Operator

Good day, everyone, and welcome to the Apple Incorporated Second Quarter Fiscal Year 2014 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 today. Speaking first today are Apple CEO, Tim Cook, and Vice President and Corporate Controller, Luca Maestri, and they will be joined by CFO, Peter Oppenheimer for the Q&A session with the analysts.

Please note that some of the information you'll hear during our discussion today will consists of forward-looking statements, including without limitation, those regarding revenue, gross margins, operating expenses, other income and expense, stock-based compensation expense, taxes, future products and capital allocation plans.

Actual results or trends could differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's Form 10-K for 2013, the Form 10-Q for the first quarter of fiscal 2014, 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 speak as of their respective dates.

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

Timothy D. Cook

Thanks, Nancy. Good afternoon, everyone. We have a lot to share with you over the next hour, and I'd like to start right away with the very strong results we're reporting for the March quarter.

We generated $45.6 billion in revenue, which was ahead of our expectations and represents a new March quarter record, and is our strongest non-holiday quarter ever. Our underlying business performance was even stronger than our reported results imply. When you take into account changes in channel inventory this year versus last year and foreign exchange had wins that we faced in several of our international markets. Setting foreign exchange and inventory changes aside, our underlying growth rate would have been close to double digits.

These strong revenue results combined with our best gross margin percentage since September of 2012 resulted in earnings per share growth of 15%, which is our highest earnings growth rate in the last six quarters. iPhone was key in driving our stronger-than-expected results. We sold almost 44 million iPhones, setting a new March quarter record. These stronger results were broad-based both from a product point of view with demand for each of our three iPhone stronger than its predecessor and from a geographic standpoint.

We gained smartphone share in many developed and emerging markets including the U.S., the UK, Japan, Canada, Germany, France, Vietnam and Greater China, just to mention a few. In fact, we established a new all-time record for total iPhone sales in the BRIC countries.

iTunes software and services revenue continue to grow at a double-digit rate, thanks to an incredible ecosystem and our very large, loyal and engaged customer base. With its strong momentum in growing profitability, iTunes is a very important driver of our business not only here in the United States, but around the world. We now have an almost 800 million iTunes accounts, most of these with credit cards. This is a staggering number.

We continue to gain share in the personal computer market as well. We defied industry trends again by growing while the market contracted. Our bold decision to make OS X free has resulted in the largest ever percentage of the Mac installed base running on the latest version of the operating system just months after its release.

iPad sales came in at the high end of our expectations, but we realized they were below analyst estimates, and I would like to proactively address, why we think there was a difference. We believe almost all of the difference can be explained by two factors. First, in the March quarter last year, we significantly increased iPad channel inventory, while this year we significantly reduced it. Luca will go into more detail about this later.

Second, we ended the December quarter last year with a substantial backlog with iPad mini that was subsequently shipped in the March quarter, whereas we ended the December quarter this year near supply demand balance. We continue to believe that the tablet market will surpass the PC market in size within the next few years and we believe that Apple will be a major beneficiary of this trend.

When we look at our company performance on a geographic basis, we’re especially proud of our very strong results in Greater China, where we established an all time quarterly revenue record of almost $10 billion including the results from our retail stores. And in Japan, where revenue was up 26% in spite of the foreign exchange headwinds and where our smartphone market share reached an incredible 55%.

We are continuing to invest in our retail stores and since our last call, we had opened our first stores in Brazil and Turkey and we now have retail stores in 15 countries around the world. I'm looking forward to welcoming our new retail and online leader, Angela Ahrendts, who will be joining Apple's Executive Team next week. Stepping back, we are now just passed the halfway mark for fiscal 2014.

Our strong March quarter results bring us to total revenues of over $103 billion for the first six months of the year and earnings per share growth close to double-digits. We estimate that over the last six months, we've added over $60 million new registered users of our four product categories. Additionally, over two-third's of people registering an iPad in the last six months, were new to iPad, while over half of the people registering iPhones were new to iPhone.

It is wonderful to add tens of millions of first time Apple product users, especially considering the strong halo effect, we've seen over and over again in our history. Customers who have a great experience with their first Apple products, often become loyal and happy owners of the multiple Apple products overtime.

As always, I'd like to thank our talented employees who make these results possible through their creativity and passion they bring to their work everyday. And I'd like to thank our hundreds of millions of customers for their loyalty and enthusiasm and for continually inspiring us to surprise and delight them.

In addition to our quarterly results, we are also announcing an update to our capital return program today, and I'd like to share a few thoughts about our guiding principles for capital allocation and our conclusion on the changes we are making for this year. Apple has created tremendous value for shareholders by developing great products that enrich people's lives and that will always be our top priority and driving force.

