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**Q1 2023 Apple IncEarnings Call - Final**

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OPERATOR: Good day, everyone, and welcome to the Apple Q1 Fiscal Year 2023 **Earnings** Conference Call. Today's call is being recorded.

And now at this time, for opening remarks and introductions, I would like to turn the call over to Tejas Gala, Director of Investor Relations and Corporate Finance. Please go ahead.

TEJAS GALA, IR CONTACT, APPLE INC.: Thank you. Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Before turning the call over to Tim, I would like to remind everyone that the December quarter spanned 14 weeks, while the March quarter, as usual, has 13 weeks. Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook, including the potential impact of COVID-19 on the company's business and results of operations.

These statements involve risks and uncertainties that may cause actual results or trends to differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed annual report on Form 10-K 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, CEO & DIRECTOR, APPLE INC.: Thank you, Tejas. Good afternoon, everyone, and thanks for joining us.

Today, we're reporting revenue of $117.2 billion for the December quarter. We set all-time revenue records in a number of markets, including Canada, Indonesia, Mexico, Spain, Turkey and Vietnam, along with quarterly records in Brazil and India. As a result of a challenging environment, our revenue was down 5% year-over-year. But I'm proud of the way we have navigated circumstances, seen and unforeseen, over the past several years, and I remain incredibly confident in our team and our mission and in the work we do every day.

Let me discuss the 3 factors that impacted our revenue performance during the quarter. The first was foreign exchange headwinds, which had a nearly 800 basis point impact. On a constant currency basis, we grew year-over-year and would have grown in the vast majority of the markets we track.

The second factor, which we described in a November 6 update was COVID-19-related challenges, which significantly impacted the supply of iPhone 14 Pro and iPhone 14 Pro Max and lasted through most of December. Because of these constraints, we had significantly less iPhone 14 Pro and iPhone 14 Pro Max supply than we planned, causing ship times to extend far beyond what we had anticipated. As we always have every step of the way throughout the pandemic, we continued to prioritize people and worked with our suppliers to ensure the health and safety of every worker. Production is now back where we want it to be.

The third factor was a challenging macroeconomic environment as the world continues to face unprecedented circumstances, from inflation to war in Eastern Europe, to the enduring impacts of the pandemic. And we know that Apple is not immune to it. But whatever conditions we face, our approach is always the same. We are thoughtful and deliberate. We manage for the long term. We adapt quickly to circumstances outside our control while delivering with excellence in the things we can. We invest in innovation, in people and in the positive difference we can make in the world. And we do it all to provide our customers with technology that will enrich their lives and help unlock their full creative potential. It's a wonderful thing to be a part of, and it's so rewarding for all of us at Apple when we hear how much our customers are loving what we create.

Let me talk now about what we saw across our product categories. Starting with iPhone. Revenue came in at $65.8 billion for the quarter, down 8% year-over-year. However, on a constant currency basis, iPhone revenue was roughly flat. Our customers continue to rave about the astounding camera capabilities and unprecedented battery life and the groundbreaking suite of health and safety features. The iPhone 14 lineup pushes the limits of what users can do with a smartphone.

During the quarter, Mac revenue came in at $7.7 billion, which was in line with what we had expected. We had a difficult compare because this time last year, we had the extremely successful launch of the redesigned M1 MacBook Pros. We also faced a challenging macroeconomic environment and foreign exchange headwinds. We remain confident in and focused on the long-term opportunity for Mac.

Just last month, we introduced new MacBook Pro models powered by our latest developments in Apple silicon, M2 Pro and M2 Max. These chips enable unprecedented performance and do so with less energy, which is not only good for the environment but gives the newest MacBook Pro the longest battery life ever in a Mac. We also introduced the M2-powered Mac mini, which will supercharge productivity for users of all kinds and leave them stunned by just how powerful a Mac mini can be.

During the quarter, iPad revenue grew 30% to a total of $9.4 billion. The very strong growth was due in part to a favorable compare to the December quarter a year ago when we experienced significant supply constraints. Customers continue to praise our new lineup for its versatility, whether it's the new iPad Pro now powered by the M2 or the newly designed iPad 10th Generation with its stunning liquid retina display and beautiful colors.

Revenue for Wearables, Home and Accessories was $13.5 billion, which was down 8% year-over-year driven by foreign exchange headwinds and a challenging macroeconomic environment. We remain excited about the long-term opportunity in the category. As an example, a few weeks ago, we announced the next-generation HomePod, which is an indispensable addition to the smart home. This powerful smart speaker relies on advanced computational audio to produce an incredible listening experience. We're also helping users make their homes safer with sound recognition. This feature, arriving later this spring, allows HomePod to send a notification directly to a user's iPhone if a smoke or carbon monoxide alarm sound is identified.

We continue to hear wide praise for Apple Watch Series 8 and Apple Watch Ultra, which has set a new standard for what's possible with a wearable. From a whole host of health and safety features to incredible new capabilities for extreme athletes, there is something for everyone in these amazing products. Customers are excited about some phenomenal new features we've made available across many of our products as well. One of the highlights is emergency SOS via satellite, which launched for iPhone 14 customers in the U.S. and Canada in November and for customers in France, Germany, Ireland and the U.K. in December. This is a feature we hope our users will never need, but it is incredibly heartening to get e-mails from people describing the life-saving impact our new safety features have had on them.

We're always looking for new ways to empower people to create and collaborate. In December, we released Freeform, a brand-new app that lets users take their ideas wherever they want, anywhere they are, all while collaborating in real time. Freeform has already received praise from reviewers for its flexibility and simplicity as it works seamlessly across iPhone, iPad and Mac.

Today, we are very excited to announce that we've achieved a truly incredible milestone. Thanks to our deep commitment to innovation, incredible customer loyalty and satisfaction and a large number of switchers, we now have more than 2 billion active devices as part of our growing installed base, double what it was just 7 years ago. This is an incredible testament to our products and services and the strength of our ecosystem.

We set an all-time revenue record of $20.8 billion in services, which was better than what we had expected. We achieved double-digit revenue growth from App Store subscriptions and set all-time revenue records across a number of categories, including cloud and payment services. All told, Apple now has more than 935 million paid subscriptions.

Apple has also just begun a historic 10-year partnership with Major League Soccer. Just yesterday, we launched MLS Season Pass, which will give fans in more than 100 countries access to every live MLS regular season game as well as the playoffs and MLS Cup, all with no blackouts. And while we're providing more content to sports fans than ever before, Apple TV+ continues to showcase powerful characters and moving storytelling. We were thrilled to celebrate the holidays alongside our Apple TV+ subscribers with the hit movie Spirited. And we're delighted to see how much people are enjoying new and returning series like Shrinking, Slow Horses and Truth

 

Be Told. And we have some great upcoming movies in Sharper and Tetris, along with Emmy Award winner Ted Lasso returning this spring.

During the quarter, we made some great updates to Fitness+ as well, expanding our catalog of more than 3,500 workouts and meditations to include a new kickboxing category and a new sleep theme for meditations. Our latest artist spotlight series features the music of the incomparable Beyonce, and we're excited to take a stroll with guests appearing on our fifth season of Time to Walk. And we continue to build on our decades-long commitment to helping small businesses thrive when we announced Apple Business Connect. This new tool gives business owners even more control over how billions of people see and engage with their products and services every day. Businesses of all sizes can now customize key information for users across Apple Maps, Messages, Wallet, Siri and other apps.

Meanwhile, in retail, we celebrated 25 years of the Apple online store and also opened Apple Pacific Centre in Vancouver and Apple American Dream in New Jersey. And I'm grateful to all the teams who helped our customers throughout the busy holiday season. At Apple, we spend a lot of time focused on creating an unparalleled experience for our customers and every product and service that we offer. We're also just as dedicated to leading with our values in everything we do. As part of that work, we strengthened our deep commitment to privacy and security, giving users 3 new tools to protect their most sensitive data: iMessage contact key verification, security keys for Apple ID and advanced data protection for iCloud.

At Apple, we feel a deep sense of responsibility to leave the world better than we found it. We're also a year closer to 2030, and we were ever focused on the environmental commitments we set out for the end of the decade. As an example, the latest Mac mini and MacBook Pro models all use 100% recycled aluminum in the enclosure and recycled rare earth elements in all magnets. And in a first for HomePod, we're using 100% recycled gold in the plating of multiple printed circuit boards. In honor of Black History Month, we released the Black Unity collection, including the Special Edition Apple Watch Black Unity Sport Loop, a new matching watch face and iPhone wallpaper. Through our racial, equity and justice initiative, we're expanding our support of 5 organizations focused on lifting up communities of color through technology. And we are committed as ever to building on our progress around inclusion and diversity.

During the quarter, we also announced that since the inception of our Giving program 11 years ago, we've donated more than $880 million to humanitarian efforts, disaster relief, childhood education and more. And over the last 16 years through our partnership with (RED), Apple-supported grants have helped more than 11 million people get the care and support services they need.

As we look ahead in 2023, we are excited about the year to come. At Apple, we are always looking forward, always focused on the next challenge, always determined to do great things with unmatched creativity and unrivaled innovation. And that makes me more confident about the future of Apple than I have ever been.

With that, I'll turn it over to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim, and good afternoon, everyone. As Tim mentioned, revenue for the December quarter was $117.2 billion, down 5% from last year. A number of factors had a significant impact on our results. First, we faced a very difficult foreign exchange environment, which affected our performance by nearly 800 basis points. In other words, we grew revenue on a constant currency basis. And in fact, we did so in the vast majority of markets.

Second, the macroeconomic environment this past quarter was markedly more challenging than 12 months ago. Third, we experienced significant supply shortages for iPhone 14 Pro and iPhone 14 Pro Max in November and through December. On the other hand, we had the positive impact of the 14th week in the quarter that Tejas just mentioned at the beginning of the call.

Products revenue was $96.4 billion, down 8% from last year due to the factors I just called out. At the same time, however, our installed base of active devices grew double digits and achieved all-time records in each geographic segment and in each major product category. We're proud to now have over 2 billion active devices in our installed base. This continued growth in the installed base is due to extremely strong levels of customer satisfaction and loyalty and a high number of customers who are new to our products.

The installed base growth also helped our services set an all-time revenue record of $20.8 billion, up 6% over a year ago. We achieved this new milestone despite more than 700 basis points of negative impact from foreign exchange. We reached all-time services revenue records in the Americas, Europe and rest of Asia Pacific and a December quarter record in Greater China. We also set records in many Services categories, including all-time revenue records for cloud services, payment services and music and December quarter records for the App Store and AppleCare. Company gross margin was 43%, up 70 basis points from last quarter due to leverage and favorable mix, partially offset by foreign exchange. Products gross margin was 37%, up 240 basis points sequentially. And Services gross margin was 70.8%, up 30 basis points sequentially, both due to the same factors that impacted total company gross margin.

Operating expenses of $14.3 billion were significantly below the guidance range we provided at the beginning of the quarter and grew at a slower pace than in the past as we took actions to respond to the current macro environment. Net income was $30 billion. Diluted **earnings** per share were $1.88, and we generated very strong operating cash flow of $34 billion.

Let me now get into more detail for each of our revenue categories. iPhone revenue was $65.8 billion despite significant foreign exchange headwinds, supply constraints on iPhone 14 Pro and iPhone 14 Pro Max and a challenging macroeconomic environment. In spite of these circumstances, we set all-time iPhone revenue records in Canada, Italy and Spain, and saw strong growth in several emerging markets, including all-time iPhone revenue records for India and Vietnam. Importantly, the installed base of active iPhones continues to grow nicely and is at an all-time high across all geographic segments.

In emerging markets, in particular, the installed base grew double digits, and we had record levels of switchers in India and in Mexico. Our customers continue to love their experience with our products with the latest survey of U.S. consumers from 451 Research indicating customer satisfaction of 98% for the iPhone 14 family.

Mac revenue was $7.7 billion, down 29% year-over-year and in line with our expectations. There were 3 key drivers for our Mac results. First, we had a challenging compare against last year's launch of the completely reimagined MacBook Pros, our first notebooks with M1 Pro and M1 Max. Second, we believe that the macro environment impacted our Mac performance. And third, we faced significant foreign exchange headwinds. At the same time, however, the installed base of active Macs reached an all-time high across all geographic segments, and we continue to see very strong upgraded activity to Apple silicon. Customer satisfaction with Mac remains very strong at 96% based on the latest survey of U.S. consumers from 451 Research.

iPad revenue was $9.4 billion, up 30% year-over-year despite significant FX headwinds. This performance was driven by 2 key items. First, during the December quarter a year ago, we experienced significant supply constraints, while this year, we had enough supply to meet demand. Second, we launched our new iPad and the iPad Pro powered by the M2 chip during the quarter. The iPad installed base reached a new all-time high, thanks to incredible customer loyalty and a high number of new customers. In fact, over half of the customers who purchased iPads during the quarter were new to the product.

Wearables, Home and Accessories revenue was $13.5 billion, down 8% year-over-year. The year-over-year decline was driven by significant FX headwinds and a challenging macroeconomic environment. However, our installed base of devices in the category set a new all-time record thanks to the largest number of customers new to our smartwatch that we've ever had in a given quarter. In fact, nearly 2/3 of customers purchasing an Apple Watch during the quarter were new to the product.

Moving to Services. We generated $20.8 billion in revenue, a new all-time record in total and for many Services offerings in spite of a difficult foreign exchange environment, and macroeconomic headwinds impacting certain categories such as digital advertising and mobile gaming. In constant currency, we grew Services revenue double digits on top of growing 24% during the December quarter a year ago.

We remain focused on the large long-term opportunity in this category, and we continue to observe several trends that reflect the strength of our ecosystem. For example, we saw increased customer engagement with our Services during the quarter. Both our transacting accounts and paid accounts grew double digits year-over-year, each setting a new all-time record.

Paid subscriptions also continued to grow nicely. We now have more than 935 million paid subscriptions across the services on our platform, up more than 150 million during the last 12 months alone and nearly 4x what we had just 5 years ago.

And we continue to increase the reach and improve the quality of our offerings. For instance, Apple Pay is now available to millions of merchants in nearly 70 countries and regions. And we saw a record-breaking number of purchases made using Apple Pay globally during the holiday shopping season.

Finally, our installed base of over 2 billion active devices represents a great foundation for future expansion of our ecosystem, and it continues to grow even during difficult macroeconomic conditions, which speaks to the exceptionally high levels of customer loyalty and satisfaction and our ability to attract new customers to our platform. The growth is coming from every major product category and geographic segment, with strong double-digit increases in emerging markets such as Brazil, Mexico, India, Indonesia, Thailand and Vietnam.

Turning to the enterprise market. we are seeing continued adoption of our Services for business like Apple Business Essentials, AppleCare, Tap to Pay and Apple Financial Services. For example, Mars Incorporated has expanded its use of AppleCare for Enterprise to provide timely device support and assurance for iPads deployed across their manufacturing sites. Meanwhile, HCA Healthcare has leveraged Apple Financial Services to manage the annual refresh of its entire fleet of iPhones. This not only ensures that their staff stay current on the latest Apple technology, but also provides them with significant annual savings in the process.

Let me now turn to our capital return program and our cash position. We returned over $25 billion to shareholders during the December quarter as our business continues to generate very strong cash flow. This included $3.8 billion in dividends and equivalents and $19 billion through open market repurchases of 133 million Apple shares. We ended the quarter with $165 billion in cash and marketable securities. We repaid $1.4 billion in maturing debt and decreased commercial paper by $8.2 billion, leaving us with total debt of $111 billion. As a result, net cash was $54 billion at the end of the quarter, and we maintain our goal of becoming net cash-neutral over time.

As we move into the March quarter, I'd like to review our outlook, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. Given the continued uncertainty around the world in the near term, we are not providing revenue guidance, but we are sharing some directional insights based on the assumption that the macroeconomic outlook and COVID-related impacts to our business do not worsen from what we are projecting today for the current quarter.

In total, we expect our March quarter year-over-year revenue performance to be similar to the December quarter. This represents an acceleration in our underlying year-over-year business performance as the December quarter benefited from an extra week. Foreign exchange will continue to be a headwind, and we expect a negative year-over-year impact of 5 percentage points.

For Services, we expect revenue to grow year-over-year while continuing to face macroeconomic headwinds in areas such as digital advertising and mobile gaming. For iPhone, we expect our March quarter year-over-year revenue performance to accelerate relative to the December quarter year-over-year revenue performance. For Mac and iPad, we expect revenue for both product categories to decline double digits year-over-year because of challenging compares and macroeconomic headwinds.

We expect gross margin to be between 43.5% and 44.5%. We expect OpEx to be between $13.7 billion and $13.9 billion. We expect OI&E to be around negative $100 million, excluding any potential impact from the mark-to-market of minority investments, and our tax rate to be around 16%.

Finally, today, our Board of Directors has declared a cash dividend of $0.23 per share of common stock payable on February 16, 2023, to shareholders of record as of February 13, 2023.

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

TEJAS GALA: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please.

Questions and Answers

OPERATOR: Certainly. We will go ahead and take our first question from David Vogt with UBS.

DAVID VOGT, ANALYST, UBS INVESTMENT BANK, RESEARCH DIVISION: So Tim, and maybe this is for Luca as well. You talked about the supply chain returning back to normal after a very difficult October, November, but we're still seeing some disruptions across tech products, whether it's enterprise or consumer-facing. How do you think about your supply chain and maybe the levels of inventory or builds that you might need as we go forward to sort of insulate your business from these sort of episodic disruptions? Have you changed your view? And if so, how does that affect ultimately margins and sort of your balance sheet and cash flow items going forward?

TIMOTHY D. COOK: This is Tim, David. From a supply point of view, we did see disruption from early November through most of December. And from a supply chain point of view, we're now at a point where production is what we need it to be. And so the problem is behind us.

In terms of going forward in the supply chain, we build our products everywhere. There are component parts coming from many different countries in the world, and the final assembly coming from 3 countries in the world on just iPhone. And so we continue to optimize it. We'll continue to optimize it over time and change it to continue to improve.

I think when you sort of zoom out and back up from it, the last 3 years have been a pretty difficult time between COVID and silicon shortages and the like. And I think it's -- I think we have had a very resilient supply chain in the aggregate.

In terms of supply for this quarter, which I think was one of your points, I think we're in decent supply on most products for the quarter currently.

OPERATOR: Our next question is from Shannon Cross of Credit Suisse.

SHANNON SIEMSEN CROSS, RESEARCH ANALYST, CRÃ©DIT SUISSE AG, RESEARCH DIVISION: Luca, I wanted to dig a bit more into the commentary on gross margins. The guidance, especially at 43.5% to 44.5%, is obviously quite strong. So I'm wondering what's helping you out there, assume mix and some other things. And then how should we think about what currency and hedge is going to do as we look forward? And then I have a follow-up.

LUCA MAESTRI: Shannon, yes, I mean, we've had good margin for the December quarter to start with. We reported 43%. Obviously, in December, we have the benefit of leverage because of the seasonality of the business, but we also had favorable mix across the board.

Of course, foreign exchange is an issue right now. In the December quarter on a sequential basis, foreign exchange was a negative 110 basis points for us. And on a year-over-year basis, it's 300 basis points. So obviously, the FX environment has changed a lot during the last 12 months.

For March, yes, we've seen a margin expansion, 43.5% to 44.5%. We're doing a lot of work around cost, of course. Mix will continue to help, both within categories and services mix as we move away from the holiday season. But we're doing a lot of work on the cost structure, and that is paying off. Foreign exchange is still a negative, about 50 basis points sequentially, but it's mitigating. The last couple of weeks, the dollar has weakened a bit. And so hopefully, as we go through the year, hopefully, things will improve. But for now, as you correctly state, we are in a good position on margins.

SHANNON SIEMSEN CROSS: And then, Tim, can you talk a bit about China? What you're seeing -- obviously, you've had the issues with production, but I mean more on the demand side. As we've gotten through Chinese New Year and the opening, I'm just wondering, are you seeing the Chinese consumer come back? What are they buying? And how are you thinking about your position there?

TIMOTHY D. COOK: Shannon, last quarter, we declined by 7% on a reported basis, but we actually grew on a constant currency basis. And that was despite some significant -- the supply constraints that we talked about earlier. And obviously, the sort of the COVID restrictions throughout China that happened in various different places throughout the country also impacted the demand during the quarter.

When you look at the opening that started happening in December, we saw a marked change in traffic in our stores as compared to November. And that followed through to demand as well. And I don't want to get into January. We've obviously -- January is included in the guidance, or the color rather, that Luca provided earlier. But we did see a marked change from December compared to November.

OPERATOR: Our next question is from Erik Woodring of Morgan Stanley.

ERIK WILLIAM RICHARD WOODRING, RESEARCH ASSOCIATE, MORGAN STANLEY, RESEARCH DIVISION: Maybe, Tim, first one for you. That 2 billion installed base -- device installed base figure, that's up, I believe, 200 million units year-over-year. That implies the strongest annual gain in new devices in your installed base basically as far back as you've provided those data points. And so I guess my 2 questions are: one, do you -- can you provide the installed base for the iPhone at year-end? And then two, is there anything that you see in this new cohort of users that might look different or similar to past cohorts, either by demographic or regions or monetization ramp? And then I have a follow-up.

TIMOTHY D. COOK: Yes. The installed base is now over 2 billion active devices, as you mentioned. And we set records across each geographic segment and major product category. And so it was a broad-based change. Two -- I'll correct one thing you said, it's up over 150 million year-over-year. The last report we reported to be over 1.85. And so it's 150 million, which we're very proud of. We also saw strong double-digit in several of the emerging markets, which is very important to us. For example, India and Brazil as just 2 examples. So very, very strong. And obviously, it bodes well for the future.

ERIK WILLIAM RICHARD WOODRING: And then, Luca, obviously, the December quarter was negatively impacted by the production challenges. Can you just maybe unpackage where channel inventory levels are today kind of across the iPhone broadly? And then what the data that you're seeing so far this quarter is telling you about iPhone demand deferral versus kind of iPhone demand destruction and perhaps pushing some upgrades later into the year rather than into the March quarter? And that's it for me.

TIMOTHY D. COOK: Yes. Erik, I'll take that one as well. The channel inventory levels on iPhone, we obviously ended the December quarter below our target range given the supply challenges on iPhone 14 Pro and iPhone 14 Pro Max. But as you think about this, keep in mind that a year ago, we also exited the December quarter below our target inventory range because of supply challenges in the year ago quarter. Not related -- not the same issue, but just as a point. And so that hopefully gives you some flavor of that.

In terms of what we're seeing in January, we've included in our color that Luca provided kind of our thinking. It's very hard to estimate the recapture because you have to know exactly what would have happened and how many people bought down. And it takes a while to get that -- to get those reports in during the quarter. And so we've made our best guess at it.

In terms of the sizing of the constraint in Q1, what we estimate, although not with precision, is that we would -- I thought we believe iPhone would have grown during the quarter had it not been for the supply shortages. So hopefully, that provides you a little bit of color.

OPERATOR: Our next question comes from Aaron Rakers of Wells Fargo.

AARON CHRISTOPHER RAKERS, MD OF IT HARDWARE & NETWORKING EQUIPMENT AND SENIOR EQUITY ANALYST, WELLS FARGO SECURITIES, LLC, RESEARCH DIVISION: I have 2 as well, if I can. I guess the first kind of question, just going back on the gross margin line. Pretty good guidance into this March quarter. I'm curious if you unpack that a little bit specific around what you're seeing as far as maybe benefits from component pricing in the guidance, if you're embedding any of that at this point.

LUCA MAESTRI: Yes. Of course, with our guidance, we try to capture every aspect of our cost structure. And obviously, components are a big portion of that. So definitely, that's included. And keep in mind, again, that foreign exchange -- I mentioned earlier, I think to Shannon, that the sequential negative on FX is 50 basis points, versus a year ago, it's 270 basis points. Obviously, the U.S. dollar has moved a lot over the last 12 months. So obviously, we need to find offsets and more to the negative FX in order to be able to provide this kind of guidance. And so obviously, components are a big part of that.

AARON CHRISTOPHER RAKERS: Yes. And then kind of from a strategic perspective, given kind of the things that we're seeing out in some of your peer group, I'm curious, Tim, how you think about the role of AI in your strategy as far as particularly in the Services segment, whether you're not -- you see opportunities to excel monetization abilities within the paid subscriber base and whether or not AI, is it something that you're implementing a bit more strategically there.

TIMOTHY D. COOK: Yes. It is a major focus of ours. It's incredible in terms of how it can enrich customers' lives. And you can look no further than some of the things that we announced in the fall with crash detection and fall detection or back a ways with ECG. I mean these things have literally saved people's lives. And so we see an enormous potential in this space to affect virtually everything we do. It's obviously a horizontal technology, not a vertical. And so it will affect every product and every service that we have.

OPERATOR: Our next question comes from Amit Daryanani of Evercore.

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I guess the first one I have is, Tim, I think based on your earlier comments that iPhones would have grown ex the production issue that implied that maybe it's a $7 billion or so impact that you had in December quarter from the production challenges on the high-end models. I'm sure it's tough to see what happens this time around. But I think historically, when you've had production issues or things like this happen, what has the consumer behavior being typically? Do they tend to go down towards the lower end models and get the phone they want quickly? Or do they just defer the production? Just from a historical perspective, I think do you typically recover what's deferred out or no?

 

TIMOTHY D. COOK: It's very hard to estimate is the real answer because you have to know a lot of data, and it's usually only in hindsight that you have a more reasonable view of it. And so we put our best views in the color that Luca provided. That's kind of what I would say.

AMIT JAWAHARLAZ DARYANANI: All right. And then I guess maybe if I think about Services as you go forward. I know you had really good growth in Services, I think, over the last several years. But as you go forward in Services, what do you think drives the growth more so? Is it the expansion of your installed base? Or is it more going to be driven by ARPU going higher for you? I'm just curious, how do you think about those 2 buckets as you go forward?

LUCA MAESTRI: Amit, there's a number of things, and I've mentioned a few of them during the call. The first step is always the installed base. Installed base is the engine for Services growth. And the fact that the installed base is growing very nicely, and it's growing in a lot of emerging markets, it's growing even faster, that gives us a larger addressable pool of customers. So that's incredibly important.

The second one is that we are seeing that the level of engagement of our customers already in our ecosystem continues to grow. We -- I mentioned that both transacting accounts and paid accounts grew double digits. And so that bodes very well for the future. And we have a lot of transacting accounts that kind of moved to paid accounts over time.

The other aspect that is very important for us is to continue constantly to improve the reach and the quality of our services. And I give the example of Apple Pay, which it's a great example because we started off primarily in the United States. Now we've taken it to 70 markets, millions of merchants. And so obviously, payment services are -- continue to set new highs all the time for us.

And then as you've seen over the last few years, we also launched new services over time, and that obviously contributes to the growth. We're very excited. And when we look at the behavior of our installed base, we think it's very promising for the continued growth of our Services business.

OPERATOR: Our next question comes from Harsh Kumar of Piper Sandler.

HARSH V. KUMAR, MD & SENIOR RESEARCH ANALYST, PIPER SANDLER & CO., RESEARCH DIVISION: Tim, I had a quick question on emerging markets. Seems like you're making a lot of strides in India. Potentially wanted to understand the kind of share you have in China and India. And relative to that, what would be your aspirational but sort of achievable share in iPhones in those territories, whether it's units or revenues? And I was hoping to draw on your experience and maybe what you've seen in other countries where you've had some longer presence.

TIMOTHY D. COOK: And looking at the business in India, we set a quarterly revenue record and grew very strong double digits year-over-year. And so we feel very good about how we performed, and that was -- that's despite the headwinds that we've talked about. Taking a step back, India is a hugely exciting market for us and is a major focus. We brought the online store there in 2020. We will soon bring Apple retail there. So we're putting a lot of emphasis on the market. There's been a lot done from a financing options and trade-ins to make products more affordable and give people more options to buy. And so there's a lot going on there.

We are, in essence, taking what we learned in China years ago and how we scale to China and bringing that to bear. And I don't have the exact market shares in front of me, but I think you would see that from a market share point of view that we grew around the world last quarter despite -- on iPhone despite the challenges that we've had on the supply side. And I wouldn't expect to have a difference in those 2 markets.

HARSH V. KUMAR: Understood. And for my follow-up, I had a sort of interesting theoretical question on pricing. Assuming we get the CHIPS Act passed, and there's a whole bunch of manufacturing that happens in U.S. and other territories that are potentially somewhat more expensive than the ones you might be now, have you -- has the company done any studies to gauge the elasticity of demand relative to small price increases in your products?

TIMOTHY D. COOK: We have experience in that, but I wouldn't necessarily draw the same conclusion that you have in terms of the cost of the product. I -- we don't know at this point exactly what that will be, but we're all in, in terms of being the largest customer for TSMC in Arizona. I'm very proud to take part in that. That's what I would say about that.

OPERATOR: Our next question comes from Wamsi Mohan of Bank of America.

 

WAMSI MOHAN, MD IN AMERICAS EQUITY RESEARCH, BOFA SECURITIES, RESEARCH DIVISION: Tim, you've done a phenomenal job of driving consumer choice towards higher-end products within your portfolio. How would you compare this cycle for iPhones if you were to segment the Pro versus non-Pro models versus the cycles from the past few years? And do you think this move to higher ASPs is sustainable? Or do you think it reverses in a tighter consumer spending environment? And I have a follow-up.

TIMOTHY D. COOK: The Pro has been a -- the 14 Pro and the 14 Pro Max have done extremely well up until the point where we had a supply shortage and couldn't provide them -- couldn't provide the total of the demand. And so it's definitely a strong Pro cycle. I think there's a number of reasons for that, but the most important one is always the product. And I think the innovations and the product speak for themselves. And we feel very good about the product that we announced back in September and are happy to now be at a point where we're shipping to the demand.

WAMSI MOHAN: And Tim, do you think that this move to sort of higher ASPs that has happened over the last few years is sustainable? Or could it sustain in this very tough macro environment that you've cited?

TIMOTHY D. COOK: I wouldn't want to predict, but I would say that the smartphone for us, the iPhone has become so integral into people's lives. It contains their contacts and their health information and their banking information and their smart home and so many different parts of their lives, their payment vehicle and -- for many people. And so I think people are willing to really stretch to get the best they can afford in that category.

WAMSI MOHAN: Okay. Great. And Tim, you clearly emphasize the focus and importance of the installed base. If we think about the absolute grit of the installed base from 1 billion to 2 billion over 7 years from a device standpoint, how should we think about the penetration of services or the growth in paying customers on services or that time frame? Is that penetration rate increasing or decreasing? How fast is that growing relative to the growth of the overall installed base?

LUCA MAESTRI: Wamsi, it's Luca. Yes, of course, we keep track of that. It's really important for us. Over the last 7 years, as we doubled the installed base, we've seen a growing engagement of our customers on the platform. That happens, first of all, by customers transacting on the platform and then moving to paid accounts. So starting to pay for some of the services. That percentage of paid accounts tends to grow over time. We've seen it in developed markets. We see it in emerging markets. And that is due to some of the reasons that I was explaining earlier, including the fact that we made it easier for our customers to get engaged on the platform. For example, we offer multiple payment methods in many countries. And we've made it easier to explore for more services because we've added a lot of services on the platform over the last 7 years. So to your question, of course, higher engagement means a higher percentage of paid accounts over time.

OPERATOR: Our next question comes from Richard Kramer of Arete Research LLP.

TEJAS GALA: Operator, can we move on to the next?

OPERATOR: Next, we'll hear from Jim Suva of Citigroup.

JAMES DICKEY SUVA, MD & RESEARCH ANALYST, CITIGROUP INC., RESEARCH DIVISION: Tim and Luca, you both mentioned earlier on the Q&A a little bit about India. I was wondering if we're now entering a situation of even more opportunity because we've exited COVID, we've exited countries with different COVID criteria. We've also seen India build out its higher speed transmissions. And your market is -- shares tremendously underrepresented there. And it appears with the supply chain, you're looking at diversifying kind of operational risk not specific to any country, but just overall. Now you look at potentially opening up stores and stuff. Am I right that, that's the way you look at it is it's even more prime for opportunity now than ever? And once you start opening up stores there, you could just see a complete green shoot of adoptions or any additional commentary on your view on India as now we've navigated COVID and supply chain and so many challenges over the past 2 years?

TIMOTHY D. COOK: Yes. Jim, we actually did fairly well through COVID in India. And I'm even more bullish now on the other side of it, or hopefully, on the other side of it. And that's the reason why we're investing there. We're bringing retail there and bringing the online store there and putting a significant amount of energy there. I'm very bullish on India.

JAMES DICKEY SUVA: And then as my quick follow-up, you had mentioned that Services, not necessarily specific to India, but Services overall were better than expected. And of course, supply chain was more challenged than expected. So what was the bridge factor of Services being better than expected on upside? Was it like advertising or apps or paid monthly subscriptions? Or what were kind of the things that really surprised you to the upside on Services?

LUCA MAESTRI: It was -- Jim, it's Luca. It's primarily the -- this level of engagement we saw, which then reflects into the, as you said, the paid subscriptions. We saw very good results in our cloud services business in payment services. Music was very strong. So we had a number of categories that set new records, all-time records. And they did a bit better than we were expecting at the beginning of the quarter.

And so Tim mentioned that during, I think, his prepared remarks that when you look at it in constant currency, we grew services double digits. And that was on top of a 24% increase a year ago. So it's very sustained growth that we're seeing.

OPERATOR: Our next question will come from Krish Sankar of Cowen and Company.

KRISH SANKAR, MD & SENIOR RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: I have 2. The first one, Tim and Luca, you mentioned how the macro did soften, and it has an impact. And as consumers tighten their belt, when you look across your hardware products and service businesses, where are you seeing the biggest impact and where are you seeing the least impact from the softening macro? And then I had a quick follow-up.

TIMOTHY D. COOK: We think there were some impact across the products and in Services. Probably, the ones that we saw the most impact on were Mac and Wearables. You can see that in those numbers. And probably, the least would have been iPhone.

KRISH SANKAR: Got it. Got it. Very helpful, Tim. And then just a quick follow-up on the Mac. The PC industry is expecting a decline in PC shipments this year also. How do you think about the Mac relative to kind of like where the PC industry as a whole is expecting the shipments to end up? Is there any color you can give on that?

TIMOTHY D. COOK: The industry is very challenged, as you say. It's -- the industry is contracting. I think from us, though, is -- and I don't know how this year will play out, so I don't want to predict the year. But over the long run, we have a market that is a reasonable-sized market, a big market. And we have low share, and we have a competitive advantage with Apple silicon. And so strategically, I think we're well positioned in the market, albeit I think it will be a little rough in the short term.

TEJAS GALA: A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor and via telephone. The number for the telephone replay is (866) 583-1035. Please enter confirmation code 6541285, followed by the pound sign.

These replays will be available by approximately 5 p.m. Pacific Time today. Members of the press with additional questions can contact Josh Rosenstock at (408) 862-1142. Financial analysts can contact me with additional questions at (669) 227-2402. Thank you again for joining us.

OPERATOR: And once again, this does conclude today's conference. We do appreciate your participation.

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**Q4 2022 Apple IncEarnings Call - Final**

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OPERATOR: Good day, and welcome to the Apple Q4 Fiscal Year 2022 **Earnings** Conference Call. For your information, today's call is being recorded. At this time, for opening remarks and introductions, I'd like to turn the call over to Tejas Gala, Director of Investor Relations and Corporate Finance. Please go ahead.

TEJAS GALA, IR CONTACT, APPLE INC.: Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts. Before turning the call over to Tim, I would like to remind you that approximately once every 6 years, we add a week to the December quarter to realign our fiscal periods with the December calendar. So this December quarter will span 14 weeks rather than the usual 13 and will end on December 31.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expense, other income and expense, taxes, capital allocation and future business outlook, including the potential impact of COVID-19 on the company's business and results of operations. These statements involve risks and uncertainties that may cause actual results or trends to differ materially from our forecast.

For more information, please refer to the risk factors discussed in Apple's most recently filed annual report on Form 10-K 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, CEO & DIRECTOR, APPLE INC.: Thank you, Tejas. Good afternoon, everyone, and thank you for joining the call today. Over the past year, despite a range of challenges facing the world, our teams have come together in incredible ways to drive unparalleled innovation and deliver again and again for our customers.

For the September quarter, we reported record revenue of $90.1 billion, which was better than we anticipated despite stronger-than-expected foreign currency headwinds. We set an all-time revenue record for Mac and September quarter records for iPhone and Wearables, Home and Accessories. Services notched a September quarter record as well with revenue of $19.2 billion and more than 900 million paid subscriptions.

We reached another record on our installed base of active devices, thanks to a quarterly record of upgraders and double-digit growth in switchers on iPhone. Across nearly every geographic segment, we reached a new revenue record for the quarter. And we continue to perform incredibly well in emerging markets with very strong double-digit growth in India, Southeast Asia and Latin America.

I'm also happy to report that during the quarter, silicon-related supply constraints were not significant. I want to acknowledge that we are still living through unprecedented times. From war in Eastern Europe to the persistence of COVID-19, from climate disasters around the world to an increasingly difficult economic environment, a lot of people and a lot of places are struggling. Through it all, we've aimed to help our customers navigate through the challenges while giving them the tools to drive progress for themselves and their communities.

At Apple, creativity and collaboration have always been at the core of who we are. That spirit of ingenuity and teamwork helped us provide our customers with incredible innovations this year and led to another yearly revenue record. In fiscal 2022, Apple achieved revenue of $394 billion, representing 8% annual growth. We set records for iPhone, Mac, Wearables, Home and Accessories and Services while growing double digits in emerging markets and setting records in the vast majority of markets we track.

Customers are loving our iPhone 14 lineup. Loaded with camera upgrades for sharper photos, Action Mode for smoother videos and new safety features like Crash Detection and Emergency SOS via Satellite, iPhone is even more indispensable to our daily lives. iPhone 14 and iPhone 14 Plus come with a new dual-camera system, industry-leading durability, incredible power and amazing battery life. And our iPhone 14 Pro models are packed with even more groundbreaking innovations, including a new camera system as well as always-on display and the Dynamic Island, which offers a whole new way to interact with iPhone.

Just yesterday, our most advanced iPad and iPad Pro ever landed in stores. With its all-screen design, advanced cameras and faster wireless connectivity, the 10th generation iPad looks and performs better than ever. For creatives, iPad Pro, now turbocharged by the blazingly fast M2 chip, is the perfect device to make something amazing.

Our Mac customers have already been raving about the power of M2 since the arrival of our newest MacBook Air and MacBook Pro this summer. Their incredible long battery life, stunningly rich display and lightning fast speeds are a signature part of the Mac experience and helped drive an all-time record revenue for Mac during the September quarter.

In Wearables, Home and Accessories, a wave of innovation spurred 10% year-over-year revenue growth during the September quarter. New features in Apple Watch Series 8, including temperature sensing capabilities, retrospective ovulation estimates and crash detection are helping to keep customers healthier and safer. And the updated Apple Watch SE is a great way for users to start their Apple Watch journey, delivering advanced features at a new low price.

The biggest, brightest and boldest Apple Watch ever made, Apple Watch Ultra pushes the boundaries of what a smartwatch can do. Packed with innovations like advanced navigation tools and the new Oceanic+ app, which turns it into a dive computer, Apple Watch Ultra has something for athletes and adventures on land and sea.

The second generation of AirPods Pro powered by the new H2 chip are receiving rave reviews for delivering an unmatched wireless earbud audio experience while canceling up to twice as much noise over the previous model. There's no better place to discover the rich spatial audio capabilities of AirPods Pro than Apple Music, the largest music catalog anywhere, now with more than 100 million songs.

And there's no other company that fuses best-in-class hardware with cutting-edge software and services to create a truly integrated and seamless experience. With iOS 16, we're giving customers more ways to personalize their iPhones through a customizable lock screen and focus filters. New features in Messages and Mail enable users to connect and collaborate like never before. Stage Manager in iPadOS 16 and MacOS Ventura helps users stay more productive with smoother multitasking. And watchOS 9 is empowering customers to live a healthier day through updates to the Sleep App, a new FDA-cleared AFib history feature and the new Medications app.

Across our Services, we continue to see enthusiasm and strong engagement from our subscribers. Apple TV+ hits like Severance, Bad Sisters and Black Bird have taken center stage on screens around the world. And baseball fans were glued to their seats this season watching Friday Night Baseball. Meanwhile, Apple TV+ productions continue to earn accolades. At the 74th Primetime Emmy Awards in September, Apple brought home 9 statues, including a second consecutive win for Best Comedy Series for Ted Lasso. And soon, we're going to give audiences an even better entertainment experience when the all-new Apple TV 4K hit stores next week.

We're also bringing Fitness+ to more customers than ever by making our entire library of over 3,000 studio-style workouts and meditations available to iPhone users in 21 countries, even those without an Apple Watch. These updates are arriving just in time for a new Artist Spotlight series with workouts featuring the music of Taylor Swift and a new workout program, Yoga for Every Runner, featuring and design with one of the world's top ultramarathon athletes, Scott Jurek.

While Fitness+ helps subscribers stay active, Apple Card is designed with our customers' financial health in mind. For the second year in a row, Apple Card has been ranked highest in customer satisfaction for midsized credit card issuers by J.D. Power. And our users' favorite Apple Card benefit just got even better with the upcoming addition of a new high-yield savings account to help them save and grow their daily cash rewards.

Turning to retail. Last month, our team members welcomed customers to the all-new Apple Jamsil in South Korea. And through today at Apple Creative Studios, we partnered with nonprofits in cities around the world to help young, diverse, creatives pursue their passions and connect with local mentors. And our retail teams have done exceptional work, helping customers explore our latest products and features. As we approach the holiday season with our product lineup set, I'd like to share my gratitude to our retail, AppleCare and channel teams for the work they are doing to support customers.

 

At Apple, we're proud of the ways we are able to help customers be productive, get healthy, stay safe and unlock their creative potential. We also understand we have important responsibilities to the communities we serve. That's why we continue to invest in education, racial equity and justice and the environment. And we are making important progress toward a more inclusive and diverse workforce.

Through our Community Education Initiative, we're working alongside more than 150 partners to help students around the world learn new science and technology skills. This summer, we joined with community partners to support coding academies across the United States from Codecademy in Nashville to One Summer Chicago to the Coding 5K Camp for Girls right next door in San Jose.

We've also just expanded our Racial Equity and Justice initiative into the U.K. for the first time. Alongside the Southbank Center, we're helping aspiring creatives develop their own voices and position themselves for long-lasting careers.

Back in the U.S., we welcomed a new class of Black, Latino and indigenous entrepreneurs to Apple's second Impact Accelerator. This group of innovators is focused on using green technology to mitigate the effects of climate change and serve communities most affected by it.

At Apple, we care deeply about protecting the planet for future generations. To that end, in support of our 2030 environmental goals, we have asked all of our suppliers to become carbon-neutral across their entire Apple-related footprint by the end of the decade. We are also providing them with resources based on what we learned achieving net-zero carbon in our own global operations.

Across our entire product lineup, we also continue to source more materials through recycling while taking less from the Earth. Every iPhone 14 is made with 100% recycled rare Earth elements in all magnets, including those used in MagSafe. And in a first for Apple Watch and iPad, we're using recycled gold in the plating of multiple printed circuit boards in our newest devices. While we're working to reduce the footprint of our hardware, we're making changes to our software to be more environmentally-friendly with the soon-to-be released Clean Energy charging feature for iPhone.

Our 2030 goal is a reflection of our relentless focus on the future at Apple. The world continues to be unpredictable as old challenges evolve and new ones emerge. What remains constant is the ability of our teams to create great products, services and experiences while being a force for good in the world. Whatever challenges lie ahead in the new year, we're moving forward, as we always have, investing for the long term to deliver incredible innovations for our customers like only Apple can. And now I'll hand it over to Luca for more details on our performance.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim, and good afternoon, everyone. We are very pleased to report record financial results for the September quarter that capped another record fiscal year for Apple despite a challenging and volatile macroeconomic backdrop. We reached a September quarter revenue record of $90.1 billion, up 8% year-over-year despite over 600 basis points of negative foreign exchange impact, with new September quarter records in the Americas, Europe, Greater China and rest of Asia Pacific. Importantly, in constant currency, we grew nicely in each of our geographic segments, with strong double-digit growth outside the U.S.

Products revenue was $71 billion, up 9% over last year despite FX headwinds and a record for the September quarter. And it was a September quarter revenue record for iPhone and Wearables, Home and Accessories and an all-time revenue record for Mac. Overall, our installed base of active devices continue to grow nicely. It reached an all-time high for all major product categories and geographic segments at the end of the quarter, thanks to extremely strong customer satisfaction and loyalty and a high number of customers that are new to our products.

Our Services set a September quarter revenue record of $19.2 billion, up 5% over a year ago despite over 600 basis points of negative impact from foreign exchange. We reached September quarter revenue records in the Americas, Europe, Greater China and rest of Asia Pacific and also in many Services categories, including all-time revenue records for cloud services and payment services.

Company gross margin was a September quarter record at 42.3%. It was down 100 basis points from last quarter due to unfavorable foreign exchange and a different mix, partially offset by leverage. Products gross margin was 34.6%, up 10 basis points sequentially, with improved leverage and favorable mix partially offset by foreign exchange. Services gross margin was 70.5%, down 100 basis points sequentially, primarily due to foreign exchange. Net income of $20.7 billion, diluted **earnings** per share of $1.29 and operating cash flow of $24.1 billion were all September quarter records.

Let me now get into more detail for each of our revenue categories. iPhone revenue grew 10% year-over-year to a September quarter record of $42.6 billion despite significant foreign exchange headwinds. We set September quarter records in the vast majority of markets we track, and our performance was particularly impressive in several large emerging markets, with India setting a new all-time revenue record and Thailand, Vietnam, Indonesia and Mexico more than doubling year-over-year.

Thanks to our strong iPhone lineup, we set a quarterly record for upgraders and grew switchers double digits. This level of sales performance, along with unmatched customer loyalty, drove the active installed base of iPhones to a new all-time high across all geographic segments. And the latest survey of U.S. consumers from 451 Research indicates iPhone customer satisfaction of 98%.

It was a great quarter for Mac. We achieved an all-time revenue record of $11.5 billion, up 25% year-over-year, despite significant FX headwinds. There were 3 key items that helped drive this performance. First, we benefited from the launch of our new MacBook Air and MacBook Pro powered by the M2 chip. Second, we were able to satisfy pent-up demand that carried forward from the significant supply constraints we faced during the June quarter. Third, as our supply position improved, we were able to fill the channel. Importantly, our investment in the category has attracted both upgraders and customers new to Mac and helped our installed base reach an all-time high. In fact, we set a quarterly record for upgraders, while nearly half of customers buying Macs during the quarter were new to the device.

iPad revenue was $7.2 billion, down 13% year-over-year due to significant negative foreign exchange and a challenging compare due to the launch of new iPads a year ago. Despite this, the iPad installed base reached a new all-time high, thanks to incredible customer loyalty and a high number of new customers. In fact, over half of the customers who purchased iPads during the quarter were new to the product.

Wearables, Home and Accessories revenue was $9.7 billion, growing 10% year-over-year, driven by the launch of Apple Watch and new AirPods Pro. This level of safe performance along with very strong new to rates drove our installed base of devices in the category to a new all-time record. For instance, 2/3 of customers purchasing an Apple Watch during the quarter were new to the product.

Moving to Services. As I mentioned, we set a September quarter record in aggregate and in most geographic segments, generating $19.2 billion in revenue in spite of very large foreign exchange headwinds. It is important to remember that we achieved double-digit constant currency growth in Services on top of growing 26% during the September quarter a year ago. However, certain services were impacted by macroeconomic headwinds, including foreign exchange. Digital advertising and gaming are areas where we've seen some softness.

Throughout the quarter, we continued to observe several trends that reflect the strength of our ecosystem and our long-term opportunity in the category. First, our continued installed base growth across each geographic segment and each major product category represents a great foundation for future expansion of our ecosystem. Second, we saw increased customer engagement with our Services during the quarter. Both our transacting accounts and paid accounts grew double digits year-over-year, each setting a new all-time record. The percentage of accounts that pay for our services continues to increase, and we still see plenty of opportunity ahead of us.

Third, paid subscriptions showed very strong growth. We now have more than 900 million paid subscriptions across the Services on our platform, up more than 155 million during the last 12 months alone and double what we had just 3 years ago. We continue investing in new content and features across our service offerings. For example, we added several popular sports titles to Apple Arcade. We're also excited about our global partnership with Major League Soccer, where, starting next season, fans can stream every single MLS match through the Apple TV app.

This momentum helped us achieve over $78 billion in Services revenue during fiscal 2022, a new record and up 14% year-over-year. We continue to invest confidently and believe strongly in the long-term potential of our Services business, which is already the size of a Fortune 50 business on its own and has nearly doubled during the last 4 years.

It was not only a record year for Services but also for our entire company. During the past 4 quarters, we grew our business by 8% or $29 billion, reaching more than $394 billion of revenue. We grew diluted **earnings** per share by 9% and generated over $111 billion of free cash flow, up 20% year-over-year. It was also a strong year for our enterprise business as we set new annual records for iPhone, iPad and Mac during fiscal 2022 and grew strong double digits year-over-year as our devices and services continue to help more and more companies empower their employees and serve their customers.

 

For instance, Ford Manufacturing employees are using iPad and iPhone to help further improve the quality of its game-changing Ford F-150 Lightning electric trucks. iPhone's powerful A-series chip and advanced camera systems, along with third-party iOS apps, are enabling Ford to automate the visual quality inspection process in real time to help address issues before they impact customers.

And Cisco expanded its Macs as a choice program and is now offering it to all its employees to help attract and retain top talent. And when given this choice, employees have chosen Macs twice as often as other options. In addition, many enterprise customers are taking advantage of the high residual value of our products and simple trade-in process to standardize the refresh cycles for their fleets of Apple devices. This allows employees to upgrade to the latest devices regularly while making it highly predictable and cost effective for the business.

Let me now turn to our cash position. Our business continues to generate very strong cash flow, which enabled us to return over $29 billion to shareholders during the September quarter. This included $3.7 billion in dividends and equivalents and $25.2 billion through open market repurchases of 160 million Apple shares. We ended the quarter with $169 billion in cash and marketable securities. We repaid $2.8 billion in maturing debt and decreased commercial paper by $1 billion while issuing $5.5 billion of new debt, leaving us with total debt of $120 billion. As a result, net cash was $49 billion at the end of the quarter as we continue to make progress toward our goal of becoming net-cash neutral over time.

As we move ahead into the December quarter, I'd like to review our outlook, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. Given the continued uncertainty around the world in the near term, we are not providing revenue guidance. But we are sharing some directional insights based on the assumption that the macroeconomic outlook and COVID-related impacts to our business do not worsen from what we are projecting today for the current quarter.

Overall, we believe total company year-over-year revenue performance will decelerate during the December quarter as compared to the September quarter for a number of reasons. First, we expect nearly 10 percentage points of negative year-over-year impact from foreign exchange. Second, on Mac, in addition to increasing FX headwinds, we have a very challenging compare against last year, which had the benefit of the launch and associated channel fill of our newly redesigned MacBook Pro with M1. Therefore, we expect Mac revenue to decline substantially year-over-year during the December quarter.

Specifically on Services, we expect to grow but to be impacted by the macroeconomic environment increasingly affecting foreign exchange, digital advertising and gaming. We expect gross margin to be between 42.5% and 43.5%. We expect OpEx to be between $14.7 billion and $14.9 billion. We expect O&E to be around negative $300 million, excluding any potential impact from the mark-to-market of minority investments and our tax rate to be around 16.5%.

Finally, today, our Board of Directors has declared a cash dividend of $0.23 per share of common stock, payable on November 10, 2022, to shareholders of record as of November 7, 2022. With that, let's open the call to questions.

TEJAS GALA: Thank you, Luca. (Operator Instructions) Operator, may we please have the first question?

Questions and Answers

OPERATOR: We'll go ahead and take our first question from Shannon Cross calling from Credit Suisse.

SHANNON SIEMSEN CROSS, RESEARCH ANALYST, CRÃ©DIT SUISSE AG, RESEARCH DIVISION: It's great to talk to you on the call again. I'm wondering, can you just talk a bit about how you're thinking about this iPhone generation? On the positive side, you've raised prices. It seems to be mixing up. On the negative side, investors are concerned about impacted demand from the higher prices, what Huawei meant to you in prior years versus what could happen now. There are just some pressures out there.

So I'm curious if you can kind of talk to what you're seeing initially in iPhone demand and how you think it will sort of move through. With the caveat that I understand, things are pretty uncertain out there. And then I have a follow-up.

TIMOTHY D. COOK: Shannon, it's Tim. Welcome back. iPhone grew 10% in the Q4 time frame to $42.6 billion. Customer demand was strong and better than we anticipated that it would be. And keep in mind that this is on top of a fiscal year of '21 that had iPhone revenue grow by 39%, and so it's a tough compare as well. And so we were happy with it.

In terms of the new products, the 14 and the 14 Pro and Pro Max, the -- it's still very early. But since the beginning, we've been constrained on the 14 Pro and the 14 Pro Max and we continue to be constrained today. And so we're working very hard to fulfill the demand. It's difficult to say what the mix will be until we can satisfy the demand because we don't really -- we're not able to determine the accurate mix until then. And so we -- but we're working very hard to do that.

We were really pleased with the broadness of the iPhone strength last quarter. We had 3 of the top 4 smartphones in the U.S. and the U.K., the top 3 in Urban China, the top 6 in Australia, 4 out of the top 5 in Germany and the top 2 in Japan. And customer satisfaction for the iPhone remains very, very strong at 98%. And so we feel very good about how we performed in Q4. And certainly, the start of the -- of this generation would suggest that we're going to be constrained for a little while on the 14 Pro and 14 Pro Max. But we're working very hard to try to remedy that.

SHANNON SIEMSEN CROSS: And then, Luca, can you talk a bit about gross margin puts and takes? Just how we should think about -- I mean, 10 basis points of currency this coming quarter is, I don't want to say unprecedented, but maybe it is. So I know you have hedges, but how do we think about it flowing through? And then what other -- components seem to be very favorable. But what else should we sort of throw into the mix as we look forward?

LUCA MAESTRI: Yes. Well, let me start with gross margin in Q4 and then I'll get to Q1. It was a September quarter record for the company. We did 42.3%, and that is in spite of, as you mentioned, very significant negative FX in -- for example, for Q4, on a sequential basis, FX was negative 70 basis points and on a year-over-year basis was negative 170 basis points. Essentially every currency around the world has weakened against the dollar.

Now we have guided Q1 to 42.5% to 43.5% in spite of the fact that we have, on a year-over-year basis, 330 basis points of negative exchange. Sequentially, it's 120 basis points unfavorable. So obviously, the strong dollar makes it difficult in a number of areas. Obviously, our pricing in emerging markets makes it difficult, and the translation of that revenue back into dollars is affected. But on the positive side, we are seeing commodities behave fairly favorably for us.

And so we believe we can offset the foreign exchange -- the negative foreign exchange that we're seeing. And I think that the guidance that we provided reflects that. It takes into account, of course, FX. It takes into account some level of inflationary pressures. But I think the outcome is, I think, is a good one.

OPERATOR: Our next question is coming from Erik Woodring with Morgan Stanley.

ERIK WILLIAM RICHARD WOODRING, RESEARCH ASSOCIATE, MORGAN STANLEY, RESEARCH DIVISION: I have 2 as well. Maybe if we could just start, Luca, we saw quite the divergence in iPad and Mac performance this quarter. Both were relatively constrained from a supply perspective. So maybe can you just elaborate on some of the most important factors that contributed to kind of the divergence in performance and whether after we get through the December quarter, those can reverse or normalize? And then I have a follow-up.

TIMOTHY D. COOK: Yes, Erik, it's Tim. I'll take your question. On -- if you look at the Mac, the Mac, it was the best quarter we've ever had in the history of the company. It was helped by the product launch of the MacBook Air with M2. It was helped that in the previous quarter, in the June quarter, if you remember, we lost output from the factory for a significant portion of the quarter. And so we had a backlog exiting our Q3 headed into Q4. We were able to satisfy all of that demand during Q4 and filled the channel for the Mac. And so that led to an incredible Mac quarter.

If you look at iPad, iPad had sort of the opposite happening from a launch point of view. The comp from a year ago, we launched iPads in September. We launched iPads this year in October. The other point to remember is that the iPad Pro had just launched before the quarter started in the year-ago quarter so it was our first full quarter of iPad Pro. So it was an exceptionally strong iPad quarter a year ago and the launches were really key to that performance. And so that's the reason iPad contracted during this quarter.

ERIK WILLIAM RICHARD WOODRING: Okay, that's helpful. And then maybe, Luca, if I were just to ask you, obviously, Tejas at the beginning of the call talked about the 14-week quarter. Maybe can you just elaborate a little bit on how you think that 14-week quarter impacts different line items, whether it's products or certain segments within the product business or the Services stand-alone? Just where we should see that 14-week quarter provide a bit more of a tailwind versus maybe not have an impact at all? And that's it for me.

LUCA MAESTRI: In general, we have a few more days in the quarter that we're going to -- are going to affect both our revenues and our costs. Not every week is equal because obviously, we have certain peaks during the course of the quarter. Think about Black Friday or the Christmas holiday. But in general, we're adding a few days of sale and additional OpEx as well on the cost front. So that's what happens to us every approximately 6 years as we need to align our weekly calendar to the fiscal calendar.

OPERATOR: The next question is coming from Ben Bollin calling from Cleveland Research.

BENJAMIN JAMES BOLLIN, SENIOR RESEARCH ANALYST, CLEVELAND RESEARCH COMPANY LLC: Tim, I was hoping we could talk a little bit about Services pieces within the portfolio. It looks like there's been some price adjustments as of late with respect to Music, TV+ and the One bundle. I'm curious how you think about balancing the consumer price versus your own costs and kind of the associated follow-through. And then I have a follow-up.

TIMOTHY D. COOK: Yes. If you look at the price increase that you referenced, Ben, on Monday of this week, we announced a price increase on Apple Music and on Apple TV+ and then the corresponding Apple One, that is the consolidated bundle that includes both of those. On -- there's really 2 different situations here. With Music, the cost of licensing increased and so we are paying more for music. The good thing about that is the artist will also get more money for their songs that are enjoyed on streaming. And so there's some bit of good news there, I suppose.

And then on Apple TV+, if you look at when we first priced it, we only had a very few shows. We were at the beginning. We are very focused on originals only, and so we had 4 or 5 shows or so in the beginning and priced it quite low. We now have a lot more content and are coming out on -- with more each and every month. And so we've increased the price to represent the value of the service. And of course, Apple One is just the consolidation of those 2 price changes.

BENJAMIN JAMES BOLLIN: Okay. And then another item. Any preliminary thoughts around capital intensity into fiscal '23? Last couple of years, CapEx has been relatively stable. Can you talk to the big constituents of the CapEx figure and maybe any moving pieces and how we could think about that to '23?

LUCA MAESTRI: Yes, Ben. So when we look at our CapEx, as you correctly said, I mean, we've been fairly stable, and I think our capital intensity is really very good. We have 3 major buckets in CapEx for the company. We have certain dedicated tools for the manufacturing facilities. We had some spend around data centers, and we have spend around our office facilities around the world. We obviously monitor all of them. There is nothing unusual that we see for the next 12 months.

OPERATOR: Our next question is coming from Kyle McNealy calling from Jefferies.

KYLE P. MCNEALY, EQUITY ANALYST, JEFFERIES LLC, RESEARCH DIVISION: Just wanted to see if you could give us a sense for what drove the Wearables result and the strength there this quarter. Was it from the maybe strong iPhone attach rates or the new products that you have available that were announced this quarter? Or maybe you're still getting some benefit from customers that are more willing to come into the store now and try things on versus the pandemic when that was kind of shut down?

TIMOTHY D. COOK: Yes. Kyle, it's Tim. The -- if you look at Wearables, we grew 10%, which we were very happy with. If you look at the individual pieces of that, Apple Watch was a contributor. And in particular, the new lineup was a contributor, including the Apple Watch Ultra and the Apple Watch Series 8 and the SE. The Ultra is -- was supply constrained and continues to be supply constrained during this quarter, thus far. And so we're working hard to satisfy the demand there and get those products to customers.

We also announced and launched the AirPods Pro in September. And the reviews for the product have just been off the charts in terms of the noise cancellation features and the sound quality. We're getting great, great reviews from there. In terms of what played the other way, the headwinds, obviously, FX was a headwind that affected Wearables, Home and Accessories, just like it affected the rest of our products and services. And we also had effect from the business in Russia, obviously, or the impact there. So that's sort of the pro and the con.

The other thing that I should mention is that about 2/3 of the Apple Watches that we sold were to customers that had not previously owned an Apple Watch. And so the -- we're still very much selling to new customers here, which is very, very good for the future.

KYLE P. MCNEALY: Okay, great. One more quick one on Mac. I wanted to see if you could quantify at all how much the channel fill and how much came from satisfying back orders from the June period for Mac. We're just trying to get a sense for where the baseline is, if there's any sense you can give us on that. What would it have grown if not for those factors? Anything you can give us would be great.

TIMOTHY D. COOK: Yes. I would just say that all 3 of the reasons that I gave were key in achieving the 25%. The M2 MacBook Air, the launch of the new product, the satisfying the back orders from the previous quarter and then filling the channel, all of those were key contributors.

OPERATOR: The next question is coming from Mr. Jim Suva calling from Citigroup.

JAMES DICKEY SUVA, MD & RESEARCH ANALYST, CITIGROUP INC., RESEARCH DIVISION: It's great to see that you talked about your suppliers going carbon-neutral, something -- a small statement I really took to heart. My question is on the Services. Could it possibly be impacted more by FX than product, meaning the Jim Suva family has Apple One and TV+ and all that, and we pay typically on annual, but then when we go into the store to buy new Watches and iPad, the price is adjusted more quickly.

So could it be that Services growth was impacted a little bit more by FX and down the road, we could see growth reaccelerate? Or am I just reading too much into the FX impact that could be different from Services versus product?

LUCA MAESTRI: Jim, it's Luca. No, you're right. Obviously, the FX impact on our business depends on the geographic mix of the sales that we do. And so yes, it can be -- services and products can have slightly different effects on foreign exchange. And so if we look at our Services business in constant currency, we would have grown double digits. And so we're very pleased with that.

As I mentioned, there were some areas that we could see some softness in digital advertising. Of course, you know that part, and gaming on the App Store was affected. But we were very happy with what we saw in terms of the behavior of our customers with the engagement with Services. And I mentioned a number of things during the prepared remarks. The fact that, obviously, that installed base is growing, that's a positive and it's a great foundation for the future.

We are seeing more transacting accounts and more paid accounts. They're both growing double digits. Paid accounts are growing faster than transacting accounts, so the penetration of paid accounts is increasing. We have a great subscription business, 900 million paid subs now on the platform and growing very fast. We doubled in 3 years. So when we look at all those dynamics, that's the part that is really interesting to us because we really believe that the engine for Services growth is there and foreign exchange is a temporary thing and -- but the fundamentals are very good.

