

Operator

Good day, everyone, and welcome to the Apple Incorporated Third 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.

Nancy Paxton

Thank you. Good afternoon, and thanks everyone for joining us today. Speaking first is Apple CEO, Tim Cook; and he will be followed by CFO, Luca Maestri, and then we'll open the call for questions from analysts. Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including without limitation, those regarding revenue, gross margins, operating expenses, other income and expense, taxes, 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 2013, the Form 10-Q for the first two quarters 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.

Tim Cook

Thanks, Nancy. Good afternoon, everyone. It's been a very busy and exciting time at Apple and I'd like to review some of the highlights of our June quarter. We hosted our best ever Worldwide Developer's Conference last month with over 20 million people from around the world watching our keynote session, which is the a record. We've had overwhelming response from customers and developers to the new features we previewed in OS X Yosemite and iOS 8. Yosemite has been redesigned with a fresh look and powerful new apps and iOS 8 is the biggest release since the launch of the App Store. With powerful continuity features, these upcoming releases will allow Macs and iOS devices to work together in even smarter ways.

Customers can start on activity like writing an email on one device and pass it to another, picking up where they left off without missing a beat. They will even be able to make and receive iPhone calls on their Mac with just a click. These are features that only Apple can deliver. With iOS 8, we have opened over 4000 APIs providing more flexibility and opportunity for developers than ever before. iOS 8 provides developers with amazing new frameworks,

enables wide use of Touch ID to securely authenticate users within apps and lets developers further customize the user experience with major extensibility features such as third-party keyboards.

We have also introduced Swift, an innovative new programming language for both iOS and OS X. Swift is the result of the latest research on programming languages, combined with decades of experience within building Apple platforms. It makes writing code interactive and fun, eliminates entire classes of unsafe code and generates apps that run lightning fast. It's easy to learn, allowing even more people to dream big and create whole new categories of apps. We believe our new OS releases, combined with Swift will result in a huge leap forward for the Apple ecosystem and we can't wait to what developers will create with Yosemite, iOS 8 and Swift.

When we introduced iOS 7 years ago, it was a revolutionary operating system for iPhone. Over the years we've extended it to the iPod family with iPod Touch and later to a tablet form factor with iPad. An explosion of apps, accessories and services for these devices has created an incredibly vibrant ecosystem. We're extending iOS in even more dimensions as customers around the world make iPhones and iPads an essential part of their lives, at home, at school, at work and on the go. We're putting a huge effort into delivering the best experience to our customers wherever they use iOS. That includes a safe and intuitive user interface for driving, called CarPlay, which is being integrated by 29 major car brands including Audi, BMW, Ford, General Motors, Honda, Hyundai, Mercedes, Toyota and Volvo; and after-market systems like Pioneer and Alpine.

We've created a new tool for developers called HealthKit, which allows health and fitness apps work to together and empowers customers to choose what health data they share. We're taking the first steps in this area in collaboration with the Mayo clinic, whose new apps can automatically receive data from a blood pressure app, for example and share it with a physician, or a nutrition app can inform fitness apps how many calories are being consumed each day. Our ARM health app will provide an easy to read dashboard of all health and fitness data.

We're enabling new ways to control light and doors and thermostats and other connected devices around the house using Siri with the HomeKit feature of iOS 8. And in the Enterprise, we are including new security, productivity and device management features in iOS 8. We forged a relationship with IBM to deliver a new class of mobile business solutions to enterprise customers around the world. We are working together to provide companies access to the power of Big Data analytics, right on every employee's iPhone or iPad. Using Swift, we will collaborate to bring over 100

Mobile First apps to enterprise clients, each addressing a specific industry need or opportunity.

This is a radical step for Enterprise and opens up a large market opportunity for Apple but more importantly, it's great for productivity and creativity of our enterprise customers. From the pocket to the car, to the workplace, home and gym, we have a very large vision of what iOS can be and we're incredibly excited about our plans.