We'll continue to innovate by investing in research and development and capitalizing on our strengths in hardware, software and services. We'll keep investing in our supply chains promote scale and efficiencies, expanding our global presence by building retail stores, investing in marketing and distribution and extending our reach into new markets.

We are expanding Apple's products and services into new categories and we are not going to under invest in this business. We are also investing through acquisitions and we've acquired 24 companies in the past 18 months. To invest organically and to make acquisition strategically, we need to maintain financial flexibility. With this framework in mind, Apple's Board and management team, will do capital allocation regularly and we solicit input on our program from a broad base of shareholders.

We very much appreciate all of the input that so many of our shareholders have provided us on how the best to deploy our cash. We've continued to seek investor input going forward and we'll update you on our conclusions around this time each year.

This regular process allows us to continually evaluate return of capital in light of the most current information available and it enables us to be thoughtful about the size, mix and pace of the program. We continue to be in the fortunate position of being able to return significant capital to shareholders. We started doing so two years ago when we announced our first program of $45 billion and we more than doubled the program last April to $100 billion.

Today, we are announcing that we are increasing the size of our program once again with an addition of over $30 billion for a total program size of over $130 billion. The size and pace of our program is unprecedented and we still expect to complete it by December of 2015 as we announced last year.

We think very deliberately about how much and in which way to return cash to our shareholders. We decided to continue to allocate the vast majority of the incremental capital return to share repurchases because we believe our current stock price does not reflect the full value of the company. The size of the share back increases the signal of the Board and the management team's strong confidence in the future of Apple.

We also understand the importance of the dividend to many of our investors and we are increasing it for the second time in less than two years. We believe this is a meaningful increase for those shareholders who value income and we are planning for annual dividend increases going forward.

Now, I would like to turn the call over to Luca for the details of our quarterly results as well as more information about our capital return program.

Luca Maestri

Thank you Tim and good afternoon everyone. As Tim said revenue for the March quarter was $45.6 billion, up $2 billion or 5% from a year ago and above our guidance range. Sales in each of our major product categories were at the high end of our expectations or better and the vast majority of the revenue upside came from strong sales of iPhone.

Gross margin was 39.3%, also above our guidance range and operating margin was $15.6 billion, representing 29.8% of revenue. Net income was $10.2 billion translating to diluted earnings per share of $11.62.

For details by product, I'd like to start with iPhone. We sold 43.7 million iPhones which was a March quarter record. That's an increase of 6.3 million iPhones over last year that represents 17% growth. The addition of China Mobile coupled with great response to our more affordably priced iPhone 4S led to an all time quarterly record for iPhone sales in Greater China. We look forward to broadening our relationship with China Mobile as they expand points of sale and continue to build out their 4G network.

In Japan, iPhone sales were up over 50% year-over-year resulting in significant market share gains, as Tim mentioned we'll try strong growth and share gains in many other major developed markets based on IDCs latest estimates for the March quarter.

iPhone also continued to perform exceptionally well in many developing markets. In Greater China, Brazil, Indonesia, Poland and Turkey. iPhone sales grew by strong double-digits year-over-year, and in India and Vietnam sales more than doubled.

We exited the quarter with 15.4 million total iPhones in channel inventory, which represents a sequential increase of about 100,000 from the December quarter and left us within our target range of four to six weeks.

In the enterprise market progressive organizations are leading the charge to replace legacy devices and systems, and are using iPhone and iOS to drive innovation at their companies. Deutsche Bank has nearly 20,000 iPhones running on its network and has created 40 internal apps that extend the capabilities of its mobile workforce.

Siemens have 30,000 iPhones on its network and has deployed over 50 internal apps for field service teams, sales associates and corporate executives for solution that are only possible with iOS and iPhone. We are really happy with the continued growth and strength of the Apple ecosystem.

Total revenue from iTunes software and services was $4.6 billion, an increase of 11% year-over-year at an all time quarterly record. Our iTunes stores generated record billings of $5.2 billion in the March quarter, up 24% year-over-year driven by very strong growth in App Store sales. These iTunes billings translated to quarterly iTunes revenue of over $2.6 billion, up 9% from the year ago quarter, and also a new all-time record.

Software and services revenue was over $1.9 billion, up 14% from a year ago. App Store momentum is incredibly strong as cumulative app downloads at 70 billion, 87% of iOS devices are now running iOS 7 and our highly engaged users are a great audience for developers.

According to App Annie, the App Store generated 85% more global revenue than Google Play in the March quarter despite the differences in unit market share between iOS and Android devices.