JAMES DICKEY SUVA: Congratulations to your teams.

OPERATOR: The next question is coming from Amit Daryanani from Evercore.

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I have 2 as well. The first one really is around the iPhone trajectory. There's been a fair amount of focus in terms of what's going to happen to iPhone demand, given the macro worries. It would be really helpful to understand though, given the strength you're seeing, where do you think channel inventory is for iPhones today versus where it would be from a historical perspective? And do you see the channel getting to an optimal level by end of December quarter? Because evenly right now given the lead time data, it looks like your revenue trajectory in iPhones is more driven by the supply you have versus demand. So any color on the channel inventory would be helpful.

TIMOTHY D. COOK: Yes. If you look at where we ended, Amit, in the September quarter, we exited below our target inventory range on iPhone. And that's -- that in and of itself is not too unusual in the quarter. We start the ramp and demand is robust and so forth. And so I wouldn't call it that abnormal from the past.

AMIT JAWAHARLAZ DARYANANI: Got it. And then I guess, Tim, you folks have been talking about digital advertising a fair bit over the last few quarters, I think. Is there any metrics, any vectors you can talk about kind of to give us a sense of how big those businesses or what vectors are you focused on? And really, if you could talk about, do you think Apple can build an advertising business at scale without sacrificing consumer privacy?

TIMOTHY D. COOK: So our -- first and foremost, we focus on privacy and so we would not do anything that stepped away from that. We feel that privacy is a basic fundamental human right, and so that's sort of the lens that we look at it under. Our specific advertising business is not large and -- relative to others and so forth. But we don't release the exact numbers on it, but it's clearly not large.

 

OPERATOR: We'll now move on to Mr. Harsh Kumar calling from Piper Sandler.

HARSH V. KUMAR, MD & SENIOR RESEARCH ANALYST, PIPER SANDLER & CO., RESEARCH DIVISION: First of all, fellows, congratulations on stellar performance. There's a lot of large-cap companies that are getting ripped around, so we appreciate the steady cadence here. Tim, I wanted to ask you about inflation pressures and labor problems here in the U.S. and globally. And maybe talk about what steps can Apple take to mitigate those. And maybe Luca, on that end, FX is becoming a pretty significant headwind. I was curious what, if at all, if there's anything that can be done to mitigate that.

TIMOTHY D. COOK: I'll let Luca talk about FX. In terms of the people piece, we're focused on taking care of our teams and offering them the best benefits and best compensation so that we can empower them to do the best work of their lives. And so that's what we're focused on in terms of our teams.

In terms of inflation, there's clearly wage inflation. There's inflation related to logistics as well. If you compare it to pre-pandemic kind of levels, that has not returned to pre-pandemic levels by any means. And there's certain silicon components that are -- have inflationary pressure as well. And so that's not an all-inclusive list of where we see it, but it gives you some ingredients of where we see inflation pressure. We've obviously taken that into consideration in the gross margin guidance that Luca gave earlier in the call.

LUCA MAESTRI: Yes. And on foreign exchange, you're right. I mean it's obviously a very significant factor that is affecting our results, both revenue and gross margin. What do we do about situation like this, one where we have a very strong dollar? Of course, we hedge our exposures. We try to hedge them in as many places as possible around the world. For example, I think we've been probably the first company that started hedging our exposure in China several years ago.

There may be a few currency, small ones, where we don't hedge because the cost is prohibitive or the market is not there. But in general, we tend to hedge because it gives us significant level of margin stability. Obviously, over time, that protection reduces because the hedges roll over and we need to buy new contracts. But that's the primary tool that we use to offset some of the FX pressure.

Of course, when we launch new products, in particular, we look at the FX situation. And in some cases, for example, customers in international markets had to -- they saw some price increases when we launched the new products, which is not something that, for example, U.S. customers have seen. And that's unfortunately the situation that we're in right now with the strong dollar. So that's the way we try to deal with that.

I have to say that one of the things that we've really appreciated the most during the quarter was the fact that in spite of this very strong dollar and the difficult FX environment, we have seen very strong performance in many international markets, particularly some very large emerging markets where even in reported currencies, so in U.S. dollars, we're seeing very strong double-digit growth in places like India, Indonesia, Mexico, Vietnam, many places where we've done incredibly well. And obviously, in local currency, those growth rates are even higher.

It's important for us to look at how these markets perform in local currency because it really gives us a good sense for the customer response to our products, the engagement with our ecosystem and in general, the strength of the brand. And I have to say, in that respect, we feel very, very good about the progress that we're making in a lot of markets around the world.

HARSH V. KUMAR: And Luca, I had a follow-up. Luca, in your prepared remarks for the guidance, you mentioned that for the December quarter, you expect the performance to decelerate relative to September. So September was a year-over-year about, call it, 8%. Should I think that, that 8% number will go down on a year-over-year basis as we look at December? Maybe you could provide some color on what you're thinking. And are we still looking -- are we looking at a positive number? Or are we thinking maybe that the growth rate will be negative on a year-over-year basis?

LUCA MAESTRI: What we said is that we're going to be decelerating from September, so September was 8% so it's going to be a lower percentage than 8%. We're not providing guidance for the reasons that we've explained. There's a lot of uncertainty there. And so we see how the quarter progresses. Keep in mind the 10 points of exchange. Certainly, in normal times, we will be talking about very different numbers, but that's where we are right now.

OPERATOR: Next question is coming from Krish Sankar calling from Cowen & Company.

KRISH SANKAR, MD & SENIOR RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: I have 2 of them. First one, either for Tim or Luca, on cash and capital allocation. Given there's some correction and valuation for some of the private and public companies, does it change your thought process on the time line to get to cash-neutral? In other words, would you be more aggressive with acquisitions? Or you think holding on to more cash due to interest income becomes more attractive versus your prior investment goals? And then I have a quick follow-up.

TIMOTHY D. COOK: This is Tim. In terms of acquisitions, we averaged about 1 per month, I believe, in across fiscal year '22. And so we're constantly looking in the market and what's out there and what things would be synergistic, and which things would provide either intellectual property or talent or preferably both that we would need. And so we're constantly looking at acquisitions of all sizes.

LUCA MAESTRI: In terms of cash deployment, obviously, we like to look at the capital return program over the long arc of time. And we have done, since the beginning of the program, we've done over $550 billion of buyback at an average repurchase price of $47. So the program has been incredibly successful. We are still in a position where we have net cash, and we said all along, we want to get to cash-neutral at some point. Our cash generation has been very, very strong over the years, particularly last year. I think I mentioned in the prepared remarks, we did $111 billion of free cash flow. That's up 20% year-over-year. And so we will put that capital to use for investors.

KRISH SANKAR: Got it, got it. Very helpful, Tim and Luca. And then a quick follow-up for Luca on the December guidance. Thanks for the color on that. I'm just kind of curious, the extra week in the quarter, is that not helping offset some of the FX? Or in other words, the 10 percentage point negative impact from FX will be much higher if that's a 13-week quarter?

LUCA MAESTRI: No, I wouldn't say that because those are percentages. So yes, no, the 10 points wouldn't be different. 13 or 14 weeks would be the same.

TEJAS GALA: Thank you, Krish. A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor and via telephone. The number for the telephone replay is (866) 583-1035. Please enter confirmation code 7086300 followed by the pound sign. These replays will be available by approximately 5:00 p.m. Pacific Time today. Members of the press with additional questions can contact Josh Rosenstock at (408) 862-1142. Financial analysts can contact me with additional questions at (669) 227-2402. Thank you again for joining us.

OPERATOR: Once again, this concludes today's conference. We do appreciate your participation.



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OPERATOR: Good day, and welcome to the Apple Q3 FY 2022 **Earnings** Conference Call. Today's call is being recorded. At this time, for opening remarks and introductions, I'd like to turn the call over to Tejas Gala, Director of Investor Relations and Corporate Finance. Please go ahead.

TEJAS GALA, IR CONTACT, APPLE INC.: Thank you. Good afternoon, and thank you for joining us. Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during the discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook, including the potential impact of COVID-19 on the company's business and results of operation. These statements involve risks and uncertainties that may cause actual results or trends to differ materially from our forecast.

For more information, please refer to the risk factors discussed in Apple's most recently filed annual report on Form 10-K 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, CEO & DIRECTOR, APPLE INC.: Thank you, Tejas. Good afternoon, everyone, and thank you for joining us. Today, Apple is reporting another record June quarter with revenue of $83 billion, which was better than we expected despite supply constraints, strong foreign exchange headwinds and the impact of our business in Russia. We set June quarter records in the Americas, in Europe and in the rest of Asia Pacific region. We also saw June quarter revenue records in both developed and emerging markets with very strong double-digit growth in Brazil, Indonesia and Vietnam and a near doubling of revenue in India.

We saw great enthusiasm for our products and services, resulting in an all-time record for our installed base of active devices. Our supply constraints were less than we anticipated at the beginning of the quarter, coming in slightly below the range we discussed during our last call. We know that this is a time of significant challenge around the world for all of us confronting new variants of COVID-19 to those experiencing a prolonged humanitarian crisis in Ukraine and everyone dealing with the consequences of an uncertain economic environment. We know that much of the world is living through uneasy times, and it is all the more reason why we are working hard to help our customers navigate the world as it is while empowering them to create the world as it can be.

Turning to iPhone. We set a June quarter record for both revenue and switchers to iPhone. With its advanced performance, capability and ease of use, customers continue to find that iPhone remains the gold standard for smartphones. And they've been raving about the iPhone 13 lineup's extraordinary camera quality with features like cinematic mode and macro photography to create eye-catching content. We were also proud to celebrate the 15th anniversary of iPhone, a device that continues to change the world in profound ways with each new innovation.

Last month, Apple unleashed a wave of innovation, including the completely redesigned MacBook Air and a new 13-inch MacBook Pro. Both of these systems are powered by M2, our next generation of Apple silicon for Mac. M2 delivers a faster CPU, GPU and neural engine along with higher memory bandwidth and new capabilities like ProRes acceleration. And it continues the tremendous pace of innovation in Apple silicon for the Mac. We continue to have supply constraints with Mac, but we're encouraged by the strong response from customers to our incredible lineup.

iPad, like Mac, continued to see strong demand during the June quarter despite ongoing supply constraints. Customers and developers have been especially excited about the new features we're bringing to iPad with iPadOS 16. This update was one of the many announcements we made at a truly extraordinary WWDC, where we shared a range of new features that give customers more control of their experience than ever before. This includes the ability to edit or delete sent messages, a new way of organizing apps on iPad and Mac, and an all-new customizable lock screen on iPhone and so much more. Today, iOS 16, iPadOS 16, macOS Ventura and watchOS 9 are all in public beta, and we couldn't be more excited to see what our community of developers creates with them.

We unveiled new innovations and accessibility such as door detection and live captions that support users with disabilities with navigation, health, communication and more. We also announced Apple Pay Later, which gives customers more flexibility to make purchases with their Apple devices. And with our next generation of CarPlay, we're improving the driving experience with deeper integration into vehicle hardware, allowing drivers to control their music, change the temperature and monitor their fuel levels, all from a single integrated platform.

In the Wearables, Home and Accessories category, the innovation infused across our products continues to win over new customers. Apple Watch remains a great way for health-conscious customers to track their overall wellness and fitness. And we're bringing them even more data about their workouts, sleep cycles and medications with updates soon to arrive on watchOS 9. We were also pleased to get FDA approval for a new feature that will let users with irregular heart rhythms track the time they spend in AFib.

Turning to Services. Customers continue to engage enthusiastically with our content across news, fitness, music, gaming and more. Services revenue rose to $19.6 billion, a June quarter record and a 12% increase year-over-year, which was in line with our expectations. We're proud of how Apple TV+ productions like Severance and Black Bird have captured the popular imagination, and we're looking forward to more exceptional content developed by extraordinary creators throughout the year.

In 2.5 years since launch, Apple TV+ has now earned 250 wins and over 1,100 award nominations and counting. Just this month, we learned that Apple TV+ earned 52 Emmy Award nominations across 13 titles. In our last call, I mentioned Friday Night Baseball on Apple TV+, which is already delighting baseball fans. And last month, we announced a 10-year deal to present Major League Soccer matches around the world, giving global soccer fans a whole new way of viewing their favorite sport.

One of the best parts of WWDC was welcoming developers to Apple Park while continuing to connect with developers all over the world. This year, we had an incredible group of developers and more opportunities to learn from one another than ever before. It was a truly special experience and a reminder of the economic miracle the App Store represents.

We are proud of the fact that the iOS app economy supports more than 2.2 million jobs here in the United States and many more around the world. It's been wonderful to see **earnings** by small developers more than double over the past 2 years. And as we're supporting developers, we're also doing our part to protect customers. In 2021, we prevented nearly $1.5 billion in fraudulent transactions by stopping over 1.6 million risky and vulnerable apps and app updates.

Now I want to turn to retail. This quarter, we opened the doors to Apple's first store in the Hubei province in China, welcoming the community to a beautiful new space. And earlier today, we opened Apple Brompton Road, our fifth store in Central London. We also expanded today at Apple Creative Studios to reach even more young creatives from underrepresented communities to help them realize their potential and bring their best ideas to life.

I'd like to take this opportunity to express my appreciation to our team members working in Apple Stores, customer care centers and channel partner stores and to our Apple Care teams for their incredible work supporting customers wherever they are.

Creating innovative products and services that enrich people's lives is our mission. Leading with our values and everything we do gives that mission purpose. That includes a commitment to the environment where we continue our aggressive pursuit of our 2030 goals. It includes our focus on diversity and inclusion, where we are committed as ever to making progress. And it includes our work to promote racial equity and justice. We recently announced that the Global Equity Innovation Hub, in partnership with Cal State Northridge, will provide new community grants to Hispanic-serving institutions to help the next generation of creators and innovators build skills and pursue high-demand careers in STEM. We also celebrated the graduation of the inaugural class of our Developer Academy in Detroit from a program designed to give students the skills they need to pursue jobs in the thriving iOS app economy.

 

Leading with our values also means leading with a steadfast commitment to privacy and security. Last month, we announced the introduction of passkey, a next-generation credential that's intended to replace passwords. A passkey can't be phished nor can it be stolen by hackers in a data breach because the information is stored on your device and your device alone. And as part of our effort to combat targeted attacks against the highest risk targets like journalists and human rights activists, we introduced Lockdown Mode, which is designed to protect those most at risk of sophisticated digital attacks.

And we're committed to doing our part to address the housing crisis across California. To date, we have deployed more than $1.3 billion to a number of initiatives, including ones that provide financial assistance to low and moderate income first-time home buyers develop new affordable housing and help support vulnerable populations.

This quarter has ultimately been a reflection of our resilience and our optimism. As we look forward, we're clear-eyed about the uncertainty in the macro environment. Yet we remain ever focused on the same vision that has guided us from the beginning. We strive every day to be a place where imagination ignites innovation like nowhere else, where good people come together to achieve great things, where customers are the center of everything we do. And we'll continue to execute on that vision as we always have, led by a focus on excellence and a desire to leave the world better than we found it.

And with that, I'll turn it over to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim, and good afternoon, everyone. We are very pleased to report June quarter financial results that continue to demonstrate our ability to innovate across hardware, software and services while operating our business effectively during very challenging economic circumstances. We set a June quarter revenue record of $83 billion, up 2% year-over-year, despite supply constraints, over 300 basis points of foreign exchange headwinds and the impact of our business in Russia. Around the world, we set new June quarter records in the Americas, in Europe and rest of Asia Pacific.

On the product side, revenue was $63.4 billion with a June quarter revenue record for iPhone. During the quarter, our installed base of active devices continue to grow well, thanks to our unmatched levels of customer satisfaction and loyalty and reached an all-time high for all major product categories and geographic segments. Our Services set a June quarter revenue record of $19.6 billion, up 12% over a year ago, with all-time revenue records in the Americas and the rest of Asia Pacific and June quarter records in Europe and Greater China.

We also achieved June quarter revenue records in each major Services category, including all-time revenue records for Music, Cloud Services, Apple Care and Payment Services. Company gross margin was 43.3%, down 40 basis points from last quarter as seasonal loss of leverage and unfavorable foreign exchange were partially offset by favorable mix. Products gross margin was 34.5%, down 190 basis points sequentially, mainly driven by seasonal loss of leverage, mix and FX. Services gross margin was 71.5%, down 110 basis points sequentially due to a different mix and foreign exchange. Net income was $19.4 billion and diluted **earnings** per share were $1.20, while operating cash flow of $22.9 billion was a June quarter record.

Let me now get into more detail for each of our revenue categories. iPhone revenue grew 3% year-over-year to a June quarter record of $40.7 billion despite foreign exchange headwinds as customer response to our iPhone 13 family continue to be strong. We set June quarter records in both developed and emerging markets. And the iPhone active installed base reached a new all-time high across all geographies as a result of this level of sales performance combined with unmatched customer loyalty. In fact, the latest survey of U.S. consumers from 451 Research indicates iPhone customer satisfaction of 98%. We also attracted a record number of switchers for the June quarter, with strong double-digit year-over-year growth.

For Mac, we generated revenue of $7.4 billion despite supply constraints and negative effects. We continue to be excited about our long-term opportunity with Mac and redefining the PC experience with our relentless innovation. Our investment focus on Mac has helped drive significant growth in our installed base, which reached an all-time high during the June quarter as nearly half of the customers purchasing a Mac were new to the product.

iPad revenue was $7.2 billion, down 2% year-over-year due to supply constraints and negative foreign exchange. Customer response to our iPad lineup continue to be strong across consumer, education and enterprise markets around the world. And the iPad installed base reached a new all-time high, with over half of the customers during the quarter being new to the product.

Wearables, Home and Accessories revenue was $8.1 billion, down 8% year-over-year as we faced foreign exchange headwinds, different launch timing for Home and Accessories products and supply constraints as well as the overall macroeconomic environment. Despite this, our installed base of devices in the category hit a new all-time record, thanks to very strong customer loyalty and high new tool rates. For example, Apple Watch continues to extend its reach, with over 2/3 of customers purchasing an Apple Watch during the quarter being new to the product.

Services had a June quarter revenue record of $19.6 billion, up 12% despite almost 500 basis points of FX headwinds as well as impacts from our business in Russia and the macroeconomic environment. We set June quarter revenue records in both developed and emerging markets and set all-time records in many countries around the world, including the U.S., Mexico, Brazil, Korea and India.

The record level of performance of our Services portfolio during the June quarter reflects the strength of our ecosystem on many fronts. First, our installed base has continued to grow, reaching an all-time high across each geographic segment and major product category. We also saw increased customer engagement with our Services during the quarter. Our transacting accounts, paid accounts and accounts with paid subscriptions all grew double digits year-over-year.

And paid subscriptions showed very strong growth. We now have more than 860 million paid subscriptions across the services on our platform, which is up more than 160 million during the last 12 months alone. And finally, we continue to improve the breadth and the quality of our current Services offerings, from a constant flow of new content on Apple TV+ and Apple Arcade to great new features we recently announced for iCloud and Apple Music, which we believe our customers will love.

In the enterprise market, our customers are increasingly investing in Apple products as a strategy to attract and retain talent. Bank of America is providing iPhones to all of its Merrill financial advisers so they can instantly access client information and provide timely wealth management advice from anywhere. Wipro, another large global enterprise customer, is investing in MacBook Air with M1 as a competitive advantage when recruiting new graduates globally, thanks to its superior performance and lower total cost of ownership. And with the new M2 chip powering MacBook Air and the 13-inch MacBook Pro, we expect more customers to make Mac available to their entire workforce.

Let me now turn to our cash position. We ended the quarter with $179 billion in cash and marketable securities. We repaid $3 billion in maturing debt while increasing commercial paper by $4 billion, leaving us with total debt of $120 billion. As a result, net cash was nearly $60 billion at the end of the quarter. We returned over $28 billion to shareholders during the June quarter. This included $3.8 billion in dividends and equivalents and $21.7 billion through open market repurchases of 143 million Apple shares. We continue to believe there is great value in our stock and maintain our target of reaching a net cash neutral position over time.

As we move ahead into the September quarter, I'd like to review our outlook, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. Given the continued uncertainty around the world in the near term, we are not providing revenue guidance but we are sharing some directional insights based on the assumption that the macroeconomic outlook and COVID-related impacts to our business do not worsen from what we are projecting today for the current quarter.

Overall, we believe our year-over-year revenue growth will accelerate during the September quarter compared to the June quarter despite approximately 600 basis points of negative year-over-year impact from foreign exchange. On the product side, we expect supply constraints to be lower than what we experienced during the June quarter. Specifically related to Services, we expect revenue to grow but decelerate from the June quarter due to macroeconomic factors and foreign exchange.

We expect gross margin to be between 41.5% and 42.5%. We expect OpEx to be between $12.9 billion and $13.1 billion. We expect OI&E to be around negative (inaudible) impact from the mark-to-market of minority investments and our tax rate to be around 16%. Finally, today, our Board of Directors has declared a cash dividend of $0.23 per share of common stock, payable on August 11, 2022, to shareholders of record as of August 8, 2022.

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

TEJAS GALA: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please?

Questions and Answers

OPERATOR: We'll take our first question from Amit Daryanani with Evercore.

 

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I guess 2 from my side. Maybe to start on the gross margin discussion, Luca. You said that -- implying gross margin will be down I think, 130, 140 basis points sequentially and down a bit year-over-year as well in September. Maybe just what other puts and takes in your -- and then very specifically, you actually just call it that the FX headwinds are embedded in the September quarter gross margin, that would be helpful.

LUCA MAESTRI: Yes, Amit. We're guiding 41.5% to 42.5%. On a sequential basis, the decline is expected to be driven by, as you mentioned, foreign exchange but also mix, which will be partially offset by better leverage. We expect the foreign exchange impact on a sequential basis to be 50 basis points.

If you look at it from a year-over-year standpoint, we are in the ballpark of a year ago in spite of the fact that foreign exchange is going to be 130 basis points negative to a year ago. So clearly, foreign exchange is something that is affecting us but we think we're navigating that fairly well.

AMIT JAWAHARLAZ DARYANANI: Fair enough. And then if I could just ask Tim the question. There's a lot of macro worries and high inflation impacting consumer demand. Certainly doesn't seem to be very visible in your performance and your expectations. So I'm wondering if you talk about, are you seeing any implications from recession fears or inflation fears to your end demand? And really just related to that, variables decline was notable. Is that where you would typically see initial signs of consumer softening perhaps?

TIMOTHY D. COOK: Thanks for the question. If you -- I'm not an economist and so I'll sort of narrow my comments to what we saw in the business. And if you look at the June quarter, we do believe that we saw macroeconomic headwinds that impacted our business and our results. And so one of those is clearly the FX, which Luca has mentioned, that was over 300 basis points on year-over-year growth rates.

When you look at the product categories, on iPhone, there was no obvious evidence of macroeconomic impact during the June quarter besides FX, obviously. Mac and iPad were so gated by supply that we didn't have enough product to test the demand. And Wearables, Home and Accessories, as you mentioned and as Luca mentioned, we did see some impact there that we would attribute to macroeconomic environment.

When you then look at Services, there were some Services that were impacted, for example, like digital advertising was clearly impacted by the macroeconomic environment. And so it's a mixed bag in terms of what we believe that we saw. Overall, we are very happy with the results. And when you think about the number of challenges in the quarter, we feel really good about the growth that we put up for the quarter.

OPERATOR: We'll take our next question from Harsh Kumar with Piper Sandler.

HARSH V. KUMAR, MD & SENIOR RESEARCH ANALYST, PIPER SANDLER & CO., RESEARCH DIVISION: Yes. First of all, congratulations. As these are tough times, you guys are putting up tremendous results so we appreciate that as investors. My question is, when I look at your Services business, I see a $20 billion business on a quarterly basis. And you keep adding -- as a company, you keep adding very interesting and transformative features such as payments, something like that every year.

So I'm struggling to find a good way to think about how to model the growth of this business, considering that you add innovative features. So now that it's fairly matured as a business, what would be a good way for us to think about as investors to model the Services business? And I do have a follow-up.

LUCA MAESTRI: Well, as you know, we don't provide guidance past the current quarter. But I think the way to think about it, certainly the way we think about it is that there's a number of levers in our Services business to take into account. The first one is installed base. Installed base is the engine for our company and it continues to grow. As I mentioned, it has reached an all-time high across every geographic segment, across every product category. And so that's very important.

Then the second lever is the customer engagement. And we know that our customers are getting more and more engaged over time. Transacting accounts, paid accounts, paid subscriptions are growing, so the level of engagement continues to grow.

And then as you mentioned, the breadth and the quality of the services that we offer tends to grow over time. So these are all things that tend to help us over the long term. If you go back and you look at our growth rates over a number of quarters now, they've always been very good. Of course, the macro environment can have an impact on this business. Tim has mentioned, for example, digital advertising can be affected at times.

 

During COVID, some of the compares have been a bit lumpy because there have been lockdowns and reopenings and so on. So it's very difficult to talk about a steady state growth rate for our Services business. But when we look at the entirety of what we are doing in the Services space, we feel very good about the future of the business.

HARSH V. KUMAR: Luca, very helpful. And for my follow-up, valuations have come down in the last 18 months or so for things and companies and targets that you might look at. I guess, particularly in the Services area, would there be an appetite on behalf of Apple to accelerate the growth of its Services business by looking at external products to acquire?

TIMOTHY D. COOK: We always look and we ask ourselves if it's -- how strategic it is, and we never buy just to buy or buy just for revenue purposes. But we would buy something that is strategic for us. To date, we have concentrated on smaller IP and people acquisitions. But I wouldn't rule anything out for the future, and obviously, we are constantly surveilling the market.

OPERATOR: We'll take our next question from Erik Woodring with Morgan Stanley.

ERIK WILLIAM RICHARD WOODRING, RESEARCH ASSOCIATE, MORGAN STANLEY, RESEARCH DIVISION: I have 2 as well. Maybe Tim, if I start with you, I think there's a debate in the market that if you look back over time, there's been a 3-year cadence to iPhone cycles. We're 2 years into your 5G iPhone evolution. You're on track to grow units in '21 and '22. That implies there could be some pressure next year as upgrade rates slow. But your comments really suggest no slowdown. You're seeing double-digit growth in customers new to iPhone. So can you just walk us through some of the various factors you believe are driving this continued iPhone strength? And then I have a follow-up.

TIMOTHY D. COOK: Today, the product and the innovation within the product that is driving it. And of course, the other key variables are some things that Luca mentioned earlier where the size of the installed base has been growing significantly. We also, just in this quarter, the June quarter, set a June quarter record for switchers with strong double-digit growth. And so this is fueling the additional installed base even more.

And we continue to execute across some significant geographies where there's very low penetration of iPhone. Some of those were called out in the opening remarks between Indonesia and Vietnam and India, where we did quite well, and iPhone tends to be the engine for those markets, particularly at the beginning of creating the market there for Apple products. And so we're really looking at all of these things from the installed base to the number of switchers to the geographic distribution.

Of course, the most important thing for us is to maintain an incredible customer satisfaction and loyalty from the customers. And we're really pleased that it's currently at 98% for the latest iPhones. And so those are the things that underpin it. 5G has been an accelerant. And the 5G penetration, particularly if you look at it globally, is still quite low. In some geographies, it's obviously higher, but around the world, 5G penetration is still low. And so I think there's reason to be optimistic.

ERIK WILLIAM RICHARD WOODRING: Okay, that's helpful. And then maybe, Luca, for you. As we move from the June to the September quarter, maybe can you dig a level deeper and kind of help us understand some of the moving pieces in the Services business? Meaning where do you think we could see an acceleration or maybe a deceleration? And should we still expect double-digit growth? If you could just frame that for us, that would be great.

LUCA MAESTRI: Yes, Erik. I mentioned in my prepared remarks that we expect some deceleration from the 12% that we've had in the June quarter. Keep in mind, we're going to see, on a year-over-year basis, 600 basis points, 6% impact from foreign exchange so that is a big element for us. Also keep in mind that we're still lapping the impact of our business in Russia in these numbers.

And Tim mentioned that there are some pockets of weakness, primarily in digital advertising that we will need to work through. But at the same time, our Services business a year ago grew a lot. And so, also, the compare is a bit challenging. So we don't have a very specific number to give out today. Of course, we expect to grow. We will see how the quarter develops.

OPERATOR: We'll take our next question from Richard Kramer with Arete Research.

RICHARD ALAN KRAMER, FOUNDER, MD & SENIOR ANALYST, ARETE RESEARCH SERVICES LLP: Tim, you cited growth in Apple App Store ads in the past, and clearly, the privacy policies you've taken have really reshaped the mobile ad market. Can you give us a sense of how you see Apple's role as an ad network and perhaps helping developers to monetize not just app sales but also growing ad monetization over time?

TIMOTHY D. COOK: Yes. Richard, we view privacy as a fundamental human right. And so what we try to do with all of our features on privacy is put the decision back at the user where we believe it belongs as to whether they want to share their data or not. And so that was what was behind application tracking transparency and a number of other features. We're trying to empower the user to own their data and make their own choices.

In terms of us selling ads, we have a search ad business across the App Store that we believe represents a great way for discovery for small and large developers. And so I see that we play a role in that.

RICHARD ALAN KRAMER: And then maybe my follow-up for Luca. Can you give us a sense, especially now that you're launching Pay Later, what steps you might be taking to improve affordability of Apple products? We know that it's going to be a tight time economically for people around the world. And how do you see the evolution of various payment plans out of the -- you see in the U.S. now into other markets, especially emerging markets?

LUCA MAESTRI: Yes. I mean, obviously, affordability is a very important topic for us. It's been for many years. Buy now, pay later is the latest that we are doing on this front. Fundamentally, we are working on 2 major initiatives for affordability. One is installment plans. And installment plans have become more widespread around the world not only here in the United States, but in most markets, particularly in emerging markets, incredibly important in terms of reducing the affordability threshold.

And trading programs. Trade-in programs are available in a number of markets. We can do better in other markets. They're incredibly important because the residual value of our products is a huge differentiator for our users. After they use our devices, they can bring them back and they retain much more value than other platforms. And therefore, it's important for us to raise that awareness. And so we will continue to expand those programs around the world. So installments and trade-ins, very, very important on affordability.

OPERATOR: We'll take our next question from David Vogt with UBS.

DAVID VOGT, ANALYST, UBS INVESTMENT BANK, RESEARCH DIVISION: I just wanted to circle back on sort of the macro and sort of the demand signals that you're seeing versus sort of the supply chains that you're facing. I know that there's been a couple of U.S. carriers that have talked about some of their customers having some difficulty paying bills. And you mentioned in your prepared remarks that you saw sort of the record number of switchers in the quarter.

So just wanted to kind of get a sense for what you're seeing in that particular channel without naming a specific customer. And are you seeing any sort of issues from a spin-down effect maybe because customers are having some difficulty because of inflation? And then I have a follow-up on Macs.

TIMOTHY D. COOK: On the -- from an aggregate point of view, looking at it worldwide, looking at the data on iPhone for the June quarter, there's not obvious evidence in there that there's a macroeconomic headwind. I'm not saying that there's not one. I'm saying that the data doesn't show it where we can clearly see that in the Wearables, Home and Accessories area. And so I would differentiate those 2.

DAVID VOGT: Great. And then on the Mac business, I know that you are severely supply chain constrained. But is there a way to kind of think about the impact of the market overall on the Mac business versus the supply chain? It sounds like -- I guess, it sounds like it's almost effectively 100% supply chain constrained, but we're obviously hearing, like I'm sure you guys are seeing anecdotal evidence and some quantifiable evidence that the broader PC market is slowing.

And I think about 90 days ago, you were pretty confident with the new M2 chip that you could continue to grow throughout a potential drawdown in that particular market. Do you still feel that way? And if you can kind of share how you're thinking about the different sort of components of your growth versus the market.

TIMOTHY D. COOK: Yes, I wouldn't want to project into this quarter. But for last quarter, what we saw was the -- when the COVID restrictions hit in the Shanghai corridor, we lost the primary source of supply for Mac units. And that was either running at a reduced rate or down completely for the majority of the quarter. And so it was a very big impact to the Mac business.

We felt good, frankly, that we were able to, by the end of the quarter, get this back to where we were down 10 points. But the negative 10 I would classify as being driven by supply. And of course, FX feeds into this as well because of the translation issues around the world. There's also some impact because of the business in Russia. But those are the 3 kind of reasons that I would tell you.

In terms of testing the demand, you can't really test the demand unless you have the supply. And we were so far from that last quarter that we have an estimate of what we believe demand was. But it is an estimate. We recognize how the industry is doing. We think that we've got a great story with the Mac with getting M1 out and now M2 out. We have a very, very strong offering for the back-to-school season and we'll see how we do this quarter. We'll report back in October.

OPERATOR: We'll take our next question from Ben Bollin with Cleveland Research.

BENJAMIN JAMES BOLLIN, SENIOR RESEARCH ANALYST, CLEVELAND RESEARCH COMPANY LLC: Tim, I was hoping you could share a little bit more about how you're thinking about the supply headwinds. You said less severe or less worse supply challenges into September. I'm interested when you think you find balance across products. And also, any thoughts on how or when that might influence replenishment of supply into your retail channels?

TIMOTHY D. COOK: To give you a little more color on what we saw in the June quarter, we came in slightly below, from a constraint point of view, the $4 billion number that we had put at the -- the 4 to 8 are the low end of that range. And the majority of that constraint last quarter was coming out of the COVID restrictions that occurred, that resulted in plant closures and plants running at less than full utilization for some amount of the quarter, in some cases, the majority of the quarter.

And then the other component that is the minority part of it is the silicon shortage that has affected our results for several quarters now. If you look into the future, the silicon shortage, we're not forecasting when that will end. We think that in the aggregate, our constraint numbers for the September quarter will be less than they were in the June quarter. But of the 2 -- there are these 2 components, and of course, we're optimistic about the COVID restriction piece of this.

BENJAMIN JAMES BOLLIN: Okay. The other item. Tim, any thoughts on how you're thinking strategy is evolving with respect to progress in AR, VR in your existing products? Anything you're learning about content or how you're thinking about that opportunity?

TIMOTHY D. COOK: We're thrilled right now to have over 14,000 ARKit apps in the App Store. And they're providing incredible AR experiences for millions of people. And that's utilizing iPhone and iPad. And of course, we are in the business of innovation so we're always exploring new and emerging technologies. But I wouldn't want to say anything beyond that.

OPERATOR: We'll take our next question from Wamsi Mohan with Bank of America.

WAMSI MOHAN, MD IN AMERICAS EQUITY RESEARCH, BOFA SECURITIES, RESEARCH DIVISION: Luca, you mentioned revenues to accelerate year-over-year overall in September versus your June growth rate. Would you say that it would be reasonable to assume normal quarter-on-quarter seasonality of about $7 billion or so? Or would you say there are additional puts and takes this time around that could drive upside and downside to that? I know you noted 600 bps year-over-year on FX as potentially one of those. But maybe help us think through, on a sequential basis, how much of a normal versus abnormal seasonality we should expect. And I have a follow-up.

LUCA MAESTRI: Yes, Wamsi, as you know, as we said earlier, we're not providing guidance because of all the uncertainty out there. But we have given a few data points. So one of them, which you've mentioned, approximately 600 basis points of negative foreign exchange. I mean, you do a rough math, it's around $5 billion. That's a big number right there that is going to affect us, that we are having some impact from the situation in Russia and that is obviously different from normal seasonality as well.

Our supply constraints, as Tim just said, are going to be lower than what we've seen in the June quarter but they're still going to be there. So when you look at those 3 headwinds and you combine them with the acceleration that we talked about, we feel that, that is pretty remarkable.

WAMSI MOHAN: Okay, thank you, Luca. And Tim, I wanted to follow up on your comment about the macro impact that you've seen on wearables. Your wearables portfolio is probably at the lowest ASP range across your product portfolio. As you're giving this guidance or directional guidance here, how much of an impact are you assuming in potentially any macro-related slowdowns across the rest of the portfolio? Why would investors not think that it would be prudent to assume some sort of creep-up of some of these -- some of the hesitation maybe that the macro environment is driving, particularly as it pertains to your higher ASP products?

 

TIMOTHY D. COOK: Yes. Let me expand a little bit on Wearables, Home and Accessories so that I clearly communicate what we saw. We saw sort of a cocktail of headwinds on Wearables, Home and Accessories. We saw FX, which we've talked about. We saw supply constraints, which we've talked about. Of course, there was an impact from the business in Russia.

But in addition to those things, which -- those things affected all the products to some degree. We also had a different launch timing for certain home and accessory products. Like in the year-ago quarter, I think, had AirTag in it. That's just one example of something that announced last year that didn't announce this -- that we didn't have a comparable announcement this year.

And in -- so in addition to those 4 items, we believe, based on the data, that there was also a macroeconomic environment hit. And whether or not that is because they're lower ASPs versus the higher ASPs of a phone, I can't tell you that. I can just tell you that looking at the numbers, there does appear to be headwinds in addition to the 4 items that we can articulate and we believe those to be macroeconomic headwinds.

OPERATOR: We'll take our next question from Samik Chatterjee with JPMorgan.

SAMIK CHATTERJEE, ANALYST, JPMORGAN CHASE & CO, RESEARCH DIVISION: Great. And congrats on the results in this tough macro. I guess I wanted to start with China smartphone market here a bit. And Tim, I thought you said in response to earlier question that you haven't really seen a material impact from the macro on iPhone yet. But wondering, did you see an impact of the COVID lockdowns there on demand itself? Or was there a snapback fall in that? If you can comment about the sort of exit run rate that you saw in that market, following the COVID shutdowns ending there. And I have a follow-up.

TIMOTHY D. COOK: Yes, both things are true. We did see a lower demand based on the COVID lockdowns in the cities the COVID lockdowns affected. And we did see a rebound in those same cities toward the end of the quarter in the June time frame. And in particular, in the run-up to June 18, which as you know, is a major shopping holiday in China. We think that the net of that was still a negative, but some of it did rebound by June time frame. The restrictions begin to come off toward the beginning of June, if my memory is correct.

SAMIK CHATTERJEE: Okay. And for my follow-up, I know you said you don't want to sort of predict the macro here or be an economist. But if I go back and look at the sort of OpEx for the last few years, you've been increasing that by a double-digit percentage. And just given the uncertainty that you've talked about in the macro further on this call a lot, how are you thinking about sort of that investment base going forward? Are you trying to look at areas that where you can sort of pull back? I mean just in terms of how you're preparing for the uncertainty is, I guess, the question.

TIMOTHY D. COOK: We believe in investing through the downturn. And so we'll continue to hire people and invest in areas, but we are being more deliberate in doing so in recognition of the realities of the environment.

OPERATOR: We'll take our next question from Jim Suva with Citigroup.

JAMES DICKEY SUVA, MD & RESEARCH ANALYST, CITIGROUP INC., RESEARCH DIVISION: While I'm calling you on my iPhone 13 Max Pro and loving it, I just wanted to ask you, though, with replacement cycles. Have you noticed any change now that we've been through like 2.5 years of COVID where people upgrading at a different rate and kind of post COVID, hopefully, upgrade cycles or replacement cycles, how we should kind of think about that? Obviously when I drop and break my phone, I replace it immediately. But a normal replacement, have they changed at all? Any insights from that would be great.

TIMOTHY D. COOK: It's challenging to measure the replacement cycle at any point in time with exact precision, and so I'm going to punt on the question a bit. However, our key task is to make a product that everybody loves and that they want to trade in their current phone to get. And so that's what we are focused on is innovating like crazy and giving somebody something that they really want and see themselves using.

JAMES DICKEY SUVA: Okay, that makes sense. Well, then maybe I can ask Luca a question more on the gross margins. As you look ahead, the supply chain issues, expedited shipping and all of that, do you think probably the September quarter is kind of the worst of FX and all those headwinds and things? Or is there a little bit of timing delays due to your contractual purchase commitments that you do, that maybe your suppliers are looking at higher costs and you're benefiting from some lower contracts or maybe that has already caught up? If you could give us some insights on the kind of longer-term nature of the directions or the gross margin impacts.

LUCA MAESTRI: Jim, I would say we provide guidance for the current quarter. But if we look ahead, there's always a couple of elements in gross margin that are a bit outside of our control and we need to be mindful of that. One of them is the foreign exchange environment. That is having an impact already for the September quarter and had an impact on June. And obviously, strong dollar tends to be a headwind for us. As you know, we have a hedging program, and so we mitigate that impact. But over time, those hedges roll off and so it becomes more challenging for us. We'll see what happens with foreign exchange rates over time. That is going to be a variable that we need to track.

The other one that has an impact on the aggregate gross margin is our mix of products and services. As you know, they have different margin profiles for very different reasons, different businesses, even different accounting treatment at times. And so that is also something that we will need to track over time. What matters to us, I think it goes back to Tim was saying earlier, is we want to make sure that people love our products and services, and we want all of them to be equally successful in the marketplace.

Certainly, as you've seen over the last year, we've had a significant expansion in gross margins in spite of very difficult economic circumstances from COVID to inflation, interest rates going up and our margins have expanded. From a commodity standpoint, I think you were asking a question around components. Commodities are behaving okay. We're seeing some price pressure on some silicon components. But other than that, we've -- actually commodities are behaving well.

JAMES DICKEY SUVA: Congratulations to you and all your team members.

TIMOTHY D. COOK: Thank you.

OPERATOR: We'll take our next question from Krish Sankar with Cowen and Company.

KRISH SANKAR, MD & SENIOR RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: And Tim, I apologize, it's also macro-related. You mentioned that it impacted digital advertising within Services. I'm just kind of curious, if the macro does worsen, do you worry about subscriber growth, App Store purchases, et cetera? And conversely, are there any parts of the Service business that you consider recession-proof, like maybe a buy now, pay later or something else? And then I have a quick follow-up for Luca.

TIMOTHY D. COOK: We have incorporated all of our thoughts in the guidance that Luca gave, which says that we think in the aggregate, we're going to accelerate revenues in the September quarter as compared to the June quarter and will decelerate on the Services side. And so we see the digital advertising cloud, if you will, continuing in the current quarter.

KRISH SANKAR: Got it. Got it. Very helpful. And then a quick follow-up on the lockdown in China during the June quarter. Do you actually see any noticeable negative effects on your App Store revenue for the region or any positive effects like maybe more gaming downloads?

TIMOTHY D. COOK: China had very good results on Services last quarter. And so they grew strong double digit better than the company average, and they set a new June quarter revenue record during the quarter.

TEJAS GALA: Thank you. A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor, and via telephone. The numbers for the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 8820355. These replays will be available by approximately 5 p.m. Pacific Time today.

Members of the press with additional questions can contact Josh Rosenstock at (408) 862-1142. Financial analysts can contact me with additional questions at (669) 227-2402. Thank you again for joining us.

OPERATOR: This concludes today's conference. We appreciate your participation.

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**Q2 2022 Apple IncEarnings Call - Final**

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Presentation

OPERATOR: Good day, and welcome to the Apple Q2 FY 2022 **Earnings** 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 Tejas Gala, Director of Investor Relations and Corporate Finance. Please go ahead.

TEJAS GALA, IR CONTACT, APPLE INC.: Thank you. Good afternoon, and thank you for joining us. Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during today's discussion will consist of forward-looking statements including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook including the potential impact of COVID-19 on the company's business and results of operations. These statements involve risks and uncertainties that may cause actual results or trends to differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed annual report on Form 10-K 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, CEO & DIRECTOR, APPLE INC.: Thank you, Tejas. Good afternoon, everyone, and thank you for joining us today. Apple is proud to report another record quarter with a March quarter revenue record of $97.3 billion, up 9% from a year ago and better than we anticipated. iPhone, Mac and Wearables, Home and Accessories had their best ever March quarter, and Services set an all-time record on the strength of subscription growth over the past year.

Before I get into details, I want to take a moment to acknowledge the humanitarian tragedy unfolding in Ukraine. We're continuing to do everything we can to support our teams in the region, and we are donating to humanitarian efforts on the ground. We've also committed to donating products to support refugees arriving here in the United States.

I also want to speak to the unpredictable nature of the pandemic. We are excited to be welcoming employees back to the offices in the U.S. and Europe. At the same time, we are monitoring COVID-related disruptions in China. Our thoughts are with all those in the path of the virus, and we remain as committed as ever to doing our part to help protect people and their communities.

These times remind us that we cannot know what the future may hold. But they remind us, too, that technology infused with humanity makes a real difference in the world. And that's where our focus has remained: on driving the innovations that can enrich people's lives.

Throughout the quarter, Apple continued its streak of unparalleled innovation at an unmatched pace. With Apple silicon, our teams are pushing the limits of what we once thought possible, and we are seeing leaps and bounds in performance and efficiency. Last month, we announced another breakthrough with M1 Ultra, the world's most powerful chip for a personal computer. The incredible customer response to our M1-powered MAX helped propel a 15% year-over-year increase in revenue despite supply constraints. We now have our most powerful Mac lineup ever with the addition of the entirely new Mac Studio. Paired with the new studio display, a 5K resolution display equipped with its own A13 Bionic chip, this new desktop and display transform any workspace into a creative powerhouse.

As we release the groundbreaking M1 Ultra, we also expanded our iPhone offerings, adding 2 beautiful green finishes to the iPhone 13 lineup and introducing the new 5G-enabled iPhone SE, which is great for our existing users who want a smaller iPhone and a great value for people buying an iPhone for the first time. They love how much power and performance we've injected into such an affordable device and rave about its incredible camera and its lightning fast speeds. In the March quarter, iPhone revenue grew 5% over the previous year despite a challenging compare as we saw strong demand from our customers for the iPhone 13 family.

And with the all-new iPad Air supercharged by M1, iPad brings more power and more versatility across the entire iPad lineup. For customers around the world, iPad continues to be essential for education, creativity and entertainment. That's why we're continuing to see such a strong demand for iPad even while navigating the significant supply constraint we predicted at the start of the quarter.

Turning to Wearables, Home and Accessories. We are pleased to see these products continue to delight our users, growing 12% year-over-year. Customers are enthusiastically taking charge of their health with Apple Watch Series 7 and Apple Watch SE. The rich sound, beautiful colors and compact design of HomePod mini continue to make it a hit with customers. And there's still no better companion to Apple Music than AirPods with spatial audio that transforms the way we listen, putting our customers right in the center of the music.

The seamless integration of hardware, software and services is at the center of our work and philosophy at Apple. Apple Services are designed to be easy to use with expert curation that brings our users compelling content from talented developers, creators, storytellers and artists. These principles are reflected in all of the services we've developed, which continue to generate incredible enthusiasm from our customers. Services revenue rose to $19.8 billion in the March quarter, reflecting a 17% increase from a year ago.

We were especially excited to cheer on CODA as it won the Academy Award for Best Picture, making Apple TV+ the first streaming service to win in this category. We were honored to be stewards of this incredibly powerful, deeply moving film. In a little over 2 years, Apple TV+ shows and movies have earned over 240 awards and more than 960 nominations. From Severance to WeCrashed to Pachinko, new Apple Originals are connecting with audiences and earning praise from critics. We're also winning over sports fans with Friday Night Baseball, which debuted earlier this month; and They Call Me Magic, a 4-part documentary that premiered last week tracing the life of the iconic Magic Johnson.

Fitness+ is helping users channel their inner athlete with a range of workout routines for any fitness level. We recently introduced a postpartum routine designed by mothers for mothers. And with our Apple Heart and Movement Study, we are helping researchers glean new insights into cardiovascular fitness.

As our products and services entertain customers and help them stay healthy, we're also working to make their lives easier. Arizona, for example, is the first state to enable its citizens to securely add their driver's license and state IDs to Apple Wallet. More states in the territory of Puerto Rico will soon follow. We've also announced plans to introduce Tap to Pay on iPhone, a simple and secure way for businesses to accept contactless payments launching across the U.S. later this year.

To meet the needs of customers wherever they are, our Apple Retail teams are constantly adapting to better serve them. We opened a new store in the United Arab Emirates this quarter at a unique waterfront location with panoramic views of the Abu Dhabi skyline. And earlier this month, we opened a new store in Korea, our third and largest store in the heart of Seoul. And across the U.S., we marked the return of in-person Today at Apple sessions with a special program featuring music from pop icon, Lady Gaga. I'd like to thank our team members working in Apple stores, customer care centers, channel partner stores and our Apple Care teams for bringing customers the best of Apple.

As we look to the environment, we are making good progress on our commitment to achieve carbon neutrality across our products and supply chain by 2030. Through our Green Bonds program, we're investing in breakthrough technologies like low-carbon aluminum, which we will be integrating into the new iPhone SE. And we were pleased to announce recently that we've nearly doubled the number of our top suppliers who have committed to accelerating the transition to clean energy. We are also investing in renewable energy projects in communities most impacted by climate change around the world.

As we do our part to protect our planet, we're also prioritizing people. As part of our long-standing commitment to inclusion and diversity, we're continuing to build a better, stronger Apple rooted in a culture where everyone belongs. Last month, we published an update on the progress we've made with inclusion and diversity at Apple. We've hired more women than ever into leadership roles. And in the U.S., nearly 60% of all leadership openings were filled by people from underrepresented communities in 2021. We also recently announced a $50 million Supplier Employee Development Fund that will help workers in our supply chain discover additional educational opportunities and build new skills. And through our Racial Equity and Justice initiative, we're continuing to advance our work to support underrepresented communities and help build a more just and equitable world.

Before I hand it over to Luca, I want to acknowledge the challenges we are seeing from supply chain disruptions driven by both COVID and silicon shortages to the devastation from the war in Ukraine. We are not immune to these challenges, but we have great confidence in our teams, in our products and services and in our strategy. Fundamentally, our work is about making technology that enriches people's lives and unlocks the full creative potential of humanity. And though the twists and turns of the future may be uncertain, what is certain is that we will never stop striving to be a force for good in the world in everything we do and everything we are.

With that, I'll turn it over to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim, and good afternoon, everyone. We are pleased to report very strong financial results for the March quarter, during which we set a revenue record of $97.3 billion, up 9% year-over-year. We also set new March quarter records in the Americas, in Europe and in Greater China.

On the product side, revenue was $77.5 billion, up 7% over a year ago and a March quarter record. We grew in each of our product categories except iPad, which remains significantly supply constrained throughout the quarter. And we set March quarter records for iPhone, Mac and Wearables, Home and Accessories. This level of sales performance, combined with unmatched customer satisfaction and loyalty, helped our installed base of active devices reach an all-time high for all major product categories as well as geographic segments. Our Services set an all-time revenue record of $19.8 billion, up 17% over a year ago with March quarter records in every geographic segment and services category.

Company gross margin was 43.7%, down 10 basis points from last quarter. A seasonal loss of leverage and unfavorable foreign exchange were partially offset by favorable mix. Products gross margin was 36.4%, down 200 basis points sequentially mainly driven by seasonal loss of leverage and FX. Services gross margin was 72.6%, up 20 basis points sequentially due to a different mix. Operating cash flow of $28.2 billion, net income of $25 billion and diluted **earnings** per share of $1.52 were all March quarter records.

These strong March quarter results capped a record first half of the fiscal year in the midst of a challenging macroeconomic environment. We generated over $220 billion in revenue, growing 10% year-over-year, and set all-time records for iPhone, Mac, Wearables, Home and Accessories and Services. These record sales results drove strong double-digit growth in operating income and **earnings** per share.

Let me now get into more detail for each of our revenue categories during the March quarter. iPhone revenue grew 5% year-over-year to a March quarter record of $50.6 billion despite supply constraints thanks to a continued strong customer response to our iPhone 13 family and the launch of our new iPhone SE. We set March quarter records in both developed and emerging markets, and the latest survey of U.S. consumers from 451 Research indicates iPhone customer satisfaction of 99% for the iPhone 13 family. As a result of this level of sales performance, combined with unmatched customer loyalty, the iPhone active installed base reached a new all-time high across all geographies.

For Mac, revenue of $10.4 billion was a March quarter record despite supply constraints, with 15% year-over-year growth driven by strong demand for our M1-powered MacBook Pro. As Tim mentioned earlier, our continued innovation and investment in Apple silicon has clearly shown in our Mac results as the last 7 quarters have been the best 7 quarter ever for Mac. Our investment focus on Mac has also helped drive significant activity in our growing installed base. In fact, we had a March quarter record for upgraders, while at the same time, nearly half of the customers purchasing a Mac were new to the product.

iPad revenue was $7.6 billion, down 2% year-over-year due to continued supply constraints. Customer response to our iPad lineup, including our new M1-powered iPad Air, remains very strong. And our installed base of iPads reached a new all-time high during the quarter with over half of the customers purchasing an iPad during the quarter being new to the product.

Wearables, Home and Accessories set a March quarter record of $8.8 billion, up 12% year-over-year, and we set March quarter revenue records in both developed and emerging markets. In particular, our Wearables business has doubled in 3 years and is nearly the size of a Fortune 100 business as we continue to attract many customers who are new to wearables. For instance, Apple Watch continues to extend its reach with over 2/3 of customers purchasing an Apple Watch during the quarter being new to the product.

 

Turning to Services. As I mentioned, we reached an all-time revenue record of $19.8 billion, up 17%, with all-time records for the App Store, Music, cloud services and AppleCare and March quarter records for video, advertising and payment services. These impressive results reflect the impact of our continued investment in improving and expanding our Services portfolio and the positive momentum that we're seeing on many fronts.

First, our installed base has continued to grow, reaching an all-time high across each geographic segment and major product category. Next, we continue to see increased customer engagement with our services. Our transacting accounts, paid accounts and accounts with paid subscriptions all reached all-time highs during the March quarter in every geographic segment. Also, paid subscriptions continued to show very strong growth. We now have more than 825 million paid subscriptions across the services on our platform, which is up more than 165 million during the last 12 months alone. And finally, as Tim highlighted before, we continue to improve the breadth and the quality of our current service offerings while launching new services.

In the enterprise market, many businesses and government organizations continue to turn to Apple for the latest technologies to deliver innovative services to customers and employees. In March, Alaska Airlines began to replace the conventional airport self-service kiosks with iPad Pros for faster passenger check-in and self bag drop. Also, last month, the Western Australia Police force completed the world's first commercial deployment of CarPlay across their entire fleet of vehicles to complement the iPhone 13s issued to each officer. This allows officers to access critical information faster on the road and enhance public safety for the community. We also unveiled the general availability of Apple Business Essentials in the U.S., adding a new subscription services designed to help small businesses manage every aspect of their Apple device life cycle.

Let me now turn to our cash position. As we continue to generate very strong cash flow, we ended the quarter with $193 billion in cash and marketable securities. We repaid $3.8 billion in maturing debt while increasing commercial paper by $2 billion, leaving us with total debt of $120 billion. As a result, net cash was $73 billion at the end of the quarter.

We returned nearly $27 billion to shareholders during the March quarter. This included $3.6 billion in dividends and equivalents and $22.9 billion through open market repurchases of 137 million Apple shares. We also retired an additional 5 million shares in the final settlement of our 18th ASR. Given the continued confidence we have in our business now and into the future, today, our Board has authorized an additional $90 billion for share repurchases as we maintain our goal of getting to net cash neutral over time. We're also raising our dividend by 5% to $0.23 a share, and we continue to plan for annual increases in the dividend going forward.

As we move ahead into the June quarter, I'd like to review our outlook, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. Given the continued uncertainty around the world in the near term, we are not providing revenue guidance. But we are sharing some directional insights based on the assumption that the COVID-related impacts to our business do not worsen from what we are projecting today for the current quarter.

We believe our year-over-year revenue performance during the June quarter will be impacted by a number of factors. Supply constraints caused by COVID-related disruptions and industry-wide silicon shortages are impacting our ability to meet customer demand for our products. We expect these constraints to be in the range of $4 billion to $8 billion, which is substantially larger than what we experienced during the March quarter. The COVID-related disruptions are also having some impact on customer demand in China.

With respect to foreign exchange, we expect it to be a nearly 300 basis point headwind to our year-over-year growth rate. Additionally, we paused all sales in Russia during the March quarter. This will impact our year-over-year growth rate by approximately 150 basis points. Specifically related to Services, we expect to continue to grow double digits but decelerate from our March quarter performance due to some of the factors I just described.

We expect gross margin to be between 42% and 43%. We expect OpEx to be between $12.7 billion and $12.9 billion. We expect OI&E to be around negative $100 million, excluding any potential impact from the mark-to-market of minority investments, and our tax rate to be around 16%. Finally, reflecting the dividend increase I mentioned earlier, today, our Board of Directors has declared a cash dividend of $0.23 per share of common stock payable on May 12, 2022, to shareholders of record as of May 9, 2022.

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

TEJAS GALA: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please?

Questions and Answers

OPERATOR: Absolutely. We'll take our first question from Katy Huberty with Morgan Stanley.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: Congrats on the quarter. A couple of macro-related questions just given everything that's going on in the market. The first is on how you're thinking about consumer spending. As we see more stock market volatility, rising interest rates, inflation, what metrics are you watching either internal to your business or external at the macro level to understand whether you'll ultimately start to see some demand impact particularly on the product side of your business? And then I have a follow-up.

TIMOTHY D. COOK: Katy, it's Tim. We're obviously monitoring our daily sales very closely. From an inflation point of view, we are seeing inflation. It is or was evident in our gross margin last quarter and in our OpEx last quarter, and it is assumed in the guidance that Luca gave for this quarter as well. So we're definitely seeing some level of inflation that I think everybody is seeing.

KATHRYN LYNN HUBERTY: And how are -- just as a follow-up to that, how are you thinking about how that might impact the consumers in your business and whether it influences their ability to purchase at the same level?

TIMOTHY D. COOK: Well, we're monitoring that closely, and we've sort of -- but right now our main focus, frankly speaking, is on the supply side.

KATHRYN LYNN HUBERTY: Okay. And as it relates to that, in China, how should we think about lockdowns from an impact on supply and an impact on demand? And what products in your portfolio should we expect to be most impacted?

TIMOTHY D. COOK: Yes. Good question. For Q2, so the quarter that we just finished, the restrictions in China had not started yet. And so Q2, we did have supply constraints. They were significantly lower than what we had experienced during the December quarter. They were driven by industry-wide silicon shortages and specifically, the issue that I talked about on previous calls with the legacy nodes. But looking ahead, we see 2 causes of supply constraints. One is the COVID-related disruptions, and there's the industry-wide silicon shortages that will continue.

We've estimated the constraints to be in the range of $4 billion to $8 billion. And if you -- these constraints are primarily centered around the Shanghai corridor. And the -- on a positive front, almost all of the affected final assembly factories have now restarted. And so the range, the $4 billion to $8 billion range, reflects various ramps of getting back up and running. We're also encouraged that the COVID case count that's been reported in Shanghai has decreased over the last few days. And so there's some reason for optimism there.

KATHRYN LYNN HUBERTY: Pretty amazing how the team has navigated all the crosscurrents. Congrats, again, on the quarter.

TIMOTHY D. COOK: Thanks so much.

OPERATOR: We'll take our next question from Amit Daryanani with Evercore.

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I guess I have 2 as well. First of all, I was hoping you'd just touch a little bit on the geographic growth vectors that you saw. And I think Americas grew really well, 19%, 20%. But Europe and China had much more muted growth, if you may. I know your compares are fairly difficult, but I'm curious if anything you would call out in terms of spillover effect on the macro side from Russia, Ukraine and Europe that's seeing some impact to consumer spend or even in China. Just help us understand what happened geographically there.

LUCA MAESTRI: So Amit, as you said, in the Americas, we had a very strong quarter, up 19%, very happy across the board there. Europe, again, was a really good quarter for us. We grew 5% in spite of the fact that, of course, as you know, during the month of March, we paused our sales in Russia. So we had an impact to our sales results there for a month of the quarter. But a number of European countries, particularly in Western Europe, did really, really well for us. And so it was a very good quarter for us, pretty much in line with our expectations. Americas was better than our expectations. China was, again, a March quarter record for us. Keep in mind, and this affected every geographic segment for us, the different launch timing for the iPhone this year versus a year ago had an impact on the March quarter results because we launched the product later a year ago than we did this year. So some of the channel fill for the new products happened during the March quarter a year ago.

 

Japan and Asia Pacific were affected by foreign exchange. Japan would have grown in line with company average in constant currency terms. Asia Pacific as well was affected by foreign exchange with the dollar appreciating against most currencies. And then, again, this difference in the launch timing for the iPhone made a difference. Keep in mind, again, the supply constraints that we had during the quarter, our results would have been obviously better without the supply constraints. Overall, we felt very good about the performance around the world.

AMIT JAWAHARLAZ DARYANANI: If I could just follow up on the supply chain, the $4 billion to $8 billion impact that you folks talked about. Do you think this is demand that's deferred out or demand that's essentially destroyed because you have a product cycle that's going to come out at some point soon this year? How do you think about demand deferred versus demand destroyed on that front? And then is there a sense of which product categories are most impacted by this versus not?

TIMOTHY D. COOK: It will affect most of the product categories. And in terms of whether it's -- whether we can recapture or not, we believe that there's a percentage of it that is recapturable and a percentage of it that is likely not where somebody needs something quickly. And that ratio or that percentage is very difficult to estimate. We obviously try to do that internally in order to demand plan, but it's not something that we share.

OPERATOR: We'll take our next question from Chris Caso with Raymond James.

CHRISTOPHER CASO, RESEARCH ANALYST, RAYMOND JAMES & ASSOCIATES, INC., RESEARCH DIVISION: Also just wanted to dig in on the supply constraints a bit. And I guess one of the things you said is that the $4 billion to $8 billion range reflects some reopening of facilities during the quarter. I know, obviously, it's tough to predict as you go forward into the second half of launch of new products. But at that point, would you expect the constraints to still be mainly on the component side and then hopefully, if things don't get worse in China, then the facilities are open and the constraints are only the component constraints as you go into the second half of the year?

TIMOTHY D. COOK: Yes. Chris, it's hard to answer a question about unannounced products. And so I'll try to not do that. But the...

CHRISTOPHER CASO: Well, yes, that's for all products, yes.

TIMOTHY D. COOK: The $4 billion to $8 billion is simply, as I had mentioned, that if you look at the -- the Shanghai corridor, we have some final assembly plants in this area. And almost all of them have restarted is the good news of it, working with local officials. But we planned various ramps for these, and that's the range of $4 billion to $8 billion that we've estimated. COVID is difficult to predict.

CHRISTOPHER CASO: For sure. For sure. As a follow-up, I wanted to also follow on some of your comments regarding inflation and how Apple is dealing with it. Obviously, component costs have been going up in many different areas. And then specifically in the semiconductor side, costs have been going up, but perhaps for some different reasons because of the additional cost of going up to new process nodes that they're -- it's higher than it has been in the past. How is Apple planning to deal with that? And is it possible for you to get through that without either raising prices on your product or affecting gross margins?