Turning to our financial results, today we are reporting record June quarter revenue, thanks to the very strong performance of iPhone, Mac and the continued growth of revenue from the Apple ecosystem. Our teams executed brilliantly during the quarter with earnings per share up 20% year-over-year, our highest growth rate in seven quarters.

We sold over 35 million iPhones, setting a new third quarter record. We generated healthy growth in our entry priced, mid-tier and lead iPhone categories. I'm especially happy about our progress in the BRIC countries, where iPhone sales were up a very strong 55% year-over-year.

We also had a record June quarter for Mac sales, with growth of 18% year-over-year in a market that is shrinking by 2% according to IDC's latest estimate. Demand has been very strong for our portables in particular and we've have had a great customer response to the new higher performance, lower priced MacBook Air. It was another strong performance for the App Store and the other services contributing to the thriving Apple ecosystem.

In fact for the first nine months of this fiscal year, the line item that we call iTunes software and services has been the fastest growing part of our business. iTunes billings grew 25% year-over-year in the June quarter and reached an all-time quarterly high, thanks to the very strong results from the App Store. We're continuing to invest in our incredible ecosystem, which is a huge asset for Apple and a very important differentiator of our customer experience. iPad sales met our expectations but we realized they didn't meet many of yours. Our sales were gated in-part by a reduction in channel inventory and in-part by market softness in certain parts of the world. For example IDC's latest estimate indicates a 5% overall decline in the U.S. tablet market, as well as a decline in the Western European tablet market in the June quarter.

But what's most important to us is that customers are enjoying their iPads and using them heavily. In a survey conducted in May by ChangeWave, iPad Air registered a 98% customer satisfaction rate, while iPad Mini with retina display received an astonishing 100% customer satisfaction rate. The survey also found that among people planning to purchase a tablet within 90 days,

63% plan to buy an iPad and our own data indicates that more than half of customers purchasing an iPad are buying their very first iPad.

Another recent study by Custora found that iPad accounts for 80% of all U.S. tablet based e-commerce purchases. We're very bullish about the future of the tablet market and we're confident that we can continue to bring significant innovation to this category through hardware, software and services. We think our partnership with IBM, providing a new generation of mobile enterprise applications, designed with iPad's legendary ease of use and backed by IBM's cloud services and data analytics will be one such catalyst for future iPad growth.

Looking ahead, we are very excited about our agreement to purchase Beats Electronics and Beats Music. We think it's part of Apple's DNA and we think the addition of Beats team will be great for music lovers. Beats provides Apple with a fantastic subscription music service, access to rare talent and a fast growing line up of products that we can build upon. Not counting Beats, we've completed 29 acquisitions since the beginning of fiscal year 2013 including five since the end of the March quarter and we have brought some incredible technology and more importantly some incredible talent into Apple in the process. We are hard at work and investing heavily on exciting opportunities across our business and we have an incredible pipeline of new products and services that we can't wait to show you.

With that I would like to turn the call over to Luca to discuss our Q3 results in more detail.

Luca Maestri

Thank you, Tim and good afternoon everyone. We set a new June quarter record for revenue at \$37.4 billion, up \$2.1 billion or 6% year-over-year. This result was towards the high end of our guidance range, despite a reduction in channel inventory for both iPhone and iPad. The revenue growth was driven by strong sales of iPhones and Macs, as well as the continued great performance of iTunes softwares and services. Gross margin was 39.4%, above our guidance range and operating margin was \$10.3 billion, representing 27.5% of revenue. Net income was \$7.7 billion, translating to diluted earnings per share of \$1.28, a 20% year-over-year increase.

For details by product, I'd like to start with iPhone. We sold 35.2 million iPhones, an increase of 4 million over last year, representing 13% growth. As Tim mentioned, iPhone sales grew well across all three of our entry-price, mid-tier and lead product categories.