Now, I'd like to talk about the Mac. We saw 4.1 million Macs compared to just under 4 million in the year ago quarter. Thanks to strong performance from MacBook Pro and MacBook Air and Macs have now gained global market share for 31 of the last 32 quarters. Response to Mavericks has been great, and we are very proud of the fact that so many of our Mac customers are taking advantage of the most advanced and secured experience possible. We ended the quarter with Mac channel inventory slightly below our four to five week target range.

Turning to iPad, we saw 16.4 million units. As Tim explained earlier, our iPad results and the comparison to the March quarter last year were heavily influenced by channel inventory changes. Specifically, this year we saw 16.4 million iPads into our channels and sold through almost 17.5 million reducing our channel inventory by 1.1 million units.

Last year we sold over 19.4 million iPads into our channels and sold through 18 million and therefore increased channel inventory by 1.4 million units. As a result, the year-over-year sell through decline was only 3% compared to the sell in decline of 16%. We exit the March quarter with 5.1 million units of iPad channel inventory, which left us within our target range of four to six weeks.

iPad continues to lead all other tablets by far in terms of user engagement, size of ecosystem, customer satisfaction and e-commerce. A recent study by Chitika Insights found that iPad users in North America generate almost four times the web traffic of all Android tablet users combined.

In a February survey, ChangeWave measured a 98% customer satisfaction rate for both iPad Air and iPad Mini with Retina display. And also found that among people planning to purchase a tablet within 90 days two-thirds plan to buy an iPad. iPad continues to allow companies around the world to reimagine the way they use technology to drive efficiency and improve employee satisfaction. Thousands of iPads are used at FedEx everyday. In an industry where efficiency is critical FedEx pilots and maintenance crews around the world use iPad to transform operational processes and save the company millions of dollars.

Eli Lilly has deployed over 20,000 iPads and 50 internal apps as part of a laptop replacement program that dramatically increased the productivity and capabilities of its employees.

The U.S. Department of Veterans Affairs is on its way to deploying iPads to 11,000 providers to transform the way doctors and patients interact. As part of this initiative, a suite of applications is being developed to allow quick access to real-time secure medical information. In education, according to the latest data published by IDC, iPad has over 95% share of the U.S. education tablet market as teachers and students increasingly benefit from the growing range of engaging iBooks, textbooks and solutions that are helping to transform the education experience.

Let me now turn to our cash position. We ended the quarter with $150.6 billion in cash plus marketable securities, a sequential decline of $8.3 billion. Our domestic cash was $18.4 billion at the end of the March quarter, a sequential decline of $16 billion and $132.2 billion or 88% of our total cash was offshore. Cash flow from operations was very strong at $13.5 billion for the quarter.

In total, we executed almost $21 billion worth of capital return activities during the March quarter. First, we launched our third accelerated share repurchase program in late January through which we will acquire an additional $12 billion of Apple stock. We received an initial delivery of 19.2 million shares under this ASR and we received a balance of shares due when the program concludes by December of this year.

Second, we paid $2.7 billion in dividends in February. And finally, we spent $6 billion on open market purchases of 11.4 million shares throughout the March quarter. At the end of March, we also settled our second ASR program, which was launched in April of last year, resulting in the retirement of an additional 1.1 million shares.

I would like now to go into more detail about the expansion of our capital return program that we’re announcing today. Let me start by summarizing the progress that we’ve made on the program we updated a year ago. By the end of March 2014, we’ve already taken action of $46 billion of the current $60 billion share repurchase authorization, over 75% of the program with seven quarters remaining to its completion.

We have acted aggressively and opportunistically and have delivered on our intention to return capital to shareholders at a fast pace. Including dividends and net-share-settlements, we’ve taken action on $66 billion of total $100 billion program announced last year.

Today we've taken additional steps that will increase the overall size of the program from $100 billion to over $130 billion within the same timeframe of December 2015 as before. There are two elements to the expansion of the program. First, we're increasing the size of our share repurchase authorization from $60 billion to $90 billion. We are very confident in Apple's future, and we believe our current stock price does not reflect the full value of the Company. That's why the vast majority of our capital program continues to be allocated to share repurchases. We will also continue to net-share-settle, restricted stock units and expect to utilize about $1 billion of cash annually for that purpose.

Second, our Board has declared a dividend of $3.29 per common share payable on May 15, 2014 to shareholders of record as of May 12, 2014. That represents an increase of about 8% in our quarterly dividend. We understand the importance of dividend increases to many of our investors, and we're increasing the dividend for the second time in less than two years. We are planning for continued annual increases and we're very proud that Apple is one of the largest dividend payers in the world, with annual payments of $11 billion.

