

## **Operator**

Good day, everyone, and welcome to this Apple Inc. Second Quarter Fiscal Year 2011 Earnings Release Conference Call. [Operator Instructions] At this time for opening remarks and introductions, I would now turn the call over to Ms. 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 today is Apple CFO, Peter Oppenheimer; and he'll be joined by Apple COO, Tim Cook; and Treasurer, Gary Wipfler, for the Q&A session with the 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 margins, 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 2010, the Form 10-Q for the first quarter of fiscal 2011 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 date.

With that, I'd like to turn the call over to Apple CFO, Peter Oppenheimer, for introductory remarks.

## **Peter Oppenheimer**

Thank you, Nancy. Thank you for joining us. We are very pleased to report the highest March quarter revenue and earnings in Apple's history. We set a new all-time quarterly record for iPhone sales, and a new March quarter record for Mac sales, and we're thrilled with the momentum for iPad.

Revenue for the quarter was \$24.7 billion, which was \$11.2 billion over the prior March quarter's result and represents the largest year-over-year quarterly revenue growth we've ever generated. This tremendous increase of 83% was fueled primarily by record iPhone sales, very robust demand for iPad and strong growth in Mac sales. Operating margin was an all-time high of almost 32%, representing 31.9% of revenue. Net income was almost \$6 billion. This represented 95% growth over the year gross quarter's earnings and translated to earnings per share of \$6.40.

Turning to the details of the quarter. I'd like to begin with our Mac products and services. We established a new March quarter record with sales of 3.76 million Macs, representing 28% growth over the year ago quarter. We're extremely pleased with this very strong growth, particularly given IDC's most recently published estimate of a 3% contraction for the PC market overall. This result makes the March quarter the 20th consecutive quarter that we outperformed the PC market. We experienced strong Mac sales growth in each of our operating segments, most notably in the Asia-Pacific segment, where Mac sales increased 76% year-over-year. The growth in Mac sales was fueled primarily by the continued great popularity of MacBook Air, which was updated in the December quarter, as well as very strong sales of MacBook Pro. We updated the entire MacBook Pro family during the March quarter with the next-generation processors and graphics, high-speed Thunderbolt I/O technology and a new FaceTime HD camera.

The new MacBook Pro lineup offers twice the speed of the previous generation and customer response has been excellent. We began at the end of the quarter with between 3 and 4 weeks of Mac channel inventory. During the quarter, we released the developer preview of Mac OS X Lion, which takes some of the best ideas from the iPad and brings them back to the Mac. Lion features Mission Control an innovative new view of everything running on the Mac. Launchpad, a new home for all your Mac Apps, full screen apps that use the entire Mac display and new multi-touch gestures. Lion is scheduled to ship to customers this summer and we look forward to showing more of its great features at our Developers Conference in June.

Moving to our music products. We sold 9 million iPods compared to 10.9 million in the year ago quarter. Though lower year-over-year, total iPod sales were ahead of our expectations with iPod touch continuing to count for over half of all iPods sold. iPod share of the U.S. market for MP3 players remains at over 70% based on the latest monthly 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 ended the quarter within our target range of 4 to 6 weeks of iPod channel inventory. The iTunes Store turned in its best quarter ever with revenue of almost \$1.4 billion, thanks to record revenue from music, video, iOS apps and books. We were very pleased to begin offering a full catalog of 17,000 ebooks from Random House on the iBookstore during the March quarter. The iBookstore now includes ebooks for more than 2,500 publishers in over 20 categories, and customers have downloaded over 100 million books.

I'd now like to turn to the iPhone. We were thrilled to have sold a record 18.6 million iPhones compared to 8.8 million in the previous March quarter.

This represents 113% year-over-year growth which is significantly ahead of IDC's latest published estimate of 74% growth for the global smartphone market overall in the March quarter. Recognized revenue from iPhone handset and accessory sales was \$12.3 billion during the quarter compared to \$5.45 billion in the year ago quarter, an increase of 126%. We continue to experience very strong year-over-year iPhone sales growth in all of our operating segments with sales in both the Americas and Asia-Pacific regions more than doubling year-over-year.

We were able to make a significant increase in our capacity, once again, allowing us to expand distribution and get much-needed supply to our channel partners. We were very pleased to begin selling iPhones on the Verizon network in the U.S. in the March quarter, and we were also happy to add SK Telecom in Korea, as well as Saudi Telecom in Saudi Arabia. Including some carrier consolidation, we ended the quarter with iPhone distribution through 186 carriers in 90 countries.

We ended the quarter with about 5.2 million iPhones in channel inventory, a sequential increase of about 1.7 million to support new carrier launches and existing channel partners. This placed us within our target range of 4 to 6 weeks of iPhone channel inventory. iPhone is continuing to see strong growth within the Enterprise segment. Today, 88% of the Fortune 500 are testing or deploying iPhone.