In the U.S., iPhone accounts for 41.9% of the smartphone subscriber base according to the latest data from ComScore, up from 41.3% in the previous

measurement period. Also based on the latest survey by ChangeWave, iPhone earned a 97% customer satisfaction rate and among responders planning purchase a smartphone within 90 days, 50% planned to purchase an iPhone, up from 42% in the March quarter and 44% a year ago.

iPhone sales were at the high end of our expectations, despite new product rumors that we believe resulted in purchase delay. In addition, tax increases and the regulatory environment in Japan affected smartphone sales in what has been one of iPhone's fastest growing markets in recent quarters. Considering these factors, the performance of iPhone was even more impressive in the June quarter and it boosts our confidence for the future. We reduced iPhone channel inventory by about 150,000 from the end of the March quarter, leaving us within our target range of four to six weeks.

Apple continues to innovate through hardware, software and services to make iPhone the best smartphone for business. Today, companies have equipped millions of employees with iPhones and they are seeing tremendous benefits in productivity, employee satisfaction and profitability. For instance medical device leader Medtronic has developed over 175 internal iOS apps for over 16,500 iPhones used by its employees to facilitate sales, improve productivity and ensure that essential marketing materials are up to date. Throughout the global offices of Nestle, the largest food company in the world, over 25,000 iPhones are accessing corporate networks, improving communication and connecting employees to critical internal resources. And at NASA over 26,000 iPhones are in use by scientists, flight crew members, technicians and researchers.

Turning to iPad, we sold 13.3 million units, compared to 14.6 million in the June quarter last year. iPad sales grew overall in the developing markets with particularly strong year-over-year growth in the Middle-East, where iPad sales were up 64%, in China where they grew 51%, and in India, where they were up 45%. This growth was more than offset by lower sales in more mature markets. We reduced iPad channel inventory by 500,000 from the end of the March quarter, which left us within our target range of four to six weeks.

In the Enterprise, global companies are using iPad to improve customer service, boost work and productivity and enhance critical processes. iPad continues to be the standard for teams across the airline industry. Qantas Airlines has over 15,000 iPads deployed to pilots as well as cabin, customer service and ground crews to enhance key processes across the daily operations and governments are deploying thousands of iPads worldwide. One of the largest examples is Sweden, where over 100,000 iPads are being used by local government offices across the country.

In education, iPad remains the tablet of choice with 85% share of the U.S. education tablet market according to the latest published estimate from IDC. We've now sold 13 million iPads to education customers globally. We're bringing teachers and students great new tools to build an experience educational count into an iPad. As of this month, teachers using the free iTunes U app can create, edit and manage entire courses that are on iPad for the first time and students can discover new ways to collaborate, including the ability to start class discussions and ask questions right from their iPad.

Next, I'd like to talk about the Mac. We sold 4.4 million Macs, compared to under 3.8 million in the year ago quarter, an increase of 18% year-over-year and a new June quarter record. The increase was driven by portables, thanks to very strong growth of MacBook Air. We achieved strong double digit Mac growth across many countries, including the U.S. Canada, Mexico, the UK, Germany, France, Australia, China, India and the Middle-East. This growth is particularly impressive, given the contraction of the overall PC market. Macs have now gained global market share for 32 of the last 33 quarters.

Macs performed well in the U.S. education buying season with double-digit growth in the K to 12 market, driven primarily by large deployments of MacBook Air. The Shawnee Mission School District in Kansas chose Apple to provide an entire solution that will equip every teacher with a MacBook Air and an iPad Air, every high school student with a MacBook Air and every middle school and elementary student with an iPad. The Rowan-Salisbury School System in North Carolina is deploying thousands of MacBook Airs to students and teachers in grades 9 to 12 as part of the district's digital learning initiatives.

We ended the quarter with Mac channel inventory slightly below our four to five week target range. The Apple ecosystem continues to grow and thrive. Total revenue from iTunes software and services was \$4.5 billion, an increase of 12% year-over-year. Our iTunes stores generated all time record billings of \$5.4 billion in the June quarter, up 25% year-over-year, driven by very strong growth in App Store sales. These items billings translated to quarterly iTunes revenue of almost \$2.6 billion, up 8% from the year ago quarter. Software and services revenue was \$1.9 billion, up 19% from a year ago.

