinkle the product everywhere and then back the later or will it be more targeted?

Timothy D. Cook

What we did initially Mark, as we planned the first 30 to 40 countries prior to introducing the product and roll those out across at September in two different dates. The balance of the quarter, we planned with an eye toward the supply and what we think the demand will be. But we do plan these in advance and so it is not a précised science. And we obviously have to plan those with several weeks of notice. And so occasionally, it can be different than what we think.

Mark A. Moskowitz – JPMorgan Securities LLC

Okay, thank you.

Timothy D. Cook

Yeah.

Nancy Paxton

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

Operator

We'll go to Steve Milunovich with UBS.

Steven M Milunovich – UBS Securities LLC

Thank you very much. Regarding the iPad, you said that you priced it very aggressively. I think many people on The Street seem to have a slightly different view. Could you maybe talk a little about your pricing philosophy? And was it driven by cost? Or is it just more to keep up a premium brand, given the quality of your products?

Peter Oppenheimer

Steve, it's Peter. When we set out the bill, the iPad Mini, we didn't set out the bill to small cheap tablet, we set out the bill to smaller iPad that offers the full iPad experience as our customers would expect. As a result, the difference between the iPad Mini and the competition is profound, our iPad Mini begins with a 7.9 inch display, which is 35% larger than 7 inch tablets, providing a much better experience. We're shipping two great cameras: FaceTime HD front and a 5 megapixel of 1080p iSight rear camera versus typically a one from our competition. We are shipping our fastest communications with dual-band Wi-Fi and have included the A5 chip, which has higher performance than our competitors. And finally, the fit and finish of our precision, unibody aluminum closure is breathtaking when held in your hands.

And so that's what we've done. The iPad Mini has higher costs and the gross margin is significantly below our cooperate average, we're beginning the higher cost curve, but in addition to wanting to make a large number, we're going to work to try and get down the cost curves and be more efficient in manufacturing as we have been in the past with our other products.

Timothy D. Cook

Steve, one of the things we try to do is to create a product that people will love for months and years after they purchase it and continue using it in a robust way. So that's what iPad Mini has been designed to do. And you can really see that more broadly on iPad by looking at the usage statistics, as I had mentioned earlier this week, over 90% of the web traffic from tablets are from iPad. And so, Apple will not make a product that somebody may feel good about it for the moment that they're paying for it and then when

they get it home, they really ever use AVR, that's not what we're about, it's not a kind of experience we want our customers to have. And I think when you – I would encourage you to use an iPad Mini and I don't think you'll be using anything other than maybe another iPad or something after you do that.

Steven M Milunovich – UBS Securities LLC

I look forward to it. could you comment on your enterprise opportunity or obviously a lot of its BYOD, but you have many retailers, you have a corporate director to use iPads and so forth. are you doing anything a little bit more aggressive to support that market particularly with the Windows pads now coming out?

Timothy D. Cook

We now have almost all of the Fortune 500 that are testing or deploying iPad and I think with the recent announcements, the penetration will only grow. We've also pushed fairly aggressively in the Global 500. And so those numbers now are above 80% on both iPhone and iPad. And so I feel like we are doing fairly well there, there is clearly much more to do. But I'm feeling pretty good about it.

Steven M Milunovich – UBS Securities LLC

Thank you.

Nancy Paxton

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

Operator

From Bank of America Merrill Lynch, we'll hear from Scott Craig.

Scott D. Craig – Bank of America/Merrill Lynch

Hey, thanks, good afternoon. Tim, maybe comment on the component environment a little bit particularly, related to the iPad, iPad Mini and iPhone and just where you see some of the constraints perhaps here as you're launching. And then Peter, the quick one for you, the volatility on the OI&E line. is that just the calendar third quarter and calendar fourth quarter issue, and then it normalizes or is that going to continue? Thanks.