All our capital return activities must be funded by domestic cash which as I mentioned was about $18 billion as we exited the March quarter, and down from $39 billion in the quarter that we paid our first dividend. We would maintain sufficient domestic liquidity to grow the business and execute capital expenditures and acquisitions. Thanks to Apple's strong growth in international expansion in recent years. We have built substantial offshore cash balances to repatriate our fall in cash on the current U.S. tax law, we will incur significant cash tax consequences and we don't believe this would be in the best interest of our shareholders.

We continue to advocate for comprehensive corporate tax reform and streamlining the tax code which we believe would be of great benefit to the U.S. economy. To execute our updated capital return program in a tax efficient manner and leverage our very strong balance sheet, we intend to access the debt markets again. We plan to be active in both the domestic and international bond markets during 2014 for an amount of term debt financing similar to what we issued in 2015, with a break down between markets currencies and tenures to be determined over the course of the year and subject to prevailing conditions in each market.

We have also prepared ourselves to access the commercial paper market given the substantial short term liquidity and flexibility that this channel can provide.

Now, as we move ahead into the June quarter, I'd like to review our outlook which includes the types of forward-looking information that Nancy referred to at the beginning of the call. We expect revenue to be between $36 billion and $38 billion compared to $35.3 billion in the year ago quarter. We expect gross margins to be between 37% and 38%.

We expect OpEx to be between $4.4 billion and $4.5 billion. We are continuing to invest heavily in R&D for current revenue generating categories as well as future products and services. We expect OI&E to be about $200 million and we expect the tax rate to be about 26.1%.

And now, I'd like to turn it back to Tim.

Timothy D. Cook

Thanks Luca. In addition to the changes to our capital return program today. We are also announcing a seven-for-one split of Apple common stock which will occur in June of this year. We are taking this action to make Apple stock more accessible to a larger number of investors. Each shareholder of record at the close of business on June the 2nd, 2014 will receive six additional shares for every outstanding share held on the record day and trading will begin on a split-adjusted basis on June the 9th, 2014.

Finally, before we start the Q&A, I would like to take a minute to talk about my dear friend and colleague Peter Oppenheimer. As you know, Peter will be transitioning from the CFO role in June. Peter has been Apple's CFO for 10 years and the list of his accomplishments is immense. Apple is now more than 20 times the size it was when Peter became our CFO and his expertise, leadership and incredibly hard work had been instrumental to the company's success. I'd like to thank him very publicly for his contributions to Apple, from the very bottom of my heart and wish him all the best in his approaching retirement at the end of September.

And I'd also like to recognize him that he has never missed guidance in the 10 years as CFO which must be an all-time record for CFOs. We're really happy and fortunate to have someone with Luca's talent on Board to replace Peter. He has over 25 years of experience, building and leading finance teams in global companies and has an exceptionally broad international background, which you might be able to detect from his accent. He's been managing most of Apple's financial functions since coming on Board last year and has done an outstanding job. I'm looking forward to working with Luca even closer as Apple's next CFO.

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

Nancy Paxton

Thank you, Tim. We'd like to ask that you limit yourself to one question and one follow-up please. Operator, may we have the first question.

Question-and-Answer Session

Operator

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

Katy Huberty – Morgan Stanley & Co. LLC

Thanks. Congrats on the great quarter. Tim, if I heard you right that $800 million account is a staggering jump from the last time you reported that number and yet iTunes, software and services growth decelerated again this quarter. Can you just talk a little bit about your view on the importance of better monetizing the installed base in the future? And then I have a follow-up.

Timothy D. Cook

Keep in mind, in that category there's several things, not just the App Store kind of revenues and so if you looked at App Store only, it would look a little different than what you're seeing. But in terms of your question about monetization, I do believe that we can monetize more than we owe from a services point of view in existing areas and in new areas. And I'm particularly encouraged that when I look at the App Store and how it's doing the strength was broad based. And in fact in China the growth was in the triple digits.

Katy Huberty – Morgan Stanley & Co. LLC

Okay. And then question the around iPhone ASPs, just looking at the trend iPhone 5s, demand has surprised to the upside over this cycle. Does that give you any confidence that Apple could actually charge more for highly innovative products in the future or does the strategy remain to add innovation at the same price as previous versions of a product?

Timothy D. Cook

We price things that we think – are priced in such a way that we think it's a fair price for the value that we're delivering and we make those on each thing as it gets closer time to come to market.

Katy Huberty – Morgan Stanley & Co. LLC

Okay. Thank you. Peter, much luck to you.