App Store momentum remains very strong and cumulative app downloads has topped 75 billion. We continue be amazed by our vibrant and diverse developer community and we are extremely proud that our developers have now earned over 20 billion for sales of their apps through the App Store, nearly half of which have been earned in the past 12 months. This number truly stands out among our competition as our developers continue to

benefit from the broad reach and powerful design of the App Store, coupled with Apple's large, loyal and very engaged customer base.

Let me now turn to our cash position. We ended the quarter with \$164.5 billion in cash plus marketable securities, a sequential increase of \$13.9 billion. Our domestic cash was \$26.8 billion at the end of the June quarter, a sequential increase of \$8.3 billion and \$137.7 billion or 84% of our total cash was offshore. Cash flow from operations was \$10.3 billion.

We executed another very successful debt offering in April, issuing a total of 12 billion in notes across 3, 5, 7, 10 and 30 year maturities. In addition, during the quarter, we entered the commercial paper market for the first time with \$2 billion in short-term obligations outstanding as of the end of June. We also continued to execute our shareholder return program with \$8.3 billion of capital returned to inventors during the June quarter. We spent \$5 billion to repurchase 59 million Apple shares to open market transactions. We paid almost \$2.9 billion in dividends and equivalents and utilized over \$400 million to net share settle vesting employee RSUs.

We've now taken action on over \$74 billion of our \$130 billion capital return program, including \$51 billion in share repurchases with six quarters remaining to its completion. And finally our Board has declared a dividend of \$0.47 per common share payable on August 14, 2014 to shareholders of record as of record as of August 11, 2014.

Now as we move ahead into September 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 \$37 billion and \$40 billion, compared to \$37.5 billion in the year ago quarter. We expect gross margin to be between 37% and 38%. We expect OpEx to be between \$4.75 billion and \$4.85 billion. We expect OI&E to be about \$250 million and we expect the tax rate to be about 26.1%. Finally, we expect the Beats transaction to close this quarter and we expect the acquisition to be accreted to our earnings in our fiscal 2015.

With that, let me open the call to questions.

Nancy Paxton

Thank you, Luca. And we 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). And your first question will come from Katy Huberty with Morgan Stanley.

Katy Huberty - Morgan Stanley

Luca, this is the third quarter in a row that gross margin came in above your guidance. Can you talk about what's driving that gap and why you expect the margin to come down sequentially in the September quarter?

Luca Maestri

Yes, Katy, it was obviously a surprise also to us. We were expecting obviously a loss in leverage from the sequential declining revenue which obviously happened. We also expect that some unfavorable mix, which also happens -- it's typical as we move away from the launch quarter. And we were expecting some cost improvements. These cost improvements came in. They came in stronger than we were anticipating. The commodity markets continue to be favorable, the product quality continues to be excellent, our teams executed really, really well. And all these things came together at the same time and it was a very nice surprise for us. As we look forward into Q4, yes, we've guided to 37% to 38%. Again, the mix is the normal mix that we see as we continue to move through the product cycle. And obviously in Q4, we got some transition costs because we're expecting a very busy fall. We're bit excited about what we've got in the pipeline. And that's the reason why we guided to that range.

Katy Huberty - Morgan Stanley

And then just a follow-up on that last point, because in the press release you referenced the excitement about new products and services. Can you remind us of your guidance philosophy as it relates to product cycles? Do you embed assumptions around the contribution from new products? And if so, do those tend to be more conservative than for products that's already shipped today?

Luca Maestri

So our guidance, Katy is that -- we put our numbers that we believe at this point in time with all the information that is available to us, we're going to land within. So we take into account the fact that we've seen some purchase delays for executing Q3, but we have seen some safe trends in certain geographies. That continues to happen. And what you see this quarter is that our guidance range is \$3 billion, as opposed to \$2 billion during the third quarter, just to take into account the fact that we got many moving pieces.