With strong employee demand and custom app development fueling adoption, we are seeing great scale of iPhone deployments in businesses worldwide. In fact, hundreds of private and public companies worldwide are supporting thousands of iPhones on their corporate networks. Some examples include Cisco, Prudential, Boston Scientific, General Motors, American Airlines, Deloitte, Yum! Brands and Xerox.

Turning to iPad, we continue to be thrilled with its momentum. We sold 4.7 million iPads during the March quarter, launching iPad 2 in U.S. on March 11 and in 25 additional countries on March 25. Customer enthusiasm has been tremendous for iPad 2 and we're working hard to get it into the hands of customers as quickly as possible.

Including both the original iPad and iPad 2, we had distribution in 59 countries by the end of the March quarter. Given the very strong customer demand and despite the increased geographic distribution, iPod (sic) [iPad] channel inventory declined by 400,000 from the beginning of the quarter, implying sell-through of about 5.1 million. This resulted in ending channel inventory of below 850,000, which was below our target range of 4 to 6 weeks. We sold every iPad 2 that we could make during the quarter and would have liked to end the quarter with more channel inventory.

Recognized revenue from sales of iPad and iPad accessories during the quarter was \$2.8 billion.

Employee demand for iPad in the corporate environment remains strong and CIOs continue to embrace iPad in an unprecedented rate. In just over a year since its debut, 75% of the Fortune 500 are testing or deploying iPad within their enterprises. Some recent examples of enterprises that are deploying iPad include FORTUNE 500 companies such as Xerox, AutoNation, Yum! Brands, ADP, Boston Scientific, Estée Lauder, Disney, Stryker, Prudential Financial, Rite Aid and USAA.

Combining iPhone, iPad and iPod touch, we reached just under 189 million cumulative iOS device sales through the end of the March quarter. In March, we introduced iOS 4.3 with new features including faster Safari mobile browsing performance with the Java Nitro script engine, iTunes Home Sharing, enhancements to AirPlay and the Personal Hotspot feature for sharing an iPhone 4 cellular data connection over Wi-Fi.

The App Store continues to be incredibly successful with over 350,000 apps available and well over 10 billion downloads to date. In February, we announced a new subscription service available to all publishers of content-based apps, including magazines, newspapers, video and music. Publishers set the price and length of subscription and customers select the subscription and length they want with 1 click. And it was also a great pleasure to announce in March that we have made more than \$2 billion in payments to developers since opening the App Store.

I'd now like to turn to the Apple Retail Stores. We are approaching the Retail Stores 10th anniversary on May 19, and we're on the verge of achieving a major milestone. In the next few days, we will be thrilled to welcome our 1 billionth visitor. Store traffic continues to be amazingly strong. And in the March quarter, we hosted a record 71.1 million visitors in our stores compared to 47 million visitors in the year ago quarter, an increase of 51%.

Retail revenue was \$3.19 billion compared to \$1.68 billion in the year ago quarter, an increase of 90%. Capitalizing on the February MacBook Pro update, the stores delivered another record Mac quarter, selling 797,000 Macs compared to 606,000 Macs in the year ago quarter, an increase of 32%, and about half the Macs sold in our stores during the March quarter were to customers who had never owned a Mac before.

To further enrich our Apple retail customer experience, we recently launched a program called Personal Setup. When customers buy a Mac, iPad, iPhone or iPod touch, our teams help the customer set up the product in the store so that they are up and running before they leave. Personal Setup includes

the customer's e-mail, contacts, calendar, applications and more. In the March quarter, our stores set up over 1 million products. We operated 323 stores during the quarter. Average revenue per store was \$9.9 million compared to \$5.9 million in the year ago quarter, an increase of 67%. International retail store sales remain strong with our average international store volume exceeding our very productive average U.S. store volume.

Retail segment margin more than doubled year-over-year to \$807 million compared to \$373 million in the year ago quarter. We anticipate opening 40 new stores in fiscal 2011, nearly 3 quarters of which will be outside the United States, including our fifth store in China.

Total company gross margin was 41.4%, which was 290 basis points higher than our guidance. More than half of this difference came from better product mix than planned, particularly higher iPhone sales. The remainder was largely a result of leverage on the higher revenue and lower-than-expected commodity, service and other costs.

Operating expenses were \$2.34 billion and included \$236 million of stock-based compensation expense. OI&E was \$26 million and the tax rate for the quarter was 24.2%, below our guidance of 25.5% due to changes in our full year forecast of foreign earnings, R&D tax credit and state taxes.

Turning to cash. Our cash for short-term and long-term marketable securities totaled \$65.8 billion at the end of the March quarter compared to \$59.7 billion at the end of the December quarter, a sequential increase of \$6.1 billion. Cash flow from operations was \$6.2 billion, an increase of 167% year-over-year. The increase in cash is net of approximately \$900 million to combine prepayments and capital expenditures related to the strategic supply agreements that we referred to in our last quarterly call.