TIMOTHY D. COOK: Well, some of what you said is in the results for the last quarter that we've announced. And obviously, we've put our current thinking in the current quarter guidance that Luca listed earlier. There are component costs that are falling and ones that are rising, and so not all of them are moving in the same direction. And so we really try to manage to the net of these, and I think we're doing a reasonable job currently navigating the -- what is a challenging environment.

OPERATOR: We'll take our next question from David Vogt with UBS.

DAVID VOGT, ANALYST, UBS INVESTMENT BANK, RESEARCH DIVISION: I just want to dig in a little bit on the product disruption, the $4 billion to $8 billion. In the past, you kind of gave us a sense for how it would affect each of the different product lines. And should we expect it to have similar pro rata impacts? And is there an opportunity to maybe reallocate resources to limit maybe some of the impact on the iPhone line and then maybe versus the iPad line? And then I have a quick follow-up.

TIMOTHY D. COOK: It will affect most of the product categories, and we obviously will look to do any kind of optimization that we can do to minimize the effect on the user.

 

DAVID VOGT: Great. And then maybe just as a follow-up. You talked about potential COVID-related demand issues in China and taking out 150 basis points from Russia. But when you look at the other geographies, is there anything that you can share with us, whether it's in Western Europe or the U.S., that you're seeing from a demand perspective that may be sort of out of the ordinary or outside of sort of the disruptions? I mean the lack of product demand seems to be sort of where you would think it would be at this point in the cycle.

TIMOTHY D. COOK: We were happy with the iPhone growth last quarter, particularly when you think about the comp that it was going against because we had very different timing on the launches in the year ago quarter where we launched in Q1. And therefore, naturally, Q2 is at a different place on the new product curve. And so it was a very difficult comp. And so we were pleased with it. And as Luca said, the Americas geography did quite well last quarter. And the U.S., of course, is the major geography within there. And so the U.S. was quite strong last quarter.

OPERATOR: We'll take our next question from Jim Suva with Citigroup.

JAMES DICKEY SUVA, MD & RESEARCH ANALYST, CITIGROUP INC., RESEARCH DIVISION: Thank you, Tim, and your entire company has done a great job at navigating through all the issues in the past several years, whether it be COVID, power outages, trade wars, shipping challenges and all that. When we hopefully someday get past all of these and the supply constraints and society and turmoil hopefully across the world, do you start to reconsider the way you do the supply chain albeit just-in-time ordering and outsourcing so much of your chips? Or do you actually consider like holding more buffer inventory internally because right now, letting $4 billion to $8 billion go away, it'd be nice to have that to be able to sell. So do you consider holding more buffer inventory or maybe even doing your own chips by outsourcing your own chips to control them more? Or how should we think about strategically when hopefully the world is in a better place from today?

TIMOTHY D. COOK: Well, I'm looking forward to that day, as I know all of you are. Our supply chain is truly global. And so the products are made everywhere, and we do a lot in the U.S. We'll probably be doing even more here as more chips are produced here. And we continue to look at optimizing. We learn something every day and make changes. But when you back up and kind of zoom out and look to see how the supply chain has done within the environment that you eloquently talked about, I think it's been very resilient with -- the top issue we've had clearly is the silicon shortage that I think everybody is struggling with. And I think we've done a really good job of managing through the COVID piece of it.

And so -- but we are learning, and we're making some changes as we go. We don't have a [tin ear]. And so to the degree that we learn something that we should change, you can bet that we're doing that. In this business, you don't want to hold a ton of inventory. It's -- and so you want to work on cycle times and so forth to do things very quickly and take strategic inventory in places where you need to buffer for interruptions and so forth. And so we're constantly thinking about where those places are. In today's world, it's not really possible for us to have buffer on silicon. And so today, silicon rolls off the fab and it's into a final assembly plant very, very quickly, and we try to make that as shorter time as possible.

JAMES DICKEY SUVA: And then my quick follow-up, we've been talking about supply chain issues for multiple quarters now. Are you kind of hearing from your suppliers that maybe later half of this year? Or is it actually going to go into kind of 2013 for some closer equilibrium time period?

TIMOTHY D. COOK: Yes, I wouldn't -- you're talking about for the silicon shortage, in particular, I assume. I don't want to predict that because the -- that entails knowing how worldwide demand and supply are for the whole -- for industries outside of even the industry we're in. And I don't proclaim to be an expert in that. That also heavily is influenced by how strong the economies are in the different markets. And so I think there are varying levels of outcomes, and what we're focused on is doing -- trying to do very well regardless of how that question is answered.

JAMES DICKEY SUVA: And congratulations to you and your entire team.

OPERATOR: We'll take our next question from Samik Chatterjee with JPMorgan.

SAMIK CHATTERJEE, ANALYST, JPMORGAN CHASE & CO, RESEARCH DIVISION: Congrats on the results as well. I'll stick to 2 more micro level questions here. Firstly, Tim, you talked about the iPhone SE 3 demand that you -- the product that you just launched. I was hoping you could compare what you're seeing in terms of momentum to previous iPhone SE cycles. Particularly, I think in the past, North America has been the largest region in terms of demand. What are you seeing with the current product in terms of demand by geography? And I have a quick follow-up for Luca.

 

TIMOTHY D. COOK: Yes. We don't get to that level of granularity because we view it to be sensitive data that our competitors would love to have. And so I'm going to punt on answering that question. I would just say that when you zoom out and look at iPhone as a total, we could not be happier with the iPhone 13 family of products and the strength we've seen for this cycle. And really, it's those products that have powered the line and given us the overall results that we've had on iPhone, which, for the first half, the revenues were $120 billion, and we feel very, very good about those results.

SAMIK CHATTERJEE: And my follow-up for Luca. Luca, we are seeing sort of a settling in, in terms of growth rate for the Services business on the tough comps that you have. We're also seeing the gross margins there settling around the sort of 72% range, and I understand there are a lot of moving pieces beneath that. But is this sort of a good range for Services longer term? Or are there sort of moving pieces there that as they scale, they can take -- there is an opportunity for more upside?

LUCA MAESTRI: Well, we feel really great about the momentum for our Services business. I was looking at the absolute numbers here. This run rate of almost $20 billion is essentially double what we had just 4 years ago. So we've done really, really well with Services. We have a lot of momentum for a variety of reasons. The first one is the fact that our installed base of active devices continues to grow very nicely. And so that is obviously a big engine for our Services business.

The second thing is that the level of engagement that we see on our platform continues to grow. We have more transacting accounts, more paying accounts, more accounts with subscriptions. The absolute amount of paid subscriptions on our platform is pretty impressive, 825 million. It's an increase of 165 million in the last 12 months alone. So you can tell that this is great growth. And of course, as you've seen over the last few years, we've added a lot of new services, and we plan to add new services and new features that we believe that our customers would love. And so we think there's great -- absolute great momentum.

The growth rates can change a bit, especially during COVID because we've gone through some cycles of lockdowns and then reopenings and so on. And so sometimes, the comps can be a bit deceiving. We are looking at it from the lens of continuing to satisfy our customers, adding to the portfolio, improving the quality of the services. And that has served us very well because in the last 12 months, we've generated $75 billion of Services revenue, and you've seen the margins are obviously accretive to company margin. So we feel good, we feel good about the Services business.

I mentioned in my prepared remarks that the growth rate for the June quarter, we expect it to be less than the 17% that we've reported in March for some of the reasons that I described. Of course, foreign exchange is an issue with the dollar being strong at this point. And of course, we paused our sales in Russia. So we need to take that into account. But in general, when we look across the board, we set all-time records and quarterly records for each one of our categories.

OPERATOR: We'll take our next question from Krish Sankar with Cowen and Company.

KRISH SANKAR, MD & SENIOR RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: Congrats on the really strong results. I have 2 questions, too, and I do apologize, the first one is on supply constraints. Luca, if I try to read the (inaudible) based on June quarter guidance, revenue is being impacted, kind of implies year-over-year down revenue. And you also spoke about a $4 billion to $8 billion supply constraint, which is a large amount compared to the revenue, and I understand you have the supply constraints and the China shutdowns. I'm just kind of curious, do you think the last 3 quarters Apple supply chain had a better buffer inventory of semis that kind of got used up and now you're kind of more tied to whatever the true supply constraints of legacy semis is? Or is there something else going on? And then I had a follow-up.

LUCA MAESTRI: What has happened, obviously, during COVID has changed over the quarters. Recently, for example, during the March quarter, the constraints that we had were limited to silicon shortages. When we are giving out this range of $4 billion to $8 billion, it's not only silicon, but it's the restrictions in China that we're seeing right now. So they are different. There's additional constraints at this point that we are seeing because of the COVID situation. So it's -- that is the fundamental difference there.

KRISH SANKAR: Got it. Got it. Very helpful. And then as a quick follow-up, with the shutdowns, especially in places like China, have you seen actually the App Stores or your Services business actually inflect positively? Or is it too short a time frame to make a judgment call on that?

LUCA MAESTRI: Yes, I think it's early to tell. The restrictions in China started at the very end of March. So it's very, very early to tell.

 

OPERATOR: We'll take our next question from Wamsi Mohan with Bank of America.

WAMSI MOHAN, MD IN AMERICAS EQUITY RESEARCH, BOFA SECURITIES, RESEARCH DIVISION: Luca, thanks for the color around the impacts to the revenue guidance. But I was wondering if you could share, a, if you expect to grow overall revenue in the June quarter on a year-on-year basis. And just to be clear on these impacts that you gave, those are on a year-on-year basis. Can you also tell us how much FX is a headwind, if any, on a quarter-on-quarter basis and incremental Russia impact quarter-on-quarter basis and incremental supply chain impact also on a quarter-on-quarter basis? And I have a follow-up.

LUCA MAESTRI: Well, as we said, we're not guiding to a specific revenue number and -- but just to repeat what I said during the prepared remarks, we're having supply constraints that are caused by the COVID-related disruptions and by the silicon shortages, and that is what is creating the constraints. We expect them to be in the range of $4 billion to $8 billion. This is substantially larger than what we've had during the March quarter. Again, let me repeat. The COVID-related disruptions did not affect the March quarter. So you need to keep that in mind.

With respect to foreign exchange, we expect it to be nearly 300 basis points headwind. It was about 200 basis points headwind during the March quarter. For Russia, we said that the impact on a year-over-year basis is approximately 150 basis points. That reflects the 3 months of the quarter. We paused sales in Russia at the beginning of March, so it was a partial impact on the March quarter. So obviously, on a sequential basis, it's an incremental factor to keep in mind.

I would say on the positive side here is that the demand for both our products and services is solid. Tim has mentioned a number of times, the iPhone 13 family is having a really strong year. We -- when we look at top-selling smartphones around the world, we've had pretty incredible results during the March quarter. The top 6 models in the United States are iPhones, the top 4 in Japan, the top 5 in Australia, 5 of the top 6 in urban China and so on and so forth. So the iPhone 13 has been truly a global success. And as you know and as you can tell from our website, most of the iPad and Mac models are constrained today. They've been constrained for several quarters because the demand is very good for those products. And the Services business, as you know, is growing double digits. So that's what gives us confidence for the June quarter and going forward.

WAMSI MOHAN: Okay. And if I could follow up. Tim, you're in a really enviable place of being pretty far from your net cash neutral objective. At the same time, you're generating a significant amount of cash flow every year. So your capital return strategy has been an extremely successful program in the past, but $90 billion is 3% of your market cap. And on the other hand, there are just a lot of assets that arguably have a lot of synergies with Apple in the health care space or the fitness area like Teladoc or Peloton or Netflix in the content area. Why is this not the right time for Apple to perhaps look at such assets instead of buying back stock or maybe do both?

TIMOTHY D. COOK: We're always looking, and we'll -- we continue to look. And -- but we would only acquire something that were strategic. We acquire a lot of smaller companies today, and we'll continue to do that for IP and for great talent. And -- but we don't discount doing something larger either if the opportunity presents itself. And so -- but I don't want to go through my list with you on the phone, but we're always looking.

OPERATOR: We'll take our next question from Kyle McNealy with Jefferies.

KYLE P. MCNEALY, EQUITY ANALYST, JEFFERIES LLC, RESEARCH DIVISION: This one is regarding Mac. Great quarter with the results by the way. Some exciting products coming out for sure. We're noticing that the lead times are longer for Macs now ordered today, with some available now but many not shipping until June. Just wanted to get your insight on how much of that you think is driven by the strong March results with the product launch and likely sellout conditions versus just real tightness in the supply chain. And the obvious follow-on to that is when do you expect you might catch up and get Mac lead times back within a week?

TIMOTHY D. COOK: Well, we're working hard. We've got lots of customers that we want to get the new Macs to. And so we're working hard on them. They are a result of the combination of the COVID disruptions and the silicon shortage that we've talked about before. And when we might remedy that, I don't -- we're not really forecasting when we can be out of the silicon shortage, so that would be a difficult answer. I think the COVID piece of it, I hope, is a transitory kind of issue. And so I would hope that it would get better over time.

OPERATOR: We'll take our next question from Ben Bollin with Cleveland Research.

BENJAMIN JAMES BOLLIN, SENIOR RESEARCH ANALYST, CLEVELAND RESEARCH COMPANY LLC: The first one is on Services. Luca, I was hoping you could share a little bit of perspective on maybe how much of the Services contribution is purely consumer versus enterprise and how you think about the longer-term opportunity to monetize the enterprise community. And then, Tim, for you, as a follow-up. I think Jim Suva had asked a question earlier about some of your strategy. I was curious how strategy might have evolved since everything that's been going on, what changes you might have seen as of late with respect to freight and some of the geographic production footprint and any evolution that has happened as of late.

LUCA MAESTRI: So Ben, on the Services side, of course, the vast majority of what we do in Services is to final consumers. We do understand and appreciate the fact that the enterprise is a great opportunity for us. Very recently, for example, we launched this -- a new subscription service here in the United States which we call Apple Business Essentials where essentially, we provide support to small- and medium-sized businesses in terms of 24/7 support, device management for small business owners, which we think small companies will value and appreciate. Obviously, we sell AppleCare to enterprises already today. But we know enterprise, in general, as a market is a very interesting market for us, and we're putting a lot of effort and focus on it. And we believe we have really good opportunities to grow.

TIMOTHY D. COOK: Ben, you brought up freight. Freight is a huge challenge in -- today, both from an inflationary point of view and from an availability point of view. And so right now, the focus is on moving the freight to customers any way that we can do that. Over time, we'll do that much more efficiently. And I would hope that the fundamental rates reset some, both -- and I'm talking about both ocean and air. And so both of them have come under some significant inflationary pressure partly due to COVID and some other reasons as well, I would guess. And in terms of geo production, we are constantly making tweaks here and there. And I don't want to go into the details of those because we view it as to be sensitive kind of information, but we're constantly making moves to optimize in the current environment.

TEJAS GALA: Thank you, Ben. A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor and via telephone. The numbers for the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 1807633. These replays will be available by approximately 5 p.m. Pacific Time today. Members of the press with additional questions can contact Josh Rosenstock at (408) 862-1142. Financial analysts can contact me with additional questions at (669) 227-2402. Thank you again for joining us.

OPERATOR: This concludes today's conference. We appreciate your participation.



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OPERATOR: Good day, and welcome to the Apple Q1 FY 2022 **Earnings** 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 Tejas Gala, Director of Investor Relations and Corporate Finance. Please go ahead.

TEJAS GALA, IR CONTACT, APPLE INC.: Thank you. Good afternoon, and thank you for joining us. Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook, including the potential impact of COVID-19 on the company's business and results of operations. These statements involve risks and uncertainties that may cause actual results or trends to differ materially from our forecast.

For more information, please refer to the risk factors discussed in Apple's most recently filed annual report on Form 10-K 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, CEO & DIRECTOR, APPLE INC.: Thank you, Tejas, and good afternoon. Today, we are proud to announce Apple's biggest quarter ever. Through the busy holiday season, we set an all-time revenue record of nearly $124 billion, up 11% from last year and better than we had expected at the beginning of the quarter. And we are pleased to see that our active installed base of devices is now at a new record with more than 1.8 billion devices.

We set all-time records for both developed and emerging markets and saw revenue growth across all of our product categories, except for iPad, which we said would be supply constrained. As expected, in the aggregate, we experienced supply constraints that were higher than the September quarter.

Before I discuss our results in greater detail, I want to first acknowledge the toll that COVID continues to have on communities around the world. In many places, case counts are higher and health systems more strained than at any point throughout the pandemic. On behalf of all of us at Apple, I want to extend our deep gratitude to the scientists, doctors, nurses and so many others on the front lines of combating COVID-19.

This is our eighth quarter reporting results in the shadow of the pandemic. And while I can't say it gets any easier, I can say I'm incredibly proud of the way our teams have come together and continue to innovate on behalf of our customers.

A few weeks ago, we marked the 15th anniversary of the day Steve revealed iPhone to the world. We knew that we had the beginnings of something fundamentally transformative, though none of us could have predicted the incredible and meaningful impact it would have on all of our lives. The creative spirit that made the first iPhone possible has thrived at Apple every day since. We never stop creating. We never stop innovating. You can see that spirit reflected throughout our products, from the incredible performance and capability of our M1 chips to our powerful yet easy-to-use operating systems, to our unrivaled iPhone camera systems, to the beauty and magic of AirPods. That's why each of our major products leads the industry in customer satisfaction for their respective category.

People expect Apple to solve hard problems with easy-to-use products, and iPhone has never been more popular. During the December quarter, we set an all-time revenue record for iPhone, thanks to the strength of our incredible iPhone 13 lineup. This is the best iPhone lineup we've ever had, and the reaction from the press and our users have been off the charts.

This past quarter, we also set another all-time revenue record for Mac, with customers eager to get their hands on an M1-powered MacBook Air, iMac or MacBook Pro. We've been thrilled with the response from Pro users to the M1 Pro and M1 Max chips and to see how Apple silicon is blowing them away with its power, performance and efficiency.

Despite the constraints I mentioned earlier, our iPad lineup continues to be indispensable to tens of millions of people, from teachers and students to artists and creators. Customers are eager to get their hands on our ninth generation iPad, which features a beautiful display and double the storage capacity as well as the new iPad mini with its ultra-portable design.

Wearables, Home, and Accessories, meanwhile, set an all-time revenue record. Customers are loving the Apple Watch Series 7 with its cutting-edge health and fitness tracking features. Nearly every day, I get notes from customers who share how a heart alert led to a life-saving appointment with the cardiologist. And more recently, I've been hearing from people who tell me that their Apple Watch saved their lives by calling 911 when they couldn't. As I've said, we're still in the early innings with our health work, but every day, I am encouraged by our positive impact.

We are also making great advancements in audio and are seeing strong demand from customers as a result. The HomePod mini continues to earn praise for combining the intelligence of Siri with an immersive, room-filling audio experience. And our customers have responded with a lot of excitement to the magic of spatial audio on AirPods, which packs the acoustics of a concert hall.

As always, the deep integration of hardware, software and services is a hallmark of everything Apple makes. It's a principle you can see at work in the introduction of SharePlay, a feature that offers a whole new way to create shared experiences by letting users watch and listen to their favorite content together on FaceTime.

And we continue to invest in innovation across our services business, which set another all-time revenue record last quarter and performed even better than we had anticipated.

The App Store continues to be an economic miracle for developers around the world and a safe and trusted place for consumers to discover their favorite apps. Since its launch, we have paid developers selling digital goods and services more than $260 billion, with 2021 setting a new record for their **earnings**.

I'm also happy to report that in its first 2 years, Apple TV+ shows and movies have earned 200 award wins and more than 890 nominations. Among the powerful lineup are feature films like The Tragedy of Macbeth, CODA and Swan Song, along with many gripping new series coming up, including Severance and The Afterparty. Each one is a tremendous credit to all the storytellers in front of the cameras and behind them who touched audiences all over the world.

Fitness+, meanwhile, continues to inspire customers to reach their health and fitness goals. We recently introduced Time to Run, an extension of our popular series Time to Walk as well as new collections of workouts and meditations to help users make more intentional training choices.

Despite the pandemic, our retail businesses saw its highest revenue in Apple's history, and we also earned our highest ever customer satisfaction scores. That is a testament to the incredible adaptability our teams have shown as we've reimagined retail experience. I also want to take a moment to thank our retail employees and AppleCare teams for the deep care you've given to our customers as they look to get the most out of our products, learn new skills or track down the perfect gift. We have always led with our values and with compassion and care, and never has that been more needed than during the pandemic.

Last quarter, we celebrated 10 years of our Employee Giving program, which we started to help our employees identify and support the causes they care most deeply about. We pledged to match their contributions to organizations doing important work at every level, from their local food pantry to global humanitarian nonprofits. In the last decade, this program has contributed nearly $725 million to charitable organizations.

We also celebrated 15 years of Apple's partnership with a global fund on (PRODUCT)RED, supporting their life-saving work to expand health care services in sub-Saharan Africa for people living with HIV/AIDS. With the support of our customers, we've now raised nearly $270 million to fund prevention, testing and counseling services for people impacted by HIV/AIDS.

And in keeping with our abiding belief in and commitment to education, we also launched a new partnership with the Boys & Girls Clubs of America. This initiative will help young people across the U.S. learn to code on iPad using our Everyone Can Code curriculum.

And we are continuing to drive innovations to help combat climate change. We are already carbon neutral across our own operations, and we are working intensely to meet our 2030 goal of carbon neutrality across our supply chain and the life cycle of our products.

To celebrate Black History Month, we will be releasing a special edition Apple Watch Black Unity Braided Solo Loop and a matching Unity Lights watch face. And through our racial equity and justice initiative, we are continuing to support organizations blazing trails to a more equitable world in our economies, our classrooms and our criminal justice system.

We recognize, as ever, that it takes all of us to confront our most profound challenges. And at Apple, we are determined to do our part. That includes our own work in inclusion and diversity, which we are advancing every day.

Let me close by saying that despite the uncertainty of the world, there is one thing of which I am certain: Apple will continue to [enter] every day and in every way to deliver on the promise of technology at its best.

I will now turn it over to Luca to go over our quarterly results in more detail.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim, and good afternoon, everyone. We are very pleased to report record financial results for the December quarter. We set an all-time revenue record of $123.9 billion, an 11% increase from a year ago. We reached new all-time records in the Americas, Europe, Greater China and the rest of Asia Pacific. And it was also an all-time record quarter for both products and services.

On the product side, revenue was $104.4 billion, up 9% over a year ago, despite significant supply constraints. We grew in each of our product categories except iPad, where supply constraints were particularly pronounced, and set all-time records for iPhone, Mac and Wearables, Home and Accessories.

The strong level of sales performance, the unmatched loyalty of our customers and the strength of our ecosystem have driven our current installed base of active devices to a new all-time record of 1.8 billion devices. The growth in the installed base were broad-based as we set all-time records in each major product category and in each geographic segment.

Our Services set an all-time revenue record of $19.5 billion, up 24% over a year ago, with December quarter records in every geographic segment.

Company gross margin was 43.8%, up 160 basis points from last quarter due to volume leverage and favorable mix, partially offset by higher cost structures. Products gross margin was 38.4%, up 410 basis points sequentially, driven by leverage and mix. Services gross margin was 72.4%, up 190 basis points sequentially, mainly due to a different mix.

Net income of $34.6 billion and diluted **earnings** per share of $2.10 both grew more than 20% year-over-year and were all-time records. Operating cash flow of $47 billion was also an all-time record.

Let me get into more detail for each of our revenue categories. iPhone revenue grew 9% year-over-year to an all-time record of $71.6 billion despite supply constraints, thanks to a remarkable customer response to our new iPhone 13 family. We set all-time records in both developed and emerging markets, reached new all-time high in the iPhone active installed base, and the latest survey of U.S. consumers from 451 Research indicates iPhone customer satisfaction of 98%.

For Mac, revenue of $10.9 billion was an all-time record with growth of 25% year-over-year, driven by strong demand for our newly redesigned MacBook Pro powered by M1, despite supply constraints.

We are 1 year into our transition to Apple silicon. And already, the vast majority of our Mac sales are from M1-powered devices, which helped drive a record number of upgraders during the December quarter. Our momentum in this category is very impressive as the last 6 quarters have been the best 6 quarters ever for Mac.

 

iPad generated $7.2 billion in revenue, down 14% year-over-year due to very significant supply constraints, but customer demand was very strong across all models. Despite the supply shortages, our installed base of iPads reached a new all-time high during the quarter, thanks to a high number of customers that are new to iPad. In fact, around half of the customers purchasing an iPad during the quarter were new to the product.

Wearables, Home and Accessories set a new all-time record of $14.7 billion, up 13% year-over-year. And we set all-time revenue records in each geographic segment. We also continue to improve and expand our product offerings in this category to create unique experiences showcasing our deep integration of hardware, software and services.

In addition to an outstanding level of sales performance globally, Apple Watch continues to extend its reach, with over 2/3 of customers purchasing an Apple Watch during the quarter being new to the product.

Turning to Services. As I mentioned, we reached an all-time revenue record of $19.5 billion, up 24%, with all-time records for cloud services, for music, video, advertising and payment services and a December quarter record for the App Store. These impressive results reflect the positive momentum we are seeing on many fronts. First, as I mentioned before, our installed base has continued to grow and has reached an all-time high across each geographic segment and major product category.

Next, we continue to see increased customer engagement with our services. The number of paid accounts on our digital content stores grew double digits and reached a new all-time high during the December quarter in every geographic segment. Also, paid subscriptions continue to show very strong growth. We now have more than 785 million paid subscriptions across the services on our platform, which is up 165 million during the last 12 months alone.

And finally, we're adding new services that we think our customers will love, and we continue to improve the breadth and quality of our current service offerings. Just in this last quarter, we have added incredible new content on Apple TV+, on Fitness+ and Apple Arcade, and a brand-new way to listen to music with Apple Music Voice.

We also announced in November the beta program for Apple Business Essentials, a new service offering that brings together device management, 24/7 support and iCloud storage to help small businesses manage the end-to-end life cycle of their employees' Apple devices. We are very excited that many thousands of small business customers are already actively participating in the beta program.

This announcement is just one of many ways we are expanding our support for enterprise and business customers. With the latest MacBook Pros that we've introduced last October, the new M1-powered Mac lineup has quickly become the preferred choice of Macs among enterprise customers.

Shopify, for example, is upgrading its entire global workforce to M1-powered MacBook Pro and MacBook Air. By standardizing on M1 Max, Shopify continues its commitment to providing the best tools to help its employees work productively and securely from anywhere. And Deloitte Consulting is expanding the deployment of the Mac Employee Choice program, including offering the new M1 MacBook Pro to empower their professionals to choose devices that work best for them in delivering consulting services.

Let me now turn to our cash position. Due to our strong operating performance and holiday quarter seasonality, we ended the quarter with $203 billion in cash plus marketable securities. We decreased commercial paper by $1 billion, leaving us with total debt of $123 billion. As a result, net cash was $80 billion at the end of the quarter.

Our business continues to generate very strong cash flow, and we were able to return nearly $27 billion to shareholders during the December quarter. This included $3.7 billion in dividends and equivalents and $14.4 billion through open market repurchases of 93 million Apple shares. We also began $6 billion accelerated share repurchase program in November, resulting in the initial delivery and retirement of 30 million shares.

As we move ahead into the March quarter, I'd like to review our outlook, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. Given the continued uncertainty around the world in the near term, we are not providing revenue guidance, but we are sharing some directional insights based on the assumption that the COVID-related impacts to our business do not worsen from what we are projecting today for the current quarter.

We expect to achieve solid year-over-year revenue growth and set a March quarter revenue record despite significant supply constraints, which we estimate to be less than what we experienced during the December quarter. We expect our revenue growth rate to decelerate from the December quarter, primarily due to 2 factors.

 

First, during the March quarter a year ago, we grew revenue by 54%. Remember that last year, we launched our new iPhones during the December quarter, while this year, we launched them during the September quarter. Due to the later launch a year ago, some of the associated channel inventory fill occurred during the March quarter last year. As a result of the different launch timing, we will face a more challenging year-over-year compare.

Second, we expect foreign exchange to be a 3-point headwind when compared to the December quarter growth rate. We currently expect FX to have a negative impact on growth of 2 points in the March quarter, while it represented a 1 point benefit during the December quarter.

Specifically related to Services, we expect to grow strong double digits but decelerate from the December quarter performance. This is due to a more challenging compare because a higher level of lockdowns around the world last year led to increased usage of digital content and services.

We expect gross margin to be between 42.5% and 43.5%. We expect OpEx to be between $12.5 billion and $12.7 billion. We expect OI&E to be around negative $150 million, excluding any potential impact from the mark-to-market of minority investments, and our tax rate to be around 16%.

Finally, today, our Board of Directors has declared a cash dividend of $0.22 per share of common stock payable on February 10, 2022, to shareholders of record as of February 7, 2022.

And with that, let's open the call to questions.

TEJAS GALA: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please?

Questions and Answers

OPERATOR: We'll take our first question from Katy Huberty with Morgan Stanley. We'll take our next question from Wamsi Mohan with Bank of America.

WAMSI MOHAN, MD IN AMERICAS EQUITY RESEARCH, BOFA SECURITIES, RESEARCH DIVISION: Yes. Your margins have clearly been very impressive. So I have one question each on product and one on services gross margins. On product gross margins, that's clearly benefiting from a very strong mix. So Tim, I'm curious, how sustainable do you think these mix trends are from the data that you see? And can you share any thoughts across how the Pro and Pro Max mix compared to prior cycles?

And on the Services side, if I could just ask that, too. When you look at the gross margins there, that's been really impressive. Can you give us some sense of where within Services you're seeing particularly favorable mix trends? And how should investors think about the trajectory of these margins, given some of the sizable investments you're making to drive very successful areas, like content for TV+ as an example?

TIMOTHY D. COOK: Wamsi, it's Tim. In terms of the mix, we don't comment directly on mix. But what I would tell you is that we saw strong demand across the iPhone 13 family. And in fact, we had several of the top-selling models in various markets, including the top 5 in the U.S. and Australia, the top 4 in urban China, 2 of the top 3 in the U.K., 3 of the top 4 in France and Germany, and 4 of the top 6 in Japan. And certainly, based on some external data that I've seen, it does seem to say that we are gaining share as well. So we feel quite good about the momentum of iPhone. And I should add that we were constrained during the quarter.

LUCA MAESTRI: Wamsi, on the Services side, you were asking about gross margin there. As you know, our Services business in aggregate is accretive to overall company margin. And as you know, our Services portfolio is very broad and it contains businesses with very different margin profiles. The difference in margin profile is due in part to the nature of those businesses and in part to the way that we account for them; in some cases, we account on a net basis as opposed to a gross basis. And so as a result, the Services gross margin percentage over time will be influenced by the relative growth of the different businesses within the portfolio.

We do not guide at the product and services level, but I think you've seen the guidance that we provided for the March quarter at the total company level, 42.5% to 43.5%, obviously very strong compared to our recent history. And so we're very pleased with that.

OPERATOR: We'll take our next question from Kyle McNealy with Jefferies.

KYLE P. MCNEALY, EQUITY ANALYST, JEFFERIES LLC, RESEARCH DIVISION: Congrats on the solid iPhone result. That's very good. I assume that you may have prioritized iPhone to the extent there may be similar components that are used for iPhone and iPad. Can you just level set me on that if that's not the case? And if it is, should we see a recovery in iPad as you move past your prime iPhone selling season and you may have better access to components or better supply as we move through the next few months of the year?

TIMOTHY D. COOK: Yes. Kyle, it's Tim. From a supply constraint point of view, as you recall, we said that in Q1, the December quarter, that we would have constraints more than 6, and we clearly did have constraints more than 6. On March, we're saying that where we will have -- we will do better or have less constraints than we had in the December quarter.

If you look at the commonality between different products, there is some. But generally, the challenge is on legacy nodes. And these legacy nodes are by supplier. And so it's much more focused on the supplier than anything else and versus us behind the curtain finding a place to take it. There's not none of that, but there -- there is some of that. But largely, we have to take it where the shortages are.

KYLE P. MCNEALY: Okay. Great. Can you give us any other color on kind of the trajectory of iPad and what's impacting this quarter and where it might go in the March and the June quarter?

TIMOTHY D. COOK: Yes. The issue with iPad, and it was a very significant constraint in the December quarter, was very much on these legacy nodes that I had talked about. Virtually all of the problem was in that area. And so overall, we're not guiding by product constraint -- by product level. But at the -- but overall, we do see an improvement in the March quarter in terms of the constraints going down versus what they were in the December quarter.

OPERATOR: We'll take our next question from Shannon Cross with Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: Tim, could you talk a bit about the Mac business? Looking back, it's up about 50% from the calendar 2019 revenue. You did almost $11 billion this quarter and you're still working through the M1 transition. So can you talk about where you see the opportunity to gain share? What are really sort of the target markets that you think you can go after in order to grow this beyond, I think it was about $37 billion in the last 12 months? And then I have a follow-up.

TIMOTHY D. COOK: Yes. Shannon, thank you for the question. Mac set an all-time revenue record at $10.9 billion for the quarter. That was up 25%. And as you point out, the last 6 quarters for the Mac have been the top 6 revenue quarters of all time. And what's further very good about this is, we set all-time revenue records in Americas, in Europe and the rest of Asia Pacific. And we set a December quarter record in Greater China. And so it's not narrowed to a particular geographic area that we're doing well in. It's almost across the board.

The response is very much because of M1. And we got even more response with the MacBook Pro that we launched in the -- during the Q1 time frame. The -- both the upgraders, which we had a record number of upgraders for the December quarter, but also in markets like China, 6 out of the -- 6 out of 10 sales are to people new to the Mac. And so it's powered by both upgraders and switchers.

Customer satisfaction is off the charts. And so what I see this as is a -- that will -- a product that will be very successful in a number of different markets from education to business, to the creative industry and in all geographic markets. We're not limiting ourselves.

SHANNON SIEMSEN CROSS: Great. And then, Luca, can you talk a bit more on Services? Just obviously outperformed your guidance or your expectations as well as certainly where we were at. Where were the -- what were the things that really outperformed? And maybe what trends are you seeing that is driving the extra revenue?

LUCA MAESTRI: Yes, Shannon. It was -- I mean it was really great on all fronts. We set December quarter records in every geographic segment. And then, as I mentioned earlier, an all-time record for cloud, for music, for video, for advertising, for payment services. December quarter record in the App Store. So we've done, as you said, better than we were expecting at the beginning of the quarter. This overperformance has been spread around the world and spread around our services categories.

And the reality is, this combination of factors, the fact that the installed base is growing, the fact that we continue to have more and more engagement of our customers on all the services -- paid subscriptions is a phenomenal story, right? We now have 785 million paid subs. We just -- we've increased 165 million in the last 12 months alone, right? And so all these things combined are really powering the business. Very, very pleased with the performance.

OPERATOR: We'll hear next from Katy Huberty with Morgan Stanley.

 

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: Can you hear me okay?

LUCA MAESTRI: Now we can.

TIMOTHY D. COOK: Yes.

KATHRYN LYNN HUBERTY: Okay. Good. So first question, just as it relates to some of the disruption you've seen on the component side, manufacturing and logistics over the past couple of years. Are you starting to rethink your broader supply chain strategy or the manufacturing footprint on the back of the significant disruption? Are you happy with the overall geographic exposure that you see in the supply chain today?

TIMOTHY D. COOK: Katy, if you sort of step back and look at how we've done, our largest issue by far has been the chip shortage. That is industry-wide and on these legacy nodes, as I had mentioned earlier. And I think our supply chain actually does very good considering the shortages because it's a fast-moving supply chain. The cycle times are very short. There's very little distance between a chip being fabricated and packaged and a product being -- going out of factory. And so no, I don't see that it makes a fundamental change in the supply chain.

KATHRYN LYNN HUBERTY: Okay. And how are you thinking about the metaverse opportunity and Apple's role in that market?

TIMOTHY D. COOK: Well, that's a big question. But we're a company in the business of innovation. So we're always exploring new and emerging technologies. And I -- you've spoken at length about how this area is very interesting to us. Right now, we have over 14,000 AR kit apps in the App Store, which provide incredible AR experiences for millions of people today. And so we see a lot of potential in this space and are investing accordingly.

OPERATOR: We'll take our next question from Amit Daryanani with Evercore.

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I have 2 as well. I guess both up on the supply chain side, I think things continue to be fairly volatile. I'd love to get your perspective if you feel if things or supply chain issues are starting to alleviate or they still remain challenging. And then maybe I missed this, but could you perhaps tell us how much revenue was left on the table in December because of the supply chain issues? And how does that number shape up in March?

TIMOTHY D. COOK: Yes. Amit, what we've said in terms of December and March was that it's very difficult to estimate with great precision the constraints. But we said that they would be more than the Q4 or more than the September quarter, and we're saying that March will be less than the December quarter. And so that's the kind of verbiage that we placed around it.

In terms of is it still challenging, yes, it is challenging. And for us, we pride ourselves on getting products to customers who really want them and try to do that in a fast basis. And so it's frustrating that we can't always do that at the speed that we would like. However, March is better than December. And so there's some encouraging sign there. We're not predicting (inaudible) overall, obviously, because of the number of variables that go into such a prediction.

AMIT JAWAHARLAZ DARYANANI: Fair enough. Tim, I think one of the topics investors can struggle a fair bit with Apple is really just sort of understand visibility around your product road map, and I think some of your tech peers tend to be more vocal about their initiatives. Some of them go change their name when they find an initiative that's attractive, I feel. You folks are spending, I think, $23 billion on R&D in '21. So you're really spending a fair amount. And maybe without telling us the road map, could you just talk about how do you think about where to focus your R&D resources on? And to some extent, is the way to think about this R&D spend, how much of it is really done on things that are more evolutionary in products that are out in the marketplace versus things that we haven't seen yet or on potential new offerings?

TIMOTHY D. COOK: We have a little different model. We try to announce things when they're ready or close to ready and try to maintain an element of surprise in there. And so that explains hopefully what we do with our road map. And I think that's proven successful for us, and other people can do it differently, of course, but it's plainly been good for us over time to do that. So we're going to continue to do that.

 

In terms of deciding where we invest in, we look at areas that are sort of at the intersection of hardware, software and services, and because we think that, that's where the magic really happens and it brings out the best in Apple. And so there are areas that have more than piqued our interest, and we are investing in those. And you can tell through time that we've ramped our R&D spend even more than we were before. And so there's quite a bit of investment going into things that are not on the market at this point, as there always are.

OPERATOR: We'll hear next from David Vogt with UBS.

DAVID VOGT, ANALYST, UBS INVESTMENT BANK, RESEARCH DIVISION: I just wanted to dive in and get your perspective on China and sort of the macro climate there and how that sort of pertains to your business as we think about it going forward. And the reason why I'm asking is we've heard some concerns that current policies might have caused a pause in this market and smartphone inventory. Maybe more specifically, the local vendors could be a little bit elevated going into Chinese New Year. So we just want to get your thoughts on what you're seeing in this market around this sort of potential development and then maybe touch on sell-in versus sell-through in that market. And then I have a follow-up.

TIMOTHY D. COOK: Well, I can only comment on for us. Our sales grew 21% there in the last quarter, and we're very proud of that. I'll stay away and let other people be the economist and make the macro determinations. But what we're seeing there was super impressive, with all-time revenue records and a record number of upgraders and strong double-digit growth in switchers on iPhone, which is very important to us. And as I've mentioned before, we had the top 4 selling phones in urban China. And so there's a lot of good there.

And I would remind you that iPhone was constrained in the quarter. And so I'm not sure where the statements are coming around about inventory, and I can't comment on whether other people have more or not. I don't know the answer to that. Thanks for the question.

DAVID VOGT: That's helpful, Tim. And then maybe just on the supply chain. Obviously, you've been managing it incredibly well over the last 12 to 18 months. And gross margins have actually performed relatively well, mix driven both between products and services. Can you help us think about sort of the quantifiable impact or maybe the costs that you're carrying due to the supply chain that may be sort of -- I don't want to use the word transitory, but we'd expect over the longer term that might be sort of -- abate a little bit and you'll get a little bit of a benefit as we get past some of these supply chain issues over the next 12 months or so?

TIMOTHY D. COOK: We're seeing inflation, and it's factored into our gross margin and OpEx that Luca reviewed with you earlier. Logistics, as I've mentioned on a previous call, is very elevated in terms of the cost of moving things around. I would hope that at least a portion of that is transitory, but the world is -- the world has changed, and so we'll see.

OPERATOR: We'll take the question from Samik Chatterjee with JPMorgan.

SAMIK CHATTERJEE, ANALYST, JPMORGAN CHASE & CO, RESEARCH DIVISION: I had a couple. The first question that I had was really on Apple TV+, and I know some of the other players in this market have talked about slowing subscriber growth as we exit the pandemic. So curious if you can share what trends you're seeing in Apple TV and Apple TV+, and how similar or dissimilar they are and how your content is maybe helping you on that aspect? And I have a follow-up.

TIMOTHY D. COOK: We don't give out subscriber numbers for Apple TV+. What we do, do is give out a subscriber number for -- our subscription number for the total number of subscriptions that we had. And I think Luca mentioned earlier we ended the quarter at 785 million. And so we were incredibly pleased with that. That's a huge growth on a year-over-year basis of 165 million. And it counts, as you recall, both Apple-branded and third-party.

In terms of how we're doing with TV+, we've been honored with 200 wins and 890 nominations. We're doing exactly like we had wanted to, giving storytellers a place to tell original stories, and feel really good about where we are competitively and strategic position of the product.

SAMIK CHATTERJEE: And if I can just follow up, and similarly on Apple Pay, can you just help us think about when you think about the next few years, where are the biggest opportunities, either be it in terms of like geographies or either segments -- customer segments that you may not be tapping into currently and have an opportunity in?

TIMOTHY D. COOK: Well, putting aside any kind of thing that sits on our road map for a second in that area, which we obviously wouldn't talk about in the call, I would say that I think Apple Card has a great runway ahead of us. It was rated the #1 midsized credit card in customer sat by J.D. Power and is getting -- has fast become people's main credit card for many, many people. And the growth of Apple Pay has just been stunning. It's been absolutely stunning. And there's still obviously a lot more there to go, and because there's still a lot of cash in the environment. And so I think that both of these and whatever else we might do have a great future ahead.

OPERATOR: We'll take our next question from Chris Caso with Raymond James.

CHRISTOPHER CASO, RESEARCH ANALYST, RAYMOND JAMES & ASSOCIATES, INC., RESEARCH DIVISION: First question is just a little bit of help in interpreting the guidance. And if you could speak to the March quarter, perhaps in terms of seasonality and seasonal performance. And Luca, as you mentioned last year, because of the later launch of the phone, that some of that came into the March quarter, and that was better than seasonal performance in March. Should we interpret, because the supply constraints are easing somewhat as you go into the March quarter, that we should see something similar, that March quarter would -- we should get some better than seasonal performance? Is that the correct way to interpret your guidance?

LUCA MAESTRI: Well, and we talked about it on a year-over-year basis because that's probably how most people look at it. And so just to recap what we said. First of all, we expect a record for the March quarter. We expect solid growth on a year-over-year basis. And -- but as Tim was saying, we still expect significant supply constraints but less than what we've seen in December. So I think on that basis, you can do the math around sequential. But given where we are in the environment, given the difficult compare both on iPhone, and as I mentioned on -- during my prepared remarks, on Services, we're very, very happy with the way we're guiding and the way the business is going right now.

CHRISTOPHER CASO: Okay. As a follow-up, a follow-up question is on perhaps the sustainability and repeatability of the growth in iPhone after 2 very good years, well-received product and the 5G upgrade cycle. And I think there was a point in time when perhaps there's a view from some that iPhone was ex growth, and that's been proven wrong. Off of these very strong results, maybe you can speak to your level of confidence that iPhone continues to grow in the future. And kind of what are the avenues for that growth?

TIMOTHY D. COOK: Yes. Chris, it's Tim. What I would say is that the iPhone has become an integral part of so many people's lives, now more than ever. And the active installed base of iPhone continues to grow and is now at an all-time high. And during December, as we had mentioned, we had a record number of upgraders and grew switchers strong double digit, which I think speaks to the strength of the product. And that's all an inducement to some -- an enormous customer satisfaction rating of 98% and our doing well throughout the geographies. And I've mentioned some of the geos that we track and how many units that we have on the top-selling model charts.

And so -- and even though this is the second product announcement that has 5G in it, we're still really in the early innings of 5G, meaning if you look at the installed base and look at how many people are on 5G versus not, and we don't release those exact numbers, but you can do some math and estimate those. We maintain a very optimistic view on iPhone long term.

OPERATOR: We'll take our next question from Ben Bollin with Cleveland Research.

BENJAMIN JAMES BOLLIN, SENIOR RESEARCH ANALYST, CLEVELAND RESEARCH COMPANY: Tim, I'm interested in how you think about the relationship between the total iOS installed base and then the subsequent performance you see within the Services or the paid subscriptions. And a second part to that is, how do you look at the existing Services business in terms of the growth you get from customers who are already subscribers versus completely net new or greenfield subscribers?

TIMOTHY D. COOK: I think I'll let Luca comment on the second part of that. But if you back up and sort of look at how we're doing, even though we have 785 million subs, relative to the total number of products offered and the customers it's offered in, there's still a lot of room to grow there. And so I -- the way that I look at it is that we -- there's a lot more greenfield in front of us.

LUCA MAESTRI: And Ben, on the Services engagement and how we think about customers, right, obviously, it's important for us that customers are engaged on our Services platforms. And the ones that we have, we know that the more engaged they are, they're more likely to stay with Apple for the long term. So we just obviously track all those metrics, and they're very important for us. And that's why we continue to improve the quality of our offerings and the quantity over time. As you've seen, we launched a lot of new services. We obviously care a lot about new customers as well, and that's why we keep track of the installed base and a lot of other metrics on that front.

It's very similar to what we do with products. I mean also for products, we care a lot about upgraders, we care a lot about switchers. It's obviously the combination of the 2 that when you put it together provides the level of growth that you've actually seen in our Services business. I mean the last 12 months, we've done over $72 billion of revenue on Services. It's the size of a Fortune 50 company. It couldn't happen with our contribution from both existing and new customers.

OPERATOR: We'll take our next question from Harsh Kumar with Piper Sandler.

HARSH V. KUMAR, MD & SENIOR RESEARCH ANALYST, PIPER SANDLER & CO., RESEARCH DIVISION: First of all, congratulations on a stellar quarter in December and all the records that the Apple community has set. Tim, I had a question on the content on Apple TV. When we look at the Apple content that you guys put out on TV, original content, it's typically very socially responsible and healthy, for example, at Ted Lasso. Has this, in effect, created a constraint or a hesitancy of some sort for Apple to go and purchase studios when they come up? Or have those decisions been primarily financial or otherwise?

TIMOTHY D. COOK: We don't make purely financial decisions about the content. We try to find great content that has a reason for being. And we love shows like Ted Lasso and several of the other shows as well that have a reason for existing and may have a good message and may make people feel better at the end of it. But we're -- but I don't view that we've narrowed our universe of things we're selecting from. There's plenty to pick from out there. And I think that we're doing a pretty good job of it as we speak.

HARSH V. KUMAR: Fair enough. And then my follow-up was the Apple vision of health care in the future. So you guys have sort of cautiously approached health care with iWatch and iPhone. It's mostly a preventative sort of approach. It provides you updates. But do you see a situation down the line where Apple perhaps plays a more active role, either through the Watch or some other device where perhaps a doctor or a hospital mandates that the Watch be worn for -- effectively for critical and vital monitoring? And I was curious if you could just give us some color on how you guys think about health care and iWatch in that confluence?

TIMOTHY D. COOK: Well, the -- with the Apple Watch, there's literally not days that go by without me getting notes about someone that's received a health alert. Maybe it's to do with their cardiovascular health. Or more recently, a lot of people have told me that they fell and was knocked unconscious and couldn't respond, and the Watch responded for them to emergency contacts and emergency personnel.

And so there's a lot that we're doing today. My sense has always been that there's more here. I don't want to get into a road map discussion in the call. But we continue to kind of pull the string and see where it takes us. But we're really satisfied with how we're doing in this area because we are fundamentally changing people's lives and, in some cases, saving people's lives. So it's an area of great interest.

TEJAS GALA: Thank you. A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor and via telephone. The numbers for the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 3599903. These replays will be available by approximately 5 p.m. Pacific Time today. Members of the press with additional questions can contact Josh Rosenstock at (408) 862-1142. Financial analysts can contact me with additional questions at (669) 227-2402. Thank you again for joining us.

OPERATOR: This concludes today's conference. We do appreciate your participation.

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OPERATOR: Good day, and welcome to the Apple Q4 Fiscal Year 2021 Earnings 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 Tejas Gala, Director of Investor Relations and Corporate Finance. Please go ahead.

TEJAS GALA, IR CONTACT, APPLE INC.: Thank you. Good afternoon, and thank you for joining us. Speaking today first is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook, including the potential impact of COVID-19 on the company's business and results of operations. These statements involve risks and uncertainties that may cause actual results or trends to differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed annual report on Form 10-K 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 like to now turn the call over to Tim for introductory remarks.

TIMOTHY D. COOK, CEO & DIRECTOR, APPLE INC.: Thanks, Tejas, and good afternoon, everyone, and thank you for joining the call today. A year ago, I spoke to you about the atmosphere of uncertainty in which we were living and the way it had come to define our daily experience, both as people and as a company. Today, much has changed, profoundly so. And while we are still living through unprecedented times, we are encouraged by progress around the world. I'm grateful to our teams who have stayed resolutely focused on our customers and the pursuit of innovation on their behalf. We've aimed to help our customers navigate the world as it is while empowering them to create the world as it can be. Whether it's public health workers managing vaccination campaigns on iPhone or students returning to classrooms full of iPads or family staying connected over FaceTime, it is an honor to know that what we make matters and to see that reflected in the world and in our performance.

This fiscal year, we reported $366 billion of revenue, which represents 33% annual growth. We also achieved more than 20% growth across all of our product categories and in every geographic segment. And today, Apple is reporting another very strong quarter. Demand was very robust, and we set a new September quarter record of $83.4 billion, up 29% from last year and in line with what we discussed on our last call despite larger-than-expected supply constraints.

We estimate these constraints had around a $6 billion revenue dollar impact, driven primarily by industry-wide silicon shortages and COVID-related manufacturing disruptions. Even so, we set an all-time record for Mac and quarterly records for iPhone, iPad, Wearables, Home and Accessories, representing 30% year-over-year growth in products. Our Services business performed better than we expected, where we hit an all-time record of $18.3 billion and grew 26% year-over-year.

And we set quarterly records in every geographic segment with strong double-digit growth across the board. During fiscal 2021, we earned nearly 1/3 of our revenue from emerging markets and doubled our business in India and Vietnam. We are optimistic about the future, especially as we see strong demand for our new products. At the end of the September quarter, we introduced our iPhone 13 lineup as well as the Apple Watch Series 7, iPad and iPad mini, all of which represent significant advances. The iPhone 13 and iPhone 13 Mini, alongside the iPhone 13 Pro and Pro Max, are setting a new standard with their superfast performance, advanced camera systems, longer battery life and brilliant Super Retina displays.

Customers are loving the ninth generation iPad, which features a beautifully sharp display and twice the storage of the previous generation as well as the new iPad mini, with its ultra portable design and impressive speed and performance. And we've been thrilled with the reviews that Apple Watch Series 7 has earned for its larger display, faster charging and refined design. And just last week, we introduced the completely reimagined MacBook Pro, powered by the extraordinary M1 PRO and M1 Max chips. These are our most powerful notebooks ever with game-changing performance and battery life and the world's best notebook display. We think customers are going to love MacBook Pro, whether they're editing video in Final Cut Pro or making music in Logic Pro and so much more. They'll be able to do things never before possible on a notebook.

We also announced our all-new AirPods that feature spatial audio and industry-leading sound, longer battery life and an all-new design. For the home, we added 3 new colors to our HomePod mini lineup, which offers seamless integration across Apple's products and services. We also announced a new subscription tier to Apple Music called Apple Music Voice, which offers subscribers access to the Services catalog of 90 million songs, all through the power of Siri.

Across the board, teams at Apple continue to drive unmatched innovation through the seamlessly integrated hardware, software experience we've long prided ourselves on. iOS 15 and iPadOS 15 have created more ways than ever to stay productive, whether choosing Focus to avoid distractions or Quick Note to capture a thought. macOS Monterey offers new ways to connect with friends and family, get more done and work fluidly across Apple devices. And watchOS 8 has made Apple Watch even more powerful and more ways than ever to stay active and to track your health on the go.

We've never had a more diverse range of Services for our customers to choose from, and we've been very encouraged by our performance, which reflects growing customer enthusiasm and satisfaction. In just its first 2 years, Apple TV+ has already proved itself to fans around the world. And I want to congratulate the incredible actors, writers, storytellers, producers and everyone else whose behind-the-scenes work has made that success possible.

This quarter, Apple TV+ won 11 Emmy's, including the Award for Outstanding Comedy Series for Ted Lasso. That show has continued to bring light and laughter to fans all over the world with its boundless optimism and beloved cast of characters. We couldn't be more proud of our entire lineup of content from the gripping second seasons of The Morning Show and Truth Be Told to our newest programs, Swagger, which is out tomorrow. The response has been incredible.

This quarter also saw major updates to Fitness+, including the addition of new activities like meditation and Pilates and the announcement of group workouts, a feature that brings fitness and friends together. We also shared that Fitness+ will soon be available in 15 new countries, bringing workouts for every age and skill level to millions more people around the world.

And those are just 2 of the Services our customers are loving. This quarter, Apple Card won a J.D. Power award for customer satisfaction in its very first year of eligibility. The App Store continues to help people find the apps they depend on to stay productive, creative and entertained. And on Apple News, we launched a news partner program that expands Apple's support for journalism while creating an even better business opportunity for publishers.

And we continue to support our customers around the world. We're glad to report we've opened several new Apple Stores. This quarter, we opened a beautiful store in Changsha, which is our first store in the Hunan province of China. We also just opened our third store in Istanbul. And we recently added a store in the Bronx, which means we are now in all 5 boroughs in New York City. All of our stores are now open worldwide and have been for 7 weeks. As we enter our busiest time of year, I particularly want to share my gratitude for our retail teams. Customers have never relied on our products more, and our retail teams have truly answered the call. We meet our customers where they are with many ways to shop through our online and retail stores and can help them choose the best product for them and get it up and running.

We are also excited about our education initiatives. This month, we introduced the Everyone Can Code Early Learners program, offering free resources, which helps students and elementary school learn coding. We see education not only as a fundamental good in its own right but is a great equalizing force. A world where all people can access a quality education isn't just a smarter world. It's a more equitable one.

That desire to create a more just and equitable world is the guiding principle behind our Racial Equity and Justice Initiative. This quarter, Apple shared plans to expand our $100 million investment by an additional $30 million. Those funds will be used in a number of ways, including the creation of a new global Hispanic-serving institution equity and innovation hub. The hub will dramatically expand the technology and resources for students in the

 

STEM fields. Those programs join our ever-expanding work with historically black colleges and universities, including the now 45 community coding centers and regional hubs, serving underrepresented communities across the United States.

This month, we were also happy to welcome the inaugural class of developers and entrepreneurs to the Apple Developer Academy in Detroit. The Academy is Apple's first in the United States and is designed to help prepare students for jobs in the thriving iOS app economy, which supports more than 2.1 million jobs across all 50 states. In August, we shared our impact accelerators first cohort of black, Latinx and indigenous-owned businesses whose pioneering work in green technology and clean energy serves many of the communities most impacted by climate change.

More broadly, we are already carbon neutral as a company. And this quarter, we made new strides towards reaching our goal of carbon neutrality across our entire supply chain and the life cycle of our devices by 2030. We've made significant product advances in this area. iPad and iPad Mini now come with 100% recycled aluminum enclosure. The antenna on iPhone 13 is made up of upcycled plastic water bottles, which marks an industry-first. And as our customers are seeing when they purchase iPhone 13, we've redesigned the packaging to eliminate the outer plastic wrap, which will allow us to avoid using 600 metric tons of plastic. This brings us closer to removing all plastic in our packaging by 2025.

We've also made good progress toward our goal to 1 day make our products without taking anything from the earth. With Apple Watch Series 7, for example, 99% of the rare earth elements we use are recycled. Ahead of COP26, I'm also pleased to report that we have more than doubled the number of our suppliers who have committed to becoming carbon neutral by 2030. We're very encouraged to see the growth in this area, and we will continue to drive those changes in the supply chain in the months and years to come.

We've never viewed our environmental work as a side project. Teams across Apple are pushing this work forward in the same spirit of innovation we bring to our products and services. We are determined to be a ripple in the pond that drives a far greater change. From the pandemic to climate change to inequity and injustice, global challenges won't abide solitary solutions, and we feel a deep sense of responsibility to help.

We are incredibly proud of the product lineup we have going into the holiday season, and we are encouraged by the customer response we've seen. And while we cannot know exactly which path the pandemic will take the world down in the months to come, we feel quite confident that this new year will be driven by the values that guide us and by the innovation that defines us.

With that, I'll hand it over to Luca for a deeper dive on our performance this quarter. Luca?

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone. We are pleased to report very strong financial results for the September quarter, capping a record-setting fiscal year 2021. We set a September quarter revenue record of $83.4 billion, an increase of nearly $19 billion or 29% from a year ago despite larger-than-expected supply constraints.

We also reached new Q4 records in every geographic segment with strong double-digit growth in each one of them. And it was a record September quarter for both products and services. On the products side, revenue was $65.1 billion, up 30% over a year ago as we experienced better-than-expected demand for our products despite supply constraints that we estimated at around $6 billion.

We grew in each of our product categories with an all-time record for Mac and September quarter records for iPhone, for iPad and for Wearables, Home and Accessories. This level of sales performance, combined with the unmatched loyalty of our customers and the strength of our ecosystem, drove our installed base of active devices to a new all-time record.

Our Services set an all-time revenue record of $18.3 billion, up 26% over a year ago, with September quarter records in every geographic segment and in every Services category.

Company gross margin was 42.2%, down 110 basis points from last quarter due to higher costs and a different mix of products, partially offset by leverage. Products gross margin was 34.3%, down 170 basis points sequentially as higher cost structures were partially offset by leverage and mix. Services gross margin was 70.5%, up 70 basis points sequentially, mainly due to a different mix.

Net income of $20.6 billion and diluted **earnings** per share of $1.24, both grew over 60% year-over-year and were September quarter records.

 

Let me get into more detail for each of our revenue categories. iPhone revenue grew 47% year-over-year and set a September quarter record of $38.9 billion despite supply constraints as customer demand was very strong. The iPhone 12 family continued to perform very well, and we are seeing enthusiastic customer response to the launch of our iPhone 13 family.

We also grew double digits in each geographic segment, setting September quarter records in both developed and emerging markets. The latest survey of U.S. consumers from 451 Research indicates iPhone customer satisfaction of 98% for iPhone, and our active installed base of iPhones reached a new all-time high.

For Mac, we set an all-time revenue record of $9.2 billion despite supply constraints, driven by strong demand for our M1-powered MacBook Air. In fact, our last 5 quarters for Mac have been the best 5 quarters ever for the category. iPad performance was also strong with a September quarter revenue record of $8.3 billion, up 21%, in spite of significant supply constraints as customer demand for the iPad Pro, also powered by M1, was very strong.

For both Mac and iPad, we continue to see a combination of high levels of customer satisfaction and first-time buyers. Around half of the customers purchasing Mac and iPad during the quarter were new to that product. And in the most recent survey of U.S. consumers from 451 Research, customer satisfaction was 97% for both Mac and iPad.

Our continued investment in iPad and Mac is taking computing to the next level. We have redesigned and reengineered both products to provide customers an unmatched experience, which resulted in record fiscal years for both categories. We are carrying this momentum also in the enterprise market. For example, SAP has already deployed Macs to tens of thousands of their employees to date. Following the launch of our new M1 MacBook Pro last week, SAP is planning to add it to the growing list of M1 Mac offerings available to their global workforce.

Another example is France's national railway company, SNCF, which equips all train drivers with iPads to manage their entire daily workflow and train operations, helping to lower energy and maintenance costs. In fact, the iPads have been so well received that 90% of the drivers choose to purchase them for personal use at the end of the corporate device refresh cycle.

Next, Wearables, Home and Accessories set a new September quarter record of $8.8 billion. We continue to improve and expand our product offerings in this category, which we believe improve the overall customer experience and showcase the integration between our products and services. Apple Watch, AirPods and HomePod mini are powerful devices in their own right, but paired with our other products, software and services, they create unique experiences, like switching audio seamlessly between devices on your AirPods.

Turning to Services. As I mentioned, we reached an all-time revenue record of $18.3 billion with all-time records for cloud services, music, video, advertising, AppleCare and payment services and a September quarter record for the App Store. Our continued investment and strong execution in Services has helped us deliver a record $68 billion in revenue during fiscal 2021, nearly tripling this category in 6 years. These impressive results reflect the positive momentum we are seeing on many fronts.

First, our installed base continues to grow and reached an all-time high across each geographic segment. Next, we continue to see increased customer engagement with our services. The number of paid accounts on our digital content stores grew double digits and reached a new all-time high during the September quarter in each geographic segment. Also, paid subscriptions continued to show very strong growth. We now have more than 745 million paid subscriptions across the Services on our platform, which is up more than 160 million from last year and nearly 5x the number of paid subscriptions we had less than 5 years ago. And finally, as Tim mentioned earlier, we're adding new services that we think our customers will love. And we continue to improve the breadth and quality of our current services offerings.

Fiscal '21 was not only a big year for Services but for our entire company. During the past 12 months, we grew our business by 33% or $91 billion, reaching nearly $366 billion of revenue with record level performance across the board. Every product category and every geographic segment set a new annual revenue record and was up at least 20% over -- of fiscal 2020.

Let me now turn to our cash position. We ended the quarter with $191 billion in cash plus marketable securities. We issued $6.5 billion of new term debt, retired $1.3 billion of term debt and decreased commercial paper by $2 billion, leaving us with total debt of $125 billion. As a result, net cash was $66 billion at the end of the quarter as we continue to make progress towards our goal of net cash neutral over time.

 

As our business continues to generate very strong cash flow, we were also able to return $24 billion to shareholders during the September quarter. This included $3.6 billion in dividends and equivalents and $20 billion through open market repurchases of 137 million Apple shares. We also retired an additional 5 million shares in the final settlement of our 17th ASR.

As we move ahead into the December quarter, I'd like to review our outlook, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. Given the continued uncertainty around the world in the near term, we are not providing revenue guidance but we are sharing some directional insights based on the assumption that the COVID-related impacts to our business do not worsen from what we are projecting today for the current quarter.

As we mentioned earlier, during the September quarter, supply constraints impacted our revenue by around $6 billion. We estimate the impact from supply constraints will be larger during the December quarter. Despite this challenge, we are seeing high demand for our products and expect to achieve very solid year-over-year revenue growth and to set a new revenue record during the December quarter.