Nancy Paxton

Thank you Katy. Can we have the next question please?

Operator

From Goldman Sachs, we will hear from Bill Shope.

Bill Shope - Goldman Sachs

With the pockets of market we just noted for tablets, could you give us some more detail on how you are thinking about the category longer term, and in particular in the context of your usage comments, how are you thinking about the competitive landscape now and how that may evolve? And then I guess, related to that, what do you think to be the next driver of renewed growth for the category?

Tim Cook

It's Tim. If you sort of back up from this, the category that we created, which has just been a little over four years, we have now sold 225 million iPads, which is I think probably a larger number than anyone would have predicted at the time and including ourselves, quite frankly. We still feel that category as a whole is in its early days and that there is also significant innovation that can be brought to the iPad and we plan on doing that. When I look at the top level numbers, I get really excited when I see that more than 50% of the iPads that we're selling are going to someone who is a first time tablet buyer. I get excited when I see that our retail share according to the MPD in the month of June was 59% of UNIX and over 70% in terms of dollars. And of course, Luca has mentioned in his preamble that our education share is 85%.

We also are in the -- virtually all Fortune 500 companies, we are in 99% of them to be exact and 93% of the Global 500. However, when we dig into the business market deeper, though our market share in the U.S., in the commercial sector is good at 76% -- this is according to IDC; the penetration in business is low. It's only 20%. And to put that in some kind of context, if you looked at penetration of notebooks in business, it would be over 60%. And so we think that there is a substantial upside in business. And this was one of the thinkings behind the partnership with IBM that we announced last week. We think that the core thing that unleashes this is a better go to market, which IBM clearly brings to the table, but even more importantly apps that are written with Mobile First in mind. Not all but many of the enterprises apps that have been written for iPad have been essentially ports from a desktop arrangement and haven't taken full advantage of mobile.

And so we're excited about bringing that to business along with partnering with IBM, which we think is a first class company. And seeing what that can do to sales of business, which I honestly believe the opportunity is huge. The market is still predicted in 2018 -- I think these are Gartner numbers -- to be about 350 million in size and put that in some context, I think the PC market right now is about 315 million.

And so I think our theory that has been there honestly since the first time that we shipped iPad, that the tablet market would eventually surpass the PC market, that theory is still intact. I just think we have to do some more things to get the business side of it moving in a faster trajectory and I think we're now on to something that can really do that. So as I look at it and sort of back up from the 90 day clock kind of thing, I'm incredibly excited. I'm excited about the plans that we have on the product side and also on the go to market side, and in particular the IBM announcement.

One other point I might add on this, because I think this is interesting. I don't think it came out in our commentary so far as; the market's very bifurcated on iPad. In the BRIC countries, iPad did extremely well. The growth was very high. Like in the China it was in the 50%s, in the Middle East it was in the 60%s. Luca may have mentioned those numbers. In the developed countries like the U.S., the market is clearly weaker there. It's interesting to note however that the U.S. as an example, we had a very, very strong Macintosh market in the U.S. and so there is probably a bit of higher add kind of stuff beginning to play out too, where higher add is clearly still very much notebook oriented. K12 on the other hand, we sell 2.5 iPads for every Mac in the K12. And so we're clearly headed into that season now and it typically starts in graduation time prime in fiscal Q3 for us. And so I think that's probably another thing that we're seeing.

Bill Shope - Goldman Sachs

One more question if I could. You've had obviously great performance in the BRIC countries and you've touched on China for few categories. Can you talk about the overall demand environment you saw for China in the quarter? Obviously there's some seasonal factors to consider but how should we think about your performance versus your expectations and how you are thinking about it for the rest of the calendar year?