Peter Oppenheimer

Thanks, Katy.

Nancy Paxton

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

Operator

From Goldman Sachs we'll hear from Bill Shope.

Bill C. Shope – Goldman Sachs & Co.

Okay, great. Thanks. Can you walk through the key drivers of the June quarter gross margin guidance off of what was admittedly very sharp upside for the March quarter.

Luca Maestri

Sure. Bill, I'll take that. So March quarter was very good as you said. There were three seasons for it. We had obviously better volume as you've seen from our revenue results. We had better cost than anticipated, and we had some favorable mix of both products and services. As we get into Q3, obviously as you've seen from our revenue guidance we are expecting some loss of leverage, which would come from the sequential decline in revenue. It's about 19% at the midpoint of the range, and we're also expecting less favorable mix. This is something very typical that happens to us as we move farther away from the quarter when we launched the new products. To offset that, it's only going to be a partial offset. We will have some cost improvements.

Bill C. Shope – Goldman Sachs & Co.

Then looking at the iPhone upside for the March quarter, obviously, it looks like China was a key driver here, but within the U.S., did you see as much pressure from the changes in U.S. carrier upgrade policy that you had discussed last quarter, and was demand I guess just strong enough to completely counter that? And then is this headwind behind us now, and potentially a tailwind in the U.S. as we head into the June quarter?

Timothy D. Cook

We saw some pressure in the quarter because of the stricter enforcement of upgrade policies. So this was primarily in the U.S. as I mentioned last time. But if you really look at iPhone, the strength of iPhone was very broad-based and as I've mentioned, we gained share in a whole host of markets, from developing markets like the U.S., U.K., France, Germany to more of the emerging markets like China, Vietnam, and had the largest total sales of iPhone in the BRIC countries that we've ever seen in our history. And so we feel very good about that the strength was broad-based.

Bill C. Shope – Goldman Sachs & Co.

Great thank you.

Nancy Paxton

Thanks Bill. Could we have the next question please.

Operator

We'll hear from Toni Sacconaghi with Sanford Bernstein.

Toni Sacconaghi – Sanford Bernstein

Yes. Thank you. Peter best wishes going forward. I have one question for Luca and a follow-up for Tim please. Luca, on the iPhone ASPs this quarter, they were down a little over $40. I think that was the largest sequential decline that we've seen in history. I was wondering if you could help us understand what drove that. Was it entirely mix? You mentioned good growth in each of the three models, but were you seeing particularly strong growth in the 4s? I think you mentioned that in China. And how significant if any was selling older generation for iPhone 4?

Luca Maestri

Yes, Toni. When you look at the $41 of decline, I would say about half of that was driven by the fact that we have continued to do very well in emerging markets with the 4s. I have mentioned that there is a lot of markets where we've grown very strongly in Latin America, in Asia-Pacific, in Eastern Europe. So, about half of that decline came from the stronger sales of the 4s. And then the rest was primarily the fact that, again as we move away from the quarter where we launched a product, we tend to have lower capacity mix in our numbers.

Toni Sacconaghi – Sanford Bernstein

Okay. Tim, I was wondering if you could talk about how you think about replacement cycles generally for the iPhone over the longer term. Clearly U.S. carriers have started introducing plans that may ultimately encourage people to keep their phone longer than two years, because their total price paid is less. And so one could argue and I'd like your opinion on whether you think that could push out replacement cycles.

I guess, the other consideration is the imperative for Apple to continue to introduce really great products to want to have people upgrade at the same frequency. And I guess, the dilemma in doing that is as we've seen with the 5 and with the 4 is introducing really great products, typically puts pressure on your BOM and pressures margin. So perhaps you could just tell us how you think conceptually about where you think replacement cycles go over time and why? And then secondly, how do you address this dilemma of well in order to make a great phone it typically costs more to do so and managing their potential margin pressure.

Timothy D. Cook

There is a lot there, let me see if I can address it quickly and I want to just add one thing to the point that you asked Luca. Just to be clear on the iPhone 4 question, we sold a very, very low single-digit percentage of those and so it had extremely minimal impact of results on the quarter. In terms of the general upgrade or the installed base, some of the programs that the carriers are running may serve to increase the upgrade cycle because there are some areas where customers can pay a bit more in the beginning and have the ability to essentially upgrade each year.

So I think there is some that work that way. I think there is some that work the way that more of the way that you're leaning, and how these balanced are very difficult currently to conclude.