Timothy D. Cook

Scott, it's Tim. In terms of iPad and iPhone, I don't see a component shortage getting us for the quarter in the numbers that we've given you in the guidance. I think we saw some challenges there and feel good about our position. In terms of general shortages on the iMac, we'll be constrained for the full quarter in a significant way, part of that is that we're beginning shipping the 21.5-inch iMac in November and the 27-inch in December. And so there will be a short amount of time during the quarter to manufacture and ramp those and I expect the demand to be robust. So we will have a significant shortage there. The others are more based on how big is big from a demand point of view and that is very difficult to predict, but you can tell that we're extremely bullish on the demand with the revenue guidance that Peter talked about earlier. Hopefully that answers your question.

Scott D. Craig – Bank of America/Merrill Lynch

Yes. Thanks.

Gary Wipfler

Hey, Scott. This is Gary. I'll take the OI&E question. Okay, I'll expand on Peter's remarks just a little bit while interest income was above what we expected, foreign exchange hedging expense was higher than we expected relative to our guidance. Without getting overly detailed, dollar weakness late in the quarter and accounting rules required us to accelerate and recognize a large amount of foreign exchange premium expense related to future quarter hedges in the current quarter. All things being equal, premium expense in Q1 should be lower. This has been factored into our December OI&E guidance of \$380 million.

Nancy Paxton

Thanks, Gary and thanks, Scott. Could we have the next question, please?

Operator

From ISI Group, we'll hear from Brian Marshall.

Brian Marshall – ISI Group

Great, thanks guys. If you look at the iPhone, unit growth versus the revenue growth, that's been a pretty similar dynamic over the past several quarters, but when you look at that same dynamic for the iPad, it's actually started to breakdown slightly over the past couple of quarters. In fact, this most recent quarter, it looks like revenues grew three times faster than the unit growth. So I guess the question is, is this just simply the market

migrating down to the sort of low-end of this skew stack or just less accessories from an attached or dollar spent in that and a quick follow up.

Peter Oppenheimer

Brian it's Peter. I didn't quite follow your three times, but the iPhone ASPs were relatively flat in the September quarter, year-on-year and were up slightly on a sequential basis. The iPad ASPs were down year-over-year in a low double-digit way, but this really was reflective of our price reduction on the iPad 2 the stronger dollar and a little bit of change in mix and that's what drove the ASP change year-over-year on a sequential basis. iPad ASPs were actually pretty flat.

Brian Marshall – ISI Group

Great thanks, and then a quick follow-up is, looks like this is the second quarter in a row that the United States iPhone activations is actually growing faster than the international market that kind of seems like a strange dynamic considering the magnitude of the turn of the international being order magnitude larger than the U.S., one of you could comment on that, thanks.

Peter Oppenheimer

I think it's important to remember there that we launched iPhone 5 in the U.S. during the quarter and where we launched in some international countries the bulk of the world we did not launch it yet and so I would have expected to have seen a more significant growth in the U.S. versus the rest of the world.

Brian Marshall – ISI Group

Thank you.

Nancy Paxton

Thanks Brian, could we have the next question please.

Operator

From Bank of Montreal, we'll go to Keith Bachman.

Keith Bachman – BMO Capital Markets

Hi thank you. A clarification question, will the iPhone 5 launch in Mainland China occur in the December quarter?

Timothy D. Cook

Keith, it's Tim. Yes we project that it will occur in December.

Keith Bachman – BMO Capital Markets

Okay thanks and the clarification on top of that, did you comment that you think you'll be able to meet supply of iPhone's at the end of the December quarter or do you think that you will end the quarter with backlogs of iPhone 5, or iPhones I should just say it's as a product's category?

Timothy D. Cook

I'm actually not projecting whether supply and demand will balance for the quarter, I'm saying that I feel great about where we are on the manufacturing ramp that our supply output is significantly higher than it was earlier in October, and I'm confident that we'll be able to supply quite a few during the quarter, but in terms of where that, when that balance occurs, I can't tell at this point.

Keith Bachman – BMO Capital Markets

Okay

Timothy D. Cook

Demand is very robust.

Keith Bachman – BMO Capital Markets

Okay, thanks very much.

Nancy Paxton

Thank you Keith. Could we have the next question, please?

Operator

From Deutsche Bank, we'll go to Chris Whitmore.