Tim Cook

China, honestly was surprising to us that it was -- we thought it would be strong but it well went past what we thought. We came in at 26% of revenue growth, including retail and if you look at the units, the unit growth was really off the charts across the board. I found 48% off that compares to

a market estimate of 24%. So growing it two times the market. iPad was up as well, as I've mentioned before. The Mac was up 39% and that's versus a market in China that's also contracting along with markets in most parts of the world and China was projected to contract by 5%. And so we're seeing some substantial strength there and the thing that's actually growing the most is the iTunes software and services category, which has the App Store and et cetera and that area is almost doubling year-over-year.

And so it's very, very exciting what we're seeing there. We are still in the process of rolling out along with our partner China Mobile, the TD-LTE into more cities and we're still in early going on that. That just started in January as you know. And my understanding is that later this year there will be a license for the other operators to begin shipping FDD-LTE, which I think is another big opportunity in China.

Nancy Paxton

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

Operator

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

Toni Sacconaghi - Sanford Bernstein

I have one for Luca and one for Tim please. Luca, I wanted to revisit the gross margin question. You talked about guidance for next quarter, that the drivers of the sequential decline being a normal mix through the cycle on transition cost. Your guidance to the midpoint is down 190 basis points in gross margin, last year in Q4 gross margins were up 10 basis points sequentially in fiscal Q4 and the product transition issues or cycle issues that you alluded to seem essentially identical. So I'd like to try and understand what might make this Q4 different let's say than last Q4?

Luca Maestri

If I understand the question, also when you look at it in terms of absolute levels of gross margin, last year it was 37%. So our range is above that level. There is obviously many, many things that affect us in different ways from one year to the other. Foreign exchange is a case where a lot of the emerging market currencies and the yen and the Australian dollar, the Canadian dollar, they have been weaker against the U.S. dollar. That has an impact on margin. And also when you think our product cycle, I think we don't get into the specifics but this is not exactly the same cycle as we've had a year ago.

Toni Sacconaghi - Sanford Bernstein

I mean is it better? If we look back two years to the iPhone 5, your product margins were down 260 basis points sequentially. So is the reference there that we should be thinking in terms of changes that are more akin to what we saw two years ago rather than to this year?

Luca Maestri

I wouldn't necessarily draw that analogy. I think we need to start thinking from the fact that we had a very, very strong Q3. A lot of things came together extremely well. 37% to 38% is a range that is -- we think is very good, and that's where we are right now and we still have several weeks in the quarter.

Toni Sacconaghi - Sanford Bernstein

Tim, I wanted to get your input on the impact of trade-in programs for the iPhone, particularly in mature markets where they are most prevalent. As best I can tell, if I look at the last four quarters, they're not hyper-focused on 90 days. It looks like the iPhone has been about flat in unit terms in the Americas and up low single digits in Europe and I think Europe includes India, which is obviously very fast growing. So perhaps low single digits in Europe. So if we look at those western geographies, we've seen relatively flattish iPhone unit sales over the last year. I know you don't report it but just sort of based on overall revenue reporting, I'm wondering if you can comment on what you're seeing in terms of iPhone trade-in programs and this is four quarters, still over a complete cycle. Whether you think they are elongating or shrinking and what impact is very prevalent, increasingly prevalent trade-in programs might be having on them and what impact your pricing of older generation devices might be having on them.

Tim Cook

Yes, the theory that you have Toni is not precisely correct. Like if I look at Europe, the operating segment of Europe for quarter or year-to-date for 2014 versus the same period last year, iPhone units were actually up 10%. Your more macro question; what I understand to be your macro question of do I think there is some sort of cannibalization going on trade-in programs on new product sales? What I think is happening in the aggregate if you look across the world is that trade-ins are actually hugely beneficial for our ecosystem because people wind up -- we have more people that are able to join the party when we have a trade-in, because in essence, it winds up being used by -- probably the prime example someone else within the family or in the example that has become more common in the last year, someone trades it in and then that goes to either somebody else in that country that

is very price sensitive or somebody in a different country and I see all of this as good.