But regardless of how those balance, what I see as the bigger opportunity for Apple is that the smartphone market is still only 1 billion or so units and it will eventually take over the entire mobile phone market. We've seen our ability to attract new users to iPhone to be very significant in the emerging markets. We were seeing new to iPhone numbers on the iPhone 4s sales in the 80 percentages in certain large geos. So, this to us give us a great comfort that we can continue to grow and we may not be able to attract some of those buyers to our top phone because of the price point. But if we can get them in on the entry iPhone, it gives them a great product, at a great value and gets them into the ecosystem.

And as you know from following us for a while, our ability to keep customers is very good and our ability to show other products that Apple produces to a family that's buying Apple product is also very good. And so, at the macro level, I see the opportunity of the market and getting more people into the Apple ecosystem much larger than any of the noise around the different carrier plans, some of which I think helped, and some of which I think worked the opposite way and it's completely unclear to me how those net.

It's probably also important to know that the bulk of the things you're seeing in the U.S. are not occurring in many of the other geos in terms of the upgrade policies and so forth. I mean, each country has its own kind of cadence associated with this, and the U.S. is – it's in the 30% of our business, not 100%. So it's important to weigh it with a proper perspective.

Toni Sacconaghi – Sanford Bernstein

Okay. And any comments on the latter part of that around, sort of the imperative to continue to come out with really great products that ensure people have an incentive to upgrade, yet when we've seen you really revolutionize phones between iterations we've seen margin pressure?

Timothy D. Cook

The most important thing, Toni, that we do is to make great products that really get our users excited to want the next one and that will always be the case. And you can bet that that's where the vast majority of all of our attention is on doing this thing. In terms of the BOM pressure of any new product, you have seen in the past that exists. I think you've also seen that we have a way of working down the cost curve. That was certainly very key in achieving the 39.3% gross margin from this past quarter. And as I said before, we price things at a level that is fair for the value that we are providing, and so we're certainly not stuck on certain price points. We price that values that are fair for the value that we are delivering.

Toni Sacconaghi – Sanford Bernstein

Thank you.

Nancy Paxton

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

Operator

And from UBS we'll hear from Steve Milunovich.

Steven M. Milunovich – UBS Securities LLC

Thank you. Tim, I understand that the iPad is not as weak as it appears on a sell-through basis, but still it's relatively flat over the last year in terms of sell-through. What are your thoughts in terms of why that is and can that accelerate with Office on the iPad going forward?

Timothy D. Cook

It’s a good question. Let’s talk about iPad a little more than we did in the comments. When I backup from iPad, here’s what I see. It absolutely has been the fastest growing product in Apple’s history and it’s been the only product that we’ve ever made that was instantly a hit in three of our key markets, from consumer to business including the enterprise and education.

And so, if you really look at it in just four years after we launched the very first iPad, we’ve sold over 210 million, which is more than we or I think anyone thought was possible at that period of time. And it’s interesting to note that that’s almost twice as many iPhones that we’ve sold in a comparable period of time, and over seven times as many iPods as we’ve sold in the period of time. So, I think it’s important to kind of to put that in perspective. We’ve come a long way very, very quickly.

Looking at it by market a bit, which I think is important. I think Luca mentioned a little bit of this in his comments. In the education market in the U.S., we have a 95% share. And so the focus in education is on penetration, is on getting more schools to buy and my belief is the match has been lit, and it’s very clear to the educators that have studied this is that student achievement is higher with iPad in the classroom than without it. And so I’m confident we’ve got a really great start in education far beyond the U.S. now. This is happening in many, many parts of the world.

In the enterprise market, we’re seeing virtually all, 98% of the Fortune 500 that using iPad. And we’re seeing, according to Good Technology who looks at activations of tablets, the latest data we have from them is that 91% of the activation of tablets in enterprise were iPads. And so this is also an astonishing number and many of those enterprises are writing apps that are key proprietary apps for running that business, and this is great for that company because they’re more productive as a result of that. And so once again, just like in education in a way, what we have to do in enterprise is focus on penetration. It has to be deeper and broader. But in terms of having people begin the process, beginning writing apps, we’re doing a pretty good job of that.

In the retail market, if you look at the U.S. as a proxy, the NPD numbers for March just came out a few days ago and we had 46% share and embedded in that 46%, there’s a lot of things in there that I personally wouldn’t put in the same category as iPad and that are weighing the share down. It’s certainly a market we wouldn’t play in and a type of product you would never see an Apple brand on. So we feel like we’re doing well there. Office, I believe does help. It’s very unclear to say how much. I believe if it would have been done earlier, it would have been even better for Microsoft frankly.