As we move into the June quarter, I'd like to review our outlook, which includes the types of forward-looking information that Nancy referred to at the beginning of the call. We expect revenue to be about \$23 billion compared to \$15.7 billion in the June quarter last year. We expect gross margin to be about 38%, reflecting approximately \$55 million related to stock-based compensation expense. We expect OpEx to be about \$2.5 billion, including about \$255 million related to stock-based compensation expense. We expect OI&E to be about \$70 million and we expect the tax rate to be about 25%. We are targeting EPS of about \$5.03.

In closing, we're thrilled with the results and accomplishments of our record March quarter. We're extremely pleased with customers' response to iPad 2 and are working hard to get it into the hands of customers as fast as we can.

We remain very confident in our strategy and are very excited about our new product pipeline.

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

### **Nancy Paxton**

Thank you, Peter. We ask that you limit yourself to 1 question and 1 follow-up. Operator, may we have the first question, please?

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

#### **Operator**

[Operator Instructions] Your first question will come from Bill Shope with Goldman Sachs.

#### **Bill Shope - Goldman Sachs Group Inc.**

Okay, great. Thanks. Can you comment, Peter, on whether or not you're seeing any supply chain disruptions from the recent earthquake in Japan. And if so, how should we think about that in terms of that being factored in your guidance?

#### **Timothy Cook**

Bill, this is Tim. Let me sort of step back and talk about Japan in general and sort of try to get all of your questions in advance. First of all, this is an incredible tragedy and our hearts go out to everyone involved. Apple, as a company, has a very long history and has many strong ties to people in Japan, and we're very, very saddened by the situation, and we've undertaken various actions to assist in the relief effort. The economic impact that we'll address today pales in comparison to the human impact. Regarding our business in Japan, we had some revenue impact in Q2 but it was not material to Apple's consolidated results. We believe revenues will be approximately \$200 million less in Q3, and this has been factored into the guidance that Peter provided you earlier in his comments. Regarding our global supply chain, as a result of outstanding teamwork and unprecedented resilience of our partners, we did not have any supply or cost impact in our fiscal Q2 as a result of the tragedy, and we currently do not anticipate any material supply or cost impact in our fiscal Q3. To provide a bit more color on this, we sourced hundreds, literally hundreds of items from Japan, and they range from components such as LCDs, optical drives, NAND Flash and DRAM to base materials such as resins, coatings and foil that are part of the production process at several layers back in the supply chain. The earthquake and subsequent tsunami and the associated nuclear crisis caused

disruption for many of these suppliers, and many unaffected suppliers have been impacted by power interruptions. But since the disaster, Apple employees have literally been working around the clock with our supplier partners in Japan, and have been able to implement a number of contingency plans. Our preference from the beginning of this tragedy has been to remain with our long-term partners in Japan. And I have to say, they have displayed an incredible resilience that I personally never seen before in the aftermath of this disaster. So while we do not anticipate -- currently anticipate any material impact to our component supply or cost in our fiscal Q3, we do need to caution everyone that the situation remains unpredictable given recent aftershocks, the uncertainty about the nuclear plant and potential power interruptions. Further, there are some supply risks that are beyond the current quarter. And although we know of no issue today that we view as unsolvable, the situation is still uncertain and there's obviously no guarantees. For this reason, it's difficult to predict whether the issues created by the tragedy would impact revenues beyond Q3. However, I'll be happy to address Q4 on our next call in July.

**Bill Shope - Goldman Sachs Group Inc.**

Okay, great. That was very helpful. I guess digging into another area of supply, looking at your iPad 2 constraints since launch in March, can you give us some color on where the constraints lie and how you're doing in terms of getting supply back in line with demand?

**Timothy Cook**

Well, the demand on iPad 2 has been staggering. And we're still amazed that we are still heavily backlogged not only at the end of the quarter but also up to date. However, I can tell you that I'm extremely pleased with the progress of the manufacturing ramp, and we were so confident that we rolled out to 25 additional countries at the end of last month. And we are shipping to an additional 13 countries next week, and we're planning to add even more countries through the quarter. And so I'm very confident that we can produce a very large number of iPads for the quarter.

**Bill Shope - Goldman Sachs Group Inc.**

Okay, great. Thank you.

**Operator**

From Citigroup, we'll go to Richard Gardner.

**Richard Gardner - Citigroup Inc**

Okay, great. Thanks. I was just hoping to get a little bit more color on what drove the iPhone's strength in the quarter? If you could, by region or carrier, you mentioned that you added SK Telecom, and I'm not sure if shipments there were material during the quarter. And then, Peter, the follow-up to that I guess is, how do we think about iPhone seasonality going into the June quarter giving all of the moving parts? We have a full quarter of Verizon. In the June quarter, you've got some potential carrier expansion benefit and yet, you have a product refresh hopefully coming midyear, so I was hoping you could help us think about that a little bit for the June quarter. Thanks.