We expect revenue for each product category to grow on a year-over-year basis, except for iPad, which we expect to decline year-over-year due to supply constraints. For Services, we expect our growth rate to decelerate from the September quarter but to remain strong. We expect gross margin to be between 41.5% and 42.5%. We expect OpEx to be between $12.4 billion and $12.6 billion. We expect OI&E to be around negative $50 million, excluding any potential impact from the mark-to-market of minority investments, and our tax rate to be around 16%. Finally, today, our Board of Directors has declared a cash dividend of $0.22 per share of common stock payable on November 11, 2021, to shareholders of record as of November 8, 2021.

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

Questions and Answers

TEJAS GALA: Thank you, Luca. We ask that you limit yourself to 2 questions. Operator, may we have the first question, please?

OPERATOR: Our first question comes from Shannon Cross from Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: Tim, I'm wondering, can you talk a bit more about specific supply chain issues you saw and how you've seen improvements, I think, during the current quarter and how we should think about what products you expect to see most impacted going forward? Just any more color you can give us on what's going on out there because clearly, this is hitting everyone.

TIMOTHY D. COOK: Sure. If you look at Q4 for a moment, we had about $6 billion in supply constraints, and it affected the iPhone, the iPad and the Mac. We had -- there were 2 causes of them for Q4. One was the chip shortages that you've heard a lot about from many different companies through the industry. And the second was COVID-related manufacturing disruptions in Southeast Asia. The second of those, the COVID disruptions, have improved materially across October to where we currently are.

And so for this quarter, we think that the primary cause of supply-chain-related shortages will be the chip shortage. It will affect -- it is affecting, I should say, pretty much most of our products currently and -- but from a demand point of view, demand is very robust. And so part of this is the demand also is very strong. But we believe that by the time we finish the quarter that the constraints will be larger than the $6 billion that we experienced in Q4.

SHANNON SIEMSEN CROSS: Okay. Great. So you'll sort of push forward in the next quarter as well. Can you -- just a different question because I'm curious, you're starting to sell more and more things on a ratable basis. And how are you thinking about that? I mean you have the new Macs and that we keep seeing, you can buy for a monthly the charge in that. How do you think that's driving sales? And how should we think about percent maybe of the portfolio that's now available? And I don't know if you want to tell us how much revenue is now under a recurring nature, but it definitely seems as you're shifting more and more to maybe sort of a bundled sale or offering from a consumer standpoint where you just pay one price every month and you get all of your Apple devices and Apple services.

TIMOTHY D. COOK: Yes. The first product, Shannon, that really sold on a monthly basis was iPhone. And that began to happen in the U.S., as an example, shortly after the subsidy kind of world changed markedly. And so I would say that predominantly, the mode of buying an iPhone in the United States is on a monthly kind of plan today. For the balance of the products, still the most popular would be buying them outright. But we are seeing more and more demand for monthly payments.

And so we want to give the customer what they want. And so you will see us do more and more things like that, that will meet the customer where -- and provide the price that they want in a way that they want to pay for it. I don't know the percentage of products that are sold that way today, but it is increasing.

OPERATOR: We will hear next from Amit Daryanani with Evercore.

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: Perfect. Thanks a lot, and good afternoon, everyone. I have 2 as well. I guess when I think about the supply chain headwinds and you're talking about $6 billion in September and getting bigger in December, Tim, I would love to understand how do you guys comfort that this is really a demand that's getting deferred versus potentially getting destroyed at least somewhere else. And if you think about the supply chain bottlenecks, you were the COO. You managed a lot of the stuff. Do you feel comfortable that sort of peaks in December and alleviates from there? Or what does the trajectory look like for improvement?

TIMOTHY D. COOK: Yes. What I feel comfortable on is I feel like we've made great progress on the COVID-related disruptions, and that happened across the month of October, and we're in a materially better position today. It is difficult to predict COVID. And so I'm not going to predict where it goes. But I can just tell you that as of today, we're in a materially better position than we were in September and in the first several weeks of October.

In terms of the chip shortage, the chip shortage is happening on legacy nodes. Primarily, we buy leading edge nodes, and we're not having issues on leading edge nodes. But on legacy nodes, we compete with many different companies for supply and it's difficult to forecast when those things will balance because you'd have to know how kind of how the economy is going to be in '22 and the accuracy of everyone else's demand projections.

And so I don't feel comfortable in making a prediction. I think it would be subject to too much inaccuracy. But I do feel very comfortable with our operational team. I think we've got a world-class one, and I'm sure they're doing everything they can do to collapse cycle times and improve yields and do all the things that you can do, in addition to fundamental capacity investment to remedy the situation.

AMIT JAWAHARLAZ DARYANANI: Got it. And then Luca, if I may ask you a question on gross margins for December, you essentially guided gross margins to be flat to maybe down a little bit versus September. Maybe just touch about it. So I think historically, I would have expected gross margins to be up in December, given how much revenue leverage you end up with. So maybe what are the puts and takes on gross margins that are resulting in a more flattish guide versus historical seasonality?

LUCA MAESTRI: Well, as you know, typically, obviously with December being the holiday season, we do get leverage, as you say. But it's also the period of the year where we launch a lot of new products. And as you know, we launch essentially in every product category. We launch new products. Demand is very strong. But as you know, when we launch these new products, we tend to have higher cost structures at the beginning of the cycle. And so that's what balances this out.

Obviously, from a year-over-year standpoint, it's actually a significant expansion, right? Because when you look at what we did a year ago in the December quarter, 39.8%, this clearly indicates a significant expansion.

OPERATOR: We'll hear next from Katy Huberty with Morgan Stanley.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: Given the supply chain is blurring the demand picture for iPhone 13, what data points can you share that help investors understand whether demand is tracking to a product cycle that is flat, growing or down from the very strong iPhone 12?

And maybe on that front, Luca, you can also comment on where you exited the quarter from a channel inventory standpoint for iPhone relative to a normal product cycle. And then I've got a follow-up.

TIMOTHY D. COOK: Yes. Look, maybe I can take both of those. The channel inventory, as you would expect in a constrained environment, the iPhone channel inventory ended below the targeted range and is currently below it. And so that's that.

In terms of the blurring of demand, we look at -- Katy, we look at a number of different data points. We look at demand across our online store, demand in retail. The -- we look through to back orders on the carrier channels, the ones that do take back orders there. We look at channel orders as well. And so we have a number of different data points that we use to conclude how strong demand is. And we feel very, very good about where demand is right now. We're -- and we're working feverishly on the supply side of that.

KATHRYN LYNN HUBERTY: And Tim, as a follow-up. We recently surveyed 4,000 consumers in the U.S. and China, and the feedback is most of them don't want to pay for apps or services direct with the developer. They value the security, privacy, ease of transactions with the App Store. So how do you think about balancing the regulators push for more choice with a customer base that's happy with the existing experience? And just as a follow-on to that, how are you and Luca thinking about the potential impact of Services revenue growth rate as some of the changes to the App Store go into effect?

TIMOTHY D. COOK: The main thing that we're focused on, on the App Store is to keep our focus on privacy and security. And so these are the 2 major tenets that have produced over the years a very trusted environment where consumers and developers come together and consumers can trust the developers on the developers and the apps or what they say they are and the developers get a huge audience to sell their software to. And so that's sort of #1 on our list. Everything else is a distant second.

And so what we're doing is working to explain the decisions that we've made that are key to keeping the privacy and security there, which is to not have sideloading and not have alternate ways on the iPhone, where it opens up the iPhone to unreviewed apps and also get by the privacy restrictions that we put on the App Store. And so we're very, very focused in discussing the privacy and security elements of the App Store with the regulators and legislators.

OPERATOR: We'll take our next question from David Vogt with UBS.

DAVID VOGT, ANALYST, UBS INVESTMENT BANK, RESEARCH DIVISION: Great. And I just have 2 quick questions, one big picture, theoretical. So you covered the supply chain in pretty extensive detail on the call. But maybe just a bigger picture on how you're thinking about it philosophically given what you just sort of went through over the last 12 to 8 months. So what I mean by that, is there sort of a recalibration needed or an adjustment around your supply chain philosophy either from a partner perspective or maybe a regional perspective? And how do you think about the current infrastructure and its ability to sort of rebound and sort of handle sort of these disruptions that seem to crop up from time to time? And then I have a follow-up.

TIMOTHY D. COOK: Yes. I don't see a fundamental error that we've made, if that's what you're picking out, in terms of creating the environment that we're in. It was created for a number of reasons. The pandemic came along. Some people in the industry and some people outside the industry thought that the pandemic would reduce demand. They pulled their orders down. Things reset. And what really happened was demand went up and went up even more than the -- than a straight trend would predict.

And so the industry is working through that now. I'm making it little overly simplistic. There's some other things like yields and things like that, that are happening as well. But those things are mainly manageable in the course of time. And so what we're doing is working with our partners on making sure that they have supply that we need and making sure that our demand statements are accurate as we see them and so forth.

And at the same time, we are reducing our lead times and cycle times so that when you get a chip off a fab that as quickly as possible, it's in a product and shipping and also helping the fab partners increase their yields. And so those things are things that we're doing. We also support the CHIPS Act and the investment there to put more investment in the ground. And so we're spending some time advocating for the CHIPS Act as well.

DAVID VOGT: Great. And that's helpful. And I didn't mean to implicate that you guys had messed up, just maybe came off that way. And maybe just as a quick follow-up. When you think about purchasing devices ratably, you touched on that earlier. But maybe can you just touch on the partnerships that you have with carriers and the support that they have given you over the last couple of years? It's been a key component of your success, the tight relationships that you have globally. Do you think sort of this business model, as it's currently sort of put together globally, is sort of a permanent structure, meaning carriers are going to be integral part of driving demand for iPhones? Or is there a sense that maybe it's a little bit more transitory depending on the part of the cycle that we're in.

TIMOTHY D. COOK: I think that 5G has provided a once-in-a-decade kind of upgrade potential, and it's a multiyear kind of thing. It's not a 1 year and done. And I think that we're motivated there. The carrier is motivated there. We have mutual interest and the customer benefits hugely from getting a new 5G phone that has 5G and a number of other features in it, too.

 

And so I think everybody is aligned on purpose. The model that you paint is -- I wouldn't call it a global model because there are different variations around the world depending upon the country. But in general, I think that the marriage, if you will, or partnership between Apple and the carrier channel has never been stronger and that it's on very solid footing.

OPERATOR: And so we'll take our next question from Krish Sankar with Cowen and Company.

KRISH SANKAR, MD & SENIOR RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: I had 2 of them, too, and Tim, I will give you a reprieve from the supply chain questions. I had 2 on Services. The first one is on your new ATT, the ad tracking transparency feature, and all the headlines that have gone there recently. I'm kind of curious, the feedback you've seen or received from your advertisers and users and how it has also impacted search ads, your own ad business. Can you let us know the feedback? And then I have a follow-up.

TIMOTHY D. COOK: The feedback from customers is overwhelmingly positive. Customers appreciate having the option of whether they want to be tracked or not. And so the -- there's an outpouring of customer satisfaction there on the customer side. And the reason that we did this is that, as you know, if you followed us for a while, we believe strongly that privacy is a basic human right. And we believe that for decades, not just in the last year or so.

And we've historically rolled out more and more features over time for -- to place the decision of whether to share data and what data to share in the hands of the user where we believe that it belongs. We don't think that's Apple's role to decide, and we don't think that's another company's role to decide but rather the individual who owns the data itself. And so that's our motivation there. There's no other motivation.

KRISH SANKAR: Got it. Got it, Tim. And that's a very fair characterization. And then as a quick follow-up, I'm just kind of curious, on the mobile gaming in your App Store, there have been some recent actions by certain governments to limit game time. Kind of curious how that affects your App Store business in those geographies. And is there a way you can quantify that? Or is it too immaterial at this point?

TIMOTHY D. COOK: You mean limiting the time on games. Is that what you're getting at?

KRISH SANKAR: Yes, exactly. Like you're trying to decide to limit game time and things like that.

TIMOTHY D. COOK: It's very difficult to measure the -- yes, with the policy that you're talking about. For those people that don't know is there's a policy to restrict kids below a certain age to, I think, it's 1 hour on Friday, Saturday, Sunday each. And it's very difficult to see the impact of it on the App Store at this point.

OPERATOR: We'll take our next question from Samik Chatterjee with JPMorgan.

SAMIK CHATTERJEE, ANALYST, JPMORGAN CHASE & CO, RESEARCH DIVISION: I guess, Tim, I wanted to first to start off on your comment about strong demand across products. And just relative to iPhone 13, if you can give us a bit more insight about what are you seeing in terms of intent, in terms of either upgrades from the installed base or even switchers rate too, if you can compare to iPhone 12 because some of the feedback we are getting is, for example, like strong switching activity in China. So just wondering if you can get a bit more granular there in terms of the -- what's driving the demand and who is it coming from. And then I have a follow-up, please.

TIMOTHY D. COOK: It's so early to talk about iPhone 13 because it's only been on the market for less than 30 days now. What I can tell you is going into the cycle, if you look at our results from last quarter, we grew on upgraders and switchers in the double digits. And so both were very meaningful for the iPhone results last quarter. And so there's significant momentum in iPhone. And I would clearly characterize the demand that we're seeing currently is robust as you can tell from the -- some of the quotes that we're quoting on the online store.

SAMIK CHATTERJEE: Okay. And as a follow-up, I guess back to the supply chain but I wanted to just ask more relative to cost implications there. And what we're hearing is not only delays but also component cost going up. So as we look through -- as I think about this upcoming cycle, how are you looking to manage component cost-related headwinds? And is that something you're seeing coming through the supply chain?

TIMOTHY D. COOK: We've put our current thoughts in the gross margin guidance that we gave you, the 41.5% to 42.5%. I would tell you that we are seeing a significant increase in freight costs. And I would assume that, that is pretty consistent across different companies. And so we're clearly seeing some inflation there.

OPERATOR: We'll take our next question from Jim Suva with Citigroup.

 

JAMES DICKEY SUVA, MD & RESEARCH ANALYST, CITIGROUP INC., RESEARCH DIVISION: And I'll ask both my questions at the same time. Probably the first one is for Tim. On the Services revenue, much better than expected. Can you give us some details about what drove that? Was it Apple Stores more open, so more AppleCare or more Apple One or Arcade or TV or Fitness?

And then probably for Luca on supply chain, when you mentioned supply chain headwind is going to get worse and you mentioned $6 billion this quarter, there's 2 ways to think about your terminology of worse. Is it the delta from $2 billion that you identified 3 months ago that went to $6 billion, so therefore, the delta of $4 billion gets worse? Or are you just saying -- and therefore, it's above $10 billion for December quarter. Are you just saying it just gets higher than the $6 billion that you just identified earlier in the call?

TIMOTHY D. COOK: Jim, I'm going to take the second question that you asked, and Luca could take the first one on Services, just in the reverse of the way you coined it. On the supply constraints, what we're saying is that the amount of -- the nominal amount of supply constraints for Q1, we estimate to be larger than $6 billion. And so it's important to know that we're getting a lot more supply in Q1 than we had in Q4, obviously, because our sequential growth is significant. And we have very solid growth year-over-year. And so the amount of supply is growing dramatically. It's just that the demand is so robust that we envision having supply constraints for the quarter.

LUCA MAESTRI: And Jim, on Services, the 26% growth rate that we had was better than what we were expecting at the beginning of the quarter. And it was really across the board. It's difficult to single out a specific area because we set all-time records on cloud. We set all-time records across the board, AppleCare, music, video, advertising, payment services, the App Store was a September quarter record. So it was strong across the board.

When we look at the Services business, we always think about some fundamental factors that allow us to have good visibility over the sustainability of the business, right? The fact that the installed base continues to grow, that's obviously a positive. The fact that the number of people that are actually paying on the platform continues to grow double digits. And so that obviously increases our opportunity. The number of subscriptions that we have on the platform, we mentioned during the call, 745 million paid subs right now. It's an increase of 160 million versus just 12 months ago, right?

And obviously, the fact that we continue to launch new services, new offerings within the services that we already have, new features, that obviously gives us a lot of momentum going forward. We're very fortunate we have a very -- now it's a very large business, $68 billion in the last 12 months and very diversified. We sell a lot of different services and our customers seem to really enjoy the experience that they have on the platform.

OPERATOR: We'll take our next question from Chris Caso with Raymond James.

CHRISTOPHER CASO, RESEARCH ANALYST, RAYMOND JAMES & ASSOCIATES, INC., RESEARCH DIVISION: For my first question, it's a question about your ability to recapture sales that you weren't able to fill in Q4, Q1 and Q2. And you have some experience in that from last year when the iPhone, not all the models, launched the same time and some are late and you did recapture some of that as you went past the holidays. Do you think that we should expect similar behavior this year? And then with that also is will all product categories behave similarly? Meaning that there are the same -- some product categories where if you missed the holidays, you just missed the sale.

TIMOTHY D. COOK: I think there are some products that people buy as gifts that if it's not there, that it's perishable. But I think that we have a lot of products as well that people will wait for and would expect those to be captured in a different time period. And so it's a combination for this certain quarter, the holiday quarter, I believe.

CHRISTOPHER CASO: Okay. As a follow-up, could you speak to iPhone mix? And one of the things we noted is that the delivery time for all iPhones are a bit long because of the constraints. They're a bit longer on the Pro and the Max. Is that a function of supply or demand or perhaps both? And again, I would imagine you have a little better handle on that this year given that all the phones were launched at the same time.

TIMOTHY D. COOK: Yes. It's really too early to make comments on mix at this point because it has been -- we have been in a constrained environment. And so the mix becomes more obvious once supply and demand are balanced.

OPERATOR: We'll take our next question from Harsh Kumar with Piper Sandler.

HARSH V. KUMAR, MD & SENIOR RESEARCH ANALYST, PIPER SANDLER & CO., RESEARCH DIVISION: Yes. Guys, first of all, great job managing through the supply constraints. It's obviously affecting everybody. So congratulations. And then Tim, one for you, a strategic question. When Apple thinks about strategic areas that as a company they want to own, for example, software is a high priority, but you're also one of the largest semiconductor companies if the company would stand alone. So curious about the kind of input, that thinking that goes into owning some piece of technology. For example, when we survey people, they say batteries and screens are very important. So why doesn't Apple -- for example, what pauses Apple from looking at areas like that?

TIMOTHY D. COOK: We look at ones where we believe we can make a substantial difference and have a level of differentiation. And so we've put a lot of energy in the silicon space because we have felt that we could design and develop products that we could not if we were in the -- just buying what's available on the commercial market. And as you can see, more recently, we made that call on the Mac as well and have shifted to our own chips there. And so it really depends on whether we see a way to do something that's differentiated or not. And I wouldn't want to rule anything out. It's more of whether or not we see our way clearer to doing something that is materially better. We feel like we've done that in the chip area.

HARSH V. KUMAR: And then I've got one for Luca. I want to go back to a question that Amit asked earlier in the call about the gross margin. So when I look at the September quarter, Services obviously grew much faster than the product business, margin was down and same thing for December. But I think you're effectively saying that there's a lot of new product launches. Would that not go into OpEx, for example, marketing, et cetera, as opposed to COGS? Or is there something that maybe needs to be clarified here?

LUCA MAESTRI: There is -- certainly, obviously, that we have launch expenses in marketing and advertising, of course, when we launch new products. But the reality, what happens, we always make our products better and -- which means adding new technology and new features to the product. So typically, when you move from one generation of products to the next one, the cost structures tend to be higher, particularly at the beginning of the cycle. And so when you make that transition, there is always some level of margin compression from the transition to a new product.

The other aspect that you need to think about is the fact that the December quarter is the holiday season, and so the percentage of products business that we have in the holiday quarter is higher than what we have in the September quarter, for example. And therefore, as you know, because the Services margins are higher than the products margin, there's also a mix between the products and services business that plays into the gross margins for the company, right? And that's what you see as you move sequentially from September to December.

OPERATOR: We'll hear next from Wamsi Mohan with Bank of America.

WAMSI MOHAN, DIRECTOR, BOFA SECURITIES, RESEARCH DIVISION: Yes. I had a question about -- broadly about pricing of new products. This year, Apple launched the iPhone 13 at a slightly lower price than where the 12 was launched last year in China. Can you maybe help us think through what are some of the things that you look at in deciding that? And is that an action that you could take more broadly in other regions? And I have a follow-up.

TIMOTHY D. COOK: We look at a variety of things, including our costs, including competition, including local conditions and exchange rates and a number of different things. And so there's not a -- there's no formula for determining it. It's done by a level of judgment looking at a number of different points -- data points. And we do that region by region.

WAMSI MOHAN: But we shouldn't, as investors, think of that as something structural that you intend to use to flex demand curves more globally?

TIMOTHY D. COOK: It's something we've always done. And so it's not something that is new to this year in this cycle.

WAMSI MOHAN: Okay. And as a follow-up, you've introduced a lot of new services over the past few years, and these have become a much more important part of the Apple story. Can you maybe share either some metrics on some of the new services like TV+ in terms of paid subs? And how are you measuring the success of these investments?

TIMOTHY D. COOK: Well, we look at a number of things internally that we don't share externally. And so you can bet that we're looking at subs and ARPUs and conversions and churn and all of the normal things you would look at with a subscription business. But we're not going to get into sharing those on an individual service basis. What we're trying to do is give you visibility to the aggregate number of subscriptions that we've had, which Luca covered earlier with the 745 million across both Apple-branded and third party. And so we're giving you an aggregated view of it instead of the -- at the individual service level. But you can bet that we're managing it at the individual service level.

TEJAS GALA: Yes. Thank you, Wamsi. A replay of today's call will be available for 2 weeks on Apple Podcast, as a webcast on apple.com/investor and via telephone. The numbers for the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 7141415. These replays will be available by approximately 5:00 p.m. Pacific Time today.

Members of the press with additional questions can contact Josh Rosenstock at (408) 862-1142. Financial analysts can contact me with additional questions at (669) 227-2402. Thank you again for joining us.

OPERATOR: This concludes today's conference. We appreciate your participation.



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Presentation

OPERATOR: Good day, and welcome to the Apple Q3 FY 2021 **Earnings** 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 Tejas Gala, Director, Investor Relations and Corporate Finance. Please go ahead.

TEJAS GALA, IR CONTACT, APPLE INC.: Thank you. Good afternoon, and thank you for joining us. Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expenses, taxes, capital allocation and future business outlook, including the potential impact of COVID-19 on the company's business and results of operations.

These statements involve risks and uncertainties that may cause actual results or trends to differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed annual report on Form 10-K 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 like to now turn the call over to Tim for introductory remarks.

TIMOTHY D. COOK, CEO & DIRECTOR, APPLE INC.: Thanks, Tejas. Good afternoon, everyone. Today, Apple is reporting a very strong quarter with double-digit revenue growth across our product and services categories and in every geographic segment.

We set a new June quarter revenue record of $81.4 billion, up 36% from last year, and the vast majority of markets we track grew double digits, with especially strong growth in emerging markets, including India, Latin America and Vietnam. Total retail sales also set a June quarter record, and almost all of our retail stores have now opened their doors.

This quarter saw a growing sense of optimism from consumers in the United States and around the world, driving renewed hope for a better future and for all that innovation can make possible. But as the last 18 months have demonstrated many times before, progress made is not progress guaranteed. An uneven recovery to the pandemic and a Delta variant surging in many countries around the world have shown us once again that the road to recovery will be a winding one.

In the midst of that enduring adversity, we are especially humbled that our technology has continued to play a key role in keeping our customers connected. Just last month, it was great to be back with our teams and customers for the opening of our newest retail store in Los Angeles, Apple Tower Theatre. It was a hopeful reminder of the energy and sense of community shared spaces bring and how appreciative we all are now of the simple privilege of talking to one another face-to-face.

As we look forward to more in-person interactions in the future, we're doubling down on innovation and doing all we can to help chart a course to a healthier and more equitable world. I'll have more to say about our work in those areas a bit later on. But first, let's turn to our product and services categories.

For iPhone, this quarter saw very strong double-digit growth in each geographic segment, and we continue to be heartened by our customers' response to the iPhone 12 lineup. We're only in the early innings of 5G, but already its incredible performance and speed have made a significant impact on how people can get the most out of our technology.

Customers love iPhone 12 for its superfast 5G speeds, A14 bionic chip and Adobe vision camera never seen before in a phone. Users continue to rely on iPad and Mac to work, learn, create and connect. iPad had its highest June quarter in nearly a decade, while Mac set an all-time June quarter record. We've seen a great response to the new iMac and iPad Pro, both powered by the M1 chip's exceptional speed and power efficient performance. The iMac's remarkable thin design and vibrant colors have made it a favorite for users everywhere. And the iPad continues to be an incredibly versatile tool in our users' toolbox, inspiring creativity and connection and keeping us entertained and productive in equal measure.

It was another very strong quarter for Wearables, Home and Accessories, which set a new June quarter record while helping people find more ways to stay entertained, healthy and connected at home and on the go. Apple Watch remains a go-to choice for users to stay on top of their health and reach their fitness goals. And our newest accessory AirTag began shipping to an enthusiastic response from customers, making the Find My network more useful than ever, while protecting user privacy.

Turning to Services, which set a new all-time revenue record as we continue to roll out innovative new features and programming. We're proud to be the recipients of 35 Emmy nominations this year, which speaks to the quality of our programming and an enthusiastic reception from customers and critics alike. Apple TV+ users are loving series like Mythic Quest and anticipating groundbreaking films like CODA, which premieres next month. And of course, Ted Lasso kicked off season 2 just last week and continues to win over viewers with its heartwarming message about the power of community, compassion and hope.

We also introduced Apple Podcasts subscriptions, a global marketplace for users to discover exclusive content and support their favorite creators. And we launched spatial audio for Apple Music, a cinematic listening experience that promises to change how music fans listen and musicians create even more immersive, layered and beautiful songs.

Last month, we shared many exciting new features at WWDC, but more powerful than any of them was the incredible showing of developers from all walks of life and around the world. The new tools we announced will help developers harness cutting-edge technologies like augmented reality, reach new users and customize their experience on the App Store, are learned to update or invent an app with Swift, Apple's powerful and intuitive programming language. Today's investments in education and coding translate to tomorrow's small businesses and groundbreaking new apps, the next app -- the next act of an app economy already creating jobs and opportunity around the world.

In June, a new study by the Analysis Group found that it was another record year for App Store developers whose combined billings and sales increased by 24% to $643 billion in 2020. The app economy continues to be an incredible engine of prosperity and opportunity fueled by the ceaseless striving of developers to make apps that enrich people's lives.

Much like the developer community, we are diehard optimist about technology's potential to help people live happier, healthier and more fulfilled lives, goals that shine through with powerful new updates coming to iOS, iPadOS, macOS and watchOS this fall. That begins with innovative new features that help users stay connected with one another, like SharePlay and spatial audio for FaceTime or disconnect when they need a break, like Focus, which limits distracting notifications when you're winding down for bed or concentrating at work. And new productivity features make iPad an even more useful tool for multitasking, helping users navigate across apps, split their screen or use Quick Note to capture a thought the moment inspiration strives.

In the health space, our new health sharing feature will make it easier than ever to securely share your health data with loved ones. That includes new capabilities like walking steadiness, which uses sensors to assess user stability doing everyday task and recommends exercises to improve stability and avoid a fall.

In the belief that privacy is a fundamental human right, we shared new features in iOS 15 that continue to drive our progress forward from mail privacy protection, which stops invisible pixels and an e-mail from tracking your mail activity, to app privacy report, which helps users check on the apps they've granted permission to use their personal data.

We also introduced some incredible next-generation technologies coming to the accessibility space, from assistive touch, which helps people with limb differences navigate Apple Watch to new voiceover capabilities to help blind and low-vision users. Accessibility remains a bedrock principle for us in the simple belief that the best technology for the world should be the best technology for everyone. But the responsibility to be a force for good in the lives of others extends beyond the technology we make, so to the teachers and students shaping our future.

This quarter, as part of our Racial Equity and Justice Initiative, we awarded innovation grants to engineering schools at 4 historically black colleges and universities to expand their coursework, scholarships and internship opportunities in hardware engineering and silicon chip design. We see education as a great equalizing force, and we're more dedicated than ever to supporting the educators, advocates and students lighting the path and leading the way. That includes the 350 Swift Student Challenge winners we recognized at this year's WWDC.

If you ever need a dose of hope or inspiration, I can't say enough about our student scholarship winners whose apt bring so much good into the world, from teaching other young people to code to helping volunteers deliver groceries to people at high risk of COVID-19. Young people's innovations remind us that our collective future is bound up in the next generation's passion for solving global challenges and of the responsibility we have to join them in building a better world.

Turning to our own backyard, we're continuing to press forward in our efforts to help bring more affordable housing to the Bay Area and across California. This month, we shared that we've contributed more than $1 billion to help first-time homeowners and construct thousands of new affordable housing units across the state. And we're continuing to stay focused on supporting the global response to the pandemic and delivering the best products and services for people.

Our greatest source of inspiration isn't technology itself but how people use it in their own lives in ways great and small: to write a novel or to read one; to care for an ailing patient or see a doctor virtually; to track their heart rate on a jog or to train for the Olympics. Every day, I'm grateful for the dedication of our teams to the simple mission of creating technology that improves people's lives. And I want to thank everyone at Apple for the purpose and passion they bring to that mission.

With that, I'll hand it over to Luca for a deeper dive on our performance this quarter.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone. We are very pleased to report record June quarter financial results, which reflect the importance of our products and services in our customers' lives and our strong underlying operating performance. Our revenue reached a June quarter record of $81.4 billion, an increase of nearly $22 billion or 36% from a year ago. We grew double digits in each of our product categories with an all-time record for Services and June quarter records for iPhone, Mac and Wearables, Home and Accessories. We also set new June quarter records in every geographic segment with very strong double-digit growth in each one of them.

Products revenue was a June quarter record of $63.9 billion, up 37% over a year ago. This level of sales performance, combined with the unmatched loyalty of our customers, drove our installed base of active devices to a new all-time record. Our Services set an all-time revenue record of $17.5 billion, up 33% over a year ago with June quarter records in each geographic segment.

Company gross margin was 43.3%, up 80 basis points from last quarter, driven by cost savings and a higher mix of services, partially offset by seasonal loss of leverage. Products gross margin was 36%, down 10 basis points sequentially, as seasonal loss of leverage was almost entirely offset by cost savings. Services gross margin was 69.8%, down 30 basis points sequentially, mainly due to a different mix.

Net income of $21.7 billion, diluted **earnings** per share of $1.30 and operating cash flow of $21.1 billion were all June quarter records by a wide margin. Let me get into more detail for each of our revenue categories.

iPhone revenue set a June quarter record of $39.6 billion, growing 50% year-over-year and exceeding our own expectations as the iPhone 12 family continue to be in very high demand. Performance was consistently strong across the world, and we grew very strong double digits in each geographic segment, setting June quarter records in most markets we track. Our active installed base of iPhones reached a new all-time high thanks to the exceptional loyalty of our customer base and the strength of our ecosystem. In the U.S., the latest survey of consumers from 451 Research indicates iPhone customer satisfaction of 97% for the iPhone 12 family.

Turning to Services. As I mentioned, we reached an all-time revenue record of $17.5 billion with all-time records for cloud services, music, video, advertising and payment services and June quarter records for the App Store and AppleCare. Our newer service offerings, Apple TV+, Apple Arcade, Apple News+, Apple Card, Apple

 

Fitness+ as well as the Apple One bundle, continue to scale across users, content and features and are contributing to overall services growth.

The key drivers for our Services business all continue to move in the right direction. First, our installed base of devices reached an all-time high across each geographic segment. Second, the number of both transacting and paid accounts on our digital content stores reached a new all-time high during the June quarter in each geographic segment, and paid accounts increased double digits. Third, paid subscriptions continue to show strong growth. We now have more than 700 million paid subscriptions across the services on our platform, which is up more than 150 million from last year and nearly 4x the number of paid subscriptions we had only 4 years ago.

And finally, we're adding new services that we think our customers will love while also continuing to improve the breadth and quality of our current services offerings. For example, during WWDC in June, we previewed our new iCloud+ and Apple Wallet features, which we believe will create a more secure and differentiated customer experience.

Wearables, Home and Accessories grew 36% year-over-year to $8.8 billion, setting new June quarter revenue records in every geographic segment. We continue to improve and expand our product offerings in this category. This quarter, we began shipping our new Apple TV 4K with a redesigned Siri Remote and our brand-new AirTags, and the customer response to both products has been very strong.

In addition to its outstanding sales performance globally, Apple Watch continues to extend its reach, with nearly 75% of the customers purchasing Apple Watch during the quarter being new to the product. For Mac, despite supply constraints, we set a June quarter record of $8.2 billion, up 16% over last year, with June quarter revenue records in most markets we track around the world. It is remarkable that the last 4 quarters for Mac have been its best 4 quarters ever. This exceptional level of sales success has been driven by the very enthusiastic customer response to our new Macs powered by the M1 chip, which we most recently brought to our newly redesigned iMac.

iPad performance was also strong with revenue of $7.4 billion, up 12% in spite of significant supply constraints. During the quarter, we also starting shipping our new iPad Pro powered by the M1 chip, and customer response has been outstanding. Both iPad and Mac have taken computing to the next level, and when you combine their performance over the last 12 months, they are now the size of a Fortune 50 business thanks to the best product lineups we've ever had, very high levels of customer satisfaction and a loyal growing installed base. In fact, around half of the customers purchasing Mac and iPad during the quarter were new to that product, and in most recent surveys of U.S. consumers from 451 Research, customer satisfaction was 92% for Mac and 95% for iPad.

In Enterprise, our customers are excited about the superior performance, battery life and security that the new M1 Macs bring. MassMutual, for example, is offering M1 MacBook Pro to all of its employees and equipping all conference rooms with M1 Mac Minis in preparation for return to work. And with its incredible performance and affordable entry price, the MacBook Air with M1 is gaining rapid adoption among many leading enterprise organizations.

Italgas, Italy's largest natural gas company, which will soon be using its extensive network to distribute renewable gases, is replacing every employee's Windows laptop with the new MacBook Air powered by Apple's M1 chip to bring the latest technology to its workforce. And Grab, Southeast Asia's leading super app that provides transportation, food delivery and digital payment services, is adding M1 MacBook Air to its company-wide M1 Mac deployment.

Let me now turn to our cash position. We ended the quarter with $194 billion in cash plus marketable securities. We retired $3 billion of term debt and increased commercial paper by $3 billion, leaving us with total debt of $122 billion. As a result, net cash was $72 billion at the end of the quarter.

As our business continued to perform at a very high level, we are also able to return $29 billion to shareholders during the June quarter. This included $3.8 billion in dividends and equivalents and $17.5 billion through open market repurchases of 136 million Apple shares. We also began a $5 billion accelerated share repurchase program in May, resulting in the initial delivery and retirement of 32 million shares.

As we move ahead into the September quarter, I'd like to review our outlook, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. Given the continued uncertainty around the world in the near term, we are not providing revenue guidance, but we are sharing some directional insights assuming that the COVID-related impacts to our business do not worsen from what we are projecting today for the current quarter.

 

We expect very strong double-digit year-over-year revenue growth during the September quarter. We expect revenue growth to be lower than our June quarter year-over-year growth of 36% for 3 reasons. First, we expect the foreign exchange impact on our year-over-year growth rate to be 3 points less favorable than it was during the June quarter. Second, we expect our services growth rate to return to a more typical level. The growth rate during the June quarter benefited from a favorable compare as certain services were significantly impacted by the COVID lockdowns a year ago. And third, we expect supply constraints during the September quarter to be greater than what we experienced during the June quarter. The constraints will primarily impact iPhone and iPad.

We expect gross margin to be between 41.5% and 42.5%. We expect OpEx to be between $11.3 billion and $11.5 billion. We expect OI&E to be around 0, excluding any potential impact from the mark-to-market of minority investments and our tax rate to be around 16%. Finally, today, our Board of Directors has declared a cash dividend of $0.22 per share of common stock payable on August 12, 2021, to shareholders of record as of August 9, 2021.

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

TEJAS GALA: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please?

Questions and Answers

OPERATOR: Our first question comes from Katy Huberty from Morgan Stanley.

Hearing no response, we'll take our next question from Chris Caso with Raymond James.

CHRISTOPHER CASO, RESEARCH ANALYST, RAYMOND JAMES & ASSOCIATES, INC., RESEARCH DIVISION: Yes. Just to dig into the commentary on guidance a little bit. Just starting with the fact that last year, obviously, there was a later launch of iPhone than we've typically seen in other years. Could you talk us through that and perhaps some of the other products, what may be different as compared to last year?

LUCA MAESTRI: Well, as I explained, there are -- first of all, we are expecting to grow very strong double digits. That's, I think, Chris, the starting point here. We expect this very strong level of growth that we've experienced during the course of the year to continue into the September quarter.

We said that the growth rate is going to be below 36%, and I've listed 3 factors. The first factor is that the dollar continues to be favorable on a year-over-year basis in the sense that it's weakened against most currencies on a year-over-year basis, but that benefit is going to be about 3 points less in the September quarter than what we've experienced during the June quarter because the dollar strengthened against most currencies in recent weeks.

Second, I mentioned that the services growth rate that we've experienced in the June quarter, 33%, that's significantly higher than what we've had in recent history. And that was due to the fact that there were a couple of services categories, namely our advertising business and AppleCare that were significantly impacted a year ago because of the COVID lockdowns and therefore, they had a relatively easy compare in the June quarter. And so we don't expect that to continue into the September quarter. And so we expect still significant growth in Services, but not to the level that we've seen in June.

And then I mentioned that the supply constraints that we've seen in the June quarter will be higher during the September quarter. Back in -- when we talked here 3 months ago, we said that we were expecting supply constraints for the June quarter between $3 billion and $4 billion to affect primarily iPad and Mac. We were able to mitigate some of those constraints during the June quarter.

And so we came in at a number that was slightly below the low end of that range that we had quoted at the beginning of the quarter, but we expect that number to be higher for the September quarter.

And so when you put all that together, again, very strong double-digit growth for September, with these caveats that I just mentioned.

CHRISTOPHER CASO: If I could follow up with regard to the supply constraints, and do you expect those supply constraints to persist through the December quarter as well what effect will that have on the holiday selling season? And then in conjunction with that, what additional costs are you absorbing because of these supply constraints? Is that having an effect on gross margins or just product cost in general as you perhaps pay a little more to get more supply?

TIMOTHY D. COOK: Chris, it's Tim. In terms of the cost, we're paying more for freight than I would like to pay, but component costs continue in the aggregate to decline. In terms of supply constraints and how long they will last, I don't want to predict that today. We're going to take it sort of one quarter at a time. And as you would guess, we'll do everything we can to mitigate whatever set of circumstances we're dealt.

LUCA MAESTRI: And Chris, on the cost side, as I mentioned during my comments, our results for gross margins for the June quarter, 43.3%, we really saw some really nice cost savings during the quarter. And I think you've seen that we provided guidance of 41.5% to 42.5% for September, which is obviously a level that we are very pleased with.

OPERATOR: We'll take our next question from Jim Suva with Citigroup Investment Research.

JAMES DICKEY SUVA, MD & RESEARCH ANALYST, CITIGROUP INC., RESEARCH DIVISION: Congratulations to you and your global team for great operations during a challenging time. Tim and Luca, I just have one question and either of you or both of you could figure out who's best to answer it. But we look at a world of pretty unprecedented, whether it be COVID, the Delta variant, China flood, supply chain components, just wondering for your like R&D and innovation, is it being materially impacted by that such where a normal cadence is unfair? Or is it kind of happening during a slow time of year where you're able to empower people to work remotely and still have the typical innovations and product launches that you've had historically in the past?

TIMOTHY D. COOK: Jim, the company has been incredibly resilient. The employees are really doing double duty. And I could not be more pleased with the cadence that we're coming out with new things. As you can see from the software announcements that we made in -- at WWDC and the corresponding launches of the software that we plan on in the fall and then all of the products that we've been able to bring out over the last 12 to 18 months, it's amazing. And so I'm very pleased with it.

OPERATOR: We'll take our next question from Shannon Cross with Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: Tim, I'm curious, what have you learned from this iPhone cycle regarding customer preferences and pricing and maybe subscriptions in that? And if there is a difference, if you could talk about it on a geographic basis.

TIMOTHY D. COOK: We've -- if you look at our results in Q3, Shannon, we had strong double-digit growth for switchers and for upgraders. And in fact, it was our largest upgrade quarter for a Q3 ever. And so we feel really, really great about both categories.

And as Luca kind of said during the preamble or opening comments, we -- our results are really strong for iPhone around the world. And so it's been a very, very strong cycle. And yet we're -- the penetration on 5G is obviously still very, very low. And so we feel really good about the future of the iPhone.

SHANNON SIEMSEN CROSS: Okay. And maybe if you can talk a bit about China, up 58%, where are you seeing the growth? What are you hearing from customers there? How is this -- actually, 58% is not sustainable, but how sustainable is the strength?

TIMOTHY D. COOK: It was an incredibly strong quarter. It set a June quarter revenue record for Greater China for us, and so we're very proud of that and doing the best job we can to serve customers there. We had a particularly strong response to the 12 Pro and the 12 Pro Max. Those results were particularly strong.

And if -- but if you look at the balance of our products, we also set June quarter records for Wearables, Home and Accessories for Mac and for Services. So it was sort of an across-the-board strength. And we're seeing plenty of new customers come to the market. For example, Mac and iPad, about 2/3 of the customers who bought in the last quarter were new to that product. For the Apple Watch, that number was 85%. And so we could not be happier with the results.

SHANNON SIEMSEN CROSS: Was the 85% China or overall?

TIMOTHY D. COOK: 85% was China. Yes, I was talking about -- specifically, the numbers I referenced were specifically for China.

LUCA MAESTRI: And then Shannon, it's -- for the world, the Watch is 75%.

OPERATOR: We'll take our next question from Amit Daryanani with Evercore.

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I have 2 as well. I guess, first off, Luca, I was hoping you could maybe talk a little bit more about the gross margins and maybe the expectations you laid out for

 

September. I think sequentially, it implies it's down 100 basis points or so. So maybe just touch on what are the puts and takes there would be helpful because I think historically, September tends to be a flattish, maybe even up a little bit gross margin number for you folks.

LUCA MAESTRI: Yes. I think it's important to go back to the Q3 results, right? It's 43.3%. And one of the things that I mentioned is that in addition to getting really good cost savings on a sequential basis, we also had a very high mix of services as part of the total, and particularly, with advertising doing really, really well because of the rebound that we saw from the COVID lockdowns a year ago.

And so as we move forward sequentially, we do expect a different mix, and so that drives the guidance that we provided, which, again, as you know, it's significantly higher than just a year ago. For example, a year ago, we were at 38.2%, so almost 400 basis points of expansion on a year-over-year basis, right? And so I think it's important to take that into account, just a different mix.

AMIT JAWAHARLAZ DARYANANI: Got it. No, absolutely. I don't think anyone expected gross margins to be north of 40% just quickly for you, folks. So that is impressive.

If I could follow up on Services, and I know you called out the 33% growth this quarter as a bit of an aberration. The compares were easier. But as you look at your services growth rate over the last 4 quarters, let's just say, what do you think is enabling this growth? Is it you're able to have a higher ARPU more monetization of your installed base? Or is your installed base growing? I'm curious, which one is bigger? And then over time, how do you think those 2 components stack up for you?

LUCA MAESTRI: It's a combination of multiple factors, right? Obviously, the fact that our installed base continues to grow and it sets new all-time highs all the time obviously gives us a larger opportunity all the time. And second, we have more and more people that are engaged in our ecosystem, both transacting for free, which is a very large number, and people that are willing to pay for some of the services, and that percentage of people that are paying for our services continues to grow nicely. I mentioned it grew double digits again this quarter. So that obviously helps on the revenue side.

And of course, we continue to increase both the quality and the quantity of the services. As you know, during the last few years, we've launched a lot of new services from Apple TV+ to Fitness+, Apple Arcade, News+ and so -- and of course, the Apple Card. And so these are businesses that we are scaling right now. And so all that additional revenue helps, and I think it flows through our growth rates. As you said, during the last 4 quarters, we are well into the mid-20s, right? So I think it's obviously very nice for us to see.

OPERATOR: We'll hear next from Katy Huberty with Morgan Stanley.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: Can you hear me okay?

TEJAS GALA: Yes, we can.

KATHRYN LYNN HUBERTY: Okay. Good. So first question, there's a debate in the market around how much Apple benefited from the pandemic, given increased spend in areas like Mac and App Store. But of course, you've mentioned over the past several quarters that there are other areas that were limited by the pandemic and store closures and less foot traffic. When you net out all the puts and takes, was your business helped? Or was it hindered by the pandemic?

LUCA MAESTRI: Well, of course, Katy, we don't have the crystal ball that tells us exactly what these different variables, how they impacted our business. We do know that on -- I would say, on the positive side of the ledger, obviously, especially during the periods of extreme lockdowns, digital services did very well because entertainment options were limited. And so obviously, our digital services did really, really well.

Obviously, with more people working from home, more people studying from home, we know that iPad and Mac demand was very, very strong.

On the other side, we had certain services like advertising because of the reduced economic activity, AppleCare because our stores were closed, that were affected negatively, and certain products like the iPhone or the Watch. So there are maybe more complex types of sales because of the complexity of the transaction. They were also affected because so many points of sale were closed all around the world, not only our stores but also our partner stores, right? So we had that dynamic during -- throughout COVID.

And now some of these businesses are rebounding. I mentioned advertising and AppleCare. iPad and Mac, it's difficult for us to gauge because we've been constrained for quite a long period of time. And the reality is that maybe the new normal after we exit COVID may be different from the past.

For example, maybe there's going to be hybrid models around work, for example. And so it's difficult to tell you on a net basis what that is, clearly -- and this is very fluid because it tends to change over time. I can certainly tell you that we're all looking forward to a COVID-free world. I think that would be very good for us and for the entire -- I mean for our customers as well.

KATHRYN LYNN HUBERTY: And just a follow-up on iPhone specifically. If you look historically after a really strong product cycle, which you've experienced this year with iPhone 12, iPhone revenues come under pressure because the upgrade rate slows, the mix often shifts to the lower end of the portfolio. Is it fair to assume a similar trend will play out over the next year? Or if not, what do you think is different this time?

TIMOTHY D. COOK: Katy, it's Tim. We're not predicting the next cycle, but I would point out a few things. One is we have a very large and growing installed base. As you know, the iPhones passed 1 billion active devices earlier this year. Two, we have loyal and satisfied customers. The customer set that we're seeing on the new iPhones are -- is just amazing. It's jaw-dropping.

And the geographic response is pervasive across the world. And in the U.S., we had the top 3 selling models. In the U.K., we have 4 out of the top 5. In Australia, we have the top 2. In Japan, we have the top 3. In Urban China, we have the top 2. And so the response from customers all around have been great. Obviously, the product itself is amazing. The 12 lineup was a huge leap that introduced 5G and had A14 Bionic and a number of other fantastic features that customers love.

The next thing I think to consider is that we're in the very early innings of 5G. If you look at 5G penetration around the world, there's only a couple of countries that are in the double-digits yet. And so that's an amazing thing 9 months or so into this. And the last thing is we're going to continue to deliver great products. We're going to continue to do what we do best is integrate hardware, software and services together into an amazing experience. And so those are the things that I would consider if I were coming up with forecast.

OPERATOR: We'll take our next question from Harsh Kumar with Piper Sandler.

HARSH V. KUMAR, MD & SENIOR RESEARCH ANALYST, PIPER SANDLER & CO., RESEARCH DIVISION: Yes. First of all, congratulations. Fantastic execution. It's resulted in consistency for your results. Tim, this is actually perfect timing for this question. You talked about your installed base of 1-billion-odd units. I was curious if you could help us understand how old that installed base is. And the reason that I'm asking this question is we're clearly seeing people upgrade to 5G phones. And if that's the case and that continues, that could be a larger force than most other forces for your revenues to continue to grow as people migrate to the 5G family of phones. So I was curious if you could shed light on how the upgrades are happening and then also how old that base is.

TIMOTHY D. COOK: Yes. What I would tell you is it's -- first of all, it's difficult to answer your question precisely. But what I would tell you is on both switchers and upgraders, we did extremely well in Q3. Both were up strong double digits. And the geographic representation of iPhone year-over-year comps were -- looks extremely well. And so we're really pleased with it.

I would remind you that the 1 billion number that I quoted also was iPhone, where we quoted a number earlier in the year in the January call, I believe, of 1.65 billion devices is the total active devices just for clarification. And so the net is very strong switchers, very strong upgraders, best upgrade quarter for June -- for the June quarter that we've seen. And we feel really great about the momentum. But at the same time, we recognize that the 5G penetration is quite low around the world and very, very low. We're at the front end of this.

HARSH V. KUMAR: Fair enough. For my follow-up, Apple is probably one of the largest semiconductor companies in the world. How do you -- how does Apple determine what's strategic and something that Apple wants to make itself versus nonstrategic? And also, I was curious, there's a lot of -- well, it's public news now that Arm is getting acquired by NVIDIA, and I was curious how Apple views that. Is that something that's beneficial to Apple or not meaningful or negative?

TIMOTHY D. COOK: Well, I think that, that acquisition has lots of questions that people are asking, and I'll sort of leave that to -- up to everyone else. And in terms of us and how we decide to make silicon, we ask ourselves if we can do something better, if we can deliver a better product, if we can buy something in the market and it's great and it's as good as what we could do, we're going to buy it. We'll only enter where we believe we have an ability to do something better and therefore, make a better product for the user.

And so the M1 is a great example of that. We have the ability within our silicon team to deliver a product that we feel is appreciably better than we could buy. And so we've taken our great hardware and software expertise and combine those and have brought the M1 out. And the response to the M1 has been unbelievable. It's powering Mac sales that are constrained. It's powering now iPad, which also has constraints on it. And so that's how we look at whether we should enter a market or not.

OPERATOR: We will take our next question from Krish Sankar with Cowen and Company.

KRISH SANKAR, MD & SENIOR RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: Yes. And congrats on the strong results. First one for Luca, you mentioned Services growth should normalize in the September quarter. And I understand the last few quarters, Services business was strong, driven by work-from-home, et cetera. So what is the normalized growth rate for the Services business as folks return back to the office in this post-COVID world? And then I have a follow-up.

LUCA MAESTRI: Well, I think you can go back several quarters and try to do a bit of an average, and that's what we were talking about. Of course, there's always a bit of variability around results, right? But certainly, we haven't done 33% in years. And so that was a bit of an anomaly. And again, I explained it's around a couple of the businesses that had a relatively easy compare during the June quarter. So our services growth has been for many, many quarters in strong double digits, and we feel confident around that level.

KRISH SANKAR: Got it. Got it. And then just a follow-up for Tim or Luca. I think, Tim, you mentioned in your prepared comments that in September quarter, there's going to be greater impact on supply constraints on the iPhone and iPad. So I'm kind of curious, this is the first time I heard you talk about component shortages impacting the iPhone. Can you be more specific? Is it display drivers? Or what exactly is the choke point on the supply?

TIMOTHY D. COOK: The majority of constraints we're seeing are of the variety that I think others are seeing that are -- I would classify as industry shortage. We do have some shortages. In addition to that, where the demand has been so great and so beyond our own expectation that it's difficult to get the entire set of parts within the lead times that we try to get those. And so it's a little bit of that as well. The -- as I said before, I think probably maybe with the basis of your question, the sort of the latest nodes, which we use in several of our products have not been as much of an issue. The legacy nodes are where the supply constraints have been on silicon.

OPERATOR: We'll hear our next question from David Vogt with UBS.

DAVID VOGT, ANALYST, UBS INVESTMENT BANK, RESEARCH DIVISION: So maybe just a point of clarification. So based on the data and the comments about upgraders and switchers being strong as well as emerging markets were relatively strong in the quarter, what does that specific set of data point strength mean for the iPhone portfolio? And I guess my question around that is, when you think about switchers and price points, I think last year you launched the SE too to really address maybe some of the lower price point markets like the emerging markets. So does that mean, thinking about the portfolio going forward, there is less of a need for a lower price product going forward? And that the current portfolio and the new cycle going forward would be more high end in nature as we currently have today? And then I have a follow-up.

TIMOTHY D. COOK: Yes, David, we did --we had an incredible quarter for the emerging markets. In Q3, we set June quarter records in Mexico and Brazil and Chile, in Turkey and UAE, in Poland and Czech Republic, India, obviously, in China, as I talked about before, Thailand, Malaysia, Vietnam, Cambodia, Indonesia. I could go on and name a few more. It's a very long list. And so we're -- those results are for the entire line of products that we have.

And keep in mind, we still do have SE in the line. We launched it a year ago, but it's still in the line today, and it's sort of our entry price point. And so I'm pleased with how all of them are doing. And I think we need sort of that range of price points to accommodate the types of people that we want to accommodate. And so we've put something for the entry buyer who really wants to get into an iPhone and then something for the pro buyer who wants the very best iPhone that they can buy. And I think that's true in the emerging markets as good as it's true in the United States or other developed markets.

DAVID VOGT: No. No, that's helpful. I appreciate that, Tim. So does that mean sort of the emerging market buyer that wants to get into the iPhone is looking for a device that has 5G capability as well? Obviously, we're early innings in a lot of markets. Or how do we think about that over the intermediate to longer term in terms of the consumer preference for 5G in those markets if available from an infrastructure perspective?

 

TIMOTHY D. COOK: In most of the markets I read, it is really, really, really early on 5G. Really early. And so -- but I think the top end buyer is buying for the future as well because they may hold their phone for 2 years or longer in some cases. And so 5G becomes an important part of their buying decision.

OPERATOR: We'll take our next question from Ben Bollin with Cleveland Research Company.

BENJAMIN JAMES BOLLIN, SENIOR RESEARCH ANALYST, CLEVELAND RESEARCH COMPANY: I wanted to start, Luca or Tim, could you walk us through a little bit about how you think Apple One bundles are influencing the trajectory of services and the economics? And then a second part on Services, I'm curious how you think IDFA is developing and influencing the trajectory of the advertising business within Services.

TIMOTHY D. COOK: In terms of Apple One, as you know, we're offering Apple One because it makes enjoying our subscription services easier than ever before, including Apple Music and Apple TV+ and Apple Arcade and iCloud and more. And so we really put the customer at the center of that and have recently began to remind people about Apple One in a way that we probably waited a few months before doing that. And so I'm very pleased with what we're seeing on Apple One right now, and think it's a great ramp for the future of services. And more importantly, it's a great customer benefit because many of our customers like to try out more than one of these services, and it allows them to do that with one easy bundle and subscription service.

In terms of IDFA or the advertising in general, I take it your question is about ATT. With ATT, we've been getting quite a bit of customer reaction, positive reaction to being able to make the decision on a transparent basis about whether to be tracked or not. And it seems to be going very well from a user point of view.

OPERATOR: We'll take our next question from Wamsi Mohan with Bank of America.

WAMSI MOHAN, DIRECTOR, BOFA SECURITIES, RESEARCH DIVISION: Yes. I have 2 as well. To begin with, Luca, you noted significant product revenue deleverage, but yet your product gross margins were roughly flat. You noted cost savings. Can you maybe talk about whether these are tactical in nature or more structural like vertical integration that will continue to drive benefits to product gross margins?

And on Services side, you noted several times about the strength in ad growth, which is obviously very high-margin contributor, but the sequential trajectory on Services margins was flat. So what were some of the offsets there? And then I have a follow-up for Tim.

LUCA MAESTRI: Yes. On the product side, I talked about cost savings. Tim mentioned that maybe on the freight side, we're seeing some level of cost pressure that is a bit out of the norm at this point in the cycle. For everything else for all the major commodities and components, we continue to see a very typical cycle where we are getting good cost savings on a sequential basis. And so far, it's been very good, as you can tell from the absolute level of gross margins because on the product side, we are up more than 600 basis points on a year-over-year basis. So it feels something that we've been able to accomplish and we're able to maintain, at least in the near term. Nothing that was abnormal during the quarter or a one-off in nature. It was pretty structural.

On the Services side, again, up a lot on a year-over-year basis. So the baseline has gone up a lot. The sequential decline, as you said, it was very, very small. And as I mentioned several times in the past, we have a very large services portfolio with very different margin profiles in our services. And so even a slight change in mix can drive some sequential differences, and this was the case this quarter, just a different mix. I mentioned, for example, that AppleCare has rebounded.

And so those -- the relative success of our Services in the marketplace can drive some slight changes in gross margins. Again, step back for a second, 69.8% gross margin. We're very, very, very happy with where we are with the Services margin trajectory.

WAMSI MOHAN: Okay. And Tim, there is increasing regulatory focus in China, in particular, on some of the Chinese companies. It's not a direct impact of Apple, but how should investors handicap the indirect impact given some of these companies are pretty large contributors to Apple's App Store revenues?

And also, is there -- are you seeing any impact at all from these? And is the limiting of the usage of some of these apps influencing how people are either interacting with your devices? Or is there any other ancillary impact that you're seeing?

TIMOTHY D. COOK: Well, for the quarter, as you can see, we grew 58%. So it was a strong quarter, and embedded in that was a quarterly record for Services, which includes the App Store. And so we're seeing strength in China. The economy has really bounced back there fairly quickly from COVID.

 

In terms of the regulatory focus, what we are focusing on from our angle is to serve users there and to make sure that they're very satisfied with the products and the services that we're showing. And we all -- we work with a lot of different companies to ensure that. And so that's our focus.

TEJAS GALA: Thank you, Wamsi. A replay of today's call will be available for 2 weeks on Apple podcast, as a webcast on apple.com/investor and via telephone. The numbers for the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 9766068. These replays will be available by approximately 5 p.m. Pacific Time today.

Members of the press with additional questions can contact Josh Rosenstock at (408) 862-1142. Financial analysts can contact me with additional questions at (669) 227-2402.

Thank you again for joining us.

OPERATOR: Thank you. That does conclude today's conference. Thank you for your participation.



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OPERATOR: Good day, and welcome to the Apple Q2 FY 2021 **Earnings** Conference Call. Today's call is being recorded. At this time, for opening remarks and introductions, I'd like to turn the call over to Tejas Gala, Director, Investor Relations and Corporate Finance. Please go ahead.

TEJAS GALA, IR CONTACT, APPLE INC.: Thank you. Good afternoon, and thank you for joining us. Speaking first today is Apple's CEO, Tim Cook, and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook, including the potential impact of COVID-19 on the company's business results of operation. These statements involve risks and uncertainties that may cause actual results or trends to differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed annual report on Form 10-K 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 over the call to Tim for introductory remarks.

TIMOTHY D. COOK, CEO & DIRECTOR, APPLE INC.: Thanks, Tejas. Good afternoon, everyone, and thanks for joining the call today. Apple is proud to report another strong quarter, one where we set new March quarter records for both revenue and **earnings**, besting our year ago revenue performance by 54%. Reflecting both the enduring ways our products have helped our users meet this moment in their own lives as well as the optimism consumers seem to feel about better days ahead, we set new March quarter records in every geographic segment, and success was broadly distributed across our product categories. Mac and Services delivered all-time record results, and we set new March quarter records for iPhone and Wearables, Home and Accessories.

To provide some color on our results, let's turn to our product categories. We saw a very strong performance for iPhone, which grew 66% year-over-year driven by the strong popularity of the iPhone 12 family. With unmatched 5G capability, the best camera system ever in an iPhone and advanced durability from Ceramic Shield, this family of devices is popular with both upgraders and new customers alike. And just last week, we unveiled an all-new purple finish for iPhone 12 and 12 Mini.

As has been the case throughout the pandemic, iPad and Mac continue to be critically important tools for our customers. Over the past year, tens of millions of iPads and Macs have been deployed to help students learn, creators create and to enhance remote work in all of its forms. This has helped iPad grow very strong double digits to its highest March quarter revenue in nearly a decade.

On Mac, fueled by the M1, we set an all-time revenue record continuing the momentum for the product category. In fact, the last 3 quarters for Mac have been its 3 best quarters ever. Last week, both iPad and Mac took a big step forward. We debuted a radically redesigned brand-new iMac designed around M1's unmatched capabilities, and we've brought M1 to iPad for the first time in the new iPad Pro with 5G capability and a Liquid Retina XDR display.

It was a quarter of sustained strength for Wearables, Home and Accessories, which grew by 25% year-over-year. Apple Watch is a global success story, and the category set March quarter records in each geographic segment, thanks to strong performance from both Apple Watch Series 6 and Apple Watch SE. It's an exciting and busy period ahead for Wearables, Home and Accessories with the launch of the next-generation Apple TV 4K and our newest accessory, AirTag. AirTag builds on the powerful and incredibly useful Find My experience, helping users privately and securely keep track of the items that matter most to them. Third-party accessories and products can also make use of the Find My network, guaranteeing a great experience no matter what products you choose to use.

Turning to Services. We achieved growth of 27% year-over-year and set new records for services in each of our geographic segments. We continue to enhance and improve our current service offerings from Apple Music to Apple News while continuing to launch new services that enhance our customers' lives.

Just last week, we introduced Apple Card Family which reinvents how you can share credit cards and build credit together. We also announced Apple Podcast subscriptions, a global marketplace for listeners to discover premium content from their favorite creators and storytellers.

While we're on the topic of services, in many ways, this quarter showed the unique value to customers created by Apple's belief in the deep integration of hardware, software and services. Across our products and throughout our software ecosystem, we continue to deploy industry-leading new tools to protect users' fundamental right to privacy. In addition to the App Store privacy nutrition labels that we discussed on last quarter's call, we're proud to have launched the full implementation of App Tracking Transparency. This powerful yet simple idea gives users a choice over how their data is used and shared across the apps that they love and use every day.

No matter what device you enjoy it from, it is a milestone period for Apple TV+, racking up many new award nominations and wins, including its first Oscar nominations. Ted Lasso, in particular, has been recognized with a multitude of awards and nominations including most recently, an AFI Program of the Year Recognition, Writers Guild of America Awards and a clean sweep at the Critics Choice Awards. Apple TV+ also continues to be a place where we can tell stories that matter and lift up important voices and experiences like our new upcoming content partnership with Malala; or our latest original documentary special, The Year the Earth Changed, narrated by the legendary David Attenborough and released to commemorate Earth Day.

This is, of course, just one example of how Apple lives its values and operationalizes the idea that to whom much is given, much is expected.

To begin with our environmental efforts, just last week, we marked a milestone Earth Day on multiple fronts. In addition to the progress we've made in our own efforts to achieve our pledge of a net zero carbon footprint by 2030 across our entire supply chain and use of our products, we're proud to play a role in the growing ripple change taking place across the private sector. As of this month, 110 of our suppliers have joined us in our renewable energy commitment, and we will bring online nearly 8 gigawatts of new clean energy, the equivalent of taking 3.4 million gas-powered vehicles off the road each year. Through Apple's $4.7 billion in green bonds and related efforts, we've supported transformative environmental projects around the world from clean energy initiatives in China to 2 of the world's largest onshore wind turbines in Denmark to 180-acre solar project outside Reno, Nevada and many more.