There is a lots of alternatives out there from a productivity point of view, some of which we brought to the market, some of which many, many innovative companies have brought. But I do see that Office is still a very key franchise in the enterprise, in particular. And I think having it on iPad is good, and I wholeheartedly welcome Microsoft to the App Store to sell Office. Our customers are clearly responding in a good way that it's available. So, I do think it helps us particularly in the enterprise area.

The other things you look at on iPad that are just blow away as customer sat is 98. There is almost nothing in the world with a 98% customer sat and the intention to buy numbers look good with two-thirds of the people planning to buy a tablet or planning to buy an iPad. The usage numbers are off the chart, far and exceeding Android tablets, four times the web traffic of all Android tablets combined.

And so, when I backup from all of these, I feel great. That doesn't mean that every quarter, every 90 days is going to be a number that everybody is thrilled with. But what it means to me is that the trend over the arc of time that things look very, very good, that iPad has a great future. And of course the thing that drives us more than any of this are the next iPads if you will, the things that are in the pipeline, the things that we can do to make the product even better and there is no shortage of work going in on that nor any shortage of ideas.

And so when I backup from all of this, I can't help but still be extremely excited about where we are.

I think we did a reasonable job of explaining what we think the disconnect was between what we had expected, which we hit it at the high end of our expectation and the street's view of this one. I believe the vast majority of it is that first thing was just channel inventory that maybe we should have been even clearer on last quarter to take into account. But I'm very bullish on iPad.

Steven M. Milunovich – UBS Securities LLC

Okay, very complete thank you. One other question, when you look at Google and Amazon and Facebook, they've very much diversified their business over time in a way that one has rarely seen. Apple, sort of the opposite. People say you ought to buy this or that and you'll do acquisitions, but you're obviously very focused. Is that because it's just a management philosophy of wanting to be more focused than some of these other companies? Or is there something about Apple's products that particularly being more hardware oriented that kind of prevents you from saying, yes, let's go make TV shows or let's go often do something else, even though you probably have the money and the technical capability to do all these things?

Timothy D. Cook

The key thing for us, Steve, is to stay focused on things that we can do best and that we can perform at a really high-level of quality that our customers have come to expect. And so we currently feel comfortable in expanding the number of things we're working on. So we've been doing that in the background and we're not ready yet to pull the string on the curtain. But we've got some great things there. We're working on them. Very, very proud of and very, very excited about.

But for us, we care about every detail and when you care about every detail and getting it right, it takes a bit longer to do that and that's always been the case, that's not something that just occur. As you probably know from following us for a long time, we didn't ship the first MP3 player, nor the first smartphone, nor the first tablet. In fact, there were tablets being shipped a decade or so before then, but arguably, we shipped the first successful modern tablet and the first successful modern smartphone and the first successful modern MP3 player. And so it means much more to us to get it right than to be first.

I think you can see so many examples out in the marketplace, where it's clear that the objective has been to be first. But customers at the end of the day don't care about that. That's not what they look for from Apple. They want great, insanely great and that's what we want to deliver, and so that's the way we look at it.

From an acquisition point of view, we have done 24 in 18 months. That shows that we're on the prowl, I suppose you could say. We look for companies that have great people and great technology and that fit culturally. And we don't have a rule that says we can't spend a lot or whatever. We'll spend what we think is a fair price. What's important to us is that strategically it makes sense and that it winds up adding value to our shareholders over the long haul. We are not in a race to spend the most or acquire the most. We're in a race to make the worlds' best product that really enrich people's lives.

So, to the tune that acquisitions can help us do that and they've done that and continue to do that, then we will acquire it. And so you can bet that you will continue to see acquisitions and some of which we'll try to keep quiet and some of which seems to be impossible to keep quiet.

Nancy Paxton

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

Operator

From Cross Research, we'll hear from Shannon Cross.

Shannon S. Cross – Cross Research LLC

Thank you. First I just want to tell Peter, thank you very much, we've really enjoyed working with you over the past 10 years. But then secondly, in terms of a question for Tim, can you talk a bit about the competitive landscape for smartphone? If you look at some of your competitors seem to be have cut prices fairly quickly in the most recent product cycle, perhaps faster than before. You've got Microsoft about to close on Nokia. Lenovo is buying Motorola, there is a lot going on from a sort of competitive standpoint. So I'm curious as to how you're seeing the market?

Timothy D. Cook

Yes, there is a lot of moving parts, a lot of acquisitions, a lot of people giving up to some degree and deciding to do other things. But at the end of the day we see it much like we've always seen it, as the part of the market that we're interested in is the market of people that really want the best smartphone and that doesn't mean that they're all at the high end of the price stand. I mean, we have smartphones that go down to a very affordable price with the 4S because we're proud to ship that product.