Chris K. Whitmore – Deutsche Bank Securities

Thanks very much. Tim I wanted to go back to the iPad one more time if I could, specifically I wanted to ask or try to give us a feel for your view around the emerging model in the tablets base where vendors are willing to subsidize their hardware with content or search, where many of these vendors are selling hardware that break-even or even a loss and hoping they

make it up on the back end, how is that impacting your iPad business if at all and is that something Apple would consider going forward?

Timothy D. Cook

We've seen low-cost challenges before and iPad continues to beat every other tablet on the market, it can be any price and so we think customers are very smart, we think they have very high expectations, we think that they want a device that can do more and we are confident that our focus on making the best product is what will win at the end of the day and so we will stay true to that.

Chris K. Whitmore – Deutsche Bank Securities

Okay and then my second question I wanted to ask about the supply, it sounds like you've made a lot of changes to your supplier list as these new products are ramping perhaps due to strategic reasons and is that creating an added layer of complexity as you try to ramp these new products and to what extent is that contributing perhaps to the higher cost structure of these products?

Timothy D. Cook

I'm not sure what you're trying to get out there, but I would not say that there has been a significant change in our supplier partners. There is always some change obviously, but I wouldn't describe any change as significant and there hasn't been a change that would have driven more cost, if that's your specific question.

Chris K. Whitmore – Deutsche Bank Securities

I was specifically asking about LCD in your Samsung relationship?

Timothy D. Cook

LCD, I wouldn't characterize any change there, it's having driven any cost. And Samsung, we continue to be a customer of Samsung and continue to have a commercial relationship.

Chris K. Whitmore – Deutsche Bank Securities

Thank you.

Timothy D. Cook

Welcome.

Nancy Paxton

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

Operator

We'll go to Kulbinder Garcha with Credit Suisse.

Kulbinder Garcha – Credit Suisse

Thanks. My first question, I guess is for Tim. Just in terms on the iPad Mini, there has obviously been a fair amount of debate within Apple over the years whether to even do the smaller screen iPad. And I guess, can you just speak about what you've learned over the last couple of years as to why the time for that now is right, or was the technology is right? Just any insight there will be helpful. And then for Peter, my question is on gross margin that's when we revisit it slightly in the sense that you guys have spoken about various higher cost structures before as well in the loop from I think the 3G as to the fall in the iPhone. And even when the iPad I think was launched. During the end, what we've seen is that the scaled Apple building, tighter revenues are getting to the component we use as, do you actually very quickly got through these potential gross margin dips. Is anything scripturally different this time around many things?

Timothy D. Cook

On your question about iPad Mini, the comment that I think you're referencing are comments that Steve had made before about 7-inch tablet. And let me be clear, we would not make one of the 7-inch tablets. We don't think they're good products, and we would never make one. Not just because it's 7-inches, but for many reasons. One of the reasons however, is size, and so I am not sure if you saw our keynote. But the difference in just the realistic size between the 7.9, almost 8 versus 7 is 35%. And when you look at the usable area, it's much greater than that. It's from 50% to 67%. And also, the iPad Mini has the same number of pixels as iPad 2 does.

And so you have access to all 275,000 apps that are in our App Store that have been custom-designed to take advantage of the four (inaudible). And so iPad Mini is the fantastic product. it's not a compromised product like the 7-inch tablets; it's in our whole different leap.

Peter Oppenheimer

Kulbinder, the sequential declining in gross margin that we see in the December quarter is largely being driven by many new form factor changes and some price reductions that we've taken that I went through in great

detail. And we believe that over 80% of the revenue that we will see in the December quarter will come from products that we've just introduced in the last six weeks. And so while having lower gross margins on a new product is not something that's new for us. What is different this time is just a sheer number of new products that we've introduced in the last six weeks. And we just have not had that magnitude in the past. So I don't see something that's structurally different. And we have a big focus on wanting to make a lot of these products to get them in customers' hands as quickly as we can. But we are often going to work to try and get down the cost curves and improve manufacturing and other efficiencies as we have successfully done in the past. So no change in what we're going to try and work on. And we'll report to you in January how we did.

Kulbinder Garcha – Credit Suisse

Thank you very much.