In looking at how much of it cannibalizes, it is very hard to answer that question with any degree of preciseness. But my gut is that the cannibalization factor is low, because you wind up having -- you wind up attracting people that are much more price sensitive in there. I think the great thing is that our products command a much higher resale value than others do. And so that leads to a larger trade-in and from my perspective, that being the larger ecosystem, more people that wind up getting on iPhone, and as you know from following us for quite some time, if we get somebody to try an Apple product and then buy an Apple product, the likelihood that they begin buying other Apple products that may be in different categories or upgrading to one in that category and the future is very high. And so net-net, I view it to be positive. It's very difficult to quantify with certainty.

Nancy Paxton

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

Operator

From UBS, we will hear from Steve Milunovich.

Steve Milunovich - UBS

Tim you mentioned that Japan was fairly flat due to regulations and taxes. Could you elaborate on that and what kind of comparisons perhaps you see going forward?

Tim Cook

Yes, it was actually Luca, but I can comment on it. VAT was increased from 5% to 8% close to the beginning of the quarter. I think it was actually April 1 or so. That was the first planned VAT increase. There are other or at least one additional planned VAT increase in the future. This was a part of the overall tax reform package in Japan. Secondly, the carriers received some guidance from the regulators to essentially stop incenting people to transfer from another carrier at a higher amount than they were incenting their -- retaining their own customers. And so it appears that the combination of these two things dampened the whole market for smartphones in Japan.

We haven't been able to get very detailed data on share but my expectation is we're not going to see very much of a share change. And we are beginning to see some coming back of that market as we step into this

quarter, may be not back to the level that it was previously but you can begin to see the market growing again which we view as very positive. In the past when we've seen these type of things, tax changes et cetera, there is usually a rush to buy before the tax increase, a pause that happens thereafter and then the market eventually goes back to some kind of steady state that may not be exactly where it was but it nears it. And so I think that's likely our guts or that's what happens on the VAT side. The other piece is a little harder to conclude what will happen in terms of that guidance and how long that might be employed. I don't know that part.

Steve Milunovich - UBS

Okay, that's very helpful. And then you talked about your three tiers of iPhones. I wonder if you would be willing to breakout in any more detail the growth and particularly how to defend the 5C in the mid-tier. I know our surveys continue to find in the U.S. that it's falling little bit as a percentage of business but you seem to believe it's doing exactly what you expected it to do.

Tim Cook

I can tell you this. That if you look at the growth rates, we don't divide out each one but if you look at year-over-year growth rates and so this would be comparing the 5C to last year. It would be comparing the 4S, which was in the mid-tier. The growth in that sector was the highest growth during the quarter we just finished.

Steve Milunovich - UBS

Of the three tiers?

Tim Cook

Of the three tiers. And so we are extremely happy with how it performed last quarter.

Nancy Paxton

Thanks Steve. Can we have the next question please?

Operator

Kulbinder Garcha with Credit Suisse.

Kulbinder Garcha - Credit Suisse

Thanks. I have just one question for Luca and one for Tim. And for Luca, you mentioned that commodity pricing, I guess the environment was good for you. Is it your working assumption in your guidance that continued to be favorable and a tailwind for you? And then my question for Tim is, with the installment plans that are being introduced in the U.S., I imagine that given the increases in flexibility for people to operate faster, would you expect that to happen? Are you seeing any evidence as these contests come up because we've had them out now for several months? And how do you see that impacting your business because obviously the U.S. iPhone part of your business is still very significant and it can be quite a big catalyst to your iPhone business going forward I would imagine or would you be more tensed in how these are playing out?

Tim Cook

I will take both of these. This is Tim. On the component question, what we saw in the June quarter was that NAND, mobile DRAM and LCD, the pricing on all of those declined, while PC DRAM increased, despite the market for PCs contracting. In the September quarter, what is factored in our guidance is that LCDs and mobile DRAM continue to decline, that NAND pricing remains essentially flat last quarter and that PC DRAM has a slight price increase. And in terms of other commodities that I didn't talk about, we've assumed that they would decline at historical rates and so that's factored into the gross margin guidance that Luca gave you. In terms of the installment plans that you mentioned in the U.S. relative to iPhone, there is a lot of different models that are being tried in the U.S. and throughout the world. And actually last quarter, as we estimated and this is subject to estimating but we're estimating that less than one out of four iPhones were sold on a traditional subsidy plan. And so that number is markedly different than it would have been two years ago.