We're also keenly focused on how this wave of green innovation can lead to equitably shared prosperity. Through our new $200 million Restore Fund, we're helping local and rural communities around the world build sustainable industries around work in forests, creating opportunities and removing up to 1 million metric tons of carbon from the atmosphere every year. And here in the United States, we started a green impact accelerator, investing and supporting minority-owned businesses at the forefront of environmental fields.

As we look forward to WWDC, we're taking new steps to foster -- to support and foster the unmatched community of developers we work with here in the United States and around the world. I'm particularly excited about our inaugural Entrepreneur Camp for black founders and developers. Building on the success of our Entrepreneur Camp program, which we began in 2019, this program gives this profoundly innovative community of developers the chance to develop next-level technical skills through hands-on technology labs, and with our partners at Harlem Capital, it also shares insights and mentorship on building and scaling an app business.

We were proud to announce that we have expanded and accelerated our commitment to the U.S. economy. Over the next 5 years, we will invest $430 billion, creating 20,000 jobs in the process. The investments will support American innovation and drive economic benefits in every state, including a new North Carolina campus and job creating investments in innovative fields like silicon engineering and 5G technology.

Looking forward, whether you're running a business or just hoping to see family again after more than a year, it's tempting at this moment to let hope about the end of the COVID-19 pandemic outstrip clear-eyed realism about the challenges we still face. In many places around the world, new waves of infections driven by even more infectious variants of the virus are driving new lockdowns. Instead of simply assuming that the end is in sight, we at Apple are doing our part to make it a reality, beginning with an enduring and uncompromising commitment to the health and safety of our teams, and extending well beyond our walls into the communities where we work. We also want to do everything we can to connect users to life-saving vaccinations that are in ever greater supply. Through Apple Maps, for example, we now showcase vaccine site locations here in the United States, building on our maps of testing locations in many countries around the world.

It's worth remembering for much more than financial reasons or year-ago compares, just how we felt at this time last year when everything we knew had to change: Planes sat grounded, entire business districts were empty and silent; people left groceries or care packages sitting in the garage or in the hall overnight in recognition of all that we didn't know and therefore, had to imagine. Thanks to researchers and scientists, doctors and nurses, everyone who can put a shot in an arm and even just check a name off a list, we have reached new days of hopeful resolve.

Our work is not done, but as I said a year ago, while we can't say for sure how many chapters are in this book, we can have confidence that the ending will be a good one. With that, I'll hand things over to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone. We are extremely pleased to report record results for our March quarter despite continued uncertainty in the macro environment. We've been operating in new ways for over a year, and we could not be more proud of the way our team continues to execute and innovate at unprecedented levels.

Our revenue reached a March quarter record of $89.6 billion an increase of over $31 billion or 54% from a year ago. We grew very strong double digits in each of our product categories, with all-time records for Mac and for Services and March quarter records for iPhone and for Wearables, Home and Accessories. We also set new March quarter records in every geographic segment with growth of at least 35% in each one of them.

Products revenue was a March quarter record of $72.7 billion, up 62% over a year ago. As a result of this level of sales performance and the unmatched loyalty of our customers, our installed base of active devices reached a new all-time record in each of our major product categories. Our services set an all-time record of $16.9 billion, growing 27% over a year ago. We established new records in each geographic segment and in most service categories. I will provide more details about the performance of our services business later.

Company gross margin was 42.5%, up 270 basis points from last quarter driven by cost savings, a strong mix and favorable foreign exchange. Products gross margin was 36.1%, growing 100 basis points sequentially also thanks to cost savings and FX, partially offset by seasonal loss of leverage. Services gross margin was 70.1%, up 170 basis points sequentially and mainly due to a different mix. Net income of $23.6 billion, diluted **earnings** per share of $1.40 and operating cash flow of $24 billion were all March quarter records by a wide margin.

Let me get into more detail for each of our revenue categories. iPhone revenues had a March quarter record of $47.9 billion, growing 66% year-over-year as the iPhone 12 family continued to be in high demand. Performance was consistently strong across the world as we grew strong double digits in each geographic segment and set March quarter records in most markets we track. Thanks to the exceptional loyalty of our customer base and strength of our ecosystem, our active installed base of iPhones reached a new all-time high. In the U.S., the latest survey of consumers from 451 Research indicates customer satisfaction of over 99% for the iPhone 12 family.

Turning to Services. We reached an all-time revenue record of $16.9 billion with all-time records for the App Store, cloud services, music, video, advertising and payment services. Our new service offerings, Apple TV+, Apple Arcade, Apple News+, Apple Card, Apple Fitness+ as well as the Apple One bundle, continue to scale across users, content and features and are contributing to overall services growth. The key drivers for our services business all continue to move in the right direction.

First, our installed base growth has accelerated and reach an all-time high across each major product category. Second, the number of both transacting and paid accounts on our digital content stores reached a new all-time high during the March quarter, with paid accounts increasing double digits in each of our geographic segments. Third, paid subscriptions continued to show strong growth. During the March quarter, we added more than 40 million paid subs sequentially, and we have now reached more than 660 million paid subscriptions across the services on our platform. This is up 145 million from just a year ago and twice the number of paid subscriptions we had only 2.5 years ago.

Finally, we're adding new services that we think our customers will love, while also continuing to improve the breadth and quality of our current service offerings. For example, Apple Arcade launched its biggest expansion yet adding incredibly fun games to the catalog, including new exclusive Arcade originals, along with 2 entirely new categories, App Store Greats and Timeless Classics. Apple Pay continues to expand geographically, launching in Mexico and in South Africa, bringing our payment service to 6 continents.

 

Wearables, Home and Accessories grew 25% year-over-year to $7.8 billion, setting new March quarter revenue records in every geographic segment. Apple Watch continues to extend its reach, with nearly 75% of the customers purchasing Apple Watch during the quarter being new to the product. We're very excited about the future of this category and believe that our integration of hardware, software and services uniquely positions us to provide great customer experiences in this category.

Next, I'd like to talk about Mac. We set an all-time revenue record of $9.1 billion, up 70% over last year, and grew very strongly in each geographic segment with all-time revenue records in Europe and rest of Asia Pacific and March quarter records in the Americas, Greater China and Japan. This amazing performance was driven by the very enthusiastic customer response to our new Macs powered by the M1 chip.

iPad performance was also outstanding with revenue of $7.8 billion, up 79%. We grew very strongly in every geographic segment with an all-time record in Japan and a March quarter record in rest of Asia Pacific.

Both Mac and iPad are incredibly relevant products for our customers in the current working and learning environments, and we are delighted that the most recent surveys of U.S. consumers from 451 Research measured customer satisfaction at 91% for Mac and 94% for iPad. With this level of customer satisfaction, and with around half of the customers purchasing Mac and iPad during the quarter being new to that product, the active installed base for both products continues to grow nicely and reached new all-time highs.

In the enterprise market, customers across many industries are accelerating their adoption of iPhone 12 and 5G as a key platform for the future of their business. Delta Airlines, for example, is putting iPhone 12 and 5G connectivity into the hands of flight attendants so they can provide the best passenger service possible as air travel rebounds. Openreach in the U.K. has started equipping tens of thousands of field engineers with iPhone 12 to speed up their deployment of broadband services to homes around the country. And UCHealth, a large health care provider in Colorado, was able to reduce per patient vaccination time from 3 minutes to only 30 seconds largely by moving from PC stations to iPhones. This has allowed their staff to rapidly scan and register new patients and vastly increase their daily vaccination capacity.

Let me now turn to our cash position. We ended the quarter with over $204 billion in cash plus marketable securities. We issued $14 billion of new term debt and retired $3.5 billion of term debt, leaving us with total debt of almost $122 billion. As a result, net cash was $83 billion at the end of the quarter.

This strong position allows us to continue to invest confidently in our future, while also returning value to our shareholders. We are innovating and investing at an unprecedented pace, including accelerating our investment in the United States with our new commitment to contribute more than $430 billion and 20,000 jobs to the country over the next 5 years.

As we continue to execute at an extremely high level, we were also able to return nearly $23 billion to shareholders during the March quarter. This included $3.4 billion in dividends and equivalents and $19 billion through open market repurchases of 147 million Apple shares. We continue to believe there is great value in our stock and maintain our target of reaching a net cash neutral position over time.

Given the confidence we have in our business today and into the future, our Board has authorized an additional $90 billion for share repurchases. We're also raising our dividend by 7% to $0.22 per share, and we continue to plan for annual increases in the dividend going forward.

As we move ahead into the June quarter, I'd like to review our outlook, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. Given the continued uncertainty around the world in the near term, we are not providing revenue guidance, but we are sharing some directional insights assuming that the COVID-related impacts to our business do not worsen from what we are seeing today for the current quarter.

We expect our June quarter revenue to grow strong double digits year-over-year. However, we believe that the sequential revenue decline from the March quarter to the June quarter will be greater than in prior years for 2 reasons. First, keep in mind that due to the later launch timing and strong demand, iPhone only achieved supply-demand balance during the March quarter. This will cause a steeper sequential decline than usual. Second, we believe supply constraints will have a revenue impact of $3 billion to $4 billion in the June quarter.

We expect gross margin to be between 41.5% and 42.5%. We expect OpEx to be between $11.1 billion and $11.3 billion. We expect OI&E to be around $50 million and our tax rate to be around 14.5%. Finally, reflecting the approved 7% dividend increase I just mentioned, today, our Board of Directors has declared a cash dividend of $0.22 per share of common stock payable on May 13, 2021, to shareholders of record as of May 10, 2021.

 

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

TEJAS GALA: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please?

Questions and Answers

OPERATOR: (Operator Instructions) We'll take our first question from Shannon Cross with Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: Tim, I had sort of a big picture question on iPhone. I'm just curious, there are so many different things happening in this cycle, 5G, pandemic. How are you thinking about the opportunity for refreshing the installed base and attracting new customers. And are you seeing lives shorten given some of the programs that are being put out there by the carriers and by yourself? Just kind of maybe big picture, if you can talk about what you're seeing in terms of iPhone out there in the market.

TIMOTHY D. COOK: Sure, Shannon. We saw double-digit increases on a year-over-year basis on both the new to iPhone and upgraders. So -- and in fact, in the March quarter, there was actually a record number of upgraders for a March quarter. And so we like what we see. It's obviously the early days of 5G. Different countries are in different points. But penetration is still -- on a global level, is still low at this point. And so a lot of the 5G upgrades will be in front of us, not behind us.

You see in China, things have moved quickly to 5G. They're moving quickly in the United States. But a lot of the other regions are slower to adopt and slower to gain coverage in 5G.

SHANNON SIEMSEN CROSS: Okay. And then, Luca, can you talk about gross margin? I mean 42% is higher than it's been that I can kind of remember actually at this point. So maybe if you talk about the drivers of gross margin. And maybe if there were any offsets from higher component costs or the logistics costs that obviously were overshadowed by currency and other things.

LUCA MAESTRI: Yes, Shannon. Yes, we did 42.5% during March, and we've guided to similar, slightly lower levels for June. So for March, we were up 270 basis points sequentially, really driven by 3 major factors. Cost savings, which has been good for us during the cycle. A really strong mix, a strong mix on iPhone, but in general, across all product categories, and that obviously was helpful. And foreign exchange sequentially, again, from December to March, was favorable 90 basis points. So that helped as well. So those are the 3 major factors there. As we transition into June, as you know, that we will expect some level of deleverage but that will be offset by cost savings. Foreign exchange doesn't have much of an impact as we go from March to June.

OPERATOR: We'll now take our next question from Amit Daryanani with Evercore.

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I have 2 as well. First one, just on Services. I think 90 days ago, the expectation was that line item would decelerate a little bit into the March quarter. It turned out it actually accelerated for us. I'd like to just understand what do you think drove that acceleration specifically? And is mid-20% sort of the growth norm as we go forward for Services?

LUCA MAESTRI: So Amit, the -- our Services business did better than what we were expecting when we had the last call in January. It was stronger across the board. One of the things that we've noticed is that throughout COVID was that obviously digital services have done very well. And then we've had a couple of categories like Apple Care because many of the points of sale and stores were closed and advertising because of the reduced economic activity that were negatively affected during COVID.

During the March quarter, we've seen a return to growth on Apple Care and obviously, we've reopened a lot of the stores during the course of the quarter. And advertising, obviously, consumer sentiment has improved and advertising is coming back. And so the combination of these factors really delivered this very, very strong performance during the March quarter.

As we look ahead, as you know, we don't provide specific guidance for our product categories. But in general, I talked during our prepared remarks, I mean, there are a number of things that we always look at around the Services business, how many new paid accounts do we have, what number of new subscriptions do we get that -- above all, is our installed base continuing to grow? Are we adding new services? Are we improving the quality of the existing services? And so when we look at all these fundamental vectors of our Services business, obviously, we feel very good. We feel very good about it.

 

AMIT JAWAHARLAZ DARYANANI: Got it. That's helpful. And then, Tim, if I could follow up with you. It seems like engagement with iPhones and Apple devices generally has gone up materially over the last 12 months. And I don't think replacement cycles, at least in the data we see, has shrunk or changed that much at the end of the day. I'm wondering, does that combination of increased usage, replacement cycles haven't changed, end up in iPhones potentially growing on a multiyear basis? Because, usually, I would imagine if I'm using something more I have to replace it more often. So I'd love your perspective on it.

TIMOTHY D. COOK: Yes. We're clearly seeing strong performance in both the new to iPhone or the switcher component and upgraders, as I'd mentioned before. And in fact, the upgrader was the best March quarter that we've ever had in -- and so that speaks to what you're seeing, I think, a lot.

It's difficult with just this far into the cycle to make a statement about the cycle in general because keep in mind that we just launched midway through the Q1 period. And so we've only been operating for 4.5 months or so. But clearly, we like what we see right now a lot. If you look at how the iPhone did around the world, we had the top 5 models of smartphone in the U.S., the top selling, the top 2 in urban China, 4 out of the top 5 in Japan, the top 4 in the U.K. and the top 6 in Australia. And so it was a sort of across the board in some really key countries, we did really, really well. I do think that the 5G cycle is important. And we're in the early days of it, frankly.

OPERATOR: We'll take our next question from Katy Huberty from Morgan Stanley.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: This was a pretty unbelievable quarter, and investors are going to ask about the sustainability of current demand trends, especially as you lap some of the benefits from COVID in areas like services and Mac later this year. So I know you don't guide beyond -- or provide an outlook beyond the next quarter. But can you talk from a high level over the next year, which segments do you see the opportunity to maintain strong revenue growth versus where is it reasonable to assume there will be some digestion as consumers shift their spending priorities? And then I have a follow-up for Luca.

TIMOTHY D. COOK: If you sort of look at the different products, iPhone, I've already mentioned some of the great momentum that we had there. Keep in mind that the compare that we're running to would be the quarter, the Q2 of last year is the quarter that China would have entered a shutdown first and then the rest of the world entered the shutdown in middle part of March. And so part of the growth is compare -- is the comparison point. But that said, the results were fabulous across the board. The shortages that Luca spoke about in the color that he provided on the future, affect primarily the iPad and the Mac. And so we'll have some challenges in there, and challenges in meeting the demand that we've got.

The demand feels very strong right now. Both on the Mac side, you have the combination of M1 and work from home and remote learning. And then iPad, you've got remote learning and work from home as well. And the product that we just announced is really killer, the iPad Pro with the M1 in it. And so there's a lot of great things of the strength of the product cycle in addition to the trends that we're seeing in the marketplace.

And where this pandemic will end, it seems like many companies will be operating in a hybrid kind of mode. And so it would seem that work from home and the productivity of working from home will remain very critical.

If you look at Wearables then, the watch had a fabulous quarter. And I still think we're in the early innings on the watch. The number of new -- people that are new to the watch is almost 3 out of 4. And so this is a long way from being a mature market. And so -- and then the Services by itself has really accelerated. And so all in all, we feel very, very good.

KATHRYN LYNN HUBERTY: And then, Luca, as I look at inventory plus vendor nontrade receivables, that grew only about 8% this quarter which is a big deceleration from last quarter. Should we read into that as a leading indicator for how we should think about the revenue growth deceleration in the business as the world normalizes? Or were there some supply disruptions during the quarter that caused you to drain inventory and create that tightness that you're talking about for June?

LUCA MAESTRI: No. On -- as you think about the June quarter, Katy, I would point you to what we said in our prepared remarks around the 2 factors that will influence our normal seasonality, right? One is the fact that iPhone -- we launched iPhone later than usual during this cycle. And so we reached supply-demand balance only during the March quarter, which makes obviously the sequential decline steeper than usual. And then this $3 billion or $4 billion of supply constraints that Tim just said, primarily on iPad and Mac. So as you look at your model and you obviously can look at our numbers that we've done in the past, I think you can try to gauge that.

 

From a channel inventory standpoint, we did what we normally do during a March quarter. So we reduced inventory as it's typical on iPhone. We exited within our target range. So I would say that on the inventory side, it was pretty straightforward. Obviously, given that the supply constraints are on the iPad and on the Mac, we wish we had more inventory of iPad and Mac. But this is all a function of high demand for all our products.

OPERATOR: We'll take our next question from Wamsi Mohan with Bank of America.

WAMSI MOHAN, DIRECTOR, BOFA SECURITIES, RESEARCH DIVISION: Tim, your content offerings are still at very compelling price points. And you've seen other content providers, whether it be Spotify, Hulu, Netflix, all announced price increases recently. I'm just wondering how you're thinking about pricing as it pertains to your offering here? And if you could share any stats around the uptake of TV+ paid subs that would be great. And I have a follow-up for Luca.

TIMOTHY D. COOK: TV+ -- let me start with TV+. TV+ is going very well. As you know, the objective and the philosophy that we've had on TV+ is to create high-quality original content and to be one of the most desired platforms for storytellers. And I see that happening day by day as we sign more shows and more storytellers including Malala as I had mentioned in my opening comments.

To date, we've received -- the Apple Originals have received 352 award nominations and had 98 wins. And this is from Oscar nominations to Emmy Awards to Critic Choice awards and all the rest. And we've got some shows that are -- have gotten significant buzz like Ted Lasso and The Morning Show and Defending Jacob and many others. And so we feel really good about where we are. We're not releasing subscriber numbers. But we feel good about where we are.

In terms of other services and pricing, I don't have anything to announce today. We try to give the customer a great value. And we feel that we're doing that in the -- with the prices that we've got. And we'll see where we go from here.

WAMSI MOHAN: Okay. As my follow-up, Luca, on the June quarter guide, when you talk about the sequential decline being a little bit about perhaps the 13% or low-teens percent that we've seen historically, are the supply constraints of the $3 billion, $4 billion impact included in that? Or is that in addition to sort of the more than average sequential decline that you're referring to? And any color on what specifically is driving the supply constraints of the subcomponent level?

LUCA MAESTRI: The -- yes. So when you look at our normal seasonality, and you've mentioned a percentage there that is really an average of several years, what we're saying is that we believe that the sequential decline this year is going to be higher than that. And it's a combination of the 2 factors, right? One is the timing of the launch and then the very high demand for iPhone during the March quarter. And the $3 billion to $4 billion supply constraints that we mentioned. Yes, and the constraints come from the semiconductor shortages that are affecting many, many industries, and it's a combination of the shortages as well as the very, very high level of demand that we are seeing for both iPad and Mac. For Mac, for example, if you just -- just to keep it into context, the last 3 quarters of Mac have been the best 3 quarters ever in the history of the product, right? So we are experiencing an incredible level of demand, which certainly is favored by working from home and learning from home environment, but also by the incredible amount of new products and innovation that we put into the products that we launched during the last couple of quarters.

OPERATOR: We'll take our next question from Aaron Rakers with Wells Fargo.

AARON CHRISTOPHER RAKERS, MD OF IT HARDWARE & NETWORKING EQUIPMENT AND SENIOR EQUITY ANALYST, WELLS FARGO SECURITIES, LLC, RESEARCH DIVISION: Congratulations on the great quarter. I wanted to go back to iPhone. As we think about the iPhone 12 cycle, appreciating that you guys don't give actual shipment numbers, it would appear though that the mix has been quite healthy. So I'm wondering if you could give us any context of what in this cycle you're seeing in terms of the mix relative to past cycles? Is that mix sustainable? I'm just trying to understand kind of the mix of -- within the iPhones and how that's driving, I guess, particularly gross margin. And I have a follow-up.

TIMOTHY D. COOK: Aaron, let me give you a little color on that. The iPhone 12 of the -- the iPhone 12 family are or more broadly affect all iPhones, the iPhone 12 is the most popular. But we did see very strong sales of the Pro portion of the family as well, the Pro plus the Pro Max. And so the revenue that you're seeing is a function of unit growth and revenue -- revenue per unit growth. Does that help?

 

AARON CHRISTOPHER RAKERS: Yes. Can you give any context of how that might have changed this cycle relative to the prior cycles? Have we seen kind of a structural change to the higher band of the product category that you believe can be sustained going forward?

TIMOTHY D. COOK: We don't predict going forward other than for our own internal use. But we're really happy with the results.

AARON CHRISTOPHER RAKERS: Okay. And then as a quick follow-up back to the supply constraints. I guess it's hard to kind of see again, looking forward beyond this quarter. But what's your best assessment of when maybe the supply constraints could ease? Do you have any views of just the industry in general, overcoming some of the supply constraint dynamics?

TIMOTHY D. COOK: Most of our issue is on legacy nodes. And so on legacy nodes, there are many different people, not only in the same industry, but across other industries that are using legacy nodes. And so in order to really answer that question on -- accurately, we would need to know the true demand from each of these players and how that's going to change over the next few months. And so it's very, very difficult to give you a good answer. I think we have a good handle on our demand. But what everybody else is doing, I don't know. And so we will do our best. That's what I can tell you.

OPERATOR: We'll take our next question from Harsh Kumar with Piper Sandler.

HARSH V. KUMAR, MD & SENIOR RESEARCH ANALYST, PIPER SANDLER & CO., RESEARCH DIVISION: Congratulations on a very nice quarter. Question on semis supply as well. You just beat by a substantial margin on the top line in the March quarter. I'm curious what went in your favor to be able to secure that kind of supply that you were able to beat by, I think it was $11 million or so? And then I had a follow-up.

TIMOTHY D. COOK: We did not have a material supply shortage in Q2. And so how were we able to do that? You wind up collapsing all of your buffers and offsets. And that happens all the way through the supply chain. And so that enables you to go a bit higher than what we were expecting to sell when we went into the quarter 90 days ago.

HARSH V. KUMAR: That's very helpful. And then for my follow-up, I know there's a lot of moving parts, Tim, but with the economy sort of reopening here in the U.S., and you mentioned about supply constraints possibly on the Mac and the iPad. I was curious if I can get your thoughts, maybe just color-wise, on what you would expect for those 2 categories, Macs and the iPads in the second half of this year.

TIMOTHY D. COOK: Well, we don't predict or rev guide to product-level detail. We're not even guiding to the top level at this point because of COVID. And so I'll sidestep that question. But I would point to Luca's point earlier about the shortages and those shortages primarily affect iPad and Mac. So we expect to be supply gated, not demand gated.

OPERATOR: We'll take our next question from Krish Sankar with Cowen & Company.

KRISH SANKAR, MD & SENIOR RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: Congrats on a fantastic quarter. First question for Tim or Luca. The Greater China sales were very strong in the March quarter. Can you give some color on what drove this strength? Which hardware products or services enabled the solid outperformance in China? And then I had a follow-up.

TIMOTHY D. COOK: We were very pleased with our performance in China. We set a March quarter revenue record and grew strong double digits across each of the product categories. And so the revenue growth was broad. We've been especially pleased by the customer response in China to the iPhone 12 family. And as I had mentioned earlier, you have to remember that China entered the shutdown phase earlier in Q2 of last year than other countries. And so they were relatively more affected in that quarter, and that has to be taken into account as you look at the results.

As I mentioned earlier, we had the top 2 selling smartphones in urban China, so we're very proud of that. And iPad, Mac both had enormously positive quarters with great strength across the board. And we're seeing a strong reception to the new iPad Pro as well that we just announced. A lot of great comments. And about 2/3 of the people buying Mac and iPad were buying them for the first time. And so we're attracting some new customers in China, which is really important to us.

KRISH SANKAR: All right. That was very helpful, Tim. And then maybe as a follow-up, I kind of have like a big picture philosophical question, and to the extent you can answer this. One of the concerns many investors have is about the overhang of regulatory risk. I understand it's very hard to handicap that. But I'm kind of curious, do you think giving more public disclosure on your Services business like App Store would help alleviate some of those concerns? Or do you think that's revealing a lot of competitive details. But kind of curious to know what you think on services disclosure.

TIMOTHY D. COOK: I think with the regulatory questions and scrutiny, we have to make sure that we're telling our story and why we do what we do, and we're very focused on doing that. If we feel that more disclosure would help, we would obviously move in that direction. The App Store and other parts of Apple are not cast in concrete. And so we can move and are flexible with the times. For example, in the App Store, as you know, just a couple of quarters ago, we lowered the commission rate for small developers to 15%. So that was an example of moving with the times, and we've gotten a great, great reception to that. And so we continue to learn, and I think it's very important that we're very clear about why we do what we do. The idea behind curating the App Store in order to get the privacy and security that our customers want, I think is very important, and we have to convey that in a very straightforward manner.

OPERATOR: We'll take our next question from Kyle McNealy with Jefferies.

KYLE P. MCNEALY, EQUITY ANALYST, JEFFERIES LLC, RESEARCH DIVISION: One of the things we've been positive about is how growing iPhone sales can pull along Watch and AirPods sales as well as customers shop the whole store. But you mentioned through COVID that accessories do much better in a physical store environment, and that's been hard due to the shutdowns, obviously. So my question is, have you seen any improvement in the attach rate for Watch and AirPods with iPhone? And can it get a lot better from here as the environment gets closer to normalization?

TIMOTHY D. COOK: I think we get a lot of benefit from our stores when they're open and are fully operational. And we're in better shape for parts of Q2 than we were previously, but we're still operating with a limited operational model in many stores. And there's still some stores today that are closed. Like stores in Michigan and stores in France and so forth. And so I think it will take some amount of time, but my view would be as the stores get back up to speed, fully up to speed, we should be able to increase some of the accessory sales. Although I think we're doing fairly well at the moment. So it's not something that we're not doing well. Online has been much more beneficial and much more productive than we would have guessed going into this.

OPERATOR: We'll take our next question from David Vogt from UBS.

DAVID VOGT, ANALYST, UBS INVESTMENT BANK, RESEARCH DIVISION: Congratulations on a great quarter. Maybe if I could just ask a question. I know it's early days, but any commentary, color from maybe the developer community on App track -- on ATT and kind of what the initial feedback and data might look like that you could share with us?

TIMOTHY D. COOK: Our -- ATT's focus is really on the user and giving the user the ability to make a decision about whether they want to be tracked or not. And so it's putting the user in the control. Not Apple, not another company, but the user of where it should be. And so that's really the focus of it. And the feedback that we've gotten from users, both before it went live when it was in the planning stages and so forth and after, has been tremendous. And so we're really standing up on behalf of the consumer here.

DAVID VOGT: Maybe just as a quick follow-up, Tim. Can you kind of discuss any sort of -- what the downloads have looked like. I know it just rolled out earlier this week and sort of the acceptance by the consumer at this point. Any sort of metrics that you can share with us, whether it's sort of an opt-in or opt-out sort of view from the consumer perspective?

TIMOTHY D. COOK: I don't even know the answer to that. It's not something that we would have predicted beforehand. And frankly, even if it's very low of people that don't want to be tracked, it's worth doing because of the -- those people should have the -- should make their own mind up, whether they would like to be tracked or not.

OPERATOR: We'll take our next question from Samik Chatterjee from JPMorgan.

SAMIK CHATTERJEE, ANALYST, JPMORGAN CHASE & CO, RESEARCH DIVISION: I have a couple. And just wanted to get into the performance by geography here a bit. And Europe really exceptional results, particularly for this time of the year. Tim, I know you mentioned some of the 5G iPhone upgrades are in front of you, and I would assume Europe is kind of in that category. But curious to hear or maybe if you can double-click on what's driving the exceptional growth here in Europe. And like are we -- are consumers moving to 5G phones even though some of the service provider plans are not rolled out? Or are we still expecting that to be much more in front of us?

LUCA MAESTRI: Samik, I'll take that one. You're right. I mean we had great performance in Europe. We grew 56% during the quarter. And it was probably one of the geos where we actually saw results that were better than even our own expectations. We grew very strong double digits across the board, every product category. Particularly, I would say, iPad and Mac. They really was very, very strong. Again, obviously, Europe has been affected by lockdowns -- more than most parts of the world, the lockdowns have lasted longer than here in the United States, for example. Tim was mentioning there are places in Europe still today where our stores are closed. And fortunately, we have a very strong online business that has really helped us. But working from home, learning from home, limited entertainment options, that has all played in our favor.

Keep in mind that our Europe segment is a very broad version of Europe because it includes Western Europe, which has done very, very well. And then Eastern Europe and it goes into the Middle East. Even India is part of Europe. And those emerging markets have done incredibly well, significantly better than company average. So very, very pleased with some of the results in India, for example, Russia, Middle East in general. So it's been very broad, both across product categories and across countries in Europe.

SAMIK CHATTERJEE: Okay. Got it. And just a quick follow-up for you, Luca. I think overall, just wanted to understand the implication of the investment plans that you announced recently for the U.S., the $430 billion over a multiyear period. Getting some questions from investors of how to think about the implication on the run rate of operating expenses for the company.

LUCA MAESTRI: If you remember, we announced back in 2018 that we were making a very sizable commitment to the United States. We -- at the time we announced $350 billion of investment over the following 5 years. And during these 3 years, since then, we've overachieved on those commitments, and we felt it was the right time to update these type of investments. And they span from, obviously, the investment that we made directly at Apple. For example, we talked about the creation of 20,000 new jobs at Apple over the next 5 years in the United States. And of course, our business has grown. And so our commitment, for example, to U.S. suppliers grows over time, and that shows in the higher numbers. In the meantime, we've got into new businesses, for example, Apple TV+, a lot of the content that we developed for our TV service is produced here in the United States. And so that's additional investment here in the United States.

From an OpEx standpoint, I think as you've seen this year, we're getting a lot of leverage. This is one of those years we said many times, sometimes our OpEx grows faster than revenue, and there are some other cycles where the opposite happens. We are growing revenue this year much faster than our OpEx increase. But we want to continue to make all the necessary investments into the business. We will never underinvest in our business. And so you will continue to see the fact that we -- we will continue to grow our operating expenses, particularly on the R&D side, which continues to be the core of the company.

TEJAS GALA: Thank you, Samik. A replay of today's call will be available for 2 weeks on Apple Podcast, as a webcast on apple.com/investor and via telephone. The numbers for the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 5799138. These replays will be available by approximately 5:00 p.m. Pacific Time today. Members of the press with additional questions can contact Kristin Huguet at (408) 974-2414. Financial analysts can contact me with additional questions at (669) 227-2402. Thank you again for joining us.

OPERATOR: Thank you. That does conclude today's Apple Q2 FY 2021 **Earnings** Conference Call. We thank you for your participation, and you may now disconnect.

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OPERATOR: Good day, and welcome to the Apple Q1 Fiscal Year 2021 **Earnings** 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 Tejas Gala, Director of Investor Relations and Corporate Finance. Please go ahead.

TEJAS GALA, IR CONTACT, APPLE INC.: Thank you. Good afternoon, and thank you for joining us. Speaking first today is Apple's CEO, Tim Cook, and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook, including the potential impact of COVID-19 on the company's business and results of operations. These statements involve risks and uncertainties that may cause actual results or trends to differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed annual report on Form 10-K 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, CEO & DIRECTOR, APPLE INC.: Thank you, Tejas. Good afternoon, everyone. Thanks for joining the call today. It's with great gratitude for the tireless and innovative work of every Apple team member worldwide that I share the results of a very strong quarter for Apple. We achieved an all-time revenue record of $111.4 billion. We saw strong double-digit growth across every product category, and we achieved all-time revenue records in each of our geographic segments.

It is not far from many of our minds that this result caps off the most challenging year any of us can remember. And it is an understatement to say that the challenges it posed to Apple as a business paled in comparison to the challenge it posed to Apple as a community of individuals, to employees, to their families and to the communities we live in and love to call home.

While these results show the central role that our products played in helping our users respond to these challenges, we are doubly aware that the work ahead of all of us to navigate the end of this pandemic, to restore normal life and prosperity in our neighborhoods and local economies and to build back with a sense of justice is profound and urgent. We will speak to these needs and Apple's efforts throughout today's call, but I want to first offer the context of a detailed look at our results this quarter, including why we outperformed our expectations.

Let's get started with hardware. We hit a new high watermark for our installed base of active devices, with growth accelerating as we passed 1.65 billion devices worldwide during the December quarter. iPhone grew by 17% year-over-year driven by strong demand for the iPhone 12 family, and our active installed base of iPhones is now over 1 billion. The customer response to the new iPhone 12 models' unprecedented innovation from world-class cameras to the great and growing potential of 5G has been enthusiastic, even in light of the ongoing COVID-19 impact at retail locations.

iPad and Mac grew by 41% and 21%, respectively, reflecting the continuing role these devices have played in our users' lives during the COVID-19 pandemic. During this quarter, availability began for both our new iPad Air as well as the first generation of Macs to feature our groundbreaking M1 chip. The demand for all of these products has been very strong.

We have also continued our efforts to bring the latest iPad's enriching content and professional support to educators, students and parents. Educational districts and governments worldwide are continuing major deployments, including the largest iPad deployments ever to schools in Germany and Japan.

Wearables, Home and Accessories grew by 30% year-over-year, driven by significant holiday demand for the latest Apple Watch, our entire AirPods lineup, including the new AirPods Max as well as the new HomePod mini. This broad strength across the category led to new revenue records for each of its 3 subgroups, and we're very excited about the road ahead for these products.

Look no further than the great potential of Fitness+, which pairs with Apple Watch to deliver real-time on-screen fitness data alongside world-class workouts by the world's best trainers. There are new sessions added each week, and customers are loving the flexibility, challenge and fun of these classes as well as how the pairing with Apple Watch pushes you to achieve your fitness goals.

This deep integration of hardware, software and services have always defined our approach here, and it has delivered an all-time quarterly Services record of $15.8 billion. This was the first quarter of the Apple One bundle, which brings together many of our great services into an easy subscription; and with new content being added to these services every day, we feel very optimistic about where we are headed.

The App Store ecosystem has been so important as individuals, families and businesses worldwide evolve and adapt to the COVID-19 pandemic, and we want to make sure that this unrivaled engine of innovation and opportunity continues. This quarter, we also took a significant new step to help smaller developers continue to experiment, innovate and scale the latest great app ideas. The App Store Small Business Program reduces the commission on the sale of digital goods and services to 15% for small businesses earning less than $1 million a year. The program launched on January 1, and we are already hearing from developers about how this change represents a transformation in their potential to create and grow on the App Store.

Tomorrow is International Privacy Day, and we continue to set new standards to protect users' right to privacy, not just for our own products but to be the ripple in the pond that moves the whole industry forward. Most recently, we're in the process of deploying new requirements across the App Store ecosystem that give users more knowledge about and new tools to control the ways that apps gather and share their personal data.

The winter holiday season is always a busy time for us and our products. But this year was unique. We had a record number of device activations during the last week of the quarter. And as COVID-19 kept us apart, we saw the highest volume of FaceTime calls ever this Christmas. As always, we could not have made so many holidays special without our talented and dedicated retail teams who helped us achieve a new all-time revenue record for retail, driven by very strong performance in our online store.

Particularly, after the events of the last few weeks, we're focused on how we can help a moment of great national need. Because none of us should have any illusions about the challenges we face as we begin a new chapter in the American story, hope for healing, for unity and for progress begins with and depends on addressing the things that continue to wound us.

In our communities, we see how every burden from COVID-19 to the resulting economic challenges, to the closure of in-person learning for students falls heaviest on those who have always faced structural barriers to opportunity and equality. This month, Apple announced major new commitments through a $100 million Racial Equity and Justice Initiative. The Propel Center launched with a $25 million commitment and with the support of historically black colleges and universities across the country, will help support the next-generation of leaders in fields ranging from machine learning to app development to entrepreneurship and design.

And our new Apple Developer Academy in Downtown Detroit will be the first of its kind in the United States. Detroit has a vibrant culture of black entrepreneurship, including over 50,000 black-owned businesses. We want to accelerate the potential of the app economy here, knowing there is no shortage of good ideas in such a creative, resilient and dedicated community. Finally, we're committing $35 million across 2 investments in Harlem Capital and the Clear Vision Impact Fund that support, accelerate and grow minority-owned businesses in areas of great potential and need.

In December, we concluded an unmatched year of giving. Since the inception of the Apple Giving program in 2011, Apple employees have donated nearly $600 million and volunteered more than 1.6 million hours to over 34,000 organizations of every stride. Through our partnership with (PRODUCT)RED, we've adapted our 14-year $250 million effort to support HIV and AIDS work globally to ensure that care continues even in the time of COVID. That includes delivering millions of units of personal protective equipment to health care providers in Zambia.

 

And here in the United States, even with COVID's effects, we are ahead of schedule on our multiyear commitment to invest $350 billion throughout the American economy. As proud as this makes us, we know there is much more to be done. Looking forward, we continue to contend with the COVID-19 pandemic, but we must also now work to imagine what we will inherit on the other side. When a disease recedes, we cannot simply assume that healing follows. Even now, we see the deep scars that this period has left in our communities. Trust has been compromised. Opportunities have been lost. Entire portions of our lives that we took for granted, schools for children, meetings with our colleagues, small businesses that have endured for generations have simply disappeared. It will take a society-wide effort across the public and private sectors as individuals and communities, every one of us, to ensure that what's ahead of us is not simply the end of a disease but the beginning of something durable and hopeful for those who gave, suffered and endured during this time.

At Apple, we have every intention to be partners in this effort, and we look forward to working in communities around the world to make it possible. And as this chapter of uncertainty continues, so will our tireless work to help our customers stay safe, connected and well.

With that, I'll hand things over to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone. We started our fiscal 2021 with exceptional business and financial performance during the December quarter as we set all-time records for revenue, operating income, net income, **earnings** per share and operating cash flow. We are thrilled with the way our teams continued to innovate and execute throughout this period of elevated uncertainty.

Our revenue reached an all-time record of $111.4 billion, an increase of nearly $20 billion or 21% from a year ago. We grew strong double digits in each of our product categories, with all-time records for iPhone; Wearables, Home and Accessories; and Services as well as a December quarter record for Mac. We also achieved double-digit growth and new all-time records in each of our 5 geographic segments and in the vast majority of countries that we track.

Products revenue was an all-time record of $95.7 billion, up 21% over a year ago. As a consequence of this level of sales performance and the unmatched loyalty of our customers, our installed base of active devices passed 1.65 billion during the December quarter and reached an all-time record in each of our major product categories.

Our Services set an all-time record of $15.8 billion, growing 24% year-over-year. We established new all-time records in most service categories and December quarter records in each geographic segment. I'll cover our Services business in more detail later.

Company gross margin was 39.8%, up 160 basis points sequentially, thanks to leverage from higher sales and a strong mix. Products gross margin was 35.1%, growing 530 basis points sequentially, driven by leverage and mix. Services gross margin was 68.4%, up 150 basis points sequentially, mainly due to a different mix.

Net income, diluted **earnings** per share and operating cash flow were all-time records. Net income was $28.8 billion, up $6.5 billion or 29% over last year. Diluted **earnings** per share were $1.68, up 35% over last year and operating cash flow was $38.8 billion, an improvement of $8.2 billion.

Let me get into more detail for each of our revenue categories. iPhone revenue was a record $65.6 billion, growing 17% year-over-year as demand for the iPhone 12 family was very strong despite COVID-19 and social distancing measures, which have impacted store operations in a significant manner. Our active installed base of iPhones reached a new all-time high and has now surpassed 1 billion devices, thanks to the exceptional loyalty of our customer base and strength of our ecosystem. In fact, in the U.S., the latest survey of consumers from 451 Research indicates iPhone customer satisfaction of 98% for the iPhone 12 family.

Turning to Services. As I said, we reached an all-time revenue record of $15.8 billion and set all-time records in App Store, cloud services, Music, advertising, AppleCare and payment services. Our new service offerings, Apple TV+, Apple Arcade, Apple News+, Apple Card, Apple Fitness+ as well as the Apple One bundle are also contributing to overall Services growth and continue to add users, content and features.

The key drivers for our Services growth all continue to move in the right direction: First, our installed base growth has accelerated and is an all-time high across each major product category; second, the number of both transacting and paid accounts on our digital content stores reached a new all-time high during the December quarter with paid accounts increasing double digits in each of our geographic segments; third, paid subscriptions continue to grow nicely, and we exceeded our target of 600 million paid subscriptions before the end of calendar 2020. During the December quarter, we added more than 35 million sequentially, and we now have more than 620 million paid subscriptions across the services on our platform, up 140 million from just a year ago.

 

Finally, we continue to improve the breadth and quality of our current Services offerings and are adding new services that we think our customers will love. For example, Apple Music recently released its biggest product update ever with features like Listen Now, all new search, personal radio stations and autoplay. 90% of Apple Music users on iOS 14 have already used these new features.

In payment services, we continue to expand our coverage with nearly 90% of stores in the United States now accepting Apple Pay so that customers can easily have a touchless payments experience.

Wearables, Home and Accessories grew 30% year-over-year to $13 billion, setting new all-time revenue records in every geographic segment. As a result of this strong performance, our Wearables business is now the size of a Fortune 120 company. Importantly, Apple Watch continues to extend its reach with nearly 75% of the customers purchasing Apple Watch during the quarter being new to the product. We're very excited about the future of this category and believe that our integration of hardware, software and services uniquely positions us to provide great customer experience in this category.

Next, I'd like to talk about Mac. We set a December quarter record for revenue at $8.7 billion, up 21% over last year. We grew strong double digits in each geographic segment and set all-time revenue records in Europe and rest of Asia Pacific as well as December quarter records in the Americas, Greater China and in Japan. This performance was driven by strong demand for the new MacBook Air, MacBook Pro and Mac mini, all powered by our brand-new M1 chip.

iPad performance was also very impressive with revenue of $8.4 billion, up 41%. We grew strong -- very strong double digits in every geographic segment, including an all-time record in Japan. During the quarter, the new -- the all-new iPad Air became available and customer response has been terrific. Both Mac and iPad are incredibly relevant products for our customers in the current working and learning environments. And we are delighted that the most recent surveys of consumers from 451 Research measured customer satisfaction at 93% for Mac and 94% for iPad. With this level of customer satisfaction and with around half of the customers purchasing Mac and iPad during the quarter being new to that product, the active installed base for both products continues to grow nicely and reached new all-time highs.

In the enterprise market, we are seeing many businesses shifting their technology investment in response to COVID. One example is how businesses are handling their hundreds of millions of office desk phones while more employees are working remotely. Last quarter, Mitsubishi UFG Bank, one of the largest banks in the world, announced that it will be replacing 75% of its fixed phones with iPhones. By doing so, it expects to realize significant cost savings while providing a secure mobile platform to employees.

We're also pleased with the rapid adoption of the Mac Employee Choice Program among the world's leading businesses, who are seeing improved productivity, increased employee satisfaction and talent retention. With the introduction of M1-powered Macs, we're excited to extend these experiences to an even broader range of customers and employees, especially in times of increased remote working.

Let me now turn to our cash position. We ended the quarter with almost $196 billion in cash plus marketable securities and retired $1 billion of maturing debt, leaving us with total debt of $112 billion. As a result, net cash was $84 billion at the end of the quarter. We returned over $30 billion to shareholders during the December quarter, including $3.6 billion in dividends and equivalents and $24 billion through open market repurchases of 200 million Apple shares as we continue on our path to reaching a net cash neutral position over time.

As we move ahead into the March quarter, I'd like to provide some color on what we are seeing, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. Given the continued uncertainty around the world in the near term, we will not be guiding to a specific revenue range. However, we are providing some directional insights assuming that COVID-related impacts of our business do not worsen from our current assumptions for the quarter.

For total company revenue, we believe growth will accelerate on a year-over-year basis and in aggregate, follow typical seasonality on a sequential basis. At the product category level, keep in mind 2 items: First, during the March quarter last year, we saw elevated activity in our digital services as lockdowns occurred around the world, so our Services business faces a tougher year-over-year comparison; second, we believe the year-over-year growth in the Wearables, Home and Accessories category will decelerate compared to Q1. As you know, we were chasing demand on AirPods last year as we expanded channel inventory from Q1 to Q2. This year, we plan to decrease AirPods channel inventory as is typical after the holiday quarter.

We expect gross margin to be similar to the December quarter. We expect OpEx to be between $10.7 billion and $10.9 billion. We expect OI&E to be up around $50 million and our tax rate to be around 17%. Finally, today, our

 

Board of Directors has declared a cash dividend of $0.205 per share of common stock payable on February 11, 2021, to shareholders of record as of February 8, 2021.

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

TEJAS GALA: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please?

Questions and Answers

OPERATOR: We'll go ahead and take our first question from Katy Huberty with Morgan Stanley.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: Congratulations on a really strong quarter. First question for Luca. The gross margin was particularly strong versus your outlook. Can you talk about whether you recognize the full impact of the weaker dollar in the December quarter given your typical currency hedges? And then how are you thinking about the headwinds and tailwinds on gross margins as you go into the March quarter? And then I have a follow-up for Tim.

LUCA MAESTRI: Yes, Katy. So yes, the gross margin was strong, was better than we had anticipated at the beginning of the quarter. The reason for that was obviously we had very strong leverage from higher sales. And the mix was strong, both the mix within products and the mix of services, and that was only partially offset by cost. As you know, we launch many new products during the fall, and that always comes with new cost structures. So in total, it was very good.

On -- from the FX standpoint, really, at the gross margin level, FX didn't play a role, neither sequentially nor on a year-over-year basis for the December quarter partially because of the hedges that you talked about but also because some currencies are still weaker against the dollar. They're still weaker than a year ago, look, specifically to emerging markets in Latin America, in Russia, in Turkey and so on.

Clearly, if the dollar remains weak or continues to weaken, that can become a tailwind for us as we get into the March quarter. At current rates, we expect some level of benefit around 60 to 70 basis points for the March quarter.

KATHRYN LYNN HUBERTY: That's great. And Tim, one of the challenges with valuing Apple is just a limited visibility that investors have into the road map and any new categories that you might enter over time. Without, of course, commenting on any given opportunity, can you talk about the framework that you use internally to evaluate new markets that might be attractive and what you believe will determine your success as you look to enter new markets?

TIMOTHY D. COOK: Thanks, Katy, for the question, and thanks for not asking me any specifics. The framework that we use is very much around we ask ourselves if this is a product that we would want to use ourselves or a service that we would want to use ourselves, and that's a pretty high bar. And we ask ourselves if it's a big enough market to be in unless it's an adjacency product, of which we're looking at it very much from a customer experience point of view.

And so there's no set way that we're looking at it, no formula kind of thing. But we're taking into account all of those things. And the kind of things that we love to work on are those where there's a requirement for hardware, software and services to come together because we believe that the magic really occurs at that intersection. And so hopefully, that gives you a little bit of insight into how we look at it.

And I think we have some good -- really good opportunities out there. And I think if you look at our current portfolio of products, we're -- we still have relatively a low share in a number of cases in very big markets. And so we feel like we have really good upside there, and we feel like we have really good upside in the Services area, too, that we've been working on for quite some time with 4, 5 new services just coming online in the last year, year plus. And so -- yes. Thank you.

OPERATOR: We'll hear next from Wamsi Mohan with Bank of America.

WAMSI MOHAN, DIRECTOR, BOFA MERRILL LYNCH, RESEARCH DIVISION: Luca, the iPhone growth exceeded your expectations despite a late launch. Can you maybe share some color on what drove that? Was it more on the unit side or the ASP side? You referred to very strong mix a couple of times on the call. And how does this change your view on the March quarter? And if you could share any color on if you're still supply constrained, and I have a follow-up for Tim.

 

LUCA MAESTRI: Yes. Yes, certainly, iPhone was one of the major factors why we exceeded our own internal expectations at the beginning of the quarter. We have a fantastic product lineup and we know that, and it's been fantastic to see the customer response for the -- for new models, particularly the Pro models, the Pro and the Pro Max. So we've done very, very well both on units and on pricing because of the strong mix.

And we've had some level of supply constraints as we went through the quarter, particularly on the Pro and the Pro Max. As you said correctly, we launched these products in the middle of the quarter, 2 models after 4 weeks, the other 2 models after 7 weeks. And so obviously, we had a very steep ramp, which fortunately went very, very well. The products are doing very well all around the world. I think you've seen that our performance has been particularly strong in China, where we've seen phenomenal customer response that probably there was also some level of pent-up demand for 5G iPhones given that the market is moving very quickly to 5G.

And so as we look ahead into the March quarter, we're very optimistic. We believe we're going to be able to be in supply-demand balance for all the models at some point during the quarter. And it's -- the product is doing very well all around the world.

WAMSI MOHAN: Great. And Tim, you mentioned about the strength of the installed base performance, which continues to grow very impressively at this scale. Can you maybe help us think through how the switcher versus upgrade activity has been tracking in recent quarters? Would love to get your thoughts on that.

TIMOTHY D. COOK: Yes. Thanks for the question. If you look at this past quarter, which has -- we started selling 2 of the iPhones 4 weeks into the quarter and the other 2 7 weeks into the quarter. And so I would caution that this is in the early going. But in looking at the iPhone 12 family, we saw both switchers and upgraders increase on a year-over-year basis; and in fact, we saw the largest number of upgraders that we've ever seen in a quarter. And so we were very thrilled about that.

OPERATOR: We'll go ahead and take our next question from Shannon Cross with Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: Tim, can you talk a bit about what you're seeing in China? Clearly, significant sequential growth, which I think has a lot to do with iPhone. But I'm curious, both from an iPhone as well as your other product categories, what you're seeing and how much back to normal you think the Chinese market is. And then I have a follow-up.

TIMOTHY D. COOK: Yes. China was more than an iPhone story. iPhone did do very well there. And sort of like the world, if you look at both switchers and upgraders, we were up year-over-year, and China also had a record number of upgraders during the quarter, the most we've ever seen in a quarter. I think probably some portion of this was that people probably delayed purchasing in the previous quarter as rumors started appearing about an iPhone.

Keep in mind that 5G in China is -- the network is well established, and the overwhelming majority of phones being sold are 5G phones. And so I think there was some level of anticipation for us delivering an iPhone with 5G. And so iPhone did extremely well.

However, the other products did as well. I mean we could not have turned in a performance like we did with only iPhone. iPad did extremely well, far beyond the company average. Mac was above the company average. Wearables, Home and Accessories was above the company average. And so if you really look at it, we did really well across the board there.

In terms of COVID, I think they're -- at least for last quarter, they were beat -- sort of beyond COVID, very much in the recovery stage. This quarter, there are different reports about some cases in some places and lockdowns occurring but we have not seen that in our business as yet. And of course, those cases are much smaller than the ones in other countries.

SHANNON SIEMSEN CROSS: Right. I guess the other thing I was curious about, with regard to the Services business, if we could dig a little bit more, I think this is one of the first times when, Luca, you talked about Apple TV+, Arcade, Apple Pay, some of the smaller services actually kind of moving the needle. And then I was also curious, you had a number of stores closed at least later in the quarter, and that typically has impacted some of your AppleCare revenue and yet you outperformed. So maybe if you could talk about a bit more about the drivers of the Services revenue.

LUCA MAESTRI: Yes. I mean, really, it's been strong across the board. There are 2 businesses during COVID that have been impacted negatively, and we talked about it in the past. One is AppleCare. Obviously, when the stores are closed, it's tougher, of course, for customers to have interaction with us. And advertising, which is -- it's in line with the overall level of economic activity.

What happened during the December quarter is that in-store traffic improved. And so AppleCare, we grew. We didn't grow as much as company average, but we grew in AppleCare, set an all-time record there in spite of the fact that, yes, we are running -- particularly in December, we started closing a few stores, particularly here in the United States but also in Western Europe. But in total, we were able to support more customers than in past quarters.

And we also saw a sequential acceleration in advertising and so that also helped the overall growth rate. Clearly, the strength was in digital services, in the App Store, in cloud services, in Music. Those were the services that really delivered very, very strong performance. It's something that we've seen happen during the COVID environment.

OPERATOR: We'll hear from Toni Sacconaghi with Bernstein.

A.M. SACCONAGHI, SENIOR ANALYST, SANFORD C. BERNSTEIN & CO., LLC., RESEARCH DIVISION: I also have one for Luca and one for Tim. Luca, I was wondering if we could just probe a little bit more into iPhone. Maybe you can just -- you talked about a drawdown in channel inventory last quarter. Our iPhone channel inventory is sort of at normal levels now exiting Q1. And should we be thinking about above-seasonal iPhone growth -- given that you're still not in supply-demand balance and you had fewer selling days in fiscal Q1, should we be thinking about sort of above-seasonal iPhone growth looking into Q2?

LUCA MAESTRI: So on the December performance, as you know, Toni, this was a very different cycle because we launched at a different time than usual. And so we had an initial part of the quarter where, obviously, we didn't have the new phones. And then as we launched the new phones, we also did the channel fill that typically happens, to a certain extent, in the September quarter.

At the end of the quarter, the demand has been very strong. And so we've been constrained, as I said, on -- especially in the Pro models. At the end of December, we exited with a level of iPhone channel inventory, which was slightly below a year ago. So we -- and we still had some level of supply constraints, which we believe we're going to be able to solve during the March quarter.

In terms of the sequential change, we talked about -- during the prepared remarks, we talked about total company average, and we said that we expect that sequential progression to be similar to the typical seasonality that you've seen in past years. Certainly, last year is not typical because of COVID. But if you go back, fiscal '17, '18, '19, that's our typical seasonal progression.

And we mentioned a couple of product categories, Services and Wearables, where we're going to be having a slightly more difficult compare. And so I think you can draw your conclusions around the iPhone.

A.M. SACCONAGHI: Okay. And then, Tim, I was wondering if you could just comment more broadly around growth for Apple and sources of growth. The company this year is going to be well over $300 billion in revenue. Historically, you've eschewed acquisitions. And I'm wondering if you could comment whether you still feel confident that Apple has Apple organic growth opportunities and that you don't believe acquisitions are an important source of growth. And then I think perhaps most importantly, as you look out, let's say, over the next 5 years, what do you think is a realistic revenue growth rate for Apple going forward?

TIMOTHY D. COOK: Yes. Toni, as you know, we give some color on the current quarter but not beyond that in terms of growth rates, so I'll punt that part of your question. But if you back up and look at the sort of the ingredients that we have at this point, we have the strongest hardware portfolio that we've ever had. And we have a great product pipeline for the future, both in products and in services.

We have an installed base that has hit new highs that we just talked about earlier in our opening comments. And we're still attracting a fair number of switchers and, of course, upgraders. We just set an all-time Services record, and we have that installed base to compound that, and particularly with the added services that we've had over the last year or so, that as they grow and mature, will contribute even more to the Services revenue stream.

And on the Wearables side, we've brought this thing from 0 to a Fortune 120 company, which was no small feat. But I still think that we're in the early stages of those products. If you look at our share in some of the other products, whether you look at iPhone or Mac or iPad, you find that the share numbers leave a fair amount of headroom for market share expansion. And this is particularly the case in some of the emerging markets, where we're proud of how we've done, but there's a lot more headroom in those markets.

 

Like if you take India as an example, we doubled our business last quarter compared to the year ago quarter, but our absolute level of business there is still quite low relative to the size of the opportunity. And you can kind of take that and go around the world and find other markets that are like that as well.

And of course, the other thing from a market point of view is we're -- we've been on a multiyear effort in the enterprise and have gained quite a bit of traction there. You've heard some of the things in Luca's comments today, and we comment some on it each quarter. We're very optimistic about what we can do in that space.

And then, of course, we've got new things that we're not going to talk about that we think will contribute to the company as well just like other new things have contributed nicely to the company in the past. So we see lots of opportunity. Thank you for the question.

OPERATOR: We'll hear from Amit Daryanani with Evercore ISI.

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I have 2 questions as well. I guess starting with you, Luca, I just wanted to go back to the gross margin discussion, and we really haven't seen gross margins at this level, high 39%, I think, since 2016. Could you maybe step back and talk about what has enabled the shift higher? What are the key drivers to get you there? And is commodity tailwinds or in-sourcing of some components really a big part of this? So just love to understand the durability of the gross margin at these levels. And what are the big drivers that got us here?

LUCA MAESTRI: Well, Amit, of course, when you grow the way we've grown this quarter, 21%, it's -- obviously, we have a certain level of fixed cost in our product structures, right? And so a high level of sales helps margin expansion without a doubt, and so that has been probably the biggest factor, to be honest.

And then as I was saying earlier, we've had, across the board, in services, in every product category, we've had a very strong mix of products, right? We were talking about the iPhone, the Pro and the Pro Max, and that's been pretty much the case in every product category. So the mix has also been very good.

The commodity environment is fairly benign. And the one thing that has not affected us this time around is the FX that it's true, it has not been a tailwind yet for the reasons that I was explaining to Katy, but at the same time, it has not been a negative. And the reality is that FX for us has been a negative over the last 5 or 6 years almost every quarter. And so that has changed, and that obviously makes a difference.

AMIT JAWAHARLAZ DARYANANI: Got it. And then, Tim, when I look at the growth rates on Mac and iPads, they've been in the 20% to 40% range for the last 3 quarters, and I suspect some of this is just folks contending with the pandemic. But love to understand, when you look at these growth rates, how much of this do you think is replacement cycle-driven folks upgrading what they have at home versus new customers and new folks that are coming into the Apple ecosystem? And do you see -- I guess what sort of growth rates do you think is more durable or predictable as we go forward over here?

TIMOTHY D. COOK: If you look at the switcher or the switchers, if you look at the new to Mac and new to iPad, these numbers are still about -- at a worldwide level, about half of the purchases are coming from people that are new. And so the installed base is still expanding with new customers in it. And so that's true on both iPad and Mac.

If you look at Mac, the M1, I think, gives us a new growth trajectory that we haven't had in the past. Certainly, if Q1 is a good proxy, there's lots of excitement about M1-based Macs. As you know, we're partly through the transition. We've got more -- a lot more to do there. We're early days of a 2-year transition, but we're excited about what we see so far.

The iPad, as we went out with the iPad Air, and we now have the best iPad lineup we've ever had, and it's clear that some people are using these as laptop replacements, others are using them as complementary to their desktop. But the level of growth there has been phenomenal. You look at it at 41%. And yes, part of it is work from home and part of it is just learning.

But I think I wouldn't underestimate how much of it is the product itself on -- in both the case of iPad and Mac. And of course, our share in the Mac is quite low in the -- for the total personal computer market. And so there's lots of headroom there.

AMIT JAWAHARLAZ DARYANANI: Congrats on a great quarter.

TIMOTHY D. COOK: Thank you.

LUCA MAESTRI: Thank you.

OPERATOR: We'll go ahead and take our next question from Samik Chatterjee with JPMorgan.

SAMIK CHATTERJEE, ANALYST, JPMORGAN CHASE & CO, RESEARCH DIVISION: Congrats on the record quarter from my side as well. I guess I wanted to start off with iPhone sales. I think in -- general impression we have is China and North America have more robust 5G infrastructure. I just wanted to see kind of what are you seeing in terms of customer engagement or velocity of sales for iPhone in Europe, where I think the general impression is that service providers haven't rolled out robust 5G services. Is that something that's impacting customer interest in the latest lineup in the region? And I have a follow-up.

TIMOTHY D. COOK: If you look at the 5G rollout in Europe, it's true that Europe is not in the place of -- certainly nowhere close to where China is and nowhere close to the U.S. either. But there are other regions that 5G is -- that has very good coverage. Like Korea is an example. And so the world, I would describe it right now, is more of a patchwork quilt. There are places that there's really excellent coverage. There are places where, within a country, that is very good but not from a nationwide point of view. And then there are places that really hasn't gotten started yet. Latin America is more closer to the last one. There's lots of opportunity ahead of us there. And I think Europe is where there are 5G implementations there. I think most of that growth is probably in front of us there as well.

SAMIK CHATTERJEE: Got it. As a follow-up, if I can just ask you, I think you mentioned the momentum you're seeing for the Apple One bundle, which I think has been a couple of months now since you launched it. Any metrics to share in terms of what you're seeing for conversion rate of customers or even insights into which services are turning -- in that bundle, are turning out to be the anchor services that's driving adoption of that bundle?

TIMOTHY D. COOK: It's really too early to answer some of those questions. As you know, we just got started in the -- into the quarter in Q1, so we have less than a quarter on this right now. What we wanted to accomplish with it, we're clearly accomplishing, which is making our services very easy to subscribe to. Our customers clearly told us that they wanted to subscribe to several services or, in some cases, all of our services. And so we've made that very simple, and it's clear from the early going that it's working but we've just gotten started on it.

OPERATOR: We'll hear from Krish Sankar with Cowen.

KRISH SANKAR, MD & SENIOR RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: Congrats on the very strong results. My first question is for Tim. Tim, I want to talk a little bit about your search and advertising business. How do you think of the long-term growth opportunities in advertising? How do you think it -- how long can it grow at 2 to 3x the App Store growth rate? And also, are there any applications where your fundamental search technology, AR-infused could be adapted for other parts of the Services business? That's the first question. And then I have a quick follow-up for Luca after that.

TIMOTHY D. COOK: The search, advertising business is going well. It's a -- there's lots of intent from search, and we do it in a very private kind of manner, observing great privacy policies and so forth. And I think people see that and are willing to try it out. And we have been growing nicely in that area. It's a part of the advertising area that Luca spoke of earlier.

KRISH SANKAR: Got it. Got it. And then a follow-up for Luca. When you look at your Services segment in the March quarter, in China, you typically see a bump due to gaming downloads during Chinese New Year. So should we see a similar trend this time around? But do you think with the pandemic and people staying primarily at home, that kind of seasonal bump might not happen in China for gaming downloads?

LUCA MAESTRI: Yes. I mean it -- and I think I was mentioning it during the prepared remarks. We -- clearly, in China, the March quarter is typically the strongest quarter for our Services business and for the App Store because of Chinese New Year, as you mentioned. And last year, what we saw was an increased level of activity because, after Chinese New Year, the whole country went into lockdown for several weeks. And so that propensity for playing games continued for several weeks, more than a typical cycle. So we expect to have a great quarter in China, but at the same time, we need to keep in mind that the compare is going to be particularly challenging because of what happened a year ago.

OPERATOR: We'll go ahead and take our next question from Chris Caso with Raymond James.

 

CHRISTOPHER CASO, RESEARCH ANALYST, RAYMOND JAMES & ASSOCIATES, INC., RESEARCH DIVISION: The first question is on iPhone ASPs, and I know you don't disclose the numbers there, but I wonder if you could speak about it qualitatively. You spoke about the richer mix, but there were also some price differences as compared to a year ago. iPhone 12 came in at a higher price point. The Pro established a new price point. Can you speak to how that -- the level of benefit that you saw there? And going forward, are you confident that you can continue to improve the mix in iPhone going forward?