**Timothy Cook**

Rich, it's Tim. In terms of iPhone, we did actually very well everywhere. I'd call out 2 places that -- where it was just off the charts. The U.S. grew 155% year-over-year, obviously, adding Verizon and beginning to offer iPhone to their enormous customer base was key in that. However, as you heard from AT&T's announcement this morning, AT&T did extremely well during the quarter. So the U.S. as a geography grew at 155% and that's about 3x IDC's forecast of growth for the smartphone market, which was about 48%. Also, we continued to be on a tear in China. Greater China saw iPhone sales being up over 3x, about 200 -- almost 250%. And this catapulted revenue for the first half or first fiscal half in Greater China to just under \$5 billion, which is up almost 4x year-over-year. And so we're extremely happy with how we're doing in China.

**Peter Oppenheimer**

Rich, and to hit the second part of your question. As I commented in my prepared remarks, we were able to increase the iPhone channel inventory by just over 1.7 million units in the March quarter, and we ended within our target, 4 to 6 week range of inventory. In terms of the June quarter, I would expect to see a significant year-over-year increase in sales.

**Richard Gardner - Citigroup Inc**

And any comment on the sequential, Peter?

**Peter Oppenheimer**

No, I think I'll leave it at year-over-year. I would expect us to be up significantly.

**Richard Gardner - Citigroup Inc**

Okay. Alright. Well, thank you.



**Nancy Paxton**

Thanks, Rich.

**Operator**

From Morgan Stanley, we'll go to Katy Huberty.

**Katy Huberty - Morgan Stanley**

Yes, thank you. Just following on the iPhone discussion, what, if anything, did you learn about the price elasticity curve for the iPhone with the \$49 3GS price point in the market this quarter?

**Timothy Cook**

Katy, it was very popular. It did very, very well.

**Katy Huberty - Morgan Stanley**

And then also from the perspective of some positive feedback on LTE phones that are out from your competitors, how do you think about the maturity of those networks and Apple's sense of urgency to get products out for those faster networks? And what if any bottlenecks exist?

**Timothy Cook**

I was asked this question or a similar question when we launched the iPhone with Verizon. And what I've said then, and I still see it as being the case today, and I think you can see this in the products that have been shipped, is that the first generation of LTE chipsets force a lot of design compromises with the handset, and some of those, we are just not willing to make. And so we are extremely happy with the iPhone 4 and the iPhone 3GS. And hitting 18.6 million units was something much larger than we thought we could do this quarter, and we're happy to have gotten it out to 3 more large carriers.

**Katy Huberty - Morgan Stanley**

Thank you.

**Nancy Paxton**

Thanks, Katy.

**Operator**

Shannon Cross with Cross Research.

**Shannon Cross**

Thank you very much. Could you talk a bit about the international penetration of Macs? Just perhaps, I don't know, Tim, comparing your adoption curve in the U.S. to where we are internationally, and if there's any difference in terms of the type of computers that your customers are purchasing internationally?

**Timothy Cook**

Yes, if you look at it, Shannon, the growth on the Mac has been enormous in Asia. The last quarter, we were up 76% in Asia-Pacific. And yes, this is many multiples of the growth that the -- that region is seeing for the market. I believe the IDC forecast is around 6%. And so we're seeing enormous growth in the Mac there. Japan also did quite well on the Mac for the quarter, and the U.S. had a surprisingly strong quarter in the Mac with being up around -- Americas is up 25%. The U.S. was up just slightly higher than that. Our market share is obviously less outside the U.S. in most places than it is in the U.S., and so I think that speaks very, very well to the opportunity that the Mac has. We've now had 20 quarters in a row where we've outgrown the PC market and the momentum is still there. And we seem to be the only guys that are really focused on building innovative products in that space.

**Shannon Cross**

Thank you. Has there been any difference between sort of portable versus desktop purchases internationally, or is it sort of trending in line with what you've seen in the U.S.?

**Timothy Cook**

There are several of the international countries that are extremely portable focused. And you can see that we had enormous growth in our portables for the quarter. However, part of that is that we had a launch of the new MacBook Pro line. But honestly, I see popularity in both the iMac and the portable factor, and believe there is a great future for both of them.

**Shannon Cross**

Great. Thank you.

**Nancy Paxton**

Thanks, Shannon.

**Operator**

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

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

Peter: Could you talk a little bit about the forces impacting your sequential decline and gross margins by, call it, 350 basis points? What are the forces that you're -- want to call out and things that we should be thinking about? Thank you.

**Peter Oppenheimer**

Sure. Sequential decline is primarily being driven by the higher mix of iPad sales, which, as you know, we priced very aggressively to capitalize on our first mover advantage. Additionally, we would expect to lose some leverage from the lower sequential revenue. And as I pointed out in my prepared remarks in a moment ago, the iPhone channel inventory increased by 1.7 million units in the March quarter. It acts within our 4 to 6 week range. Conversely, the iPad channel inventory fell by 400,000 units, and we were below our 4 to 6 week inventory range. So those are the forces I would highlight.