I think that this quarter, if you were unsure, hopefully this quarter demonstrates to you that we can do well in a number of geographies from emerging markets to develop markets. Some of the numbers that we've experienced just to quote some of the more historic prepaid market through the first half of 2014; Brazil was up 61%, Russia was up 97%, Turkey was up 56%, India was up 55%, Vietnam was up 262%.

I could go on, but the point is that there's a number of markets out there where we are beginning to really catch on to a number of customers, and I am particularly proud of the results in these markets because these have not been historic strong points for Apple. We've been working at China for a while and have learned a lot and I'm very proud of what we've done there. But I think some of these other numbers I just read demonstrates that we're beginning to have really nice success outside of there as well.

Shannon S. Cross – Cross Research LLC

Great and then, if you can just, actually as a follow-up on the China side, I think it grew at 13% year-over-year, and you mentioned obviously China

Mobile has been the driver of that. But can you talk about some of the other categories as well, and perhaps some of the other carriers in terms of where you're seeing demand out of China?

Timothy D. Cook

Yes, really great question. We did have an all-time revenue record in Greater China, just under $10 billion at $9.8 billion. iPhone sales were up 28%, that's versus the IDCs market forecast of 20% growth. So we gained share. Mac units were up double-digit, in particular they were up 13%, and that's far outpacing IDCs PC market forecast of a negative 8%. So we gained share there as well.

If you look at the iTunes software and services revenue in China, we more than doubled it. Year-over-year, we were in the triple digits percentages. And if you look at iPad and you take out the channel inventories, ins and outs and look at demand instead of sell in, we grew by 6% and that compares to IDC’s forecast of a flat tablet market in China for last quarter. And so we literally did well in every single area in China. It wasn’t just because we were able to come to an agreement with the world’s largest carrier. That was certainly key, but as you can tell from the rest of these numbers there are other things going on.

Also, I’d mentioned this briefly with Steve, but I think it’s important to point out that if you look at some of the numbers we’re seeing on first-time iPhone buyers, people that bought the iPhone 4s, 85% were first-time iPhone buyers, and the 5c, 69% first-time iPhone buyers. So these are extraordinary, and as you would expect, these are also heavily Android switchers. 62% of the people that bought the 4s switched from Android. 60% of the people that bought the 5c switched from Android. And so we’re incredibly pleased with this.

For the first half, including our retail stores, Greater China revenue topped $19 billion. So this is a 21% year-over-year, and is our fastest growing region. So, we’re looking at this data and deciding to continue investing in a big way. We plan to triple the number of Apple Retail Stores over the next two years. We’re continuing to expand in online. We’re continuing to build out channels.

We’re up to 40,000 points of sales now in iPhone, but we’re not nearly where we need to be on the rest of our product line and even the 40,000 is a low number in considering the broad landmass and the number of folks in China. And so, I feel like there’s still loads of opportunity there, and feel really, really good about how we’re doing.

Shannon S. Cross – Cross Research LLC

Thank you.

Nancy Paxton

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

Operator

And from Piper Jaffray we got Gene Munster.

Gene Munster – Piper Jaffray

Hey, good afternoon and I'll add congratulations to Peter on itinerary for the record there. And Tim, I want to talk a little bit about some of your comments at the recent shareholder meeting. You mentioned that Apple TV is no longer a hobby. Wanted to hear a little bit about why you made that distinction? And separately, it would be interesting to hear your feedback on the HBO Amazon announcement today and what you think that means, if anything, in terms of some content partners being a little more – work with some more players like yourself? Thanks.

Timothy D. Cook

Good questions, Gene. The reason that I stripped off the hobby label is that when you look at the sales of the Apple TV box itself, and you look at a content that was bought directly off of Apple TV for 2013, that number was over $1 billion. And so, it didn't feel right to me to refer to something that's over $1 billion as a hobby. Also from an investment point of view, we continue to make the product better and better. And so it doesn't feel right from that point of view either.

We had HBO GO already on Apple TV and you have to authenticate in order to use it, but you have to do that with Amazon service as well from my brief read of their announcement. I think they in addition to that got some older content from HBO to put on there.

I haven't had a chance to evaluate exactly what it is and don't have a personal point of view on that yet. But if I look broadly at the content on Apple TV, I think it compares extremely favorable to the content that is on the Amazon box. We've sold now, Gene, about 20 million of the Apple TV, and so we've got a pretty large installed base there. And I'm feeling quite good about that business and where it can go.

Gene Munster – Piper Jaffray

Excellent, thank you.

Timothy D. Cook

You bet.