The installment plan that you're speaking about which gives the customer the right to upgrade SAP or faster than a usual two year cycle, we think that plays to our customer base in a large way. And so that makes us incredibly bullish that customers on those plans would be very likely to upgrade when we announce a new product.

Nancy Paxton

Thank you, Kulbinder. May we have a next question please?

Operator

Next we'll hear from Ben Reitzes with Barclays.

Ben Reitzes - Barclays

Thanks a lot. Tim, questions for you. I guess during the quarter you did two very big things in our opinion, obviously buying Beats, biggest acquisition in your history and you also did this IBM deal, which obviously was in this quarter, but since the last call, and that was very interesting, obviously really collaborating with another huge company to get further into the enterprise. And I was just wondering, what are you seeing in Apple that's changing? These seem like big deals that change your direction a bit, something that you wouldn't have done in the past. And do you see a lot more partnerships and larger acquisitions on the horizon to grow your TAM in various markets?

Tim Cook

Well, I think we have a lot of really great people and I think we have the capability. As I've said before, I think we have the capability to acquire a sizable company and manage it. And relative to IBM, I feel the same way. I think you can only do so many partnerships well, and so it is unusual that we enter into a partnership. But in this particular case, I think arguably the companies are so complementary, and I've gotten to know Gini fairly well over the last couple of years and I think we see the importance of the customer, a lot of the same way and both feel that Mobile and Enterprise is just an enormous opportunity. And we're not competing with each other. And so I think a partnership in that case is particularly great. Would we do more of either of the things we did? We're always looking in the acquisition space, but we don't let our money burn a hole in our pocket and we don't do things that aren't strategic.

And so with Beats we felt we were getting an incredible subscription service, a very rare set of talent that we think can do great things in Apple and access to a very fast growing businesses in their headphone and earphone space. And culturally we felt there was a match and music has been deeply embedded in Apple's DNA for many, many years. And so it was a great marriage and I think the partnership with IBM is a great marriage as well. It's more like that, presented themselves -- or I think we can manage more things. I think that we have a very, very strong executive team and can do that. But it's not my goal to acquire certain number of companies or spend a certain amount of money. We want to do things that help us make great products that are great for our customers and so forth.

Ben Reitzes - Barclays

I am sorry, just really quick on the IBM. Does this say something about Apple doing more in Big Data, and taking a cut maybe of some of the analytics opportunities as well?

Tim Cook

Yes, we didn't talk about how the business model is going to work. But generally speaking, I think that each of us have revenue streams in the enterprise and each of us went from having those revenue streams. So that's how I look at that. And we win if we can drive that penetration number I spoke about from 20% to 60%. That would be incredibly exciting here. The walls would shake. And so that's what I hope for.

Nancy Paxton

Thank you Ben. Could we have the next question please?

Operator

We will hear from Ben Schachter with Macquarie.

Ben Schachter - Macquarie

Tim, I just wanted to talk about the app market for Enterprise. Right now I believe that app developers can sell to the enterprise directly and therefore that they can bypass sharing revenue from these app sales with Apple. Is Apple going to allow that to continue, and can you also just more broadly discuss how Apple thinks about the opportunity to sell apps directly to the enterprise?

Tim Cook

We have no plans to change the rules with Enterprise. Some enterprises like proprietary apps that they do not want to offer to others and so we obviously have a way for them to distribute those into their enterprise or just the employees that they want to and so I'm not worried about changing that. We're also taking friction out of the system and not adding it. Again, the big thing for us is getting the penetration number, I think getting our product, iPhones and iPads and Macs in more people hands and we think there is a huge opportunity in Enterprise to do that.