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

Okay. And then perhaps 1 for Tim on my follow-up related to Shannon's question, how are you seeing different opportunities in the large enterprises with your MacBook in traditional markets of U.S. and Western Europe, given the seemingly greater receptiveness towards your iPhones, and what will be the tablets, I think. In other words, is that opening doors to go ahead and get the Macs in with CIOs?

**Timothy Cook**

It clearly seems to be creating a halo effect for the Mac. And I think that's 1 reason we see the growth that we are seeing on the Mac. It's amazing when you see the 28% year-over-year versus the worldwide market in PCs contracting by 3 points. It's an astonishing delta.

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

Right, right. Okay, thanks very much guys.

**Nancy Paxton**

Thanks Keith.

**Operator**

From Barclays, we'll hear from Ben Reitzes.

**Benjamin Reitzes - Barclays Capital**

Yes, thanks a lot. Can you talk about the ASP trends for the iPad and the iPhone? What were they in the quarter? And are there any dynamics that would change that as we move throughout the year or at least into the June quarter?

**Peter Oppenheimer**

Sure. Ben, it's Peter. For competitive reasons, I don't want to provide any more precise ASPs for either of these products. We just don't want to help our competitors. But on the data summary, we provide you both the iPhone and iPad units that we shipped and revenues, which include the accessories that you can make your own estimate.

**Benjamin Reitzes - Barclays Capital**

Okay. And I guess my other question was with regard to the iPad constraints. When do you think that you'll be to equilibrium or have channel inventory where you need it to be? You were able to say that you increased production a lot for the iPhone. When can you say at least the same thing for the iPad where you feel like you've alleviated your shortage?

**Timothy Cook**

Ben, what I would say is this, I am confident we're going to produce a very large number for the quarter. Whether that will be enough to meet demand, I don't know. Demand has been staggering. I'm not going to predict when supply and demand will come into balance. I can only be confident on the supply side.

**Benjamin Reitzes - Barclays Capital**

Thank you very much.

**Nancy Paxton**

Thank you, Ben.

**Operator**

We'll hear from Scott Craig with Bank of America Merrill Lynch.

**Scott Craig**

Thanks. Tim, can you maybe talk a little bit about the CDMA phone and maybe specifically, which new markets you're looking at entering with CDMA over the next couple of quarters? And then with regards to the facility investments, can you maybe talk about the magnitude of spending you expect as you go through the year on -- with the partners, I mean, sort of in investments both on a CapEx side that you're making as well as overall investments? Thanks.

**Timothy Cook**

On the carrier side, I don't want to get into specifics about the CDMA or GSM for that matter. But we are constantly looking at where we should bring on incremental partners. And as we have said earlier, we brought on 3 this quarter, 3 large ones with Verizon, SKT and Saudi Telecom. That's on top of the ones that we brought on in December where we added O2 and Vodafone in Germany. And so we are constantly looking and adding where it makes sense, and you can keep confidence that we'll continue to do that.

**Peter Oppenheimer**

Scott, on your capital question, a couple of updates. We expect to spend in our fiscal '11 about \$5.7 billion in capital expenditures. That's unchanged from what we told you last quarter. We expect about \$700 million of that to be in our retail area and \$5 billion outside of retail. Some of the bigger areas outside of retail and the biggest is in the operations area. We talked about on the last call arrangements we had done with 3 suppliers. We expect to spend about \$3.5 billion during fiscal '11 and fiscal '12 with those 3 suppliers on those deals in the form of prepayments and capital expenditures. And as I said in my prepared comments, we expected \$900 million of that in the March quarter, and we expect to spend the remainder across fiscal '11 and fiscal '12.

**Scott Craig**

Thank you.

**Nancy Paxton**

Thanks, Scott.

**Operator**

We'll go to Mike Abramsky with RBC Capital Markets.

**Mike Abramsky - RBC Capital Markets, LLC**

Yes, thanks very much. It may not be a perfect analogy but just wondering with the rise of Android, what might be some of the similarities and differences you see versus the rise of Windows PCs in the 1990s versus Mac? And I'm just wondering if you think in the U.S., particularly Android, could become a possible headwind to your U.S. smartphone business, and how do you maintain such incredible growth in the space of that shift?

**Timothy Cook**

I think, Mike, I just saw yesterday -- it's interesting you should point out the U.S. The comScore data released yesterday reported that the iOS platform outreaches Android by 59% in the U.S., and so this is an enormous percentage. On a worldwide basis, we just did 18.6 million iPhones, which is up 113%, which is materially faster than the market rate of growth. And we launched the iPad 2 and sold everyone of them that we could make. As we've said before, we're gaining traction in Enterprise on both the iPhone and iPad with astonishing 88% and 75%, respectively, of the Fortune 500 companies deploying or testing these. We've got the largest App Store with over 350,000 apps for iPhone and over 65,000 iPad-specific apps on iOS versus what appears to be fewer than 100 on Android. And so we feel very, very good about where we are and we feel great about our future product plan. We've also paid over \$2 billion to developers, and we've had well over 10 billion applications downloaded. And so our business proposition is very, very strong. And as we've said before, we continue to believe and even more and more everyday that iPhone's integrated approach is materially better than Android's fragmented approach, where you have multiple OSs on multiple devices with different screen resolutions and multiple app stores with different roles, payment methods and update strategies. I think the user appreciates that Apple can take full responsibility for their experience, whereas the fragmented approach turns the customer into a systems integrator and few customers that I know want to be a systems integrator.