LUCA MAESTRI: So as I said earlier, we grew iPhone revenue 17%, and that growth came from both unit sales and ASPs because of the strong mix that I mentioned before. So I think that answers your question for the December quarter. What we've seen so far, it's very early because we launched the new products only a few weeks ago. What we've seen so far is a very high level of interest for the Pro models, the Pro and the Pro Max. We worked very hard to ramp up our supply. We've had some supply constraints during the December quarter. We think we're going to be able to solve them during the March quarter. But so far, the mix has been very, very strong on iPhone.

CHRISTOPHER CASO: Okay. As a follow-up question, if you could talk a bit to the benefit that you may have seen from some of the carrier actions? We've seen very aggressive trade-ins during the quarter. Did that provide a benefit, in your view, on units or mix or perhaps both? And what would be the level of permanence that you would see in some of those actions such that if those subsidies were removed, could that potentially be a headwind going forward?

TIMOTHY D. COOK: I think -- Chris, it's Tim. I think subsidies always help that anything that reduces the price to the customer is good for the customer and obviously good for the carrier that's doing it and good for us as well. And so it's a win across the board. I believe that, at least based on what I see right now, is that there would be probably continuing to have quite a bit of competition in the market, if you're talking about the U.S. market for customers as the carriers work to get more customers to move to 5G.

In -- outside of the U.S., the subsidies are not used in all geographies, and so it really varies greatly by country. Some of them are -- separate completely, the handset and the service; and in those areas, we don't have subsidies.

OPERATOR: We'll go ahead and hear from Jim Suva with Citigroup.

JAMES DICKEY SUVA, MD & RESEARCH ANALYST, CITIGROUP INC., RESEARCH DIVISION: It's amazing how your company has pivoted and progressed through this uncertain time in society. A lot of the pushback we get on our view on Apple is that everyone around them or that they know in developed countries has an iPhone or Apple product and the market is kind of being saturated some. But when I look at other countries like India, I believe statistically, you are materially below that in market share. So are you doing active efforts there? It seems like there's been some news reports of moving supply chain there or you recently opened up an Apple Store. How should we think about that? Because it just seems like you're really not full market share equally around the world.

TIMOTHY D. COOK: Yes. There are several markets, as I alluded to before, India is one of those, where our share is quite low. It's -- it did improve from the year ago quarter. Our business roughly doubled over that period of time, and so we feel very good about the trajectory. We are doing a number of things in the area. We put the online store there, for example, and last quarter was the first full quarter of the online store. And that has gotten a great reaction to it and has helped us achieve the results that we got to last quarter.

We're also going in there with retail stores in the future. And so we look for that to be another great initiative and we continue to develop the channel as well. And so there's lots of things, not only in India but in several of the other markets that you might name where our share is lower than we would like.

And I -- again, I would also say, even in the developed markets, when you look at our share, definitely, everybody doesn't have an iPhone, not even close. And so we really don't have a significant share in any market. We're -- so there's headroom left even in those developed markets where you might hear that.

JAMES DICKEY SUVA: Congratulations to you and your team and employees.

TIMOTHY D. COOK: Thank you, Jim. Appreciate that.

TEJAS GALA: Thank you. A replay of today's call will be available for 2 weeks on Apple Podcast, as a webcast on apple.com/investor and via telephone. The numbers for the telephone replay are (888) 203-1112 or (719)

 

457-0820. Please enter confirmation code 1828830. These replays will be available by approximately 5 p.m. Pacific Time today.

Members of the press with additional questions can contact Kristin Huguet at (408) 974-2414. Financial analysts can contact me with additional questions at (669) 227-2402. Thank you again for joining us.

OPERATOR: Once again, that does conclude today's conference. We do appreciate your participation.



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**Q4 2020 Apple IncEarnings Call - Final**

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Presentation

OPERATOR: Good day, everyone. Welcome to the Apple Inc. Fourth Quarter Fiscal Year 2020 **Earnings** Conference Call. Today's call is being recorded. At this time, for opening remarks and introductions, I would like to turn things over to Tejas Gala, Senior Analyst, Corporate Finance and Investor Relations. Please go ahead, sir.

TEJAS GALA, IR CONTACT, APPLE INC.: Thank you. Good afternoon, and thank you for joining us. Speaking first today is Apple's CEO, Tim Cook, and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during the discussion today will consist of our forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook, including the potential impact of COVID-19 on the company's business and results of operations.

These statements involve risks and uncertainties that may cause actual results or trends to differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed annual report on Form 10-K 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, CEO & DIRECTOR, APPLE INC.: Thanks, Tejas, and good afternoon, and thanks for joining the call today. Back in April, I said we were in the most challenging environment in which Apple as a company has ever operated. That atmosphere of uncertainty, of resolve, of making difficult calls with limited information, has not only come to define Apple's year but each of our lives as individuals across this country and around the world. It has been a chapter that none of us will forget.

In the face of these challenges, Apple stayed relentlessly focused on what we do best, seeing in every obstacle an opportunity to do something new, something creative, something better on behalf of our customers.

Today, we report a quarter and a fiscal year that reflects that effort. This quarter, Apple achieved revenue of $64.7 billion, a September quarter record despite the anticipated absence of new iPhone availability during the quarter and the ongoing impacts of COVID-19, including closures at many of our retail locations. We also set a new all-time record for Mac and Services. Outside of iPhone, each of our product categories saw strong double-digit year-over-year growth despite supply constraints in several product categories.

Our results for this quarter were ahead of our expectations, driven by stronger-than-expected iPhone and Services performance. As we anticipated, we launched new iPhone models in October, a few weeks later than last year's mid-September launch. Up to that mid-September point, customer demand for iPhone was very strong and grew double digits. On Services, we saw stronger-than-expected performance across the board.

Geographically, we set September quarter records in the Americas, Europe and rest of Asia Pacific. We also set a September quarter record in India, thanks in part to a very strong reception to this quarter's launch of our online store in the country. Greater China is the region that was most heavily impacted by the absence of the new iPhones during the September quarter. Still, we beat our internal expectations in the region, growing non-iPhone revenue strong double digits, and iPhone customer demand grew through mid-September.

When you pull back the lens to the entire fiscal year, it's a testament to the team's work and to the resilience of the business in the era of COVID-19. This year, we set an all-time revenue record of $274.5 billion, growing 6% year-on-year. We grew every quarter, set all-time yearly records in Mac, Wearables, Home and Accessories and Services and grew by double digits in every product category outside of iPhone.

When we first began to grapple with COVID-19, I said there are worse things for a company whose business is innovation than having to periodically do just about everything in an entirely new way. This year, we not only launched our most powerful and compelling generation of hardware, software and services ever, we did it in a way that pushed us to reimagine every part of that innovation process down to how we share these announcements with the world and how we get new products into our customers' hands. Working from kitchen tables and bedrooms, in distanced office settings and reworked labs and manufacturing facilities, the team rebuilt every part of the plane while it was midair, and the results speak for themselves.

In a year that has been enormously challenging, our retail teams, contact centers and all those who work with our customers most closely have gone to creative and dedicated lengths to keep serving our customers, from adapting our stores for contactless pickup to new Apple express storefronts to new online customer support options. Amid store closings, reopenings and reimaginings, these teams have been an unfailing source of energy, creativity and determination. Innovation isn't just about what you make, it's about how you approach problems, and these teams and every team across Apple have not faced a single question this year that they haven't found an answer to with passion and resolve. Their actions didn't just meet the moment, they will make us a better company moving forward.

The pandemic has hit home for all of us, and at Apple, we have seen it as a call to action. We have seen the pain in our communities. Many of us have seen our children work hard to adapt to remote learning. And we have -- and we all know that the road ahead is uncertain. This quarter and throughout the year, our response to this crisis has been to ask, how can we help? In terms of COVID-19 response, that has meant sourcing and donating millions of face masks, designing and manufacturing millions of face shields and scaling the production of millions of test kits.

But we have tried to live our values more broadly. We've pledged $100 million to our new Racial Equity and Justice Initiative. We've committed to be fully carbon-neutral by 2030 across our entire supply chain and device usage as massive wildfires, hurricanes and floods bring home the consequences of climate change for all of us. And we've deepened our enduring educational partnerships, from coding education beginning in elementary school to new efforts with dozens of historically black colleges and universities.

One of the many areas where COVID-19 continues to have a significant impact is in education. As teachers, students and parents alike work hard to keep education relevant, creative and effective, our products have helped them meet the moment. In a typical year, the back-to-school season is a bustling time for us. This year, that was true in the biggest way ever. We've helped school districts around the world meet this moment in an unprecedented way, including starting 9 of our 10 largest school district deployments ever that alone will support over 1 million students and teachers. We have also supported these deployments and educators and learners everywhere with free tools and training, reaching over 150,000 teachers and millions of parents and students around the world.

Looking forward, we feel great optimism about the road in front of us. We're in the midst of our most prolific product introduction period ever. In addition to the announcement of HomePod mini, which achieves unmatched sound quality and Siri and smart home capabilities in a small and affordable format, we just marked the beginning of a new era for iPhone with the arrival of our first 5G-enabled devices. The iPhone 12 and 12 mini boast powerful breakthroughs like an edge-to-edge Super Retina XDR display, unprecedented durability with a new Ceramic Shield developed with our partners at Corning, new MagSafe charging and accessories, the fastest-ever A14 Bionic chip and a new dual camera system driven by computational photography.

The iPhone 12 Pro and 12 Pro Max take all of this to an even higher level, driven by the most powerful photo and video tools ever delivered by a smartphone, including an all-new LiDAR scanner and the ability to shoot in Apple ProRaw and full Dolby video.

And of course, all of these devices bring the 5G experience users have been waiting for, with lightning-fast downloads and uploads, a new standard in video streaming, more responsive gaming and much more. The early product reviews have been tremendously positive, and our customers have been similarly excited to get their hands on this next era of devices. We're very optimistic about what the next few weeks will bring.

We're also seeing a very positive response to our September announcement. The all-new Apple Watch Series 6 boasts powerful new health and wellness features, including a blood oxygen sensor, a next-generation altimeter and a wide variety of new colors and bands. The potential for Apple Watch's powerful health and wellness capabilities continues to grow.

Just yesterday, the government of Singapore and Apple launched LumiHealth, a first-of-its-kind program designed to encourage healthy activity and behaviors using Apple Watch. Created in collaboration with a team of physicians and public health experts, LumiHealth uses technology and behavioral insights to encourage Singaporeans to keep healthy and complete wellness challenges through their Apple Watch and iPhone. Singapore is a trailblazer here, and we're proud to be their partner.

Our iPad lineup continues to set the pace for the category, including the new iPad Air now shipping with the A14 Bionic, our most powerful chip ever. We announced Apple Fitness+, which delivers deep personalization and integration across the fitness tools our users love and depend on. And Apple One, launching tomorrow, is the easiest way for users to enjoy Apple services like Music, TV+, Arcade, iCloud, News+ and Fitness+ on a single plan that is right for them and their family.

Looking across Services more broadly, we're really excited about what we see. This was a record quarter for the App Store, AppleCare, cloud services, Music and payment services. The App Store, in particular, continues to play an essential role in helping small businesses, educational institutions and workplaces adapt to COVID-19. Apple TV+ continues to impress from fan favorites like Ted Lasso, which has won a worldwide audience with its hopeful tone during challenging times, to critical and award praise, including a Primetime Emmy for Billy Crudup in The Morning Show.

Luca will speak in greater detail about our expectations for the December quarter. Without giving away too much, I can tell you that this year has a few more exciting things in store. Before I hand things off, I want to offer 1 more comment on resilience because I think if I had to describe our performance this quarter in a single word, it's resilient. Financial performance aside, I don't think this year will be a time that any of us look back on with great fondness or nostalgia. Those of us who wake up every day hoping for a return to normal can count ourselves fortunate. Others don't have that luxury. There is the great pain of a lost loved one, the uncertainty and fear of a lost job, a deep well of concern for people we care about who we are not able to see. A sense of opportunities missed, of plans delayed, of time lost.

Even though we're apart, it's been obvious this year that around the company, teams and colleagues have been leaning on and counting on each other more than in normal times. I think that instinct, that resilience has been an essential part of how we have navigated this year. Work can't solve for all the things we're missing right now, but a shared sense of purpose goes a long way. A belief that we can do more together than we can alone, that people of goodwill, driven by creativity and passion and that certain itch of a big idea, can still do things that help other people in our own small way to teach, to learn, to create or just to relax at a time like this.

Even as the things we make require us to operate at the very cutting edge of technology, in materials, products and ideas that didn't exist just a few years ago, this year has forced us to face plainly the things that make us human: disease, resilience and hope. You never wish for a year like this one, but I couldn't be prouder of the team, the work we have done and the small role we have played in helping our communities find hope and resilience in this time. With that, I'll hand things over to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone. We're very pleased to report today a new September quarter revenue record, which caps a remarkable level of performance for our fiscal year 2020, during which we set new all-time records for revenue, **earnings** per share and free cash flow in spite of an extremely volatile and challenging macro environment. We could not be more proud of the way our team has innovated and executed throughout this unprecedented period of uncertainty.

We reported total revenue of $64.7 billion for the September quarter, up 1% from a year ago. This is a very impressive level of performance when we consider that this year, we did not launch and ship any new iPhone models during the quarter. Outside of iPhone, we grew 25% in aggregate and had strong double-digit year-over-year revenue growth in each of our product categories. We set all-time records for Mac and Services and a September quarter record for Wearables, Home and Accessories.

We also achieved new September quarter records in the vast majorities of countries that we track, including, among others, the U.S., Canada, Brazil, Germany, France, Italy, Spain, Turkey, Russia, India, Korea, Thailand, Malaysia and Vietnam. Products revenue was $50.1 billion, with very strong underlying performance across each product category. Our products outside of iPhone grew a combined 30% despite supply constraints on iPad, Mac and Apple Watch throughout the quarter.

For iPhone, through mid-September, customer demand grew double digits. As a result of this level of sales performance and the unmatched loyalty of our customers, our installed base of active devices reached an all-time high in aggregate and in each of our major product categories. Our Services set an all-time record of $14.5 billion, growing 16% year-over-year. We established new all-time records in many Services categories and September quarter records in each geographic segment. I'll cover this in more detail later.

 

Company gross margin was 38.2%. This was up 20 basis points sequentially due to cost savings and a higher mix of services, partially offset by a different mix of products. Products gross margin was 29.8%, growing 10 basis points sequentially, driven by cost savings, partially offset by a different mix. Services gross margin was 66.9%, decreasing 30 basis points sequentially, mainly due to a different mix.

Let me get into more detail for each of our product categories. iPhone revenue was $26.4 billion as we did not have availability of new iPhone models during the September quarter this year, which we had mentioned during our call in July. While COVID-19 and social distancing measures impacted store operations in a significant manner, demand for iPhone remained very strong. In fact, through mid-September, customer demand for our current product lineup grew double digits and was well above our expectations.

Our active installed base of iPhones reached a new all-time high, thanks to the exceptional loyalty of our customer base and strength of our ecosystem. In fact, in the U.S., the last survey of consumers from 451 Research indicates iPhone customer satisfaction of 98% for iPhone 11, 11 Pro and 11 Pro Max combined.

Turning to Services, as I said, we set an all-time revenue record of $14.5 billion. We grew strong double digits and set all-time records in App Store, cloud services, Music, advertising and payment services. We also set an all-time record in AppleCare as in-store traffic improved and we were able to support more customers. Our new services, Apple TV+, Apple Arcade, Apple News+ and Apple Card, are also contributing to overall Services growth and continue to add users, content and features.

The key drivers for our Services growth all continue to be moving in the right direction. First, our installed base continues to grow and is an all-time high across each major product category. Second, the number of both transacting and paid accounts on our digital content stores reached a new all-time high. during the September quarter, with paid accounts increasing double digits in each of our geographic segments. Third, paid subscriptions grew more than 35 million sequentially, and we now have over 585 million paid subscriptions across the services on our platform, up 135 million from just a year ago. With this momentum, we are very confident to reach and exceed our increased target of 600 million paid subscriptions before the end of calendar 2020.

Finally, as Tim mentioned, we continue to improve the breadth and the quality of our current Services offerings and are adding new service offerings that we think our customers will love, like Apple One and Apple Fitness+.

Wearables, Home and Accessories established a new September quarter record with revenue of $7.9 billion, up 21% year-over-year. We set September quarter records in every geographic segment and for each of the 3 product categories: Wearables, Home and Accessories. As a result, our Wearables business is now the size of a Fortune 130 company. Importantly, Apple Watch continues to extend its reach, with over 75% of the customers purchasing Apple Watch during the quarter being new to the product. We're very excited about the future of this category, including the recent launches of our new products: Apple Watch Series 6 and SE, HomePod mini and the MagSafe ecosystem of accessories.

Next, I'd like to talk about Mac. Revenue was, by far, an all-time record at $9 billion, up 29% over last year and $1.6 billion above our previous record in spite of supply constraints during the quarter. We grew strong double digits in each geographic segment and set all-time revenue records in the Americas and rest of Asia Pacific as well as September quarter records in Europe and Japan. We have seen amazing customer response to the new MacBook Air and MacBook Pro and very strong demand during the back-to-school season.

iPad performance was also very impressive with revenue of $6.8 billion, up 46% and our highest September quarter revenue in 8 years despite supply constraints. Demand exceeded our expectations around the world as we grew very strong double digits in every geographic segment, including an all-time record in Japan and a September quarter record in the Americas.

Both Mac and iPad are incredibly relevant products for our customers in the current working and learning environments, and we are delighted that the most recent surveys of consumers from 451 Research measured customer satisfaction at 93% for Mac and 95% for iPad. With this level of customer satisfaction and with around half of the customers purchasing Mac and iPad during the quarter being new to that product, it is no surprise that the active installed base for both products reached a new all-time high.

In the enterprise market, our products are helping companies grow their business while achieving their sustainability goals. One example is Vestas, a leading producer of wind turbines. Vestas is using Apple products and native iOS apps extensively across their operations to deliver renewable energy efficiently to customers worldwide. For instance, they use iPads to help -- optimize on-site construction operations, having crane usage, on average, by 1 day per project. Vestas' field technicians are using iPhone for work orders, troubleshooting and remote collaboration, saving them 400,000 service hours annually. More recently, they have started piloting the augmented reality capability in iPads to help customers visualize wind turbine installations in the field.

Another example of how organizations are using Apple products to reduce carbon impact is digitizing paper workflows. In Switzerland alone, Zurich Insurance has reduced paper consumption by over 10,000 sheets per day by equipping 1,000 customer advisers with iPads. Air Canada is reducing its carbon footprint by over 2,200 metric tons annually by loading flight plans and manuals onto iPads rather than using paper. We are thrilled that our products are helping businesses run more efficiently and sustainably.

Let me now turn to our cash position. We ended the quarter with almost $192 billion in cash plus marketable securities. We issued $5.5 billion of new term debt and decreased short-term borrowing facilities by $6.2 billion during the quarter, leaving us with total debt of $112 billion. As a result, net cash was $79 billion at the end of the quarter as we continue on our path to reaching a net cash neutral position over time. We returned nearly $22 billion to shareholders during the September quarter, including $3.5 billion in dividends and equivalents and $18 billion through open market repurchases of 168.7 million Apple shares. We also retired an additional 3.1 million shares in the final settlement of our 16th ASR.

Before looking ahead, I want to provide just a few highlights for the amazing fiscal year we just completed. In fiscal '20, we grew revenue by 6% to $274.5 billion, a new all-time record. We showed remarkable resilience throughout the year as we were able to grow both revenue and installed base of active devices in every quarter. In spite of the most challenging economic environment we can remember, we set new revenue records in the Americas, in Europe and in the rest of Asia Pacific. We grew our business outside of iPhone by 16%. We grew **earnings** per share 10% to a new all-time record. And most importantly, we continued to deliver innovative products and services that our customers love.

As we move ahead into the December quarter, I'd like to provide some color on what we are seeing, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. Given the continued uncertainty around the world in the near term, we will not be issuing revenue guidance for the coming quarter. However, we are providing some insights on our expectations for the December quarter for our product categories. These directional comments assume that COVID-related impacts to our business in November and December are similar to what we've seen in October.

We just started shipping iPhone 12 and 12 Pro, and we're off to a great start. We are also excited to start preorders on iPhone 12 mini and 12 Pro Max next Friday. Given the tremendously positive response, we expect iPhone revenue to grow during the December quarter despite shipping iPhone 12 and 12 Pro 4 weeks into the quarter and iPhone 12 mini and 12 Pro Max 7 weeks into the quarter. We expect all other products in aggregate to grow double digits, and we also expect Services to continue to grow double digits.

For gross margin, we expect it to be similar to our most recent quarters despite the costs associated with the launch of several new products. For OpEx, we expect to be between $10.7 billion and $10.8 billion. We expect OI&E to be around $50 million and the tax rate to be around 16%.

Finally, today, our Board of Directors has declared a cash dividend of $0.205 per share of common stock payable on November 12, 2020, to shareholders of record as of November 9, 2020. With that, let's open the call to questions.

TEJAS GALA: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please?

Questions and Answers

OPERATOR: We'll hear first today from Shannon Cross, Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: Tim, can you talk a bit more about China? And in terms of linearity, I think, Luca, you'd mentioned that Services in all regions were at an all-time high. I'm not sure exactly what your comment was. But maybe give us a little idea of whether you're seeing any blowback or benefit from the Huawei situation and just dig a bit more into the trends you're seeing in China. And then I have a follow-up.

TIMOTHY D. COOK: Thanks, Shannon. If you look at China and look at last quarters -- I'll talk about both last quarter and this quarter a bit. Last quarter, what we saw was our non-iPhone business was up strong double digit for the full quarter. And then if you look at iPhone and you look at it in 2 parts: one, pre-mid-September, which is pre the point at which the previous year we would have launched iPhones, that, that period of time, which was the bulk of the quarter, iPhone was growing from a customer demand point of view. And of course, the -- not shipping new iPhones for the last 2 weeks of September makes that number in the aggregate a negative.

But the net is the underlying business in China last quarter was very strong and perhaps very different than you might think from just a quick look at the stated number.

In terms of this quarter, given the explanation for last quarter and the momentum that we've got, and as importantly, given the initial data points that we see on iPhone 12 and iPhone 12 Pro, although we don't guide to revenue, as Luca said, I would tell you that we are confident that we will grow this quarter in China. And so we're very bullish on what's going on there.

A little more color on last quarter. We had a much more significant inventory drawdown on the channel side than other regions. And so that is one reason why the numbers are different than other regions. And additionally, the new products in the year-ago quarter were a higher percentage of our iPhone sales than they were in other regions. So hopefully, that explains what's going on in China.

In terms of the market there, 5G is fairly advanced there. They're forecasting 600,000 base stations by the end of the year, and so we're entering the market at a very good time. And with the reception that we've gotten so far, we're very confident there.

SHANNON SIEMSEN CROSS: Okay, great. And then can you talk a bit about just overall in the world -- the cadence that you see sort of for the 5G adoption launch? What you see will be sort of the key drivers? Obviously, there's a fair amount of subsidies going on in the U.S. at this point.

TIMOTHY D. COOK: Yes. We're working hard to provide the best experience for our iPhone users. To do so, we've been collaborating closely with carriers all around the world to ensure iPhone has great throughput and coverage and battery and call quality. We've completed 5G testing so far on over 100 carriers, in over 30 regions. And so it's pretty pervasive around the world. But grantedly, it will continue to roll out in more places as carriers continue to expand their coverage, and this will happen every week. And so it's just going to get better. There are obvious places in the world where it's more ahead than in others, but we feel like we are entering at -- sort of at exactly the right time.

OPERATOR: That will be from Jeriel Ong with Deutsche Bank.

KANGHUI ONG, RESEARCH ANALYST, DEUTSCHE BANK AG, RESEARCH DIVISION: Yes. I guess -- I appreciate the guidance for revenues to grow. But I guess my question, perhaps if I could, is relative to seasonality. You guys -- over the last 5 years, your seasonality is typically up about 50% quarter-on-quarter. Do you think that you can beat that even with the later release? And I have a follow-up.

LUCA MAESTRI: So as I said, Jeriel, we're not providing a range for the reasons that I explained during my prepared remarks. So you need to keep in mind a couple of things that are unique about this quarter versus the past. And then I mentioned again, the launch timing of the phones is different from the past. So we're launching the new iPhones 4 weeks into the quarter for 2 models, for the 12 and the 12 Pro; and 7 weeks into the quarter for the other 2, the iPhone mini and the 12 Pro Max. So that is something to keep in mind as you think about the growth rates.

With regard to all the other product categories, as I said, we are expecting to grow double digits essentially across the board for the rest of our products and for services. And so we are incredibly optimistic about what we're seeing so far. Obviously, we started taking preorders 5 days ago, and so it's a bit early for the phone. But we think that there are a lot of tailwinds this year for iPhone, for the entire cycle, some of the comments that Tim has already made, right? We've got the best lineup of iPhones that we've ever had. We've got an installed base of iPhone that is very large, continues to grow. It's at an all-time high.

Obviously, 5G is a once-in-a-decade opportunity. And as you've seen in some markets, certainly here in the United States, carrier offers are very aggressive. And so that is very good for consumers and ultimately very good for us. So very, very optimistic, given what we've seen so far.

KANGHUI ONG: Awesome. Thank you so much for that context and giving us some of the levers to think about. I'd like to ask a little bit more of a strategic one, a little bit longer term in nature. I think the one thing that's interesting about the Apple One bundle is the desire to bundle in the first place. I guess I'm wondering, and some investors have asked me this as well, is that why wouldn't you also take that rationale perhaps to hardware, perhaps maybe AirPods and iPhone or AirPods, Watch and iPhone? Because if it makes sense to bundle services, wouldn't it also make sense to bundle hardware? And if that's not the case, then are there benefits of services bundling that don't necessarily translate to hardware bundling?

TIMOTHY D. COOK: Yes. We don't have anything to announce today on a hardware bundle. But backing up a bit, and we do view that people like to pay for their hardware, or at least some substantial portion of it, monthly. And so that's the reason that we have implemented installments in our stores and online. And that's the reason you see in some of the channels, too, selling a hardware on a per month kind of basis. That begins to look like subscription perhaps to some buyers because they're used to holding the phone for X period of time and then turning it over and using the residual value of that phone in a way that gives them a de facto kind of subsidy on a new phone. And so there is something today in the market that works somewhat similar. On the Services side, we had customers coming to us and asking for an easier way to buy all of our services, and we wanted to provide that, and we're looking forward to tomorrow to getting Apple One out there.

OPERATOR: That will come from Katy Huberty with Morgan Stanley.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: New technologies, including the chips that support 5G, put upward pressure on cost this year, but you managed to leave ASPs for iPhones relatively unchanged this product cycle. How should we think about the margin profile of iPhone 12 relative to past iPhone cycles?

LUCA MAESTRI: Katy, obviously, we don't provide any outlook at the gross margin level for product categories. What I said in my prepared remarks, we expect gross margins in total for the company to be pretty much in line with what we've seen during the last quarter, which obviously, as you said, it's very good, right, because we are offering the new phones at price points that are essentially unchanged, and we're taking on a lot of new technology into the phones.

The -- I would say the commodity environment is good. For the first time in many, many quarters, I don't have to say that foreign exchange is a headwind getting into the quarter. It's not going to be a factor during the quarter. As we've made clear in our comments, we are bullish about our sales performance expectations, so we should be getting some leverage. And so I think the gross margin dynamics are good, and it's very good to see that we're able to offer so much more technology and still able to deliver the level of gross margins that I think investors are expecting.

KATHRYN LYNN HUBERTY: Okay. And shifting to the Services business. This isn't dependent on certainly any one service, but licensing and other historically has been a driver of growth. That's where the ad-based revenue comes in. When you think about the Google antitrust pressure, what's the risk that you see some shrinkage in your licensing and other segment within Services? And do you see opportunities for other services to make up for any potential weakness?

TIMOTHY D. COOK: We've got -- Katy, as you know, we've announced a number of services over the last couple of years. And we are ramping those between Apple TV+ and Apple News+ and Apple Arcade. We've got Apple Card. We've got Apple Fitness+ coming. We've got a number of services that have been launched a bit longer that are doing really well from the App Store to iCloud. And so there's a lot of room there and potential there. I have no idea how the DOJ suit will go, but I think it's a long way from a conclusion on it.

OPERATOR: That will come from Evercore's Amit Daryanani.

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I guess I have 2 as well. First off, Tim, on iPhones, you talked about the iPhone installed base, I think, being the highest or largest it's ever been. Satisfaction rate is obviously pretty high. And our data would suggest replacement cycles are getting elongated. And if I take all of that together, along with the fact that if iPhone users are like me with embarrassingly high weekly usage rates, does that, in aggregate, give you better confidence, better clarity that we could enter an extensive period of iPhone revenue growth versus what we've seen in the last couple of years?

TIMOTHY D. COOK: We are very bullish on this cycle, very bullish on it because as I sort of step back from it and look at what we've now done, we have -- for the first time ever, we've launched 4 iPhones, and there is an iPhone for everyone there. And it is the strongest lineup we've ever had by far. We have -- we do have a very large, loyal and growing installed base, and we're also reaching out to switchers, and so I'm very optimistic there. We've got a once-in-a-decade opportunity with 5G. There's a lot of excitement around 5G. And we've got some aggressive offers in the marketplace. And so when I think about all of those, I'm really -- and I looked at the initial data points that we've got on the iPhone 12 and the 12 Pro, we are off to a great start.

 

AMIT JAWAHARLAZ DARYANANI: Got it. And then I guess, Luca, I had a follow-up for you on the Services gross margins, which have kind of continued to move higher rather nicely. I mean do you think these levels at 67% essentially are sustainable? And what do you think are the 2 or 3 factors that are enabling these gross margins to remain here as we go forward?

LUCA MAESTRI: I mean, obviously, we're very pleased with the level of gross margins in Services. As you said, they've been expanding almost 300 basis points on a year-over-year basis. The reason for that is, of course, that we are growing the Services revenue and therefore, we're getting leverage on a lot of these Services, right? Some of it, as explained in the past, we have a portfolio of services that got different margin profiles. And so sometimes depending on the mix of products we have, we can see margin expansion through mix as well.

So -- but we're also launching new services that where we need to invest heavily upfront. And -- but we think we've been able to show, for example, this year that we've launched a lot of new services, made all the necessary investments and still being able to expand gross margin. So we feel quite confident about the trajectory that we have for Services. And we're very, very happy to see the customer response to really all of them because, as we've mentioned earlier, I mean, we've seen revenue records across essentially every category and across the entire world, right? We've seen September quarter records in every geography around the world. So all the dynamics, all the levers that we have in the Services business are working very well right now. And that translates also into margin, of course.

OPERATOR: We'll hear from Samik Chatterjee with JPMorgan.

SAMIK CHATTERJEE, ANALYST, JPMORGAN CHASE & CO, RESEARCH DIVISION: I just wanted to start off with the iPhone lineup here, particularly, as you mentioned, the carrier subsidies that you're seeing makes you optimistic about iPhone sales. I think just looking at some other factors here, earlier in the year, you had mentioned that iPhone sales were seeing an uptick with stimulus checks going out to consumers, helping in the consumer spending overall here in the U.S. So as we see some delays here on that front, are you seeing anything change on the consumer spending side? Is the macro impacting how you think about iPhone sales, particularly even with the new product lineup? And I have a follow-up.

TIMOTHY D. COOK: It's -- prior to mid-September, we were seeing double-digit growth in customer demand on iPhone. So there's a lot of momentum there, and there is a lot of momentum even much more so now given the launch of the 12 Pro and the iPhone 12. If you're asking whether it could have been even more with a different macro spending environment, I believe the answer to be yes. But you can't run the experiment, and so I don't know for sure. But I suspect that just the COVID, in general, takes something off from a worldwide economic point of view.

SAMIK CHATTERJEE: Okay. All right. And if I can just follow up -- just following up on that COVID discussion. We are potentially here looking at a second wave, right? And I think all companies are trying to prepare for that, which you discussed as well in your prepared remarks. But if you can share any kind of thoughts about how you're preparing in relation to either inventory levels or sourcing from the supply chain to prepare for any potential disruption like we had earlier this year.

TIMOTHY D. COOK: Well, we're doing everything we can do, but we're prioritizing safety first, obviously. And so with our stores as an example, we've come up with a new concept that puts an -- essentially turns the store into an express storefront. And we've implemented that in a number of places where we believe it helps from the safety of our employee and the safety of the customer's point of view but still allows for an interaction to take place.

And so we've also put a lot more people on the phones because a lot more people are reaching out to us in that way. And of course, the online store has stayed up and running through the whole of this. I think if you take some of those, the channel is doing some similar things and then some different things as well. And so I think everybody, to the best of their ability, is putting in contingency plans and finding a way to adapt to the environment. But it is difficult to call, and there's a level of uncertainty in it, obviously, and that's what Luca was referring to earlier.

OPERATOR: That will come from Krish Sankar with Cowen and Company.

KRISH SANKAR, MD & SENIOR RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: I had 2 of them. First 1 for Luca. I understand you don't want to give color on gross margin by product or segment. But Luca, you mentioned gross margin should be similar in December versus September, and Services should grow around double digits. There's a general view that on the iPhone side, the BOM cost would be a headwind for gross margin, but the carrier subsidies would be a tailwind. So I'm kind of curious, how should we think about the different like gross margin levels into December quarter? And then I had a follow-up for Tim.

LUCA MAESTRI: Yes. So typically, during the December quarter, we have positive factors because we have the typical seasonal leverage, right, sequentially as we go from September to the holiday season. And we also have an improved mix between products, particularly this year, as we've launched the new iPhone. At the same time, we shouldn't forget that we have launched a lot of new products during the last several weeks. We launched 4 new models of iPhone. We launched new models of Apple Watch, new models of iPad. And so clearly, every time we launch a new product, the cost structure is higher, and so that is going to be the other side of the coin. But we think that those 2 things should balance out. And again, as I was saying earlier, we are accomplishing this while delivering a lot of new technologies, a lot of new features to our customers. This time, foreign exchange is not a factor, and that's something that is a bit different from the past. So -- but those are the pluses and minuses.

KRISH SANKAR: Got it. That's very helpful, Luca. And then a follow-up for Tim. Tim, was kind of surprised, you didn't say a lot about the payments ecosystem in these prepared comments. Kind of curious to find out from your vantage point how you think of your whole payment ecosystem, including Apple Card, Apple Pay, Apple Cash and how you're disaggregating the whole fintech environment.

TIMOTHY D. COOK: Thanks for the question. There's just a limited number of things I can talk about, it's kind of the reason I didn't talk about it. We're -- we continue to be very enthusiastic about the whole payment services area. Apple Card is doing well, and Apple Pay is doing exceptionally well. As you can imagine, in this environment, people are -- less want to hand over a card, so this contactless payment has taken on a different level of adoption in it that I think will never go back. The U.S. has been lagging a bit in contactless payment, and I think that the pandemic may well get -- put the U.S. on a different trajectory there. And so we are very bullish about this area and view that there are more things that Apple can do in this space. And so it's an area of great interest to us.

OPERATOR: That will come from Kyle McNealy with Jefferies.

KYLE P. MCNEALY, EQUITY ANALYST, JEFFERIES LLC, RESEARCH DIVISION: I wanted to ask a little bit about the supply chain, given your later start for manufacturing for the flagship phone lineup this year. Do you think that supply will be able to meet demand through the end of the calendar year? And are there any component shortages that you're seeing? Or are there any actions that you can take to increase weekly output versus last year?

TIMOTHY D. COOK: Yes. Kyle, I don't know if you're talking about iPhone in particular. But if you look at iPhone, we are constrained today, and that's not a surprise, we're at the front end of the ramp, if you will. And how long we will be supply constrained, it's hard to predict. I mean we haven't taken orders yet for the iPhone 12 mini or the Pro Max either. And so those are coming, and so we shall see. But right now, we are supply constrained.

We are also supply-constrained -- for avoidance of any confusion, we're supply-constrained on Mac. We're supply-constrained on iPad, and we're supply-constrained on some Apple Watches as well. And so we have a fair number of areas right now of focus, and we're working really, really hard to remedy those as quickly as we can. But at this point, I can't estimate when we'll be out of that.

KYLE P. MCNEALY: Okay. Great. And then switching to Mac and iPad. How do you think about the durability of the strength you're seeing there with Mac and iPad? Is there any potential for stronger-than-seasonal pullback after the strong back-to-school season and holiday season? And the supply constraints make it feel like there's a good chance for continuation of the strong demand trends and flow-through of that. What should we think about the seasonality into the December and March quarter, being more positive than seasonal or less positive than seasonal?

TIMOTHY D. COOK: Yes. We've placed our thoughts in the color that Luca provided when he said that all products excluding iPhone -- all products and services excluding iPhone -- or all products, rather, excluding iPhone would grow in the double digits. And so we continue to be bullish on what Mac and iPad can do. The -- I think the moves that have taken place to remote learning and remote work are not going to go back to normal. Normal will become something different because I think people are learning that there are aspects of this that work well. And so I don't believe that we're going to go back to where we were.

And I think that means that iPads and Macs are even more important in those environments. The growth in both of these last quarter were phenomenal, as you can tell from your -- from data sheet with Mac at 29 and iPad at 46. These are tremendous numbers. And as Luca said, the September quarter was the all-time high for Mac in the history of the company and by -- not by a little bit, by $1.6 billion. And so it was a substantial difference. Now we did have an aggressive promotion for college students that were going back to school. And so that was an invariably part of it. But I think the other part of the remote work thing is not something that's going to step back to the way it used to be anytime soon.

OPERATOR: That will come from Chris Caso with Raymond James.

CHRISTOPHER CASO, RESEARCH ANALYST, RAYMOND JAMES & ASSOCIATES, INC., RESEARCH DIVISION: Yes. I guess first question is on iPhone pricing. There were some changes in the iPhone price back this year. The iPhone price point for iPhone 12 moved up a bit. And I guess the difference, the gap between 12 and 12 Pro is smaller. And I guess that's after you made some adjustments years prior where the price points came down a bit. Can you talk through the thought process behind that and the potential implications for either unit elasticity or blended ASP as a result of the price changes?

TIMOTHY D. COOK: Well, the iPhone 12 family starts at $699 in many places because you get -- and the deals that people are really paying are very different than that because a lot of people, particularly in this country but also in several of other countries in the world, connect to a carrier plan. And of course, those offers are much more aggressive. And so the price that a customer is paying is probably the most important one.

The iPhone 12 is at $799, and so I think what you're saying is there's a $200 difference there. But I would guess that people are viewing it more as a $300 difference between the 12 mini and the 12 Pro. And so we'll see what the mix turns out. Right now, we have no data other than 12 and 12 Pro. We lack the data on the 12 mini and the Pro Max because we're not taking orders yet. But what we try to always do in pricing is give the customer a great value, and I feel like we really did that this year. And that's despite, as was mentioned earlier, all of the extra features that we placed into the phones, including 5G. Thanks for the question.

CHRISTOPHER CASO: All right. As a follow-up, the -- you mentioned some of the carrier incentives we've seen here in the U.S. And if you could provide some more color about that, about what you're seeing now. And obviously, as we went through years ago, the incentives from carriers were a lot larger. Does this mark some shift in the approach of carriers as we're moving into 5G? What's the extent of the permanence of some of these incentives? And then as 5G rolls out around the world into other geographies, is this something we should expect that as either they try to protect from switchers or kind of promote the 5G networks, we'll see a higher prevalence of incentives from carriers as we go forward?

TIMOTHY D. COOK: I don't want to speak for our carrier partners. That would be up to them to talk about their plans. Generally, I think it's, to the vast, vast majority of carriers around the world, to their -- in their interest to move customers to 5G, and I think it's in the customers' interest to move to 5G. And obviously, we like that as well. And so I think you have a situation where everyone's oaring in the same direction. And that's a very different kind of situation than normally we would have.

And so it is one of the things, as I alluded to earlier, that makes me very bullish, only one though -- the other things are very important, too, the size of the installed base, the product lineup. These things are critically important as well.

TEJAS GALA: Thank you, Chris. A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor and via telephone. The numbers for the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 9501153. These replays will be available by approximately 5:00 p.m. Pacific Time today. Members of the press with additional questions can contact Kristin Huguet at (408) 974-2414. Financial analysts can contact me with additional questions at (669) 227-2402. Thank you again for joining us.

OPERATOR: And again, that does conclude today's conference. Thank you all for joining us today.

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OPERATOR: Good day, everyone. Welcome to the Apple Inc. Second Quarter Fiscal Year 2020 **Earnings** 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 Mr. Tejas Gala, Senior Manager, Corporate Finance and Investor Relations. Please go ahead.

TEJAS GALA, IR CONTACT, APPLE INC.: Thank you. Good afternoon and thank you for joining us. Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation, and future business outlook including the potential impact of COVID-19 on the company's business and results of operations. Actual results or trends could differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed periodic reports on Form 10-K and Form 10-Q 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, CEO & DIRECTOR, APPLE INC.: Thanks, Tejas. Good afternoon, everyone. Thanks for joining us today. I hope you're staying safe and well. Today, Apple reports $58.3 billion in revenue, an all-time record for Services and a quarterly record for Wearables, Home and Accessories. It was also a quarterly revenue record for Apple retail powered by phenomenal growth in our online store. Amid the most challenging global environment in which we've ever operated our business, we're proud to say that Apple grew during the quarter.

But before we dive more deeply into the numbers, I want to speak just for a bit on COVID-19. This is something Apple has been contending with since January, and I think that how we have responded, what we have been inspired to do tells an important story about Apple's great durability as a business and the enduring importance of our products in our customers' lives. It also speaks to Apple's unmatched capacity to be creative, to think always in terms of the long term and to forge ahead when others may feel an instinct to pull back.

Before COVID-19 was on the horizon, we anticipated that Q2 was going to be a prolific and energetic period for Apple. And when the pandemic did strike, our teams not only succeeded in growing the business, in introducing powerful new products and in meeting our customers' needs, but they also rose to the occasion in terms of meeting our broader obligations to the communities in which we live and work.

Let's look quickly across the business. At the same time that they were leaving no stone unturned to get our latest generation of devices manufactured and into our customers' hands, our worldwide network of supply chain partners, logistics and operations folks in every part of the company were also sourcing more than 30 million masks for frontline medical workers, ensuring they're donated to places of greatest need in every region around the world. While our product teams were preparing to launch a new iPad Pro, Magic Keyboard, Macbook Air and the new iPhone SE, all of which have been very well received by reviewers and consumers alike, they were also working with our suppliers to design, test, manufacture and distribute more than 7.5 million face shields, and we continue to ship more than 1 million of these every week to the doctors, nurses and medical personnel on the front lines.

In a quarter where our Services teams achieved strong growth, which Luca will dig into in a minute and which speaks to the real durability of our Services strategy, these teams were also putting COVID-19 front and center.

As Apple News reached 125 million monthly active users, we elevated trusted information from reliable sources through a special COVID-19 vertical. We let customers skip payments without incurring interest on Apple Card for March and April in light of financial hardship for many families. We worked with everyone from Oprah to Lady Gaga to inform, entertain and give back through Apple TV. And Services like FaceTime and Messages set new all-time records for daily volume during this quarter as users rely on their devices to stay connected in a new reality.

In software, at the same time that our teams worked with great creativity and excitement as we prepared to deliver our first ever all-online Worldwide Developers Conference later this quarter, they also worked with the same creativity and speed to put together our COVID-19 symptom checking website and app in partnership with the CDC. As of today, the app has been installed nearly 2 million times, and the web tool has received over 3 million unique visits. And just this month, to accelerate contact tracing, we are launching a joint effort with Google to enable the use of Bluetooth technology to help governments and health agencies spread the -- reduce the spread of the virus with user privacy and security central to the design.

We paired these programmatic efforts with a broader strategy to give back where it's needed most. We've made major corporate donations to response efforts around the world to support Global Citizen as well as a new fund for Americans experiencing food and security as a result of the crisis. When you tally these things up and consider our ongoing 2:1 match for employee donations, Apple's contributions to the global response are significant, diverse and a great source of pride for the whole team.

We're also doing what we can to help our employees, their families and, by extension, their communities stay safe and well by modifying our operations where appropriate. This extends, of course, to our retail employees. They are Apple's face to our customers and an instrumental part of our business, and we're compensating them normally despite store closures. During a quarter where circumstances evolve by the hour, we have been gratified by the resilience and adaptability of our global supply chain. While we felt some temporary supply constraints in February, our operations team, suppliers and manufacturing partners have been safely returning to work, and production was back at typical levels toward the end of March.

At this time of social distance, of shuttered schools and gathering places, of delayed plans and new ways of socializing, we have seen significant evidence that our products have taken a renewed importance for customers. Teachers and students around the world are relying on our technology to teach, learn and stay connected with each other. We are in the process of deploying major orders of iPads to school systems working to keep learning going strong at a distance, including tens of thousands in Ontario, Canada; Glasgow, Scotland; and Puerto Rico; 100,000 to the city of Los Angeles; and 350,000 to New York City, our largest educational iPad deployment ever.

Since early March, we've seen unprecedented demand for our Pro apps from students, enthusiasts and creative professionals. These folks are keeping us all entertained and inspired as we stay at home, and to help them do it, we made Final Cut Pro X and Logic Pro X available for free for 90 days for everyone. And the reaction has been overwhelming, driving software downloads and usage to record levels.

And doctors and medical professionals are making even greater use of Apple Watch and other health features to communicate with patients and to treat them safely from a distance when necessary. With new FDA guidance on noninvasive remote patient monitoring, for example, the ECG app on Apple Watch is increasingly being used to facilitate remote ECG measurements and recordings for telemedicine usage, reducing patient and health care provider contact and exposure. Many hospitals, such as Geisinger Health System, NYU Langone Health and Stanford Health Care are using apps on iPad and iPhone to support communication and video conferences between hospitalized patients and their care teams. This enables the care teams to keep a close watch on patients without entering isolation rooms, which helps to minimize exposure and reduces some of the need for personal protective equipment.

Now when you step back and tally all this up, when you consider all the ways COVID-19 has touched Apple, our customers and the way we work, this may not have been the quarter it could have been absent this pandemic, but I don't think I can recall a quarter where I've been prouder of what we do or how we do it. As I said at the outset, we achieved revenue of $58.3 billion, and underneath that was product revenue of $45 billion. The performance of our product business had 3 very different phases during the March quarter. Based on Apple's performance during the first 5 weeks of the quarter, we were confident we were headed toward a record second quarter at the very high end of our expectations.

In the next 5 weeks of the quarter, as COVID-19 started impacting China, iPhone supply was temporarily affected as well as demand for our products within China. This caused us to withdraw our revenue guidance in February. At that point, demand for our products outside of China was still strong and in line with our expectations. During the last 3 weeks of the quarter, as the virus spread globally and social distancing measures were put in place worldwide, including the closure of all our retail stores outside of Greater China on March 13 and many channel partner points of sales around the world, we saw downward pressure on demand, particularly for iPhone and Wearables.

Given the lack of visibility and certainty in the near term, we will not be issuing guidance for the coming quarter. Over the long term though, we have a high degree of confidence in the enduring strength of our business. Our global supply chain is profoundly durable and resilient. We have shown the consistent ability to meet and manage temporary supply challenges like those caused by COVID-19. We have continued to deliver innovative new products across multiple categories that appeal to a broad cross-section of customers, including the all-new iPhone SE, which achieved unmatched technological capacity at an incredible value.

Our teams worldwide have tackled the complexities of this moment with unmatched creativity, good humor and dedication to our customers. For a company whose business is innovation, there are real upsides in periodically having to figure out how to do just about everything in a brand-new way. Our long-running investment in our Services strategy is succeeding. This business is growing and is a reflection of our enduring, large and growing installed base. We expect to meet our long-standing goal of doubling our fiscal 2016 Services revenue in 2020.

We have always run Apple for the long term. We entered this period with unmatched financial strength, a robust cash position and our best product pipeline ever. Major investments, including our 5-year commitment to contribute $350 billion to the economy here in the United States, are moving forward full speed ahead. It's in these moments that we set ourselves apart. We've always managed through difficult moments by doubling down and investing in the next generation of innovation, and that's our strategy today.

And so while we can't say for sure how many chapters are in this book, we can have confidence that the ending will be a good one. Apple will continue to do everything we can do to help the global response and to keep our customers learning, creating, sharing and connecting so that life can remain as normal as it can during this challenging time.

With that, I'll hand things off to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone. It has been a very different quarter than we were expecting when we last talked to you at the end of January. But we could not be more proud of our Apple teams around the world, our role in supporting local communities and our partners throughout the value chain and how resilient our business and financial performance has been during these challenging times.

Total revenue for the quarter was $58.3 billion, up 1% from a year ago despite the extreme circumstances from the impact of COVID-19 and a headwind of 100 basis points from foreign exchange. Products revenue was $45 billion, down 3%. After a very strong January, our performance was impacted, particularly during the last 3 weeks of the quarter when lockdowns and point-of-sale closures increased due to COVID-19 spreading around the world and affected our product sales. However, on a demand basis, our performance was stronger than our reported results as we reduced iPhone channel inventory more than we did a year ago. Importantly, our installed base of active devices reached an all-time high in all of our geographic segments and all major product categories.

Services revenue followed a different trend with very strong year-over-year growth of 17%. We set a new all-time revenue record of $13.3 billion with all-time records in many of our Services categories and in most countries we track. I'll provide more details on this later.

Company gross margin was 38.4%, flat sequentially with cost savings, a mix shift towards Services offset by the seasonal loss of leverage. Products gross margin was 30.3%, decreasing 380 basis points sequentially due to loss of leverage and unfavorable mix. This drop was more pronounced than under normal circumstances due to the COVID-19 impact I mentioned earlier.

Services gross margin was 65.4%, up 100 basis points sequentially driven by favorable mix. Our reported tax rate for the quarter was 14.4%. This was lower than our 16.5% guidance due to onetime discrete items. Net income was $11.2 billion and **earnings** per share were $2.55, up 4%. Operating cash flow was very strong at $13.3 billion, an improvement of $2.2 billion over a year ago.

Let me get into more detail for each of our revenue categories. iPhone revenue of $29 billion declined 7% year-over-year as both iPhone supply and demand were affected by the impact of COVID-19 at some point during the quarter. On the supply side, we suffered from some temporary supply shortages during February, but we've been extremely pleased with the resilience and adaptability of our global supply chain as well as its ability to get people back to work safely when circumstances allow.

 

Our operations team and manufacturing partners put forth an extraordinary effort to restore production quickly, and we exited the quarter in a good supply position for most of our product lines. On the demand side, after a very strong first 5 weeks, we saw the impact of COVID-19 affect demand in China for the next 5 weeks and then more broadly around the world for the last 3 weeks of the quarter when lockdowns and point-of-sale closures became more widespread in many countries.

While we did see a slight elongation in our replacement cycle towards the end of the quarter, which we attribute to the widespread point-of-sale closures, our active installed base of iPhones has reached an all-time high. This speaks to the quality of our products and strength of our ecosystem. In fact, in the U.S., the latest survey of consumers from 451 Research indicates iPhone customer satisfaction of 99% for iPhone 11, 11 Pro and 11 Pro Max combined.

Turning to Services. We set an all-time revenue record of $13.3 billion. We had strong performance across the board with all-time revenue records in the App Store, Apple Music, video, cloud services and our App Store Search Ad business. And we also set a March quarter record for Apple Care. Our new services, Apple TV+, Apple Arcade, Apple News+ and Apple Card, continue to add users, content and features while contributing to overall Services growth. As Tim mentioned, we're well on our way to accomplishing our goal of doubling our fiscal '16 Services revenue during 2020.

App Store revenue grew by strong double digits thanks to robust customer demand for both in-app purchases and subscriptions. Our third-party subscription business grew across multiple categories and increased over 30% year-over-year, reaching a new all-time high. Our first-party subscription services also continued to perform very well. Apple Music and cloud services both set all-time revenue records and Apple Care set a March quarter record. Paid subscriptions for all 3 of these services were up strong double digits.

Customer engagement in our ecosystem continues to grow strongly, and the number of both transacting and paid accounts on our digital content stores reached a new all-time high during the March quarter. In particular, the number of paid accounts increased double digits in all of our geographic segments. We now have over 515 million paid subscriptions across the services on our platform, up 125 million from a year ago. On a sequential basis, paid subscriptions grew by over 35 million. This is the highest sequential growth we have ever experienced. With this momentum, we are confident we will reach our increased target of 600 million paid subscriptions before the end of calendar 2020.

Wearables, Home and Accessories established a new March quarter record with revenue of $6.3 billion, up 23% year-over-year with strong double-digit performance across all 5 geographic segments. Our Wearables business is now the size of a Fortune 140 company, and we're very excited by the many opportunities in front of us for this product category. For example, Apple Watch continues to extend its reach at over 75% of the customers purchasing Apple Watch around the world during the quarter were new to the product.

Next, I'd like to talk about Mac and iPad. Mac revenue was $5.4 billion. iPad revenue was $4.4 billion. Towards the end of the quarter, we launched a brand-new iPad Pro that includes a first-in-class LiDAR scanner with some really exciting augmented reality applications and MacBook Air with significantly improved performance at a lower price. We're very pleased with the strong customer interest for both products.

Importantly, around half of the customers purchasing Macs and iPads around the world during the quarter were new to that product, and the active installed base for both Mac and iPad reached a new all-time high. And the most recent surveys of consumers from 451 Research measured customer satisfaction at 95% for iPad and 96% for Mac.

In the enterprise market, businesses everywhere have been making the transition to working remotely. We've created content to assist our customers in this transition, including an on-demand video learning series focused on topics like remote deployments of iPads and Macs and security. We have also realigned our own retail business and enterprise teams to provide timely and relevant support to customers as they navigate new work environments. Some of our largest customers offering Mac to employees, such as IBM and SAP, have been able to pivot quickly to allow employees to easily set up and secure their devices from home, benefiting from Apple Business Manager and zero-touch deployment. And we've seen countless examples of new projects and remote deployments implemented in just a few hours. Peloton, for instance, worked with our New York teams to deploy an entire fleet of Macs overnight so their team could work remotely.

In essential sectors such as grocery and financial services, we're seeing organizations adopt our technology to better serve their customers safely. Leading grocers around the world like Trader Joe's, Woolworths, Lawson, Sainsbury's, Lidl and Carrefour offer Apple Pay so customers can use contactless payments, and a store shift to become fulfillment centers for online orders, organizations are leveraging apps for remote shoppers and food delivery to reduce foot traffic.

In banking, where safety and security is a top priority, one way to protect company and client information is by providing corporate iOS devices to employees who use mobile phones daily as part of their jobs. As an example, Bank of America is purchasing tens of thousands of additional iOS devices for their workforce.

Let me now turn to our cash position. First, I want to note that liquidity has not been an issue for us during these highly unusual financial market conditions. We have an extraordinarily strong balance sheet, very deep access to capital markets and unmatched free cash flow generation. We ended the quarter with $193 billion in cash plus marketable securities, total debt of $110 billion, and as a result, net cash was $83 billion at the end of the quarter. We returned $22 billion to shareholders during the March quarter, including $18.5 billion through open market repurchases of 64.7 million Apple shares and $3.4 billion in dividends and equivalents.

Finally, as we move ahead into the June quarter, I'd like to provide some color on what we are seeing, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. As Tim mentioned, given the lack of visibility and certainty in the near term, we will not be issuing guidance for the coming quarter. However, based on what we have seen in April and how we think things might play out, I would like to provide some additional insight on headwinds and tailwinds we're facing.

From a foreign exchange standpoint, the U.S. dollar has appreciated recently against most currencies around the world, and as a result, we expect our revenue to be negatively impacted by more than $1.5 billion on a year-over-year basis. Our global supply chain is back up and running. We are in a typical supply position, including our usual ramp associated with new products recently launched. These newly launched products, iPad Pro, MacBook Air and iPhone SE have all received outstanding customer response even during these extreme circumstances.

On iPhone and Wearables, we expect the year-over-year revenue performance to worsen in the June quarter relative to the March quarter. On iPad and Mac, we expect the year-over-year revenue performance to improve in the June quarter. On Services, we are seeing 2 distinct trends. First, customers are actively engaging with our ecosystem and digital services, and we believe the very strong recent performance in the App Store, video, Music and cloud services will continue throughout the June quarter. Second, due to the overall reduced level of economic activity due to the lockdowns around the world, services like Apple Care and advertising have been impacted. Apple Care is comprised of our product repair business and the warranty agreements with our customers, both of which have been obviously affected by store closures and reduced level of customer traffic. Advertising, which is comprised of third-party agreements, our App Store search ads and Apple News ads has been impacted by overall economic weakness and uncertainty on when businesses will reopen.

For gross margin, sequential headwinds include foreign exchange, the mix within products and the seasonal loss of leverage on our product business. Foreign exchange will have a 70 basis points impact sequentially and 130 basis points impact year-over-year. Regarding product mix, keep in mind the commentary we provided at the revenue level. Sequential tailwinds include cost savings and the mix shift towards Services.

With regard to capital allocation, our approach remains unchanged. We continue to invest confidently in our future while also returning value to our shareholders. We are in the midst of developing our most exciting pipeline of products and services ever while contributing over $350 billion to the U.S. economy and expanding our footprint in many cities around the country over a 5-year period.

We also continue to believe that there is great value in our stock, and we are maintaining our target of reaching a net cash neutral position over time. As a testament to the confidence we have in our business today and into the future, our Board has authorized $50 billion for share repurchases in addition to the over $40 billion authorization remaining under the current share repurchase plan. Our Board has also authorized a 6% increase in our quarterly dividend and today declared a cash dividend of $0.82 per share of common stock payable on May 14, 2020, to shareholders of record as of May 11, 2020.

Finally and most importantly, we are managing Apple for the long term as we've always done. During uncertain times historically, we have continued to invest in the business, and this remains our philosophy. We will continue to stay focused on what we do best, investing in our product and service pipeline, managing the business wisely and taking care of our teams and believe we will come out from this stronger.

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

TEJAS GALA: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please?

 

Questions and Answers

OPERATOR: Yes. That will come from Shannon Cross, Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: I hope everyone is well. Tim, you talked about seeing some improvement in the second half of April. So I was wondering if you could just talk maybe a bit more on the segment and geographic basis what you're seeing in the various regions that you're selling in and what you're hearing from your customers. And then I have a follow-up.

TIMOTHY D. COOK: Sure, Shannon. If you look at -- I'll start with China. If you look at what happened in China, we were having a really good January. The lockdown started there toward the end of January as you know. February, we saw a steep decline in demand. We closed our stores in February. As the lockdown completed in mid-February toward the second half of February, we began to open stores. We opened them on a staggered basis. That took about 30 days until mid-March. And from a demand point of view, we saw an improvement in March over February. And if you look at kind of where we are today, we've seen further improvement in April as compared to March. And so that's China.

If you look at the rest of the world, we were doing great in January, the first 5 weeks of the quarter. And we do believe that we were headed toward the sort of the top end of our expectations that we had talked to you about on the last call, that the next 5 weeks were spent sort of reacting and getting the supply chain back up in full force and working through the sharp decline in China that I already talked about.

The real thing for the rest of the world happened in March when the shelter-in-place orders went in and the work from home began. For those 2-, 3-week period, at the end of the quarter, we saw a sharp decline in demand. If you now step out into April and look at that, early April started like the end of March, but in the second half of April, we've seen an uptick across -- really across the board. It's not just related to a certain geo or a certain product. We think, by looking at it, a part of it is due to just our new products. A part of it is due to the stimulus programs taking effect in April, and then a part of it is probably the consumer behavior of knowing this is going to go on for a little while longer and getting some devices and so forth lined up to work at home more.

In particular for, as I think Luca shared, we believe that iPad and Mac are going to improve on a year-over-year basis during this quarter. And that's customers that are either taking online education or working remotely. And so complex answer to your question but that's what we're seeing.

SHANNON SIEMSEN CROSS: That was helpful. Luca, unless I missed it, you talked about various puts and takes in the quarter but didn't really discuss operating expenses. I know you mentioned some cost savings on the COGS line. I'm curious how you're thinking about your spending in OpEx given some of the macro challenges that you may be facing.

LUCA MAESTRI: Yes. Well, Shannon, as we said, we manage the company for the long term, right? So we know that the core of the business, the core of the company is innovation and product and services development, so we will continue to invest in our pipeline. We're very excited about what we have in store, and so we will continue to invest there. Obviously, we are aware of the environment, and so we will manage the SG&A portion of the company tightly. We are making new investments in the new services that we launched recently. We -- as you know, we purchased the baseband activities from Intel, and obviously, we want to develop that technology because we consider it's a core technology for us. And so we will try to balance the need to continue to invest during difficult circumstances and the fact that we like to manage the business wisely.

OPERATOR: That will be from Wamsi Mohan with Bank of America.

WAMSI MOHAN, DIRECTOR, BOFA MERRILL LYNCH, RESEARCH DIVISION: Tim, I think I speak for everyone on the call that we're all very appreciative of Apple's contribution during this pandemic. We all appreciate it.

TIMOTHY D. COOK: Thank you very much for that.

WAMSI MOHAN: No, it's been great. Tim, in past downturns, we have not really seen Apple pull back from investing, and you as a company have largely maintained the product introduction cadence. But given these are unprecedented times and there are a lot of challenges associated with product development during a time when you have a global footprint for such activities and unable to really do a lot of things in person, how should we think about the product development and introduction cadence as we go over the next several quarters? And I have a follow-up.

 

TIMOTHY D. COOK: Well, we're continuing to operate. And so as you can tell, along with everything else going on, we were able to launch and ship the iPhone SE, the iPad Pro with the Magic Keyboard and the MacBook Air. And so business continues and the new products are our lifeblood. And so we're continuing to work. Everybody is getting used to the work at home. In some areas of the company, people may be even more productive. In some other areas, they're not as productive, and so it's mixed depending upon what the roles are. But as you can tell from what we did this quarter, despite the environment, we have our head down, are working because we know that our customers want the products that we've got. They are even more important in these times.

WAMSI MOHAN: As a follow-up, I know you're doing a lot with both the Apple Card and financing plan for iPhones to get your products in the hands of customers. But I was wondering, would you consider using the strength of your balance sheet maybe a little differently structured, maybe deferred payments or things like that? And -- or do you think that there could be other steps like bundling that you will consider versus what you already currently do?

TIMOTHY D. COOK: Well, as you know, we launched the payment plan earlier on Apple Card for iPhone. We're working on doing that for other products as well, and you'll see something on that shortly. So we're very focused on the affordability point. The trade-in programs also are fairly wide across the board and act as both something great for the environment, also something great from a way to get that entry price down.

In terms of deferred payments, nothing to announce today. But as you know, having access to the Card, at least in the United States, gives us more degrees of freedom, and that is not using our balance sheet. It's -- but we play a key role in deciding what kind of programs go with the Card.