**Mike Abramsky - RBC Capital Markets, LLC**

Okay, thanks.

**Nancy Paxton**

Thank you, Mike.

**Operator**

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

**Charles Munster - Piper Jaffray Companies**

And a question first on the iPhone. Demand, obviously, has been phenomenal. And if we look down the road at the opportunity in the post-versus the prepaid markets, are there any considerations that you can share in terms of -- that you weigh, in terms of price or subsidies or growing market share in this large prepaid market?

**Timothy Cook**

Gene, it's Tim. Our focus has very much been on China. We wanted to understand that market and understand the levers there. And as I said before, we're -- iPhone sales were up over 3x during the quarter. And in the first half, we did over 5 -- just slightly under \$5 billion in Greater China in revenue, which is about 10% of Apple, to put it in perspective. And it wasn't but a couple of years ago that, that number would have been less than 2. And so it's a sea change. And that's certainly not, what I would call, a classic post-pay market by any means of the imagination. And so we have some ideas about other countries as well. I'm not in a position that I want to share those today. But we purposely put the bulk of our emphasis from an emerging market point of view on China to really learn, and then we're going to take that learning to other markets.

**Charles Munster - Piper Jaffray Companies**

Would you know if China, if more than half of -- do you know if more than half of China is prepaid?

**Timothy Cook**

I think considerably more than half of China's prepaid, Gene. I think the first digit would start with a 9.

**Charles Munster - Piper Jaffray Companies**

Okay. Very, very good. And then separately, it's great to see Steve attending the iPad 2 event. And since going on medical leave, how closely has he stayed involved with the company's decisions, and do you have any idea when he might return?

**Timothy Cook**

He is still on medical leave, as you say, but we do see him on a regular basis. And as we previously said, he continues to be involved in major strategic decisions. And I know he wants to be back full-time as soon as he can.

**Charles Munster - Piper Jaffray Companies**

Great. Thank you.

**Nancy Paxton**

Thank you, Gene.

**Operator**

Toni Sacconaghi with Sanford Bernstein.

**Toni Sacconaghi - Sanford C. Bernstein & Co., Inc.**

I wanted to revisit the supply question on both iPhone and iPad. So last quarter, you were chasing iPhone demand, and you said you're going to work as hard as possible to try and make sure you catch up with your demand, and given the inventory build, it sounds like you're comfortable and you've gotten there. On the iPad side, it's a little less clear to me. You made, I guess, over 7 million iPads in last quarter in fiscal Q1. This quarter, including the inventory drawdown, maybe there were 5.1 million made. So was this -- I mean, you've proven that you have the capacity or the relationships to build a lot more. Was this simply a forecasting error on the iPad side? And can you comment about linearity of demand and why you couldn't have kept production at a similar rate to the prior quarter and been able to fulfill a lot more?

**Timothy Cook**

Let me mention a few things for you to consider, Toni. First off, product transitions are never simple. And as you can probably appreciate, we are in a position that we have to call them for many, many weeks in advance in terms of how many of the current product we want to produce and the dates at which we will announce the new product. We drew the channel down on the current product or the original iPad, I should say, by 570,000 units during the quarter. And we added at the end of the quarter 170,000 of the new iPad 2s although most of that was in transit at the end of the quarter. And so the net reduction was \$400,000. And so our sell-through was above \$5 million for the quarter. And again, this has to be planned quite a ways in the future. I think the key point here is -- also the dates, just to remind you, we set out an invitation to the event toward the end of February. We had the event in early March. We placed the unit on sale in the United States on March 11 and our quarter ended about 2 weeks thereafter. And so there was some expectation of a new product, and we would have obviously factored that into our thinking about the product transition as we plan the number of the original unit to build. And so I think the key point here is that I'm extremely pleased with the progress that we were making on the manufacturing ramp. We have gotten off to a materially better start and



produced a lot more units than we did on the original ramp of the first iPad. And when we're so confident with our ability to supply that we've already put on 25 additional countries at the end of March, and we'll be placing on 13 more next week and we'll do even more as we stepped through the quarter.

**Toni Sacconaghi - Sanford C. Bernstein & Co., Inc.**

Okay. That's helpful. If I could turn to another topic, which is just your overall guidance for next quarter on the revenue and EPS side. If I look back at your last 8 quarters, Q2 to Q3, last 8 years. 7 of the 8, you've been flat to up in revenues. And 8 out of 8, you've been up in EPS sequentially from Q2 to Q3. On both those metrics, you're providing guidance that is dramatically down double digits. Can you comment on forces at work? Obviously, you're typically pretty conservative in your guidance. But what are the things that are kind of underpinning those directionally, those assumptions, particularly since you're pointing to a dramatic increase in iPads?

**Peter Oppenheimer**

Sure. Toni, it's Peter. Let me start with top line. I would highlight 2 things. First of all, our sequential revenue guidance of \$23 million is for a 7% decline, and it have been up in prior years. And 2 things to point out: first of all, in our most recent March quarter, we were able to increase the iPhone channel inventory by 1.7 million units and within our target range. And that had not occurred in any of the prior years. And second, last year, we launched the iPad in the year ago June quarter, and it was a fabulous launch contributing \$2.2 billion in revenue without a comparison to the prior March quarter, and we obviously have that comparison this year. On a year-over-year basis, I am very pleased we're providing revenue guidance for growth of 46% year-over-year and EPS growing almost as quickly at 43%.

**Toni Sacconaghi - Sanford C. Bernstein & Co., Inc.**

Thank you.

**Nancy Paxton**

Thanks, Toni.

**Operator**

We'll go to Chris Whitmore with Deutsche Bank.

**Chris Whitmore - Deutsche Bank AG**

Thanks very much. Just a follow-up on the iPad question. Can you give us a split of iPad 2 versus iPad 1 as a percentage of the 5 million you shipped in the March quarter?

**Timothy Cook**

We purposely aren't giving that because we don't want to help out any of our competition. But I would tell you, I wish we could have produced a lot more iPad 2s because there were certainly a lot of people waiting for them.

**Chris Whitmore - Deutsche Bank AG**

Secondly, the follow-up on the sequential revenue guidance question. Can you provide any color what you expect from Macs, particularly as we enter the educational buying season? Have you seen any pressure on school budgets that is creating a little caution with respect to your Mac business?

**Peter Oppenheimer**

It's a difficult funding environment for schools here in the U.S. We don't see any evidence of a share loss. And Macs are very of popular in schools and iPads are proving to be as well. On a year-over-year basis, we would expect to see a sequential -- I'm sorry, a year-over-year very significant increase in Mac sales, and I'm very confident about the product lines as we head into the back-to-school season.

**Timothy Cook**

1 thing I would add to that, this was surprising to me and I think several people here is, K-12 is sort of even more conservative than Enterprise on adopting new technology. And last quarter, we were about a 1:1 ratio of iPads to Macs, which is I think very -- is amazing with the short life of the iPad, and really demonstrates what kind of opportunity there probably is there.

**Chris Whitmore - Deutsche Bank AG**

Thank you.

**Nancy Paxton**

Thank you, Chris.

**Operator**

Brian Blair with Wedge Partners.

**Brian Blair - Wedge Partners**

Thank you. For the last several years, we've seen a new iPhone in June and we've seen a new iPod models in September. Can you maybe just share some of your views on how you've historically viewed that 1 year time horizon for new products, and maybe talk about what might cause that kind of a time line to change?

**Timothy Cook**

We don't -- we never comment on an Apps products, and so I don't have anything to share from that perspective.

**Brian Blair - Wedge Partners**

And then can you -- you've touched on it a little bit, but can you maybe give some updated thoughts on how you view the supply-demand balance right now for the iPhone? You've talked a bit about it with iPad but 1 of the things that really stuck out to me in the last few quarters is your -- just the demand has been so great globally, especially if you've added new carriers that you still haven't met demand for the iPhone. Can you maybe just give some updated thoughts on that?

**Timothy Cook**

Yes, that's a good question. We -- by the end of the quarter, we were in supply-demand balance in almost all of our major markets. And I would say as of today, we're in supply-demand balance virtually everywhere. The other products, the Mac is in supply-demand balance and the iPod is in supply-demand balance. And the iPad has the mother of all backlogs that we're working very, very hard to get out to customers as quickly as we can.

**Brian Blair - Wedge Partners**

Great. Thank you very much.

**Nancy Paxton**

Thank you, Brian.

**Operator**

From Pacific Crest, we'll go to Andy Hargreaves.

**Andy Hargreaves - Pacific Crest Securities, Inc.**

Thanks. Just going back to the supply stuff real quick. Can you clarify -- would it require some kind of new disruption to cause problems beyond fiscal Q3, or were your comments just that we could kind of run low on inventory, and if production doesn't get back to full capacity, there could be issues later in the year?

**Timothy Cook**

Sorry, I wasn't trying to be unclear. I'm saying that as of today, we currently do not anticipate any material supply or cost, in fact, as far as that goes in our fiscal Q3. That's the quarter that we're in now that ends in June. Beyond June, there are risks but there's no issue that we're aware of today that we view as unsolvable. However, new things could happen and I'm sure you've been paying attention to the news. There's aftershocks, there's still uncertainty about the nuclear plant, there's power interruptions. If that stayed at the level it is today, I'm not as worried. I would worry if something happened and took a turn for the worse. And obviously, I can't predict that and certainly hope that it does not occur.