OPERATOR: That will come from Morgan Stanley's Katy Huberty.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: I hope the whole team is staying healthy and safe. Tim, I want to start on a longer-term question. Where do you see structural changes on the back of this health crisis that might present opportunities for new revenue streams at Apple? And I'm particularly thinking about your past comments on health and augmented reality, but I'm sure there's even more areas of inspiration and creativity coming out of the company. And then I have a follow-up.

TIMOTHY D. COOK: I think there are things from just a great reminder of how important our products are and -- for remote work. And it's pretty clear to me that where things will get a lot closer to normal than they are today, obviously, I think many people are finding that they can learn remotely, and so I suspect that trend will accelerate some. I think that's probably also true about working remotely on -- in some areas and in some jobs. And so I think we have significant solutions and products for those -- for all of those groups.

On the health area, I gave some examples in my opening comments about the ECG being used on the Watch. You can bet that we're looking at other areas in this. We were already doing that because we've viewed that, that area was a huge opportunity for the company and a way for us to help a lot of people. And so you will see us continue on that. I wouldn't say that the health door opened wider. I would say it was already opened fairly wide.

KATHRYN LYNN HUBERTY: Okay. And then as a follow-up, the $50 billion share repurchase authorization is impressive in absolute terms, but it is a bit lower than the last couple of years. So just any context around the thought process of landing on $50 billion? And then related to that, you have one of the strongest balance sheets in the world. Does the current environment change your thinking at all around M&A opportunities?

LUCA MAESTRI: Well, let me answer that, Katy. First of all, on the buyback, as I said, in general, our approach to capital allocation has remained the same for the last several years, and it's not changing now. Keep in mind here, we're talking about just the authorization, right? And when you look at our actual results at the end of every quarter, you see how much we actually do in terms of share repurchases. The $50 billion is in addition to over $40 billion that is still remaining from the past authorization that we've received from our Board, right? So it's the total available or outstanding in terms of authorization is over $90 billion.

And as you look at our run rate during the last several years, you know that, that is a very adequate amount. And as you know, we will provide an additional update a year from now. So nothing really has changed there.

And nothing has changed on our approach for M&A. We've been quite active over the last several years. We purchase companies on a very regular basis. We're always looking for ways to accelerate our product road maps or fill gaps in our portfolio, both on the hardware side, on the software side, on the Services side. So we will continue to do that. And so also on the M&A front, nothing has changed.

OPERATOR: That will come from Amit Daryanani with Evercore.

 

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I have 2 as well. I guess, first off, on the channel inventory, I was hoping if you could talk about how did channel inventory look like in the March quarter because it sounds like it may be below the historical ranges. And then the discussion you had for June quarter performance of iPhones, what are you embedding from a channel building back inventory levels in that expectation?

TIMOTHY D. COOK: Amit, it's Tim. If you look at the iPhone channel inventory during Q2, the reduction of it was more than the reduction from the previous year. It's not unusual that we reduce in Q2, and in fact, if you look back on -- generally speaking, in the first half of the calendar year, we reduce channel inventories. During the second half of the calendar year, we generally raise channel inventories. That's a seasonal thing. And I believe -- sitting here today, I believe that will happen this year as well. So hopefully, that answers your question. And by the way, we ended in a comfortable position, so you could conclude from that, that we were within a target range.

AMIT JAWAHARLAZ DARYANANI: That's really helpful. And could I just follow up? Tim, I was hoping you could maybe talk a little bit about how do you think about Apple's manufacturing strategy and perhaps need for some diversity, especially given everything the company and everyone has gone through over the last 12 months. How do you think about that? And do you feel comfortable that the supply chain and the manufacturing base is well situated today to launch the traditional fall products that they used to get from Apple?

TIMOTHY D. COOK: Yes. As you know, our supply chain is global and so our products are truly made everywhere. And I would focus on that versus focus on one element of the manufacturing process, which tends to get more visibility, which is the final assembly. We have some final assembly in the United States. We have final assembly in China as well. I think you'd have to conclude or at least I conclude that if you look at the shock to the supply chain that took place this quarter, for it to come back up so quickly really demonstrates that it's durable and resilient. And so I feel good about where we are. That said, we're always looking at tweaks, and it's just not something we talk about because we view it as confidential and competitive information. And so we will look at the -- as we get out of this totally, we will look to see what we learned and what we should change.

OPERATOR: We'll hear from Jeriel Ong with Deutsche Bank.

KANGHUI ONG, RESEARCH ANALYST, DEUTSCHE BANK AG, RESEARCH DIVISION: So I want to focus the question on Services. The segment was solid in the quarter in spite overall macro weakness. I can kind of see launch behind it being strong despite product weakness overall. As you kind of look at the rest of the year, do you think that's sustained? Or at some point, does the macro impacts worldwide impact the Services line?

LUCA MAESTRI: Jeriel, let me take that one. We typically don't give a lot of specifics about our categories. But I've said, as we look into the June quarter, we see 2 distinct trends in our Services business overall. Our ecosystem is very strong. Our customers are very engaged. We are continuing to grow double digits the number of transacting accounts and paid accounts. And so we expect our digital services to continue at the same level of performance that we have seen during the March quarter. And that includes the App Store, of course, our video business, our Music business, cloud services, so we expect all these businesses to continue to grow very strongly.

Given the overall economic environment, the level of demand right now, there are 2 businesses that we believe are going to be impacted during the June quarter. One of them is Apple Care. Apple Care is essentially comprised of our product repair business and the warranty agreements that we signed with our customers when they purchased our devices. Both these businesses have been affected obviously by the store closures, not only our retail stores but also our partners' points of sale. And obviously, they reduced level of customer traffic because of the social distancing measures, right? And we do expect Apple Care to be affected during the June quarter.

The other business which we think is going to be impacted by the overall economic weakness and the uncertainty on when businesses will reopen is advertising, which is the sum of our advertising business on the App Store, on Apple News and the third-party agreements that we have on the advertising front. So these are 2 things that, during the June quarter, will create a headwind for the Services business.

KANGHUI ONG: Got it. Appreciate that. My second question comes about the overall purchasing decisions consumers are making. So far through April, have you seen increased perhaps downticks across your product line? So for example, somebody might have a shift maybe towards the lower end of the storage mix of certain products. And do you expect that going forward as unemployment uptick and macro impacts kind of layer on through rest of '20?

 

TIMOTHY D. COOK: I haven't seen what you're asking, no. I have seen a strong customer response to iPhone SE, which is our most affordable iPhone. But it appears that those customers are primarily coming from wanting a smaller form factor with the latest technology or coming over from Android. And so those are the 2 principal kind of segments versus somebody buying down as you're talking about it. We've also seen -- we launched the iPad Pro in the midst of all of this, and the reception there has also been incredibly good. And that's obviously our top-of-the-line iPad. And so I'm not seeing what you're alluding to at least at this point.

OPERATOR: That will be from JPMorgan's Samik Chatterjee.

SAMIK CHATTERJEE, ANALYST, JP MORGAN CHASE & CO, RESEARCH DIVISION: So if I can just start with a question on kind of what you're seeing in China, you mentioned kind of the pickup in activity. But is that driven by more kind of footfall in the stores or what you're seeing relative to online activity and how much of this recovery is driven online? Any thoughts on that, please?

TIMOTHY D. COOK: Yes. What we saw in China for the full quarter, and I'll speak about Mainland China because I think that's the source of your question, we saw strong results in iPad and in Wearables and in Services. And if you look up underneath the full quarter, we saw a strong January and then a significantly reduced demand in February as the shelter-in-place orders and the lockdowns went into effect in China and the stores closed. And then in March, as stores reopened, we -- the recovery began, and then we've seen further recovery in April. Where that goes, we will see, but that's kind of what we've seen so far there.

To your question about store traffic, store traffic is obviously up from where it was in February, but it is not back to where it was pre the lockdown. There has been, however, more move to online. And as I'd mentioned earlier in my remarks, the -- it's pretty phenomenal actually. Retail had a quarterly record for us during the quarter, and that's despite stores being closed for the 3-week period around the world ex China and then China was closed prior to that 3 weeks. And that's partly because the online store had such a phenomenal quarter, and that included in China but it was also other regions as well. So there is definitely a move. And whether that's a permanent shift, I would hesitate to go that far as I think people like to be out and about. They just know that now is not the time to do that.

SAMIK CHATTERJEE: Got it. And if I can just follow up on your previous comment about the strong demand you're seeing for iPhone SE, just given the price point, I'm wondering if you're expecting any change in terms of the geographic mix of where the demand comes from relative to typically what you see for other iPhones in the lineup just given the lower price point.

TIMOTHY D. COOK: I think it plays in every geo, but I would expect to see it doing even better in areas where the median incomes are less. And so we'll see how that plays out. And I expect some fair number of people switching over to iOS. And so it's an unbelievable offer. It's, if you will, the engine of our top phones in a very affordable package. And I think -- and it's faster than the fastest Android phones, and so it's an exceptional value.

OPERATOR: Our last question today will be from Chris Caso with Raymond James.

CHRISTOPHER CASO, RESEARCH ANALYST, RAYMOND JAMES & ASSOCIATES, INC., RESEARCH DIVISION: I wanted to follow up with another question on iPhone SE and the decision to bring it back and where it sits within the total iPhone strategy. And I guess coupled with the fact that iPhone 11, you made the decision to bring that at a lower price point, what does that tell us with respect to your approach to iPhone pricing and flexibility? Is this helping to add users and kind of bring people into the ecosystem? And if so, what does that imply for gross margins?

TIMOTHY D. COOK: Chris, we've always been about delivering the best product at a good price, and that fundamental strategy has not changed at all. As you know, we did have an SE for a while. It's great to bring it back. It was a beloved product, and so I wouldn't read anything into that other than we want to give people the best deal that we can while making the best product.

CHRISTOPHER CASO: Okay. As a follow-up, the follow-up question is on commodity pricing, and I think you had expected to see some commodity price declines through the March quarter. If you could talk about what you expect as you go through the year perhaps in this new environment and again, whether that turned into a tailwind or a headwind for gross margins as you go into the second half.

TIMOTHY D. COOK: Yes. For March, Chris, we saw NAND pricing increase slightly, while DRAM and displays and the other commodities declined. For the June quarter, we would expect NAND and DRAM pricing to remain at this historically low level, while displays and most other commodity prices, we expect to decline.

 

TEJAS GALA: Thank you, Chris. A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor and via telephone. The numbers for the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 3229513. These replays will be available by approximately 5:00 p.m. Pacific Time today. Members of the press with additional questions can contact Kristin Huguet at (408) 974-2414. Financial analysts can contact me with additional questions at (669) 227-2402. Thank you again for joining us.

OPERATOR: And that does conclude today's conference. Thank you all for joining us today.



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OPERATOR: Good day, everyone. Welcome to the Apple Inc. First Quarter Fiscal Year 2020 **Earnings** Conference Call. Today's conference is being recorded.

At this time, for opening remarks and introductions, I would like to turn the call over to Tejas Gala, Senior Analyst, Corporate Finance and Investor Relations. Please go ahead.

TEJAS GALA, IR CONTACT, APPLE INC.: Thank you. Good afternoon, and thank you for joining us. Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expenses, taxes, capital allocation and future business outlook. Actual results or trends could differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed periodic reports on Form 10-K and Form 10-Q and the Form 8-K filed with the SEC today along with the associated press release. Apple assumes no obligation to update any forward-looking statements or information, which speaks as of their respective dates.

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

TIMOTHY D. COOK, CEO & DIRECTOR, APPLE INC.: Thanks, Tejas. Good afternoon, and thanks to all of you for joining us.

We're thrilled to report Apple's biggest quarter ever, which set new all-time records in both revenue and **earnings**. We generated revenue of $91.8 billion, which is above the high end of our guidance range, with revenue growth accelerating for the third consecutive quarter. Geographically, we set all-time records in the Americas, Europe and rest of Asia Pacific and saw Greater China return to growth.

Our record performance was fueled by iPhone, where December quarter revenue was up 8% year-over-year and by our fifth consecutive quarter of double-digit growth outside of iPhone including a new all-time record for Services and another blowout quarter for Wearables. Our active installed base of devices has now surpassed 1.5 billion, up over 100 million in the last 12 months alone, reaching a new all-time high for each of our main product categories and geographic segments. Not only is our large and growing installed base a powerful testament to the satisfaction, engagement and loyalty of our customers but it's also fueling our growth across the board, particularly in Services.

Let's take each category one by one. On iPhone, revenue in the December quarter was $56 billion. Again, that's up 8% over a year ago, thanks to the exceptional demand for the iPhone 11, iPhone 11 Pro and iPhone 11 Pro Max. In fact, iPhone 11 was our top-selling model every week during the December quarter, and the 3 new models were our 3 most popular iPhones. We had double-digit growth in many developed markets, including the U.S., the U.K., France and Singapore and also grew double digits in emerging markets, led by strong performances in Brazil, Mainland China, India, Thailand and Turkey. These new models are, by far, the best iPhones we've ever shipped with advanced technologies, an unprecedented leap in battery life to easily get through the day and a best-in-class camera experience. We have been wowed with the photos customers have shared in our all-new Night mode photo challenge this month.

Turning to Services. Q1 revenue reached $12.7 billion, an all-time record, growing 17% over last year. Once again, we saw double-digit growth in all 5 of our geographic segments and established new all-time records for multiple categories including cloud services, music, payment services and our App Store search ad business as well as setting a December quarter record for the App Store and AppleCare. 2019 was a historic year for our Services business, and I'd like to touch on some highlights.

For the App Store, 2020 started off strong with customer spending a new single-day record $386 million on New Year's Day alone, a 20% increase over last year. Apple Arcade, our new game subscription service, has been fast off the blocks with a catalog of over 100 new and exclusive games you won't find anywhere else, all playable across Apple devices with new games and expansions added every month.

Apple TV+ is off to a rousing start, and I want to congratulate the entire team at The Morning Show for their multiple Golden Globe nominations: Jennifer Aniston on her Screen Actors Guild award; and Billy Crudup on his Critics' Choice Award. We continue to focus on telling stories that matter like Little America, which recently premiered to widespread critical acclaim with much more great content still to come.

Apple News now draws over 100 million monthly active users in the U.S., U.K., Australia and Canada and provides a curated and personalized experience using on-device intelligence to recommend stories. Apple News+ continues to add new titles, offering subscribers seamless access to the world's top publications across all of their devices.

For Apple Pay, revenue and transactions more than doubled year-over-year with a run rate exceeding 15 billion transactions a year. Apple Pay transit support expanded with customers paying for journeys on Transport for London more easily with Apple Pay Express Transit. And in spring of 2020, iPhone and Apple Watch customers will be able to simply tap to ride trains and buses in even more cities, including Shenzhen and Guangzhou.

We are thrilled with the continued growth of Apple Card, and last month, customers began using Apple Card monthly installments at Apple retail and online to purchase new iPhones and pay for them over 24 months. We see great promise for these recently launched services, and we're optimistic about what we've got in the pipeline for each of them.

Now turning to Wearables. We had another incredible quarter, setting an all-time record in virtually every market we track around the world, and this product category is now the size of a Fortune 150 company. Demand for AirPods continues to be phenomenal, particularly for our recently launched AirPods Pro, our new addition to the AirPods family that features active noise cancellation.

Apple Watch had a great start to fiscal 2020, setting an all-time revenue record during the quarter. It continues to have a profound impact on our customers' lives, and it continues to further its reach as over 75% of the customers purchasing Apple Watch during the quarter were new to Apple Watch. Both AirPods and Apple Watch were must-have holiday gifts, helping drive unprecedented results for the category even as we face supply constraints for Apple Watch Series 3 and AirPods Pro.

Mac and iPad generated $7.2 billion and $6 billion in revenue, respectively, and the high level of customer satisfaction and loyalty for both products drove the active installed base of both Mac and iPad to new records in all geographic segments. For iPad, we saw growth in key emerging markets like Mexico, India, Turkey, Poland, Thailand, Malaysia, the Philippines and Vietnam. With our current lineup of iPad Pro, iPad Air, iPad mini and iPad, along with the new iPadOS, we give customers an unparalleled tablet experience integrating hardware, software and services in a way that only Apple can.

This was also a very exciting quarter for the Mac as we launched our most powerful notebook ever, the 16-inch MacBook Pro as well as Mac Pro and Pro Display XDR, the most powerful tools Apple has ever put in the hands of pros. And we've already seen a strong response from the pro community from developers, photographers and music producers to filmmakers and scientists who rely on the Mac to create their life's best work.

We also want to take a moment to congratulate all the Grammy-winning and nominated artists this past weekend, who rely on Logic Pro X and their Mac to create incredible music we all love. I want to call out and celebrate the exceptional work of our retail and online teams. This quarter, we opened a beautiful new store in Kawasaki, Japan, and exciting things are taking place inside each and every store. Thanks in part to a doubling in iPhone trade-ins versus last year, our retail and online stores set an all-time record and delivered strong double-digit growth in iPhone. We see a very bright future for these efforts, and we continue to innovate to ensure that everyone who visits an Apple retail location has a great experience.

We began 2020 with our greatest product lineup ever, and we are only deepening our commitment to do our part to make the world a better place. In November, we released a completely redesigned Everyone Can Code curriculum to help introduce more elementary and middle school students to the world of coding. The new curriculum includes even more resources for teachers, a brand-new guide for students and updated Swift Coding

 

Club materials. Today, millions of students in more than 5,000 schools worldwide use Everyone Can Code curriculum to bring their ideas to life and develop important skills, including creativity, collaboration and problem-solving.

November also saw the launch of our new Research app, the latest in our ongoing effort to put the future of health in the hands of every user. Customers in the U.S. can enroll in 3 landmark multiyear health studies that we're undertaking with leading academic and research institutions: the Apple Women's Health Study, the Apple Heart and Movement Study and the Apple Hearing Study. As in everything we do, we built user privacy into the Research app from the ground up.

This quarter, we also announced a $2.5 billion plan to help address the housing availability and affording crisis in our home state of California. We feel a great responsibility to help the region we have always called home stay vibrant and to ensure that it remains a great place for everyone to live and raise a family, including those who do so much to serve the community like firefighters and teachers.

In much more recent news, we're closely following the development of the coronavirus. We're donating to groups that are working to contain the outbreak. We are working closely with our Apple team members and partners in the affected areas, and our thoughts are with all of those affected across the region.

As we close the books on a record-breaking December quarter, we are already well underway on some new and exciting developments for the future. Apple's strength will always be its balanced creativity and innovation, and this year will be no different.

But for now, for more details on the results, I'd like to turn the call over to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone.

Our business and financial performance in the December quarter were exceptional as we set new all-time records for revenue, net income and **earnings** per share. Revenue for the quarter was $91.8 billion, up $7.5 billion or 9% from a year ago in spite of a $1 billion headwind from foreign exchange.

Geographically, we established all-time revenue records in many major developed and emerging markets, including, among others, the U.S., Canada, Mexico, Brazil, the U.K., Germany, France, Italy, Spain, Poland, Thailand, Malaysia and Vietnam. Products revenue was $79.1 billion, up 8% as iPhone returned to growth, and we had incredibly strong results in Wearables, where we set all-time records for both Apple Watch and AirPods.

Services revenue grew 17% to a new all-time record $12.7 billion with double-digit growth in every geographic segment and new all-time records across our portfolio. Company gross margin was 38.4%, up 40 basis points sequentially, driven by leverage from higher revenue in spite of a negative 60 basis point impact from foreign exchange. Products gross margin was 34.2%, up 260 basis points sequentially, thanks to leverage and favorable mix. Services gross margin was 64.4%, up 30 basis points sequentially, driven by favorable mix.

Our reported tax rate for the quarter was 14.2%. Before discrete items, the rate was 16.5%, exactly in line with our guidance. A favorable onetime item impacted the rate by 230 basis points. Net income was an all-time record at $22.2 billion, up $2.3 billion or 11% over last year. Diluted EPS was also an all-time record at $4.99, up 19%, and operating cash flow was a very strong $30.5 billion, an improvement of $3.8 billion over a year ago.

Let me get into more detail for each of our revenue categories. iPhone revenue of $56 billion grew 8% year-over-year as we saw great customer response to the launch of our newest iPhones. We set all-time revenue records in several countries, including the U.S., Mexico, the U.K., France, Spain, Poland, Thailand, Malaysia and Vietnam. Our active installed base of iPhones has reached an all-time high and is growing in each of our geographic segments. In the U.S., the latest survey of consumers from 451 Research indicates iPhone customer satisfaction of 98% for iPhone 11, 11 Pro and 11 Pro Max combined. Among business buyers planning to purchase smartphones in the next quarter, 84% plan to purchase iPhones.

Turning to Services. We set an all-time revenue record of $12.7 billion with double-digit growth in all of our 5 geographic segments. As Tim mentioned, we established new all-time records for Apple Music, cloud services, payment services and our App Store search ad business and December quarter records for the App Store and AppleCare. We are well on our way to accomplishing our goal of doubling our fiscal year '16 services revenue during 2020. We've actually already reached that goal on a run rate basis with the results of the December quarter.

 

Customer engagement in our ecosystem continues to grow, and the number of both transacting and paid accounts on our digital content stores reached a new all-time high, with paid accounts growing double digits in all of our geographic segments. We now have over 480 million paid subscriptions across the services on our platform, up 120 million from a year ago. And at this point, we expect to hit our goal of surpassing the 500 million mark already during the March quarter. Given the tremendous momentum we are experiencing across our Services offerings, we are increasing our target for paid subscriptions and aim to reach 600 million before the end of calendar 2020.

App Store revenue grew strong double digits, thanks to robust customer demand for both in-app purchases and subscriptions. Our third-party subscription business grew across multiple categories and increased almost 40% year-over-year. Our first-party subscription services also continued to perform extremely well. Apple Music set an all-time revenue record, offering a catalog of over 60 million songs to our customers. iCloud also generated an all-time revenue record, growing very strong double digits while offering our customers a safe, secure and seamless experience across all their devices.

It was a December quarter record for AppleCare, thanks to strong service agreement attach rates and expanded distribution. Many of our partners have come to appreciate the strength of the AppleCare brand and our ability to deliver the very best service and support in the world. That value resonates with both our partners and our customers, and we're very happy to see that quality of experience delivered to more and more of our users.

Next, I'd like to talk about Mac and iPad. Mac revenue was $7.2 billion and iPad revenue was $6 billion. Both products had a difficult year-over-year comparison due to the launches of MacBook Air, Mac mini and iPad Pro during the December quarter a year ago and the subsequent channel fill. Despite the tough compare, on a demand basis, our performance for both Mac and iPad was around even to last year. Importantly, around half of the customers purchasing Macs and iPads around the world during the quarter were new to that product, and the active installed base for both Mac and iPad reached a new all-time high.

The most recent surveys from 451 Research measured a 93% customer satisfaction rating for iPad from consumers and 92% from businesses. And among both consumers and businesses who are planning to purchase tablets in the March quarter, 78% plan to purchase iPads.

Wearables, Home and Accessories established a new all-time record with revenue of $10 billion, up 37% year-over-year, with very strong double-digit performance across all 5 geographic segments and growth across Wearables, Accessories and Home. We set all-time records for Wearables in virtually every market we track even as we experienced some product shortages due to very strong customer demand for both Apple Watch and AirPods during the quarter.

We also continue to see strong demand for our products in the enterprise market as our technology solutions enable businesses to do their best work. 100% of Fortune 500 companies in the health care sector use Apple technology in areas such as patient experience, clinical communications and nursing workflows. And we're also seeing smaller companies in this sector drive innovation with our technology and apps.

One example is Gauss Surgical, which uses Core ML in iOS to more accurately estimate blood loss during childbirth and surgery. This helps clinicians have more complete and timely information on whether a patient needs an intervention, which can impact both clinical outcomes and costs.

Another example is Butterfly Network, a medical imaging company which makes a handheld ultrasound device that connects to iPhone or iPad to enable clinicians to take an ultrasound anywhere at a cost that is dramatically lower than other solutions on the market today.

Let me now turn to our cash positions. We ended the quarter with $207 billion in cash plus marketable securities. We issued a 2 billion euro-denominated green bond, retired $1 billion of maturing debt and reduced commercial paper by $1 billion during the quarter, leaving us with total debt of $108 billion. As a result, net cash was $99 billion at the end of the quarter, and we maintain our target of reaching a net cash neutral position over time.

We returned nearly $25 billion to shareholders during the December quarter. We began a $10 billion accelerated share repurchase program in November, resulting in initial delivery and retirement of 30.4 million shares. We also repurchased 40 million Apple shares for $10 billion through open market transactions, and we paid $3.5 billion in dividends and equivalents. As we have done for the last several years, we will share our plans for the next phase of our capital return program when we report results for the March quarter.

Finally, as we move ahead into the March quarter, I'd like to review our outlook, which includes the types of forward-looking information that Tejas referred to at the beginning of the call. We expect revenue to be between

 

$63 billion and $67 billion. The wider-than-usual revenue range comprehends uncertainty related to the recently unfolding public health situation in China. We expect gross margin to be between 38% and 39%. We expect OpEx to be between $9.6 billion and $9.7 billion. We expect OI&E to be about $250 million, and we expect the tax rate to be about 16.5%.

Also today, our Board of Directors has declared a cash dividend of $0.77 per share of common stock payable on February 13, 2020, to shareholders of record as of February 10, 2020.

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

TEJAS GALA: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please?

Questions and Answers

OPERATOR: Yes. That will be from Amit Daryanani with Evercore.

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I guess first one for me. On Wearables, fairly impressive to see it's already a $10 billion business for you guys. Can you just touch on the growth that you see on the Wearables side? How much of the growth do you think is coming from first-time buyers of AirPods or Apple Watch versus folks that seem to be just upgrading the products that they have? Because it looks to us adoption rates are fairly low in your installed base so there should be a long runway, but love to just understand how you see the growth divided between those 2 buckets.

TIMOTHY D. COOK: Yes. Amit, it's Tim. If you look at the Apple -- or the Wearables as a category within the Wearables, Home and Accessories revenue, Wearables grew 44%, so it was very strong, as you say. The -- both Apple Watch and AirPods did very well in terms of collecting new customers. Apple Watch, in particular, 75% of the customers are new to the Apple Watch, and so it's still very much selling to new customers at this point.

AMIT JAWAHARLAZ DARYANANI: Perfect. And I guess, Luca, if you could just touch on gross margins. The March quarter guide, I think, implies gross margins are flat to actually up 10, 15 basis points. It's rare for you guys to actually guide gross margins up in March, I think, because you have a fairly high seasonal sales deleverage happening. So what are the offsets that's enabling what looks like a better-than-seasonal guide for gross margins?

LUCA MAESTRI: Yes, that's right, Amit. It's about flat sequentially and, by the way, significantly higher on a year-over-year basis. But on a sequential basis, you're right. On one side, we got the loss of leverage from the usual seasonality, but we expect that, that loss of leverage will be offset by better mix and cost savings.

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

OPERATOR: That will come from Tom Forte with D.A. Davidson.

THOMAS FERRIS FORTE, MD & SENIOR RESEARCH ANALYST, D.A. DAVIDSON & CO., RESEARCH DIVISION: Great. So congrats on the launch of Apple TV+. I wanted to know internally how you are gauging success. Is it purely on critical acclaim? Is it on number of consumers that are using the service, contribution of service revenue, et cetera, et cetera?

TIMOTHY D. COOK: Tom, it's Tim. We are primarily measuring ourselves on the number of subscribers. As you can tell from the way that we launched the product, we started with a very aggressive price at $4.99. And in addition to that, we have our bundle, where if you buy pretty much any device, you're getting a year for free, and so we're very focused on subscribers. That said, our -- the product itself is about storytelling. And we think if we do that well, then we'll find that there will be some number of those that will also be critically acclaimed and we're seeing that with The Morning Show. We're seeing that with Little America and others.

THOMAS FERRIS FORTE: Great. And then my second question is, I think you indicated that last month, you started offering consumers the ability to use their Apple Card to buy an iPhone on an installment basis. Can you talk about how that's had an impact on your unit sales for iPhones?

TIMOTHY D. COOK: The retail stores did fantastic on iPhone, very strong double-digit growth in iPhone from a year-over-year point of view. And one of the factors that enabled that was the -- getting to monthly payments on the Apple Card to make it very simple. Of course, that's U.S.-only at this point, but the U.S. is a very key market for us. And so it was an important part of it.

 

TEJAS GALA: Thank you, Tom. Can we have the next question, please?

OPERATOR: That will come from Shannon Cross, Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: I wanted to go back to revisit China. Tim, can you talk about what you're seeing in the region -- what you were seeing in the region prior to the health crisis? And then can you also update us a bit in terms of your manufacturing strategy, dual sourcing, geographic diversification even within the region just so we have some idea of how this will be managed?

TIMOTHY D. COOK: Yes. Thanks, Shannon. In terms of China, the results from last quarter and then I'll get into the coronavirus second. For the results from last quarter, we had double-digit growth for iPhone in Mainland China, so that was an important change from where we had been running. We also had double-digit growth in Services in Mainland China, and we had extremely strong double-digit on Wearables. And so really, there were a number of different factors.

In terms of the things that customers are responding to, iPhone 11 is doing particularly well there. The product has been very well received with its battery life, and the camera is unbelievable. We also, as you probably know, have certain trade-in programs going and financing programs. These have also been well-received. And so it's sort of the sum of all of this, and we're attracting quite a large percentage of new customers on products like the Mac. 3/4 of the customers buying a Mac in China are new, and nearly 2/3 of the customers buying iPad are new. And so it was a terrific quarter. We had 3 of the top 4 selling smartphones in urban China according to Kantar.

In terms of the coronavirus, as I mentioned earlier, first and foremost, our thoughts are with all of those that are affected across the region. And as I've mentioned, we're donating to groups that are working to contain the outbreak. We're also working very closely with our team and our partners in the affected areas, and we have limited travel to business-critical situations as of last week. The situation is emerging, and we're still gathering lots of data points and monitoring it very closely. As Luca had mentioned, we have a wider-than-usual revenue range for the second quarter due to the greater uncertainty.

I'll talk about supply chain and customer demand some to give you some color. With respect to the supply chain, we do have some suppliers in the Wuhan area. All of these suppliers, there are alternate sources, and we're obviously working on mitigation plans to make up any expected production loss. We factored our best thinking in the guidance that we provided you.

With respect to supply sources that are outside the Wuhan area, the impact is less clear at this time. The reopening of those factories after Chinese New Year has been moved from the end of this month to February 10, depending upon the supplier location. And we've attempted to account for this delayed start-up through our larger range of outcomes that Luca mentioned earlier.

With respect to customer demand and sales, we've currently closed 1 of our retail stores, and a number of channel partners have also closed their storefronts. Many of the stores that remain open have also reduced operating hours. We're taking additional precautions and frequently deep cleaning our stores as well as conducting temperature checks for employees. While our sales within the Wuhan area itself are small, retail traffic has also been impacted outside of this area across the country in the last few days. And again, we have attempted to account for this in our guidance range that we've provided you. I hope that gives you some color.

SHANNON SIEMSEN CROSS: Yes, that was really helpful. Luca, maybe if you could just touch on, from a gross margin perspective, the commodity pricing environment and availability. Obviously, there's been some movement on DRAM and NAND. So if you can talk about how you're thinking about inventory levels and managing that going forward.

LUCA MAESTRI: Yes. As I said earlier to the question around the gross margin guidance for the March quarter, we are seeing a benign commodity environment. Most commodities have been declining during the December quarter, and we expect the same to happen in the March quarter. As always and as you probably know, we look at the way these prices move. And at times when we feel it's appropriate, we buy certain commodities in advance. And so we will continue that practice as we go through the year.

TEJAS GALA: Thank you, Shannon. Can we have the next question, please?

OPERATOR: That will come from Katy Huberty with Morgan Stanley.

 

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: Luca, can you address the modest slowdown in Services growth this quarter, 17% versus 18% in September? Which Services categories accelerated versus where did you see some deceleration in the growth?

LUCA MAESTRI: Katy, let me make a couple of comments here. The 17% during the December quarter, we look at it against our fiscal year '19 growth rate, which was 16%, so we feel very good about the results for the December quarter. As Tim and I mentioned during our prepared remarks, it was a very broad-based growth because we grew double digits in Services across all the 5 geographies. We set all-time records for many, many categories, music, cloud, search ads, payment services, December records for the App Store and AppleCare.

If you remember, we had set 2 goals for ourselves in the Services segment. First, we set a goal to double our fiscal '16 revenue during 2020, and when we look at it on a run rate basis, we've already achieved that goal with the results for the December quarter. We also set a goal to pass 500 million paid subscriptions during 2020. And given that we are already at 480 million at the end of December, we expect to pass that mark during the March quarter. And so now we are setting a new target for ourselves for paid subscriptions. And so we are now aiming to reach 600 million before the end of calendar 2020.

So we feel that the Services business is growing incredibly well. Of course, we have launched new services very recently. For example, Apple TV+ just launched in November. And so while these services did not have a material impact in our December quarter results, we expect that over time, these are contributing to the growth of the Services business. But we feel very happy with the 17%.

KATHRYN LYNN HUBERTY: Tim, as a follow-up, at some point in the future, Apple will launch a 5G iPhone. How big of a demand driver do you view 5G capability in a handset? And what's your view as to what the killer app will be from a consumer perspective?

TIMOTHY D. COOK: We don't comment on future products, and so I'll try to sidestep a bit. With respect to 5G, I think it's -- and we're in the early innings of its deployment on a global basis. We obviously couldn't be prouder of our lineup and is -- and are very excited about our pipeline as well and wouldn't trade our position for anybody.

OPERATOR: We'll hear from Kyle McNealy with Jefferies.

KYLE P. MCNEALY, EQUITY ANALYST, JEFFERIES LLC, RESEARCH DIVISION: So we're seeing some signs of new spectrum being deployed for 5G deployments and even additional 4G capacity, and it's already having a positive impact for handset upgrades to use that new capacity. Do you get the sense that wireless carriers are getting more incentivized to upgrade handsets to get leverage out of these new network investments? How much might this be helping? And do you think it will continue to accelerate?

TIMOTHY D. COOK: I think that we've had some great partners not only in the U.S. but also around the world that were really helpful this quarter as partners. And so I think that probably a part of that is the level of investments they have, and then a part of it is probably making sure that those customers stick with them in an environment where there's a lot of trading back and forth. So I'm optimistic that it will continue.

KYLE P. MCNEALY: Okay, great. And then the comment that you made about capacity in your Wearables division with AirPods Pro and Apple Watch 3, what should we think about the time line of when those capacity constraints might be alleviated? And will they come from capacity additions or the natural workout of kind of unit shipments and something on the demand side?

TIMOTHY D. COOK: I'm hopeful that the Series 3 will come into balance during this quarter. On AirPods Pro, I don't have an estimate for that for you. I just can't predict when at this point where -- we seem to be fairly substantially off there, and we're working very hard to put in additional capacity.

TEJAS GALA: Thanks, Kyle. Can we have the next question, please?

OPERATOR: Yes. Wamsi Mohan, Bank of America.

WAMSI MOHAN, DIRECTOR, BOFA MERRILL LYNCH, RESEARCH DIVISION: Tim, Apple has a very valuable installed base of users. Can you see a future where Apple can become larger in the advertising market as you build out TV+, given you could have the unique position and ability to drive targeted ads to users without compromising on privacy?

TIMOTHY D. COOK: I think it's -- I think it is possible to have advertising in a straightforward manner that doesn't encroach on people's privacy. I wouldn't want to conjecture about us in that business. I think for the TV+

 

business, we feel strongly that what that customer wants is an ad-free product, and so that's not our aversion to ads, it's what we believe that the customer wants.

WAMSI MOHAN: Okay. And Luca, can you just clarify if the Services revenue this quarter had any impact of deferrals associated with TV+ at all? And how can you help us maybe size the impact of the amortization of the content cost associated with TV+ as we think about the next couple of years?

LUCA MAESTRI: Yes. So yes, of course, we launched the service, and so there was a very small contribution to revenue from the deferral. And there was also a contribution to revenue from the people, the subscribers that are actually paying for the service. When you think about what goes into the Apple TV+ revenue, at this point, there are 2 components: the paid subscribers, these are the customers that pay for the service and we recognize revenue over the subscription period; and then we've got the what we call the Apple TV+ bundle subscribers, these are the customers that buy an eligible hardware device and redeem the offer for a free year of TV+ services. We defer revenue for this offer based on 3 items. The first one is the value of the service that is being provided, the 1-year of Apple TV+. The second one is the number of customers that are eligible for the offer, and the third one is our estimate of the expected number of customers that will redeem the offer. So you need to keep in mind that from our total eligible device sales, you need to make a number of reductions for family sharing, for multiple device purchases and for geographic availability. Also the take rate can also be impacted by the availability of local content, and we also require a payment method on file. So this estimate is reviewed quarterly and gets updated based on actual trends of the offer.

And so these inputs provide us with the amount of revenue that we defer for each device sale that then gets recognized over the 1-year period that the TV+ service is provided. And so when you take the combination of pay subscribers and bundled subscribers, you get the Apple TV+ revenue. Of course, because we launched the service very recently, the amount of revenue that we recognized during the quarter was immaterial to our results.

With regard to the cost of the service, of developing the content, we -- essentially, as we incur these costs, we put them on the balance sheet, and then we amortize them over a certain period of time depending on the type of content that we produce.

OPERATOR: We'll hear from Cowen and Company's Krish Sankar.

KRISH SANKAR, MD & SENIOR RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: Congrats on the great results. I had 2 questions. First one, Tim, I just wanted to pick your brain a little bit on the overall smartphone market. There's a general view that when 5G phones come out, they're going to be more expensive due to higher component costs. But at the same time, it looks like you guys have proven that there is a market for low-cost geographies with phones like iPhone SE. So how do you see these 2 different segments within the smartphone market evolving over the next 1 to 3 years? And then I have a follow-up for Luca.

TIMOTHY D. COOK: Again, I want to stay away from commenting about future products. But generally, I think it's important when you think about 5G is to look around the world at the different deployment schedules. And some of those look very different perhaps than what you might be seeing here. And so that's very important. In terms of the price, I wouldn't want to comment on the price of handsets that aren't announced.

KRISH SANKAR: Got it. No worries, Tim. And then a follow-up for Luca. OpEx as a percentage of sales for March looks like about 15% higher than in your prior quarters. Kind of curious, how much of that, as part of it, is driven by some of your Intel modem asset purchases or TV+ in the OpEx? Or how do we think about it on a go-forward basis?

LUCA MAESTRI: Yes. I think we felt good about our OpEx results because they were at the low end of our guidance range. But clearly, we want to make all the necessary investments in the business. And from -- in terms of the new services, not only for TV+ but all the new services that we launched during 2019, this is a period where we're making the necessary investments in advertising and marketing, and that level of investment is reflected in our OpEx results.

And also, as you correctly stated, we completed the acquisition of the Intel baseband business during the December quarter. And so we had -- we reflected the run rate of the expenses related to that business partially during the quarter after the completion of the transaction. And we -- that is a very important core technology for the company, so we will continue to make all the necessary investments also there. There is a third category of expenses that affected the December quarter and is the fact that our revenue was very strong, and we have certain variable expenses, for example, credit card fees that are associated with higher volume and, of course, impacted our OpEx results.

 

TEJAS GALA: Thanks, Krish. Can we have the next question, please?

OPERATOR: That will be from Mike Olson with Piper Sandler.

MICHAEL JOSEPH OLSON, MD & SENIOR RESEARCH ANALYST, PIPER SANDLER & CO., RESEARCH DIVISION: So a slightly different take on an earlier question on Wearables, and that is, what impact do you think Wearables is having on driving people into the Apple ecosystem? You mentioned 75% of watch buyers are new to the Apple Watch, but are many of them new to Apple overall? I'm sure a lot of existing iPhone, iPad or Mac users are going to be Wearables customers, but do you think Wearables bring people into the ecosystem to buy other devices in a material way?

TIMOTHY D. COOK: I think that -- Michael, it's Tim. With each Apple product that a customer buys, I think they get tighter into the ecosystem because they like -- that's the reason that they're buying into it, is they like the experience, the customer experience. And so from that point of view, I think each of our products can drive another product. I would think in that case, it's more likely that the iPhone comes first, but there's no doubt in my mind that there's some people that came into the ecosystem for the Watch.

MICHAEL JOSEPH OLSON: Yes. And then I think you recently mentioned that augmented reality will pervade our entire lives. And I'm wondering if you could share your thoughts about how you think it starts to impact our lives most significantly. For example, will the inflection point in AR come from gaming or industrial usage or some other category? In other words, where will the average person kind of first feel the impact of AR on their lives in a significant way?

TIMOTHY D. COOK: I think when you look at AR today, you would see that there are consumer applications, there are enterprise applications. This is the reason I'm so excited about it, is you rarely have a new technology where business and consumer are both -- most see it as key to them. And so I think it's -- the answer is that that's the reason that I think it's going to pervade your life, is because it's going to go across both business and your home life. And I think these things will happen in parallel. There are already companies that are deep into the enterprise business that are working on applications for the enterprise. And of course, you can see -- you can go on the store and see thousands of apps that are ARKit-enabled at this time and with even more coming.

TEJAS GALA: Thank you, Mike. Can we have the next question, please?

OPERATOR: That will come from Raymond James' Chris Caso.

CHRISTOPHER CASO, RESEARCH ANALYST, RAYMOND JAMES & ASSOCIATES, INC., RESEARCH DIVISION: I guess the first question is on gross margins, and you spoke about the favorable mix. Wondering if you could expand on that a little bit. And clearly, iPhone is doing well within the overall mix, growing year-on-year. But if you could talk about what's happening to the mix within iPhone. Is that improving as well and also helping margins? And is there anything else you would point to with regard to the overall mix in margins?

LUCA MAESTRI: Yes. I think that the mix helped us both in Q1, and it's helping us with the guidance for Q2. And as you said, some of it is mix of iPhones. The customer response for iPhone 11, 11 Pro and 11 Pro Max has been exceptional, and that clearly has helped our mix. iPhone 11 was our top-selling model throughout the quarter, every single week of the quarter. And so certainly, better mix within iPhone.

The other point that I'd like to point out is that as we move from Q1 to Q2, the proportion of revenue coming from Services increases versus the holiday quarter. And given the fact that Services are accretive to gross margin for the company, we end up getting a better mix from Services as well.

CHRISTOPHER CASO: Okay. And I guess a follow-on question with regard to OpEx, and it has been growing at a faster rate than revenue for, I guess, largely over the last 3 years or so. Can you set us some expectation with regard to when you get a return on that investment? I understand there are new investments that are happening now. But how should we think about potential leverage going forward? Is there a point in time where the OpEx spending tend to level off and you get some return on that? Or is it just a function of faster revenue growth in the future?

LUCA MAESTRI: Well, I would start by saying that our expense to revenue ratio is incredibly competitive relative to other companies in our sector. There are years when our OpEx grows faster than our revenue, but we've also had years in the recent past where the opposite has happened. We continue to believe that we have a lot of great opportunities in front of us. And just if you look at this past year, we launched many new initiatives, for example, on the Services front, which we want to support with the appropriate level of investment, not only marketing and advertising but also in R&D.

As I mentioned earlier, we closed the acquisition of the Intel baseband business because we think it's a very important strategic core technology for the company going forward. And I think from the results that you've seen during this quarter and the guidance that we provided during -- for the March quarter, I think we're doing a pretty good job at balancing the level of investments that we are making on the expense front with the level of returns that we get, both in terms of revenue and in terms of profitability that we're getting. Our net income, for example, was up 11% during the December quarter.

TEJAS GALA: Thank you. Can we have the next question, please?

OPERATOR: That will come from Samik Chatterjee with JPMorgan.

SAMIK CHATTERJEE, ANALYST, JP MORGAN CHASE & CO, RESEARCH DIVISION: Just wanted to kind of ask on the iPhone revenue growth and definitely good to see it return to growth. Based on the velocity or momentum you're seeing for the products exiting the quarter, how comfortable are you feeling about sustaining growth in iPhone revenues through the year? And I have a follow-up.

TIMOTHY D. COOK: We have a practice of forecasting the current quarter, and so we've given you the range that we expect for the current quarter and really don't give a range beyond that.

SAMIK CHATTERJEE: Okay. So if I can just maybe then follow up in terms of, obviously, you've returned to growth in most of the regions you report. One of the regions that are declining is Japan, so if you can share your thoughts on what actions you need to take there to return that segment -- that geography to growth. And what are the product trends there? What's probably the headwind that's kind of limiting growth there?

LUCA MAESTRI: Yes. So Japan was down 10% during the December quarter, was primarily due to iPhone performance, which was challenged because there were some regulatory changes that took effect on the 1st of October, where essentially, the regulators decoupled the mobile phone pricing from the 2-year contracts and are capping the maximum amount of carrier discounts that can be made. At the same time, I would say, within a more difficult macro environment, iPhone did incredibly well during the quarter. 6 of the top 7 selling smartphone models in Japan during the December quarter were iPhones. So it was a very strong performance by iPhone in a difficult environment.

Also, in Japan, we had very strong double-digit growth from Services, stronger than company average, and very strong double-digit growth in Wearables, also stronger than company average. So we feel very good. Japan is a country where it's starting to -- we've had great success. The customers are very loyal and very engaged, and we have a very strong position there, and we feel we have a very good momentum.

TEJAS GALA: Thank you, Samik. A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor and via telephone. The numbers for the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 6826206. These replays will be available by approximately 5 p.m. Pacific Time today. Members of the press with additional questions can contact Kristin Huguet at (408) 974-2414. Financial analysts can contact me with additional questions at (669) 227-2402. Thank you again for joining us.

OPERATOR: Again, that will conclude today's conference. Thank you all for your participation.

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Presentation

OPERATOR: Good day and welcome to the Apple Inc. Third Quarter Fiscal Year 2019 Earnings 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, DIRECTOR-IR, APPLE INC.: Thank you. Good afternoon and thanks to everyone for joining us today. Speaking first is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri and after that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook. Actual results or trends could differ materially from our forecast.

For more information, please refer to the risk factors discussed in Apple's most recently filed periodic reports on Form 10-K and Form 10-Q 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, CEO & DIRECTOR, APPLE INC.: Thank you, Nancy. Good afternoon, and thanks to all of you for joining us today. We're thrilled to report a return to growth and a new June quarter revenue record of $53.8 billion. We saw significant improvement in year-over-year iPhone performance compared to last quarter, very strong performances for both Mac and iPad and absolutely blowout quarter for Wearables, where we had accelerating growth of well over 50% and a new high watermark for services where we set an all-time revenue record of $11.5 billion. When you step back and consider Wearables and Services together, 2 areas where we have strategically invested in the last several years, they now approach the size of a Fortune 50 company.

Geographically, we're happy with our performance across the board, including a return to growth in Mainland China. We accomplished these results despite strong headwinds from foreign exchange, which impacted our top line growth rate by 300 basis points compared to a year ago. That's equivalent to about $1.5 billion of revenue.

Importantly, in constant currency, our revenue grew in all 5 of our geographic segments. For iPhone, we generated $26 billion in revenue. While this is down 12% from last year's June quarter, it is a significant improvement to the 17% year-over-year decline in Q2. We're encouraged by the results we're seeing from the initiatives that we spoke about in January, including strong customer response to our in-store, trade-in and financing programs. In fact, iPhone in our retail and online stores returned to growth on a year-over-year basis in the month of June. Our active installed base of iPhone reached a new all-time high and was up year-over-year in each of our top 20 markets, underscoring the quality of our products and the satisfaction and loyalty of iPhone customers around the world.

Revenue, excluding iPhone, was up 17% from last year with growth across all categories. Starting with Services. We generated all-time record revenue of $11.5 billion. That's up 13% year-over-year, and if we exclude the $236 million favorable onetime item from the June quarter last year, Services growth was 15% or 18% in constant currency, which is consistent with our Q2 performance.

Our strong Services performance was broad-based. We set new all-time records for AppleCare, Music, cloud services and our App Store search ad business, and we achieved a new third quarter revenue record for the App Store. What's more, we had double-digit services revenue growth in all 5 of our geographic segments. We surpassed 420 million paid subscriptions to services across our platform, and we remain on track to double our fiscal year '16 services revenue in 2020.

In May, we launched our all-new Apple TV app in over 100 countries, bringing together all the ways to watch TV in a single app across iPhone, iPad, Apple TV and select smart TVs. Monthly viewers in the Apple TV app in the United States are up over 40% year-over-year. We've seen our success being driven here by several factors: First, the fact that we have been able to integrate content from over 150 leading content providers all in one place; second, the same ease of use and unmatched user interface that sets Apple apart in other categories sets us apart in TV as well; and third, we're benefiting from a broader secular move to over-the-top services.

We're engaging with this third trend in 5 ways: Our Apple TV hardware; Apple TV Channels, where customers can choose to pay only for the channels they want; our massive library of over 100,000 iTunes movies and TV shows; the App Store, where users can find their favorite streaming services; and later this year, our original programming service, Apple TV+.

Apple Pay is now completing nearly 1 billion transactions per month, more than twice the volume of a year ago. Apple Pay launched in 17 countries in the June quarter, completing our coverage in the European Union and bringing us to a total of 47 markets currently. Based on June quarter performance, Apple Pay is now adding more new users than PayPal and monthly transaction volume is growing 4x as fast.

In the United States, in addition to a successful integration into Portland's transit system in May, we're beginning the rollout of New York City transit and will launch in Chicago later this year. In China, Apple Pay launched the payment card for DiDi, the world's largest ride-hailing provider. As I've said before, transit integration is a major driver of a broader digital wallet adoption, and we're going to keep up this push to help users leave their wallet at home in more and more instances. On a related note, thousands of Apple employees are using Apple Card every day in our beta test, and we plan to begin the rollout of Apple Card in August.

As I mentioned at the outset, it was another sensational quarter for Wearables with growth accelerating to well over 50%. We had great results for Apple Watch, which set a new June quarter revenue record and is reaching millions of new users. Over 75% of customers buying Apple Watch in the June quarter were buying their first Apple Watch. We continue to see phenomenal demand for AirPods. And when you tally up the last 4 quarters, our Wearables business is now bigger than 60% of the companies in the Fortune 500.

We had great performance from iPad with revenue of over $5 billion and growth driven by iPad Pro and by strong customer response to the new iPad mini and iPad Air. This was our third consecutive quarter of growth and with revenue up 15% year-to-date, we feel great about where we're headed with iPad. With our current lineup of iPad, iPad mini, iPad Air and iPad Pro, we've got the perfect device for everyone from young learners to professionals.

We were also very happy with double-digit revenue growth from Mac, fueled by a strong performance of Macbook Air and MacBook Pro. Looking forward, there's an enormous amount to be excited about for Mac. On the heels of our Mac mini and iMac updates earlier in the fiscal year, we brought significant updates to the bulk of our notebook lineup in the last couple of months. We now have a $999 MacBook Air that is killer for college students, and for our Pro users who push the limits of what a Mac can do, we were thrilled to unveil the most powerful Mac ever, the new Mac Pro and the all-new Pro Display XDR, which will be available this fall.

They're designed for maximum performance, expansion and configurability and at breakthrough pricing, and they're the most powerful tools Apple has ever put in the hands of Pro customers. What's more, the Mac ecosystem as a whole is about to get a big boost. At our recent Worldwide Developers Conference, we announced a game-changing tool to help developers easily adapt their iOS and iPadOS apps for the Mac. I'll have a bit more to say on that in a moment.

I'd like to provide some color on our performance in Greater China, where we saw significant improvement compared to the first half of fiscal 2019 and returned to growth in constant currency. We experienced noticeably better year-over-year comparisons for our iPhone business there than we saw in the last 2 quarters, and we had sequential improvement in the performance of every category. The combined effects of government stimulus, consumer response to trade-in programs, financing offers and other sales initiatives and growing engagement with the broader Apple ecosystem had a positive effect. We were especially pleased with the double-digit increase in Services driven by strong growth from the App Store in China.

Turning to the future. Last week, we announced an agreement with Intel to acquire the majority of its smartphone modem business. This is our second largest acquisition by dollars and our largest ever in terms of staff. We're looking forward to welcoming all of them to Apple. We see this as a great opportunity to work with some of the leading talents in this field, to grow our portfolio of wireless technology patents to over 17,000, to expedite our development of our future products and to further our long-term strategy of owning and controlling the primary technologies behind the products that we make.

We also had our best WWDC ever last month, packed with announcements of great new features coming this fall across our 4 software platforms, making them more powerful, more personal and more private. For iPhone users, iOS 13 will take on a dramatic new look with dark mode, on delivering major updates to the apps you use every day, including Photos, Camera and Maps, iOS 13 offers great new ways to help you manage your privacy and security, including Sign-on with Apple, which uses Face ID or Touch ID to quickly sign into apps and websites without sharing your personal information. And improvements across the entire system will make iPhone even faster and more delightful to use than ever before.

For the first time, iPad is getting its own version of iOS called iPadOS, a strategic step forward that takes the iPad experience to a whole new level. The redesigned home screen, powerful new multitasking tools and deeper integration with Apple Pencil take productivity and creativity further, including using your iPad as an extended and interactive second monitor for your Mac.

For Apple TV, tvOS 13 will make the big-screen experience even more personal. With a redesigned home screen and multi-user support, everyone in the family can get a more engaging and tailored experience with their favorite TV shows, movies, sports and news, along with Apple Music, photos and videos in iCloud and an App Store with thousands of great games and apps.

watchOS 6 is a major step forward in helping Apple Watch users stay healthy, active and connected. Apple Watch now has a dedicated App Store that users can access directly from the device and new watch faces, Siri enhancements, and music and audio features make Apple Watch more useful than ever.

And of course, we continue to innovate on Apple Watch's promise to be an intelligent guardian for your health. watchOS 6 includes powerful new features like notifications that warn about high decibel noise to protect your hearing and cycle tracking to aid in women's health care decisions. In the June quarter, we expanded the availability of the ECG app and regular rhythm notifications to 5 additional European countries and added Canada and Singapore just last week, making them available in 31 countries and regions around the world with more to come later this year. We're very proud of the muscle we've built in bringing regulated products like these to market. This is an important competency that creates exciting opportunities for us moving forward.

As I noted earlier, we believe macOS Catalina will be a breakthrough in the Mac ecosystem. A new tool included in macOS Catalina called Mac Catalyst gives developers a major head start in bringing their iOS apps to the Mac. Thousands of developers are already using it to bring their apps to the Mac ecosystem, and we expect to see a wave of popular apps arriving for the Mac as early as this fall.

Again, it's worth taking a step back and digesting the bigger picture here. These updates are the latest steps in a broader strategic effort to make the user experience across iOS, macOS, iPadOS, watchOS and tvOS more effortless and more intuitive. Apple is alone in offering this kind of value and ecosystem to its customers, and these devices and their platforms are unmatched in their ease of use, their seamlessness and their privacy and security. And while providing these things, we've created a dynamic environment where our developers benefit greatly from creating for and distributing on these platforms. And our customers, of course, benefit greatly from access to all of this creativity and innovation.

We also unveiled other exciting technologies to make it easier and faster for developers to create powerful new apps. Swift UI provides an intuitive new framework for building sophisticated user interfaces across our software platforms using simple, easy-to-use code. Core ML 3 supports the acceleration of more types of advanced real-time machine learning models and Create ML lets developers build machine learning models without writing code.

We have the world's largest augmented reality-enabled platform and thousands of ARKit-enabled applications in the App Store. Building on this strategy and our momentum in this area, we introduced 3 new AR-based technologies: ARKit 3 uses on-device, real-time machine learning to recognize the human form and integrates people seamlessly into AR experiences; Reality Kit is a new developer framework built from the ground up to provide all the tools and technologies required to make AR objects virtually lifelike; and Reality Composer brings AR content creation to tens of millions of developers who had no 3D experience. Our developers are already running with these new technologies, and we think our customers are going to love some of the apps that these creators have in store in the months ahead.

On so many fronts, there's an enormous amount to look forward to over the next few months, including the launch of new services like Apple Arcade, Apple TV+ and Apple Card. And without giving too much away, we have several new products that we can't wait to share with you. Until then, thanks for joining us today, and for more details on the June quarter results, I'll turn the call over to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone. We're happy to report a June quarter revenue record of $53.8 billion, up 1% year-over-year. We returned to growth in spite of a difficult foreign exchange environment around the world, which impacted our year-over-year growth rate by 300 basis points. We set June quarter revenue records in the Americas, in Japan and the rest of Asia Pacific, and as Tim mentioned earlier, all our geographic segments grew in constant currency.

Overall products revenue was $42.4 billion, down 2% year-over-year, which is significantly better than the 8% decline in products revenue that we experienced during the first half of the fiscal year. Product categories outside of iPhone grew 20% with strong results in Wearables, Mac and iPad. Services revenue grew 13% to a new all-time record of $11.5 billion. Excluding the onetime item we highlighted a year ago in connection with the final resolution of various lawsuits, Services revenue growth was 15% and 18% in constant currency terms.

On a geographic basis, we saw marked improvement in our year-over-year comparisons from emerging markets relative to the first half of this fiscal year, particularly in the BRIC countries where year-over-year performance went from a 25% revenue decline in the first half to 3% growth in the June quarter. We set June quarter revenue records in several major developed markets, including the U.S., Canada, Germany, France, Japan, Australia and Korea. In emerging markets, we returned to growth in Mainland China, grew strong double digits in India and in Brazil, and we set new Q3 records in Thailand, Vietnam and the Philippines.

Company gross margin was 37.6%, flat sequentially and in line with our guidance. Products gross margin was 30.4%, down about 80 basis points sequentially due to seasonal loss of leverage and product mix, partially offset by favorable costs. Services gross margin was 64.1%, up 30 basis points sequentially primarily due to a favorable mix. Net income was $10 billion, diluted **earnings** per share were $2.18 and operating cash flow was $11.6 billion.

Let me get into more detail for each of our revenue categories. iPhone revenue was $26 billion, down 12% compared to a year ago. This was significantly better year-over-year performance than last quarter's 17% decline with sequential improvement in year-over-year comparisons in 15 of our top 20 markets. Our active installed base of iPhone continued to grow to a new all-time high in each of our geographic segments. And in the U.S., the latest survey of consumers from 451 Research indicates iPhone customer satisfaction of 99% for iPhone XR, iPhone XS and XS Max combined. Among business buyers who plan to purchase smartphones in the September quarter, 83% plan to purchase iPhones.

Turning to Services. We reached an all-time revenue record in spite of foreign exchange headwinds with double-digit growth from the App Store, Apple Music, cloud services and AppleCare and triple-digit growth from Apple Pay and our App Store search ad business. All geographic segments had double-digit growth in Services revenue and set new June quarter records with all-time records in the Americas and rest of Asia Pacific. In total, Services accounted for 21% of Apple revenue and 36% of gross margin dollars.

Customer engagement in our ecosystem continues to grow. The number of transacting accounts on our digital content stores reached a new all-time high in the June quarter, and the number of paid accounts grew strong double digits compared to last year. We now have over 420 million paid subscriptions across the services on our platforms, and we are well on our way to our goal of surpassing the 500 million mark during 2020.

On the App Store, our growth accelerated sequentially. Our subscription business continues to grow strongly and is extremely diversified across many categories such as entertainment, lifestyle, photo and video and music. Third-party subscription revenue grew by over 40%, and across all third-party subscription apps, the largest accounted for only 0.25% of total Services revenue.

Among our many Services records, it was our best quarter ever for AppleCare. We are seeing an increase in service contract attach rates and our expanding distribution of AppleCare through our partners. We also recently expanded our authorized service provider network, and nearly 1,000 Best Buy stores across the U.S. are now offering expert service and repairs for Apple's products. This expansion provides customers with an even more convenient access to repairs using parts certified for safety, quality and reliability. In addition to Apple retail stores, there are over 1,800 third-party Apple Authorized Service Providers in the U.S., which is 3x as many locations as 3 years ago.

Next, I'd like to talk about the Mac. Revenue was $5.8 billion, up 11% compared to last year. Mac revenue grew in 4 of our 5 geographic segments and set June quarter records in the U.S., Europe and Japan as our overall market performance significantly outpaced the global PC industry. Nearly half of the customers purchasing Macs during the quarter were new to Mac, with revenue growing in both developed and emerging markets and the active installed base of Macs again reached a new all-time high.

We also had great results for iPad with $5 billion in revenue, up 8%. iPad revenue grew in all 5 of our geographic segments with a Q3 revenue record in Mainland China and double-digit growth in emerging markets. In total, over half of the customers purchasing iPads during the June quarter were new to iPad, and the iPad active installed base also reached a new all-time high. The most recent surveys from 451 Research measured a 94% customer satisfaction rating for iPad from consumers and among business customers who plan to purchase tablets in the September quarter, 75% plan to purchase iPads.

Wearables, Home and Accessories revenue accelerated across all our geographic segments, growing 48% to over $5.5 billion and setting a June quarter record. This growth was fueled primarily by the strong performance of our Wearables business, which was up well over 50% and has become the size of a Fortune 200 company over the last 12 months. In addition, we generated double-digit revenue growth from AppleTV and accessories during the quarter.

Our retail and online stores produced their best June quarter revenue ever with double-digit revenue growth across Apple Watch, iPad, Mac and accessories. Our trade-in program is showing great momentum with more than 5x the number of iPhones traded in compared to a year ago. We opened stunning new stores in the Carnegie Library in Washington, D.C. and the busy Xinyi District in Taipei as well as a beautiful new location in the Dallas Galleria. We ended the quarter with 506 physical stores in 22 countries alongside our online store presence in 35 countries.

In the enterprise market, we're gaining traction with our strategy of transforming major industries by expanding our leading positions in key functional areas to grow our reach and modernize customer and employee experiences.

In the financial services industry, 90 of the largest 100 banks by asset size are deploying Apple products to improve efficiency and effectiveness across their organizations. iPhone and iPad are overwhelmingly the preferred mobile devices for bankers on the go. For example, 60% of the biggest banks are supporting iPads for wealth managers. In retail banking, 2/3 of top banks are deploying iPad for branch transformation and modernizing legacy interfaces with a unified iPad experience.

One of the world's largest banks created an iPad suite that reduced customer on-boarding time from more than an hour to just 12 minutes. Bank branch employees are also using Apple Watch for communication and notifications and Apple TV for customer presentations from iPads using AirPlay.

Financial institutions also tell us that they receive positive feedback from leveraging Apple solutions for direct customer engagement. American Express, CrÃ©dit Suisse, Discover and TD Ameritrade have launched Apple Business Chat as a dynamic way to support and interact with customers. The intuitive interface of messages on iOS enables rich communication between customers and contact center staff. TD Ameritrade has also become the first brokerage in the world to enable immediate funding of accounts using Apple Pay, eliminating the 2 to 3 business days it used to take to fund accounts by wire transfer.