**Andy Hargreaves - Pacific Crest Securities, Inc.**

Okay, that's really helpful. Thanks. And then just on the iPhone, you talked a lot about the number of new Mac customers every quarter. Can you give us any help on what the mix is of replacement sales versus new customers, or what your total user base is there?

**Timothy Cook**

It's a number that we haven't given out before, and so it's a number that we hold tight to the best.

**Andy Hargreaves - Pacific Crest Securities, Inc.**

Okay, thanks.

**Nancy Paxton**

Thanks, Andy.

**Operator**

We'll go to Shaw Wu with Sterne Agee.

**Shaw Wu - Sterne Agee & Leach Inc.**

Thanks for having me on. Just 2 quick ones. Just back on components, it seems if you look at other vendors and spot pricing, component pricing has

actually been increasing. I just wanted a little more color why Apple has been able to beat that. I know you're a very well-run company, obviously. Just a little more color on that.

**Timothy Cook**

Yes, it's a good question, Shaw. Certainly, spot markets have spiked. This is particularly true if you follow the NAND Flash and the DRAM markets. However, we do not typically buy in the spot market. And so, for that reason, we see very minimal impact. Beyond Q3, I'm saying I'm not sure because it's tough to see that far, but for Q3, we feel very good. Companies that buy on the spot market would obviously be seeing something extremely differently than we would.

**Shaw Wu - Sterne Agee & Leach Inc.**

Okay, thanks for the color on that. And then just on the iPad, in terms of the selling model, does it make sense or is there interest in terms of having it subsidized by service providers at some point?

**Timothy Cook**

The iPad today is subsidized in a few markets. It is subsidized in Korea if people sign a 24-month contract, it's subsidized in Japan with a 24-month contract and a couple of European countries. But the vast majority of people that are using the iPad on 3G are doing so on a pay-as-you-go plan and no commitment plan. And so, yes, carriers can do that but I think many customers prefer the pay-as-you-go plan.

**Shaw Wu - Sterne Agee & Leach Inc.**

Okay, thanks.

**Timothy Cook**

Thank you very much.

**Nancy Paxton**

Thank you, Shaw.

**Operator**

From UBS, we'll go to Maynard Um.

**Maynard Um - UBS Investment Bank**

Thank you. 2 questions. Last year, when you gave gross margin guidance for the fiscal third quarter, I think you -- 1 thing you mentioned was a new product transition that would impact the gross margins. Just curious if that's also a factor. You didn't mention that. And then secondly, if you could just talk a little bit about the suit against Samsung. I'm just wondering how that might impact anything on your component-supply relationship? Thanks.

**Peter Oppenheimer**

I'll take your gross margin question, it's Peter. It's hard for us to comment on gross margin changes year-over-year because we're in different product cycles, commodity environments, different mixes and other factors. So I prefer just to talk about it sequentially, and I gave you really the biggest drivers of the change that we see. We expect to have a sequential increase in terms of our mix of iPad sales and also expect our revenues to be down sequentially a little bit and to lose some leverage. So those are the factors that I think are important on a sequential basis for those margin.

**Timothy Cook**

And on your question on Samsung, we are Samsung's largest customer and Samsung is a very valued component supplier to us, and I expect the strong relationship will continue. Separately from this, we felt the Mobile Communication Division of Samsung had crossed the line. And after trying for some time to work the issue, we decided we needed to rely on the courts.

**Maynard Um - UBS Investment Bank**

Great, thank you.

**Nancy Paxton**

Thank you, Maynard.

**Operator**

We'll go to Mark Moskowitz with JP Morgan.

**Mark Moskowitz - JP Morgan Chase & Co**

Yes, thanks. Tim, you mentioned earlier about the success of the iTunes here. Can you talk a little philosophically about what will be [ph] the next to really optimize that platform in terms of cloud-like capabilities? And then, Peter, the question for you is really around the OpEx. How should we think about OpEx? Does your guidance already imply that you will have to

increase some S&M employees to serve these greater region enterprises? Or is that already kind of in the model?

**Peter Oppenheimer**

I'll take both your questions. We don't talk about what we'll do in the future, so I'm quite limited to what we can say about the future of iTunes. We operate the most popular store in the world, giving customers a fabulous experience. We have the largest libraries and have provided more content to more customers than anybody. We're very confident about what we're doing and what we will do in the future. I can't take it beyond there. In terms of OpEx, we've provided guidance for the June quarter, about \$2.5 billion, and that includes our thinking for the investment that we're going to make in the quarter for the business. We are investing in engineering, in our retail stores, we are investing in our indirect distribution, which it would include covering the enterprise and the infrastructure investment that we need to support the terrific growth that you're seeing from the company. I'm glad that we are making good investments that are paying off but also providing - continuing to provide leverage in the model.

**Mark Moskowitz - JP Morgan Chase & Co**

Thank you.