Let me now turn to our cash position. We ended the quarter with almost $211 billion in cash plus marketable securities. We retired $3 billion of term debt and reduced commercial paper by $2 billion during the quarter, leaving us with total debt of $108 billion. As a result, net cash was $102 billion at the end of the quarter, and we continue on our path to reaching a net cash neutral position over time. We returned over $21 billion to shareholders during the quarter, including $17 billion through open market repurchases of almost 88 million Apple shares and $3.6 billion in dividends and equivalents.

As we move ahead into the 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 $61 billion and $64 billion. This guidance includes almost $1 billion of year-over-year negative impact from foreign exchange. We expect gross margin to be between 37.5% and 38.5%. We expect OpEx to be between $8.7 billion and $8.8 billion. We expect OI&E to be about $200 million, and we expect our tax rate to be about 16.5%.

 

Also today, our Board of Directors has declared a cash dividend of $0.77 per share of common stock payable on August 15, 2019, to shareholders of record as of August 12, 2019.

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

NANCY PAXTON: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please?

Questions and Answers

OPERATOR: The first question will come from Amit Daryanani from Evercore.

AMIT JAWAHARLAZ DARYANANI, SENIOR MD & FUNDAMENTAL RESEARCH ANALYST, EVERCORE ISI INSTITUTIONAL EQUITIES, RESEARCH DIVISION: I guess 2 from me. First off, could you just talk about, when I think about the September quarter guide, it's implied, I think, up 16% or so sequentially. Historically, at least in that guide has been in the 10%, low double-digit kind of range. Just maybe help us understand what gives you the confidence for a better-than-seasonal guide in September either from a geo or product basis would be helpful.

LUCA MAESTRI: Amit, it's Luca. Of course, this is our best estimate of where we think we will land. Clearly, we expect to have continued strong growth from the non-iPhone categories. We have great momentum in Wearables. We mentioned that we were up almost 50% in the June quarter or actually over 50% in the June quarter. Our Services business, we set an all-time record in June. And so these 2 categories have become really important and really large for us. And so as we continue to grow quickly, that is going to help us as we go through the year. Keep in mind that the guidance includes an estimated almost $1 billion of foreign exchange headwind for the quarter.

AMIT JAWAHARLAZ DARYANANI: Fair enough. That's really helpful. And I guess if I just follow up on China, impressed to see the continued recovery you guys are seeing there despite all the headlines that are out there. Just curious, what are the few things that are driving the success in China? And how sustainable do you think those changes are for Apple as you go forward?

TIMOTHY D. COOK: Yes, Amit. It's Tim. I apologize for my voice. I'm suffering from an allergy. But what happened last quarter in China was, it's a confluence of things. The government stimulus, this came in terms of a VAT reduction, a very bold one. We took some pricing action. We instituted our trade-in and financing programs in our retail stores and worked with certain channel partners on that as well. And we're seeing a growing engagement with the broader Apple ecosystem during the quarter.

And so when you look at it, each of our categories, iPhone, iPad, Mac, Wearables, Services, everything improved sequentially. So we couldn't be happier with the results or the progress, I should say. I would point out, as I think I had mentioned in my comments, that we actually grew in constant currency for Greater China, and we grew in Mainland China on a reported basis. So there's several things going on there that are quite positive.

OPERATOR: The next question will come from Shannon Cross with Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: Can you talk a bit about what's going on within Services, some of the puts and takes? I know Luca, you gave us some color in terms of the growth rates in that. But I'm just curious as -- and I know you won't talk about future products, but as you think about the opportunities, you think about what you've got now and in the future and then some of the -- what's been going on with China in that, is there something that could reaccelerate or -- again, the 18% on a constant currency basis is obviously quite strong. But how are you thinking about it?

LUCA MAESTRI: Yes. I think it's important to start with that 18% in constant currencies, Shannon. Our reported results are on a normalized basis, removing the onetime item from last year, was 15%. Clearly, FX plays a role around the world, 300 basis points of FX impact during the June quarter. In spite of that, it was an all-time record revenue. Our installed base continues to grow. It's growing in every geography and it's growing across all our major product categories, and that is very, very important for the Services -- for the Services business.

I would say -- I'll give you a bit more color around 2 offsetting factors around this performance during the June quarter. On one side, the App Store, I mentioned in my prepared remarks that growth accelerated sequentially. We had double-digit growth on the App Store in every geography. In China, we saw significant acceleration. As you know, we tend to monetize in China on the App Store through game titles, and the government has approved a few key game titles during the quarter that has helped our performance there.

On the other side, AppleCare. I mentioned AppleCare was an all-time record in June, so a really strong performance. But our growth has decelerated in AppleCare due to factors that we fully expected because we are comping this expansion of our coverage for AppleCare that we've had, we've had significant success during the last 18 to 24 months in really broadening our coverage of AppleCare around the world with some key partners, carriers and resellers. And obviously, as we go through the year, those comps become a bit more difficult.

Having said all that, you know that we've given ourselves a couple of targets, and we feel very confident about reaching those targets. The first one is that we wanted to double the size of the Services business from our fiscal '16 to 2020. We are on our way there. Paid subscriptions is another target. It's important to us. It's an important way for us to monetize our ecosystem. We set a target of surpassing 0.5 billion paid subscriptions on the ecosystem during 2020. We're already at 420 million now. So we feel confident there.

And of course, as you mentioned, we're very excited about the fact that we're going to be launching new services soon. As Tim said, we're starting the rollout of Apple Card in August. And there's 2 more very important services that we're going to be adding to our portfolio during the fall. One is Apple Arcade, which is our gaming subscription service, and of course, Apple TV+, which is our video streaming service. So obviously, these services will help us carry on with the momentum that we have in Services.

SHANNON SIEMSEN CROSS: Great. And this is probably for you too as well, Luca. Can you talk about gross margin? The guidance was pretty solid. Obviously, there are various things that are at play here. I know you mentioned the $1 billion worth of top line impact, I think, from currency next quarter. But maybe if you can kind of talk about what went into your gross margin guidance?

LUCA MAESTRI: Yes. So of course, Shannon, as you've seen, our guidance for margin is 50 basis points higher than the guidance that we had given for June. I would say on the positive, we expect to benefit from leverage, as you've seen from our revenue guidance, and from cost savings because, as you know, the commodity environment is fairly favorable right now. On the negative side, the headwind on gross margins on a year-over-year basis from foreign exchange is about 100 basis points. And so we need to keep that in mind, but we feel pretty good about the guidance we provided.

OPERATOR: Our next question will come from Katy Huberty with Morgan Stanley.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: I'd like to go back to the discussion around strength in China in the quarter and understand what linearity looked like. I asked because there was some industry data around the smartphone market in China that seemed to deteriorate in the month of June, the App Store data deteriorated a little bit in June. And just curious if that's something you saw in the business, and if it at all informs your outlook around the pace of the China business as you go into September.

TIMOTHY D. COOK: Katy, it's Tim. We obviously took into account all of the information that we had in coming out with the guidance, including linearity across last quarter and how this quarter has started. And so we've obviously looked at that in quite much detail.

KATHRYN LYNN HUBERTY: And then just on the App Store, appreciate there's not a lot of detail out around exact timing and even some pricing of the new services. But how should we think about the new services that launched in March impacting the overall Services growth? Does that start to benefit the model in the back half of this calendar year? Or will the impact be more longer term in nature and really show up in 2020?

LUCA MAESTRI: Katy, let me just talk about the new services that we've announced in March and then also about the timing of how we get to revenue, right? We've announced Apple News+, and this is the service that is available for consumers right now. We've announced our channel service, which has also become available a few weeks ago. The other 3 services, the Card is launching in August, the gaming service and the video service are starting in the fall. Keep in mind for all these services, there's a trial period upfront. There's going to be different trial periods, we'll see what they look like. So the road to monetization takes some time. Obviously, all of them will add to our base and will help us with growth rates as we get into next year.

OPERATOR: That question will come from Krish Sankar with Cowen and Company.

KRISH SANKAR, MD & SENIOR RESEARCH ANALYST, COWEN AND COMPANY, LLC, RESEARCH DIVISION: I have 2 of them. First one, on the iPhone trade-in program, how effective was it and what percentage of iPhone sales came from the trade-ins? And are there any other geographies where you're left to roll it out? And then I have a follow-up.

TIMOTHY D. COOK: It's Tim. In retail, it was quite successful. We got going in a larger way during that quarter. We were pretty much just ramping in the previous quarter. And trade-in, as a percentage of their total sales, is significant and financing is a key element of it. Those 2 things in the aggregate led retail -- the combination of retail and online, we -- to short form that as retail, are Apple Store, led to growth in June. And so we feel very, very good about our trajectory. We are obviously taking those programs and advocating those more widely. And that is at different levels of implementation throughout different geographies because we're working with our carrier partners on those and retail partners.

KRISH SANKAR: Got it, got it. That's very helpful, Tim. And then a follow-up for you, a much longer-term question. I understand we're in the very early innings of the Services growth story. Is there a way to think about it down the road that 3 or 5 years down the road, would the Services growth be focused or will it still be tethered to the hardware of the iPhone? Or do you think at some point down the road, Services would be independent by itself and not really tied to your hardware installed base?

TIMOTHY D. COOK: Well, there are elements today that are not necessarily tethered to iPhone, right? We have other products where people are both purchasing things, they're watching Apple TV. We offer Apple Music on Android, and so there's a series of things that are outside of that. And so we'll see what we do in the future. I don't want to really get into that.

But more broadly, to answer your question about growth as we go forward, the way I see it is we have the strongest hardware portfolio ever. We've got new products on the way. The pipeline is full of great new stuff, both on the product and services side. We're very fortunate and work very hard to have loyal customers and to continue attracting an impressive number of switchers. The installed base is growing, hit a new record. That's obviously good. And it hit a new record across all geographies and across all categories. And so this is a really good thing.

And we've got the Wearables area that is doing extremely well. We stuck with that when others perhaps didn't and really put a lot of energy into this and a lot of R&D and are in a very good position today to keep playing out the what's next there.

At the same time, on the market side, we have emerging markets where we have low penetration. And in -- during the quarter, tactically, emerging markets had a bit of a rebound. In fact, on a constant currency basis, we actually grew slightly in emerging markets. We still declined on a reported basis. India bounced back. During the quarter, we returned to growth there. We're very happy with that. We grew in Brazil as well.

We're also continuing to focus on the enterprise market. Luca mentioned some of this in his comments, and we think that continues to be a big opportunity for us. And then we've got lots of what I would call core technology kinds of things like augmented reality, where we're placing big bets, and I think we have a big future in addition to the health kinds of things that may fall out of the Watch. And so hopefully that kind of gives you a view over the total. And so we're focusing on products and services and there will be some services that aren't hooked and some that are hooked not on current period sales are mostly -- very much services are rarely connected on that today or at least not a high percentage by any means. They're more correlated to the installed base, the active installed base and also the level of transacting customers that are there and the amount per customer, which relates also to the offering that we have.

OPERATOR: Next, we'll go to Wamsi Mohan with Bank of America Merrill Lynch.

WAMSI MOHAN, DIRECTOR, BOFA MERRILL LYNCH, RESEARCH DIVISION: Tim, the China trade situation remains sort of fluid over here and recently -- more recently, you asked for some tariff exceptions. We're not granted those. How are you thinking about the longer-term footprint for manufacturing? And can you talk about any potential alternatives that you've looked at and considered in moving parts of production potentially out of China? And I have a follow-up.

TIMOTHY D. COOK: Yes. I know there's been a lot of speculation around the topic of different moves and so forth. I wouldn't put a lot of stock into those, if I were you. The way that I view this is the vast majority of our products are kind of made everywhere. There's a significant level of content from the United States and a lot from Japan to Korea to China and the European Union also contributes a fair amount. And so that's the nature of a global supply chain. I think -- largely, I think that will carry the day in the future as well. In terms of the exclusions, we've been making the Mac Pro in the U.S. We want to continue to doing that. And so we're working and investing currently in capacity to do so because we want to continue to be here. And so that's what's behind the exclusions. And so we're explaining that and hope for a positive outcome.

WAMSI MOHAN: And there's -- Luca, maybe for you, there's been some significant destocking of inventory in the first calendar half of this year in iPhone. Can you comment about the broader channel inventory levels, where you are in your typical ranges, especially given the comment around June iPhone sales being quite strong? And do you expect anything atypical in channel inventory dynamics in the September quarter?

LUCA MAESTRI: Yes, Wamsi. As you know, we're not getting into this topic very much, but I think I can give you some color here. You know that in general, we decreased our inventory during the March quarter and the June quarter. That has been traditionally what we've done. This year, we reduced channel inventory for iPhone slightly more than last year. And that is true in total, and it's true for Greater China as well. So we feel very good about our channel inventory ranges as we get into the September quarter. I hope that helps you with that.

OPERATOR: Our next question comes from Jim Suva with Citigroup.

JIM SUVA, DIRECTOR, CITIGROUP INC, RESEARCH DIVISION: The first question is probably for Tim and the second one for Luca, and I'll ask them at the same time so you can pick and choose whichever one you want to answer, first and second. But the first question, Tim. Regarding the installed base comment you've made, which is quite encouraging, but yet when you look at the iPhone revenue year-over-year, the past several quarters has been down. Can you help us bridge the gap of how is the installed base growing?

Is it mostly because like secondary users are the new ones coming into the system as people are holding their phones longer? And what does that user typically bring in with them or something rather unique relative to what we historically know? And then for Luca, you've been investing a lot, a lot, lot, lot and a lot of these services are now coming to pass, whether it be AppleCare, Apple cloud, all these Wearables, and soon Apple Pay and Arcade. Are we at a point where now, a lot of harvesting is going to happen? Or do you kind of continue these relatively same investments that you've been doing for the future strategy?

TIMOTHY D. COOK: Okay. Jim, it's Tim. I'll start with your installed base question. Installed base is a function of upgrades and the time between those. It's a function of the number of switchers coming into the iOS, macOS and so forth tents. It's a function of the robustness of the secondary market, which we think overwhelmingly hits incremental customer. And it's a function still in the emerging markets and somewhat developed markets, to a lesser degree, of people new that -- they're buying their first smartphone. There are still quite a few people in the world in that category.

And so the reason that the installed base doesn't correlate to the 90-day clock is that what's happening underneath the numbers is switchers are still a very key piece of what's going on. The secondary market is very key, and we're doing programs, et cetera, to try to increase that because we think we'd wind up hitting a customer that we don't hit in another way. And the upgrades, where people are holding on to their device a bit longer than they were, they're staying in the ecosystem. And then you have the people in the new category as well. And so that's sort of the equation. I don't want to go into the specific numbers, but I think you can see readily, mathematically, how the installed base is growing in an environment where the iPhone revenue is declining within a 90-day kind of window.

LUCA MAESTRI: And Jim, on OpEx, obviously, it's very important for us to continue to invest in the business, particularly on the R&D side because we always want to bring more innovation into the market. We want to improve the user experience and differentiate our products and services in the marketplace. So we will continue to do that.

There are some types of investments, of course, that are very strategic for us and they will have long-term implications. You've seen the announcement that we made around the Intel acquisition. Very important strategically for us. It requires upfront investment, of course. As you've seen from this quarter and also from the past, we will continue to run our SG&A portion of OpEx tightly. We will -- of course, we'll continue to invest in marketing and advertising. We talked about a lot of new services that we are launching during the fall and Apple Card the next month. Obviously, they will require the appropriate level of marketing and advertising as we launch them to the general public.

When you look in total at where we are in terms of our expense-to-revenue ratio for operating expenses, you know quite well that we are extremely competitive relative to other tech companies. So we want to continue to be competitive and at the same time, we will not underinvest in the business.

OPERATOR: The next question will come from Samik Chatterjee with JPMorgan.

SAMIK CHATTERJEE, ANALYST, JP MORGAN CHASE & CO, RESEARCH DIVISION: I just wanted to start off with the announcement of the WWDC around the independent App Stores for the Watch and the iPads. What level of interest have you seen from developers and how are they thinking about the ability to monetize services independently on those App Stores? And how does it help you position Wearables more formally into the health and fitness category?

TIMOTHY D. COOK: We're seeing good interest across virtually everything that we announced at WWDC. I couldn't be happier with the developer tools around ARKit and AR in general that I went through earlier. Lots of interest there. Lots of interest from the watch App Store to the Catalyst that will be released with macOS Catalina, which allows developers quickly to port a iOS app to the Mac. We think this is huge and so great for the user experience. And so you look at all of these and all of the things that I talked about earlier and I couldn't be happier with the reception that we're getting and the work that is going on behind the scenes right now to ready -- for the developers readying their apps for the fall.

SAMIK CHATTERJEE: Got it. If I can just follow up on the China market. One of the things that we're looking at is with these -- going into the new year into 2020, there'll be a lot of 5G phones launching in that market from the Android players. How you're thinking about the competitive landscape there as you enter next year?

TIMOTHY D. COOK: We don't comment on future products. With respect to 5G, it's -- I think most people would tell you it's -- we're in sort of the extremely early, early innings of it and even more so on a global basis. So we couldn't be more proud of what our lineup is, and we're excited about the great pipeline of both hardware and software, and we won't trade our position for anyone's.

NANCY PAXTON: Thank you, Samik. A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor and via telephone and the numbers to the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 3057347. These replays will be available by approximately 5 p.m. Pacific Time today.

Members of the press with additional questions can contact Kristin Huguet at (408) 974-2414 and financial analysts can contact Tejas Gala or me with additional questions. Tejas is at (669) 227-2402, and I'm at (408) 974-5420. Thanks again for joining us.

OPERATOR: That does conclude our conference for today. Thank you for your participation.



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OPERATOR: Good day, and welcome to the Apple Inc. Second Quarter Fiscal Year 2019 **Earnings** 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, SENIOR DIRECTOR OF IR AND TREASURY, APPLE INC.: Thank you. Good afternoon, and thanks to everyone for joining us today. Speaking first is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook. Actual results or trends could differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed periodic reports on Form 10-K and Form 10-Q 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, CEO & DIRECTOR, APPLE INC.: Thanks, Nancy. Good afternoon, and thanks to all of you for joining us today.

This has been an exciting and productive quarter for Apple. In my letter to investors at the beginning of January, I wrote that one of Apple's great strengths is our culture of flexibility, adaptability and creativity. This quarter featured some important announcements that speak to the power of our commitment to innovation and long-term thinking. I'd like to start with some top line highlights and then move into greater detail with you.

I'll get started with financial results. Our revenue was $58 billion, toward the high end of our guidance range. We see this result as a positive outcome in light of ongoing headwinds from weaker foreign currencies relative to the U.S. dollar. In constant currency, our year-over-year revenue performance would have been 200 basis points better than our reported results indicate.

We had great results in a number of areas across our business. It was our best quarter ever for Services with revenue reaching $11.5 billion. We had a blockbuster quarter for iPad with revenue up 22% from a year ago. This is our highest iPad revenue growth rate in 6 years. And it was another sensational quarter for Wearables with growth near 50%. This business is now about the size of a Fortune 200 company, an amazing statistic when you consider it's only been 4 years since we delivered the very first Apple Watch. I'll talk more about these categories later.

While we grew year-over-year in developed markets and while we had record March quarter results in a number of major markets, including the United States, Canada, the United Kingdom and Japan, we did experience a revenue decline in emerging markets. But we feel positive about our trajectory. Our year-over-year revenue performance in Greater China improved relative to the December quarter, and we've seen very positive customer response to the pricing actions we've taken in that market, our trade-in and financing programs in our retail stores, the effects of government measures to stimulate the economy and improved trade dialogue between the United States and China. Our App Store results are still reflecting the impact of the slowdown of regulatory approval in gaming apps in China, but we're encouraged by the recent increase in the pace of approvals. We believe strongly in our long-term opportunity in China thanks to our robust ecosystem, our talented developer community and the country's growing population of tech-savvy consumers who value the very best products and services.

For iPhone, while our worldwide revenue was down 17% from a year ago, declines were significantly smaller in the final weeks of the March quarter. Looking back at the past 5 months, November and December were the most challenging, so this is an encouraging trend. We like the direction we're headed with iPhone, and our goal now is to pick up the pace.

Importantly, our active installed base of devices continues to grow in each of our geographic segments and setting new all-time record for all major product categories. That growing installed base is a reflection of the satisfaction and loyalty of our customers, and it's driving our Services business to new heights.

In fact, we had our best quarter ever for the App Store, Apple Music, cloud services and our App Store search ad business, and we set new March quarter revenue records for AppleCare and Apple Pay. Apple Pay transaction volume more than doubled year-over-year, and we're on track to reach 10 billion transactions this calendar year. Apple Pay is now available in 30 markets, and we expect to be live in 40 markets by the end of the year. More and more transit systems are accepting Apple Pay, and New York's MTA system will begin their rollout in early summer. As we've seen in places like London, Tokyo and Shanghai, contactless entry into transit systems helps to spur broader Apple Pay adoption, and we believe this will get even more people using Apple Pay in the United States.

And Ticketmaster has just announced that they will be accepting Apple Pay for ticket purchases on the web and through the Ticketmaster app. And over 50 of their entertainment and sporting event venues are launching contactless tickets this year, including the vast majority of NFL stadiums.

Subscriptions are a powerful driver of our Services business. We reached a new high of over 390 million paid subscriptions at the end of March, an increase of 30 million in the last quarter alone. This was also an incredibly important quarter for our Services moving forward. In March, we previewed a game-changing array of new services, each of them rooted in principles that are fundamentally Apple. They're easy to use. They feature unmatched attention to detail. They put a premium on user privacy and security. They're expertly curated, personalized and ready to be shared by everyone in your family. These features aren't just nice to have. They actually help to eliminate the boundary between hardware, software and service, creating a singularly exceptional experience for our users.

First, building on the great momentum of Apple News, which is already the #1 news app in the United States and the United Kingdom, we launched Apple News+. It will bring together over 30 popular magazines, leading newspapers and digital publishers into a beautiful, convenient and curated experience within the Apple News app. Apple News+ builds on our commitment to supporting quality journalism from trusted sources while providing the best magazine and news reading experience ever for mobile devices.

Advancing our vision to replace the wallet, we announced Apple Card, built on principles Apple stands for like transparency, simplicity and privacy. Apple Card is integrated into the Wallet app and delivers all new experiences that only Apple can provide, integrating our hardware, software and services in an elegant solution that places the customer at the center. It's the first card to encourage you to pay less interest, eliminate fees and give you daily cash on all your purchases, and customer interest to date has been terrific.

We also previewed Apple Arcade, the world's first game subscription service for mobile, desktop in the living room. With over 100 new games all with no ads or ad tracking, no additional purchases and respect for user privacy, we've created a service for players of all ages, kids to teens to adults and one that families can enjoy together. The App Store is already the world's biggest gaming platform, and we think Apple Arcade is a great way to unleash the creativity of the game developer community with a collection of new games not available on any other mobile platform or in any other subscription service. We can't wait for our customers to experience it for themselves beginning this fall.

We were thrilled to provide a peek at what's new for TV. Beginning in mid-May, the all-new Apple TV app will bring together the different ways to discover and watch shows, movies, sports, news and more in 1 app across iPhone, iPad, Apple TV, Mac, smart TVs and streaming devices. And users can subscribe to and watch new Apple TV channels like HBO, Showtime and Starz, paying only for services they want, all on demand available on and offline. And coming this fall, Apple TV+ will be the new home for the world's most creative storytellers featuring exclusive original shows, movies and documentaries.

We also had several major product introductions during the quarter. We launched a new, more powerful iMac with dramatic increases in both compute and graphics performance, making it a great update for consumers and pros alike. For our Mac business overall, we faced some processor constraints in the March quarter, leading to a 5% revenue decline compared to last year. But we believe that our Mac revenue would have been up compared to last year without those constraints and don't believe this challenge will have a significant impact on our Q3 results.

For iPad, we were very happy to return to growth in Greater China while generating strong double-digit growth in each of our other geographic segments. Our great iPad results were driven primarily by strong customer response to iPad Pro. Late in the quarter, we launched an all-new iPad Air with an ultra-thin design, Apple Pencil support and high-end performance powered by Apple's A12 Bionic chip. In addition, we introduced a new iPad mini, a major upgrade for iPad fans who love an ultra-portable design, and like the new iPad Air, it delivers the power of the A12 Bionic and support for Apple Pencil.

Last month, we introduced new AirPods, the second generation of the world's most popular wireless headphones and demand has been incredible. This is nothing less than a cultural phenomenon. With the new Apple-designed H1 chip, the new AirPods deliver faster connect times, more talk time and the convenience of hands-free Hey Siri.

Our retail and online stores continue to be a key point of innovation. As we mentioned in January, we've been working on an initiative to make it simple to trade in our -- trade in a phone in our store, finance the purchase over time and get help transferring data from the old phone to the new phone. As part of this initiative, we rolled out new trade-in and financing programs in the U.S., China, the U.K., Spain, Italy and Australia. The results had been striking. Across our stores, we had an all-time record response to our trade-in programs and with more than 4x the trade-in volume of our March quarter a year ago.

With each passing quarter, we're more inspired by the impact our products are having on people's fitness and health. This quarter, we brought the ECG app on Apple Watch Series 4 to Hong Kong and 19 European countries, including France, Germany, Italy, Spain and the U.K. Just like when the ECG app launched in the United States, there's hardly a day that goes by that I don't get a letter or an e-mail from a customer in one of these countries talking about how this feature had significantly changed their life.

We believe we're really just beginning to tap into what we can do to help our users actively manage their health and well-being. For example, last month, Stanford Medicine reported results of the Apple Heart Study, the largest study ever of its kind, which enrolled over 400,000 participants from all 50 states in a span of only 8 months. And hundreds of institutions are now supporting health records on iPhone with recent additions including Michigan Medicine and UT Health Austin. In February, we announced that we are working with the U.S. Department of Veterans Affairs to make health records on iPhone available to veterans. This will be the first record sharing platform of its kind available to the VA, which is the largest medical system in the U.S. providing service to more than 9 million veterans across more than 1,200 facilities.

Apple's innovation extends beyond the impact we have in the lives of our customers to the impact we leave on the world around us. We recently marked Earth Day with several major announcements about our efforts to leave the world better than we found it. We've completed the allocation of our $2.5 billion green bond proceeds across 40 environmental initiatives around the world to projects ranging from solar power generation to water conservation to development of custom alloys for our products made from 100% recycled aluminum.

We've announced a major expansion of our recycling programs, including quadrupling the number of locations where U.S. customers can send their iPhones to be disassembled by Daisy, our recycling robot. Each Daisy can now disassemble 1.2 million devices per year, allowing recovered materials to be recycled into the manufacturing process.

And we partnered with a record number of our suppliers to follow our lead and transition to 100% clean energy. With the help of these 44 suppliers, we will exceed our goal of bringing 4 gigawatts of renewable energy into our supply chain by 2020 with over 1 additional gigawatt projected within that time frame. In the last calendar year alone, the partners that have joined this effort have generated enough clean energy to power over 600,000 homes in the United States.

We're very proud of the progress that we and our partners are making and hope our actions will inspire other businesses to do what they can to protect the world that we share. We are as excited as ever about our great pipeline of hardware, software and services, and we're looking forward to sharing more information about the future of our 4 software platforms at our Worldwide Developer Conference now less than 5 weeks from now. Everyone here is hard at work to prepare for WWDC, and it's always a privilege to get to share the future of our platforms with the community of world-changing developers who bring it to life. You are not going to want to miss this one.

We're in the fortunate position of generating more cash than we need to run our business and invest confidently in our future, so today, we're announcing the latest update to our capital return program, including an increase to our share repurchase authorization and our quarterly dividend. For more details on that and our March quarter results, I'll turn the call over to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone.

Revenue in the March quarter was $58 billion, near the high end of the guidance range that we provided 90 days ago and down 5% from last year. Our revenue decline reflects 200 basis points of negative foreign exchange due to the strength of the U.S. dollar. Overall products revenue declined 9% driven primarily by iPhone, while Services revenue grew 16% to a new all-time record. We also set a new March quarter record for Wearables, Home and Accessories, and we recorded our best iPad growth rate in 6 years.

Company gross margin was 37.6%, in line with our guidance. Products gross margin was 31.2%, down about 310 basis points sequentially due to the seasonal loss of leverage and headwinds from foreign exchange. Services gross margin was 63.8%, up 100 basis points sequentially due to a different mix and leverage from higher revenue. Net income was $11.6 billion. Diluted **earnings** per share were $2.46, and operating cash flow was $11.2 billion.

Let me provide more color for our various revenue categories. iPhone revenue was $31.1 billion. We're seeing positive customer response to recent pricing actions in certain emerging markets as well as enhancements to our trade-in and financing programs. And our year-over-year performance improved relative to our December quarter results in Greater China, in the Americas and in Japan. Our active installed base of iPhone reached a new all-time high at the end of March. This growing installed base reflects the industry-leading satisfaction and loyalty of our customers. The latest survey of U.S. consumers from 451 Research indicates customer satisfaction of 99% for iPhone XR, XS and XS Max combined. And among business buyers who plan to purchase smartphones in the June quarter, 81% plan to purchase iPhones.

Turning to Services. As Tim said, it was our best quarter ever with $11.5 billion in revenue, an increase of 16% from last year. We generated double-digit revenue growth across the App Store, Apple Music, cloud services, AppleCare, Apple Pay and our App Store search ad business. And we set all-time services revenue records in 4 of our 5 geographic segments. We're very happy with this performance. As you can see from our new disclosures, Services accounted for 20% of our March quarter revenue and about 1/3 of our gross profit dollars.

Customer engagement in our ecosystem continues to grow. The number of transacting accounts on our digital content stores reached another new all-time high during the quarter with the number of paid accounts also setting a new all-time record and growing by strong double digits over last year. And we now have over 390 million paid subscriptions across our Services portfolio, an increase of 120 million versus just 12 months ago. All subscription categories are growing strong double digits, and as we mentioned a quarter ago, we expect the number of paid subscriptions to surpass 0.5 billion during 2020.

On the App Store, our subscription business is extremely diversified and is growing strongly around the world. In fact, the number of paid third-party subscriptions increased by over 40% compared to last year in each of our geographic segments. And across all third-party subscription apps, the largest accounted for only 0.3% of our total Services revenue.

Next, I'd like to talk about the Mac. Revenue was $5.5 billion compared to $5.8 billion a year ago with the decline driven primarily by processor constraint on certain popular models. In spite of this challenge, we generated double-digit Mac revenue growth in Japan and Korea, setting new all-time Mac revenue records in both markets. On a global basis, nearly half of the customers purchasing Macs during the quarter were new to Mac, and the active installed base of Macs reached a new all-time high.

We had great results for iPad with $4.9 billion in revenue and growth accelerating from the December quarter to 22%. iPad revenue grew in all 5 of our geographic segments with a return to growth in Greater China and strong double-digit growth in all other segments. We had our best March quarter ever for iPad in Japan, and we were especially pleased by performance in Korea, Thailand and Mexico where revenue more than doubled over last year. In total, over half of the customers purchasing iPads during the March quarter were new to iPad, and the iPad active installed base also reached a new all-time high.

iPad revenue growth has been fueled primarily by the great customer response to our new iPad Pros. These completely redesigned iPads with full-screen Liquid Retina display, Face ID, powerful A12X Bionic chip with Neural Engine and support for the new Apple Pencil and Smart Keyboard make iPad Pro the perfect PC, laptop replacement for both consumers and professionals.

 

The most recent surveys from 451 Research measured a 93% customer satisfaction rating for iPad overall. Among customers who plan to purchase tablets, 77% of consumers and 75% of businesses plan to purchase iPads.

Wearables, Home and Accessories revenue set a new March quarter revenue record of $5.1 billion fueled primarily by the strong performance of our Wearables business, which grew close to 50%. Within this category, Apple Watch is the best selling and most loved smartwatch in the world and produced its best results ever for a nonholiday quarter. It's reaching many new customers with 3/4 of purchases going to customers who have never owned an Apple Watch before. Interest in AirPods has been off the charts, and we're working hard to catch up with the incredible customer demand.

Turning to our retail and online stores. We generated very strong double-digit revenue growth from Apple Watch and iPad. We also announced 50 new Today at Apple sessions during the quarter in 3 new and expanded formats, Skills, Walks and Labs, free at our stores around the world.

We're making important progress in the enterprise market, helping transform major industries. We're building on Apple's leading position in key functional areas to expand our reach and share within large accounts. Aviation is a strong example of this strategy at work. Across 450 airlines, iPad is overwhelmingly the preferred solution for the pilot's electronic flight bag. We've been making great progress expanding Apple's footprint beyond the cockpit into the cabin, where more than half of the top 50 airlines have now implemented iOS to enhance the guest experience as well as enable a new use case with mobile point of sale.

We're also seeing traction with other mission-critical airline functions in ground operations and flight maintenance. For example, one of the largest airlines in the world tells us that the adoption of iPad has cut maintenance delays in half. Apple services are also making their way onboard, including growing adoption of Apple Pay for food and beverage purchases and in-flight access to Apple Music.

We're also seeing significant iOS traction with large enterprise platforms, which are the face of complex back-end systems to tens of millions of employees around the world. The end user employee experience is vital to engagement and productivity, and with increasing mobility of today's modern workforce, those experiences are best on native iOS applications. We see great momentum through the growing number of iOS SDKs being delivered by the world's largest enterprise platforms. For instance, SAP's SDK for iOS continues to gain strong traction with their customers, growing by more than 40% in the last 6 months. And this past quarter, Salesforce released its SDK, enabling developers to be native iOS applications directly on top of the Salesforce platform.

And finally, our enterprise channels continue to build momentum. In February, our Apple at Work initiative was launched with AT&T. This extension to our ongoing collaboration with AT&T will make it easy for more customers to choose the best Apple products for their needs in the enterprise and modernize their business. AT&T will enable business services for Apple products to help companies with their IT strategy, including device management, security, productivity and collaboration.

Let me now turn to our cash position. We ended the quarter with $225 billion in cash plus marketable securities. We also had $101 billion in term debt and $12 billion in commercial paper outstanding for a net cash position of almost $113 billion. As a result, we're in a very strong position that allows us to invest confidently in all areas of the business while continuing to return value to our shareholders. Just last year, we announced a commitment to contribute more than $350 billion to the U.S. economy over the next 5 years, including the creation of 20,000 jobs. More recently, we've announced a major expansion in Austin, Texas and in other cities across the country. All these efforts are essential investments to make sure that we're incorporating innovative ideas and top talent wherever they emerge.

As we execute those initiatives, we're also able to return over $27 billion to investors during the March quarter. We began a $12 billion accelerated share repurchase program in February, resulting in the initial delivery and retirement of 55.1 million shares. We also repurchased 71.7 million Apple shares for $12 billion through open market transactions, and we paid $3.4 billion in dividends and equivalents.

Our priorities for cash have not changed over the years. Most importantly, we always want to maintain the cash we need to run our business, maintain strategic flexibility and invest in our future. We're well on our way towards meeting the investment projections we laid out early last year. We also want to work towards a more optimal capital structure, and as we said before, it is our plan to reach a net cash neutral position over time.

Given our confidence in Apple's future and the value we see in our stock, our Board has authorized an additional $75 billion for share repurchases. And because we know many of our investors value income, we're also raising our quarterly dividend for the seventh time in less than 7 years to $0.77, an increase of about 5% from the previous amount. We paid over $14 billion in dividends and equivalents over the last 4 quarters alone, making us 1 of the largest dividend payers in the world. Going forward, we continue to plan for annual increases in dividends per share.

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 $52.5 billion and $54.5 billion. This guidance range comprehends 300 basis points of negative foreign exchange impact year-over-year. Also, as a reminder, in the June quarter last year, our Services revenue included a favorable $236 million onetime item in connection with the final resolution of various lawsuits.

We expect gross margin to be between 37% and 38%. We expect OpEx to be between $8.7 billion and $8.8 billion. We expect OI&E to be about $250 million, and we expect the tax rate to be about 16.5%. Also, reflecting the approved increase, today, our Board of Directors has declared a cash dividend of $0.77 per share of common stock payable on May 16, 2019, to shareholders of record as of May 13, 2019.

With that, I would like to open the call to questions.

NANCY PAXTON: Thank you, Luca. (Operator Instructions) Operator, may we have the first question, please?

Questions and Answers

OPERATOR: Certainly. Our first question will come from Shannon Cross with Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: Tim, can you talk a bit more about what you're seeing in China? Clearly, it looks like things are improving sequentially. You also mentioned that last few weeks of the quarter were stabilizing in emerging markets, I believe. So what are customers saying there? What are your partners saying in China? And then I have a follow-up.

TIMOTHY D. COOK: Yes. Thanks for the question, Shannon. We're seeing -- in the iPhone space, we saw a better year-over-year performance in the last weeks of the quarter as compared to the full quarter or November and December, which was sort of a -- appears to be the trough. I think there's a set of reasons for this. One, we made some price adjustments, essentially backing out the weaker currency effect and then some. The -- there's stimulus programs that the government has executed, including, and this happened in early April, VAT being reduced from 16% to 13%, so they've been aggressive in the stimulus side. Three, our trade-in and financing programs that we implemented in our retail stores have been very well received there, and I'm happy with the results to date there. And then four, the -- there's an improved trade dialogue between the U.S. and China. And from our point of view, this has affected consumer confidence on the ground there in a positive way. And so I think it's a set of all of these things, and we certainly feel a lot better than we did 90 days ago.

SHANNON SIEMSEN CROSS: And then I'm sure you're probably expecting a question on Qualcomm settlement. So what would you like to say on the settlement? How are you thinking about your component providers going forward? And how should we think about this with regard to, I don't know, your development plans in the future? Because I'm sure you're not going to talk about when you're going to do 5G but clearly, it helps that path.

TIMOTHY D. COOK: Yes. Thank you, Shannon. We're glad to put the litigation behind us, and all the litigation around the world have been dismissed and settled. We're very happy to have a multi-year supply agreement. And we're happy that we have a direct license arrangement with Qualcomm, which was, I know, important for both companies, and so we feel good about the resolution.

OPERATOR: The next question will come from Samik Chatterjee with JPMorgan.

SAMIK CHATTERJEE, ANALYST, JP MORGAN CHASE & CO, RESEARCH DIVISION: Tim, you talked about China responding well to the pricing actions that you've taken in that market. Do any of those learnings kind of carry through into how you decide pricing in the remaining emerging markets like India, et cetera, as you get ready for the next product cycle?

TIMOTHY D. COOK: We have made some adjustments in India, and we've seen preliminarily some better results there. Everything that we do does advise everything we do in the future, so we try to learn the best we can and fold that into our thinking. And we'll obviously do that with this as well.

SAMIK CHATTERJEE: I just had a quick follow-up for Luca on the Services side. Luca, we see that you're guiding to higher operating expenses quarter-on-quarter. How much of that incremental is going in to support the new services that you're planning to launch later in the year?

 

LUCA MAESTRI: Yes. Of course, we are supporting both our products and Services business, and you can see the trajectory of our OpEx over the different quarters. Clearly, as we add new services, we will need to make the necessary investments to support them. Our Services business is -- has multiple streams. In total, it is accretive to company gross margins. You've seen the latest -- we're running services margins at over 60%. So it's a very important business for us in many ways for our ecosystem and for our ability to monetize it. And so clearly, we will make all the necessary investments to ensure that the new services are successful. And we're really encouraged by the level of customer response that we received so far in anticipation for the launch of these services.

OPERATOR: The next question will come from Katy Huberty with Morgan Stanley.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: Luca, if I look back over the past 5 years, June quarter revenue typically declines about 15% from the March quarter. You're guiding to an 8% drop this year. So can you just talk about which regions or product segments you think can outperform that typical seasonality?

LUCA MAESTRI: Yes, Katy. And keep in mind, by the way, we are reporting this guidance including a 300 basis point negative impact from foreign exchange, so actually, in constant currency, the numbers would be even stronger. At the product category level, we expect that we continue to have strong revenue growth from the non-iPhone categories as we've had for the first half of our fiscal year. We're also expecting a relative improvement in our iPhone performance on a year-over-year basis in Q3 versus the first half. As Tim said, March was the strongest month of the quarter on a year-over-year basis, and so this has given the confidence to provide the guidance that you've seen. Geographically, of course, as you've seen from our results for the March quarter, China is the geo where we found some challenges, but we believe the trajectory should improve over time.

KATHRYN LYNN HUBERTY: And then just as a follow-up, Shannon said you're not going to talk specifics around the timing of the 5G phone, but Tim, maybe you can talk about how the company approaches a new technology like this given the higher cost but also potentially significant benefit, how you think about the right timing for coming to market with a product with those characteristics and then just, generally, how meaningful, you think, 5G is as a demand driver for upgrades in your iPhone installed base.

TIMOTHY D. COOK: Katy, this is one that I'm going to largely punt on as you would probably guess. We look at a lot of things on the different technologies and try to look at the -- and select the right time that things come together and get those into products as soon as we can. And the -- certainly, from a cost point of view, there has been -- the technologies have had cost pressure over the last couple of years or so. On the flip side of that, there's a number of things in the commodity markets going in the other direction at the moment like DRAM and NAND. And so it's difficult to project what happens next, but it's the aggregate of all of it that really matters from a price point of view.

OPERATOR: Jim Suva from Citi has our next question.

JIM SUVA, DIRECTOR, CITIGROUP INC, RESEARCH DIVISION: A topic that's probably split or shared by both Tim and Luca on a response but I'll ask the question and you can decide how to divide it up. In your opening remarks, Tim, you'd mentioned about pricing adjustments that you made in some of the markets, and then Luca talked also about the strength of the trade-in program or maybe it was Tim also. Can you help us understand about what type of lessons or elasticity you've learned about pricing and the trade-in programs of how it impacts like revenues and COGS and margins and things?

TIMOTHY D. COOK: Yes. Jim, the -- in the opening remarks, I was really talking about China specifically. And I mentioned 4 things that I believe are responsible for the better year-over-year performance in the Q2 relative to Q1 and also the final weeks of March being better than the Q2 average. And those 4 are the price reductions but that's 1 of them. But there are 3 others, and 1 of the others is the trade-in and financing programs that we instituted in our retail stores. Clearly, what we've learned here and it's not a surprise really is that the -- many, many people do want to trade in their current phone. It does -- from a customer user point of view, the trade-in looks like a subsidy, and so it is a way to offset the device cost itself. And many people in literally every market that we've tried this in, there is a reasonable number of people that want to take and pay for something on installments instead of all at once. And so it's a little different in each market in terms of what the elasticity is, but you can bet that we're learning quickly on all of those.

The other 2 items that are not insignificant in China that I don't want to lose here is that the stimulus programs, I believe, are having an effect on the consumer. And the 1 that I got much visibility in -- that happened in early April was the VAT reduction from 16% to 13%, so it's a very aggressive move. But there are other stimulus programs as well that likely have an effect to the consumer level. And then finally, and this is not to be underweighted either, I think the improved trade dialogue between the countries affects consumer confidence in a positive way. And so I think it's sort of the sum of all of those things.

LUCA MAESTRI: And Jim, if I may add on the gross margin level, as we look at pricing actions, of course, anytime you do a pricing action, it is gross margin percentage diluted. But what really matters to us and what we look at when we look at the elasticity of these programs is to see the impact on our gross margin dollars. And what -- the experience that we've had in a few of these emerging markets has been positive in that respect, and so that's what we think matters the most really.

OPERATOR: The next question will come from Wamsi Mohan with Bank of America Merrill Lynch.

WAMSI MOHAN, DIRECTOR, BOFA MERRILL LYNCH, RESEARCH DIVISION: Tim, you shared a lot of color around trade-ins, but I was also hoping maybe you can characterize what sort of dynamics you're seeing across your installed base on these trade-ins. What type of devices are being traded in? Is the profile of someone who has a really old iPhone? Or are you seeing folks that have newer iPhones trading in? And what sort of incentives are you providing beyond sort of the financing to drive that? And do you see this as something that can accelerate replacement cycles here over the next year or so? And I have a follow-up.

TIMOTHY D. COOK: We're -- actually, the product that's being traded in is all over the place, to be honest. It's 6, 6 Plus, 6s, 6s Plus, 7, 7 Plus and then fewer 8 and 8 Plus. But there's some of each of those, and so you get customers that are on the 2-year cycle and customers -- some customers on the 1-year cycle and then customers as well on the 3- and 4-year cycles. And so it's really all over the place. In terms of the incentives, we're offering currently in our retail stores a trade-in value that has -- that is more than the sort of the blue book of the device, if you will, for lack of a better description. And so we have topped those up to provide an extra benefit to the user.

The installments are different in each geography. I would say that, at the moment, the geography that is doing the best in installments would be China. And we have a bit of a unique offering there, I think, versus the -- versus what you can get in the regular market, and so that probably further helps there. And so you can bet that we're learning on each of these, finding the parts that the user likes the most.

I think the key is we're trying to build a -- build something into the consumer mindset that it's good for the environment and good for them to trade in their current device on a new device. And we do our best of getting the current device to someone else that can use that or, in some cases, if the product is at an end of life, we are recycling the parts on it to make sure that it can carry on in another form.

WAMSI MOHAN: And as my follow-up, Luca, can you just clarify if the settlement with Qualcomm is creating either a headwind or a tailwind to your gross margins in the near term? And does your guidance contemplate incremental pricing actions that could be creating some gross margin headwinds?

LUCA MAESTRI: As Tim has explained, we've reach this comprehensive agreement with Qualcomm. As part of this, we have agreed that we're not going to share the financial terms of the agreement, so we plan to honor that. What you see in our gross margin guidance for the June quarter, we guided 37% to 38%, fully comprehends the outcome of the agreement with Qualcomm.

OPERATOR: Mike Olson from Piper Jaffray has our next question.

MICHAEL JOSEPH OLSON, MD & SENIOR RESEARCH ANALYST, PIPER JAFFRAY COMPANIES, RESEARCH DIVISION: So you have more than 1.4 billion active devices, and at your event, you announced services that leverage that installed base. And you have obviously a remarkable position with kind of this Trojan horse of devices out in so many households. So I guess the question is -- and I know some of these services aren't even live yet, but should we expect a continuation of the building out of new services categories like what we saw at the March event? Is there a pipeline of new services in the works? Or have we kind of seen what we're likely to see on that front for the near to intermediate term? And then I have a follow-up.

TIMOTHY D. COOK: Yes, I wouldn't want to get into announcing things on the call, but obviously, we're always working on new things. And -- but we're -- right now, we're really focused on getting these 4 out there. We have the News+ in the market today. We'll have the Apple Arcade and the Apple TV+ products in the market in the fall, and Apple Card will go out in the summer timeframe. And so we've got lots in front of us, and we're very excited about getting these out there.

MICHAEL JOSEPH OLSON: Right. And then you mentioned the App Store search ad business a couple of times in the prepared remarks. Is that reaching a point where it's become material and maybe moving the needle for overall Services revenue? Or is there anything you can quantify related to that? I also imagine that this is a high-margin business, at least maybe higher than the overall Services margin but wondering if you can confirm if that's the case or not.

TIMOTHY D. COOK: It's growing very, very fast, Mike. I think it was up around 70% over the previous year. We're expanding into new geographies as well, and we still have more geographies out there that we think can move the dial further. So it is a -- it's definitely a business that is big and getting bigger.

OPERATOR: Our next question comes from Lou Miscioscia with Daiwa Capital Markets.

LOUIS ROCCO MISCIOSCIA, RESEARCH ANALYST, DAIWA SECURITIES CO. LTD., RESEARCH DIVISION: Tim, when you look at the 4 things that you have announced, and I realize they have different dates when they're coming out, but which ones would you say, over the next 12 months, has the most potential to help your Services line? And then maybe which one has the best long-term potential? And then I have a quick follow-up.

TIMOTHY D. COOK: We're going to wait until we get these things out. And what I can tell you right now is that the -- we're taking sort of consumer interest on the Apple Card, and there's been a significant level of interest on that and we're excited. As you know, the -- gaming is the top category on the App Store. And so the Apple Arcade will serve some of that market, and it serves it with a different kind of game, which we think will be great for developers and great for users.

The TV+ product plays in a market where it's -- there's a huge move from the cable bundle to over the top. We think that most users are going to get multiple over-the-top products, and we're going to do our best to convince them that the Apple TV+ product should be one of them. And then we're working very hard to get everyone to give Apple News+ a look because we think it's a very unique product. And I love magazines, and we have really wanted to support the publishers. And so we're working very hard to -- at the -- but at the very beginning of the ramp there. We wouldn't do a service that we didn't think could be meaningful, so that's sort of the way I look at it. Yes, these aren't hobbies.

LOUIS ROCCO MISCIOSCIA: Okay. A quick follow-up on India. Obviously, market share there is well, well below China. I believe you're looking to start manufacturing there. But what's the -- obviously, the potential could be huge, but the market already seems to be pretty dominated on the Android side. So maybe if you could just talk about trying to really aggressively ramp up share there.

TIMOTHY D. COOK: I think India is a very important market in the long term. It's a challenging market in the short term, but we're learning a lot. We have started manufacturing there, which is very important to be able to serve the market in a reasonable way, and we're growing that capability there. And we would like to place retail stores there, and we're working with the government to seek approval to do that. And so we plan on going in there with sort of all of our might. We've opened a developer accelerator there, which we're very happy with some of the things coming out of there. It's a long-term play. It's not something that's going to be on overnight huge business, but I think the growth potential is phenomenal. It doesn't bother me that it's primarily Android business at the moment because that just means there's a lot of opportunity there.

NANCY PAXTON: A replay of today's call will be available for 2 weeks on Apple Podcasts as a webcast on Apple.com/investor and via telephone. And the numbers to the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 7060604. And these replays will be available by approximately 5 p.m. Pacific Time today.

Members of the press with additional questions can contact Kristin Huguet at (408) 974-2414, and financial analysts can contact Matt Blake or me with additional questions. Matt is at (408) 974-7406, and I'm at (408) 974-5420. Thanks again for joining us.

OPERATOR: That does conclude our conference for today. Thank you for your participation.

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Presentation

OPERATOR: Good day, and welcome to the Apple Inc. First Quarter Fiscal Year 2019 **Earnings** 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, SENIOR DIRECTOR OF IR AND TREASURY, APPLE INC.: Thank you. Good afternoon, and thanks to everyone for joining us. Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. And after that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook. Actual results or trends could differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed periodic reports on Form 10-K and Form 10-Q 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, CEO & DIRECTOR, APPLE INC.: Thank you, Nancy, and thanks to everyone for joining us today. This isn't the first time you've heard from us regarding the December quarter, so the first thing I want to do is provide some final results and connect those back to the letter we shared at the beginning of the month.

As you know, our December quarter revenue was below our original expectations coming in at $84.3 billion. That's down 5% from a year ago or down 3% adjusting for foreign exchange. We noted 4 factors that would impact our results when we provided guidance in November: different iPhone launch timing from a year ago, FX headwinds, supply constraints on certain products and macroeconomic conditions in emerging markets.

One of those factors, weak macro conditions in some emerging markets, was significantly more severe than we originally foresaw, especially in Greater China. As our letter noted, that challenge was compounded by quarterly iPhone upgrades that were lower than we anticipated. We'll return to upgrades in a moment, but I first want to say a bit more about our business in Greater China. Our revenue there was down by $4.8 billion from last year with declines across iPhone, Mac and iPad. Most of the shortfall relative to our original guidance and over 100% of our worldwide year-over-year revenue decline was driven by our performance in Greater China.

Despite iPhone upgrades being lower than we anticipated, our business grew outside of China, including new records in the Americas, Western Europe, Central and Eastern Europe and our rest of Asia-Pacific segment. We had record performance in large markets, including the United States, Canada, Mexico, Germany, Italy, Spain and Korea.

In the letter we shared earlier this month, we said we are proud to participate in the Chinese marketplace and that we believe our business has a bright future there over time. But I think some of that got lost, so I want to share a bit more detail on the positives we see in China.

We generated record December quarter services revenue in Greater China, fueled by an amazing ecosystem with over 2.5 million registered iOS developers. We saw very strong results from our Wearables business there with revenues up over 50%. We also continued to grow our total active installed base by adding new customers. In fact, more than 2/3 of all customers in China who bought a Mac or an iPad during the December quarter were purchasing that product for the first time.

Finally, for perspective, despite the challenging December quarter, our revenue from China grew slightly for the full calendar year. Macroeconomic factors will come and go, but we see great upside in continuing to focus on the things that we can control.

Returning to iPhone, I'd like to talk about our results in the context of those lower-than-expected upgrades. iPhone XR, iPhone XS and iPhone XS Max are, by far, the best iPhones we've ever shipped. They share advanced technologies, including the A12 Bionic, the most powerful chip ever in a smartphone with our next-generation Neural Engine capable of 5 trillion operations per second. These are also completely modern iPhones with stunning large full-screen displays and Face ID, the most secure authentication of any kind available in a smartphone.

And the cameras are simply amazing with portrait mode and depth control to allow users to create studio-quality photos as well as stunning 4K video, opening a whole new era of photography. We couldn't be more proud of our iPhone lineup and our industry-leading customer satisfaction. We wouldn't change our position for anyone.

Now our customers are holding on to their older iPhones a bit longer than in the past. When you pair this with the macroeconomic factors, particularly in emerging markets, it resulted in iPhone revenue that was down 15% from last year. Our iPhone results accounted for significantly more than our entire year-over-year revenue decline. In fact, outside of iPhone, our business grew strongly by 19%. So what's behind this?

It's important to understand what's going on from the customer perspective at the point of purchase. We believe that it's the sum of several factors: first, foreign exchange. The relative strength of the U.S. dollar has made our products more expensive in many parts of the world. In Turkey, for example, the lira depreciated by 33% over the course of calendar 2018, and in the December quarter, our revenue there was down by almost $700 million from the previous year.

Second, subsidies. For various reasons, iPhone subsidies are becoming increasingly less common. In Japan, for example, iPhone purchases were traditionally subsidized by carriers and bundled with service contracts. Competitive promotional activity frequently increase the amount of subsidy during key periods. Today, local regulations have significantly restricted those subsidies as well as related competition. As a result, we estimate that less than half of iPhones sold in Japan in Q1 of this year were subsidized compared to about 3/4 a year ago and that the total value of those subsidies had come down as well.

Third, our battery replacement program. For millions of customers, we made it inexpensive and efficient to replace the battery and hold onto their existing iPhones a bit longer. Some people have suggested that we shouldn't have done this because of the potential impact on upgrades, but we strongly believe it was the right thing to do for our customers.

What's very important, however, is that in spite of these factors, our total active installed base of devices has grown from 1.3 billion at the end of January of 2018 to 1.4 billion by the end of December, reaching a new all-time high for each of the main product categories and for all 5 of our geographic segments. Not only is our large and growing installed base a powerful testament to the satisfaction and loyalty of our customers, but it's also fueling our fast growing Services business. In fact, Services revenue set an all-time record at $10.9 billion in the December quarter, growing 19%.

We not only generated our highest global Services revenue ever, but we also had all-time records across multiple categories of Services, including the App Store, Apple Pay, cloud services and our App Store Search Ad business, and we had a December quarter record for AppleCare. And I'm very proud to say that nearly 16 years after launching the iTunes Store, we generated our highest quarterly music revenue ever, thanks to the great popularity of Apple Music, now with over 50 million paid subscribers.

The App Store wrapped up its best year ever with record holiday period results propelled by the biggest Christmas Day and Christmas week ever. Customers also spent over $322 million on New Year's Day alone, setting a new single-day record for both the number of customers and purchase volume. It was also a great holiday season for Apple Pay with over 1.8 billion transactions in the quarter, well over twice the volume of the year-ago quarter. Merchant adoption continues to reach new milestones. Customers can now use Apple Pay with iPhone and Apple Watch at nearly 3,000 Speedway locations, while all Target, Taco Bell and Jack in the Box stores will be accepting Apple Pay soon.

We launched Apple Pay in 3 new countries in the December quarter: Germany, Belgium and Kazakhstan and it's now live in 27 markets around the world. The rollout in Germany has been a huge success with Deutsche Bank reporting more activations for Apple Pay in 1 week than for Android in an entire year. This is yet another example of what's possible when you bring together Apple's world-class hardware, software and ecosystem with our engaged and active user base. Shoppers around the world love Apple Pay, and it has increasingly become an indispensable part of daily life.

Revenue from cloud services continues to grow rapidly with year-over-year revenue up over 40% in the December quarter. And readership of Apple News set a new record with over 85 million monthly active users in the 3 countries where we've launched: the United States, the U.K. and Australia. Here in the U.S., the latest data from comScore shows that Apple News has the largest audience of all news apps. And the international audience will continue to grow with our first-ever bilingual launch in Canada available to customers later this quarter.

In summary, we're very happy not only with the growth but also the breadth of our Services portfolio. Our revenue from Services has grown from less than $8 billion in calendar 2010 to over $41 billion in calendar 2018. The largest category represents less than 30% of total Services revenue, and the new services we've launched in the last few years are all experiencing tremendous growth.

We had our best quarter ever for Mac revenue, which was up 9% fueled by our new MacBook Air and Mac mini introduced in October. The MacBook Air includes a beautiful new Retina display, Touch ID and Force Touch Trackpad, while the new Mac mini provides a powerful, flexible solution for everything from home automation to giant render farms.

iPad revenue was up 17%, its highest growth rate in almost 6 years, powered by the new iPad Pro released in November. With its edge-to-edge Liquid Retina display, Face ID and A12X Bionic chip, the new iPad Pro has been described by reviewers as a tablet with no equal and the most powerful mobile device ever made.

We also had our best quarter ever for Wearables, Home and Accessories with 33% growth in total and almost 50% growth from Wearables, thanks to strong sales of both Apple Watch and AirPods.

We don't measure our success in 90-day increments. We manage Apple for the long term, and when we consider the keys to our success over time, there are 3 that stand out: our highly satisfied and loyal customers; our large and growing active installed base; and at the heart of it all, our deeply ingrained culture of innovation. Thanks to all this, our ecosystem is stronger than ever before.

We have an amazingly talented team, creating hardware, software and services, optimizing each of them to create an unparalleled user experience. Apple Watch is a powerful example of that. It's humbling to read e-mails from customers around the world telling us how Apple Watch has dramatically changed their lives by motivating them to be more fit and active, by alerting them to potentially serious health conditions such as AFib and by helping them in times of crisis with features like fall detection and emergency SOS. We believe we are just beginning to see the impact we can make to improving health and are deeply inspired by the possibilities.

Another example is the work we're doing with silicon. We've embedded machine learning directly into the silicon with our A12 Bionic chip. Our custom Neural Engine not only provides power efficiency and incredible performance in a very small package, but it also enables processing of data and transactions directly on the device. This means iPhone can recognize patterns, make predictions and learn from experience, and it does all this while keeping personal information private. This is a powerful example of how innovation and privacy can go hand in hand at a time when these issues are increasingly important to our users.

We are undertaking and accelerating a number of initiatives to improve our results. It's not in our DNA to just stand around and wait for macroeconomic conditions to improve. One such initiative is making it simple to trade in an iPhone in our stores and raising awareness of this opportunity. Because of the quality and durability of iPhones, they maintain significant residual value, making trade-ins a great opportunity. It's not only great for the environment. It's great for the customer as their existing phone acts as a subsidy for their new phone, and it's great for developers as the phone that is traded in and redistributed can help grow our active installed base.

Beginning last week, we started making it easier for people to pay for their phones over time with installment payments, and we're working on rolling out this program to more geographies as soon as we can. We are as confident as ever in the fundamental strength of our business, and we have a very strong pipeline of products and services with some exciting announcements coming later this year. Apple innovates like no other company on Earth, and we are not taking our foot off the gas. We'll continue to invest through near-term headwinds just as we always have, and we'll emerge stronger as a result.

Now for more details on our December quarter results, I'd like to turn the call over to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone. As Tim said, revenue for the December quarter was $84.3 billion. This result was below our expectations, but we were able to set new all-time revenue records in the U.S., Canada, Latin America, Western Europe, Central and Eastern Europe and Korea. Our results were especially strong in the U.S., where revenue was up by more than $1.5 billion compared to a year ago and in several markets where revenue grew by double digits, including, among others, Germany, Spain, Poland, Mexico, Malaysia and Vietnam.

Looking at product categories. iPhone revenue declined 15% from a year ago, while revenue from the rest of our business grew 19% to an all-time record, including our best results ever for Services, for Wearables and for Mac. Company gross margin was 38%. This quarter, for the first time, we're making an important new disclosure to our investors as we believe it will foster a better understanding of our business. We're now reporting, on a quarterly basis, gross margin for products in aggregate and for services in aggregate. Products gross margin was 34.3%, and services gross margin was 62.8%.

On a sequential basis, products gross margin increased 60 basis points due to positive leverage from the holiday quarter partially offset by higher cost structures as we launched several new products and by headwinds from foreign exchange. Services gross margin also increased 170 basis points sequentially due to favorable mix and leverage partially offset by foreign exchange. While both products and services gross margins improved sequentially, total company gross margin was down 30 basis points due to a different mix between products and services.

Net income was $20 billion, about flat to last year; and diluted **earnings** per share were an all-time record at $4.18, an increase of 7.5% over last year. Operating cash flow was also very strong at $26.7 billion.

Let me provide more color for the various products categories. iPhone revenue was $52 billion. On a geographic basis, most of the decline from last year came from Greater China and other emerging markets, where difficult macro and foreign exchange conditions affected our results. We also believe that the reduction of carrier subsidies and our battery replacement program had an impact in a number of countries around the world. And as Tim mentioned, we had a lower number of upgrades than we had anticipated at the beginning of the quarter.

However, our global active installed base of iPhones continues to grow and has reached an all-time high at the end of December. We are disclosing that number now for the first time. And it has surpassed 900 million devices, up year-over-year in each of our 5 geographic segments and growing almost 75 million in the last 12 months alone. We plan to provide information on the iPhone installed base as well as total installed base on a periodic basis.

Customer satisfaction and loyalty for iPhone continue to be outstanding and are the highest in the industry. The latest survey of U.S. consumers from 451 Research indicates customer satisfaction of 99% for iPhone XR, XS and XS Max combined. And among business buyers who plan to purchase smartphones in the March quarter, 81% plan to purchase iPhones. Based on the latest information from Kantar, iPhone experienced a 90% customer loyalty rating for iPhone customers in the U.S., 23 points above the next highest brand measured.

Turning to Services. It was our best quarter ever with revenue of $10.9 billion, up 19% year-over-year with new December quarter records in all 5 of our geographic segments. Many Services categories set new all-time revenue records, and we are on track to achieve our goal of doubling our fiscal 2016 Services revenue by 2020. To be clear and as we've already explained 90 days ago, our 2020 goal remains unchanged, and it excludes the impact of the revenue reclassification between products and services we recorded in connection with ASC 606, the new revenue recognition accounting standard that we adopted at the beginning of fiscal '19.

The level of engagement of our customers in our ecosystem continues to grow. The number of transacting accounts on our digital stores reached a new all-time high during the quarter with the number of paid accounts growing by strong double digits over last year. And we now have over 360 million paid subscriptions across our Services portfolio, an increase of 120 million versus a year ago. Given the continued strength and momentum in this part of the business, we now expect the number of paid subscriptions to surpass 0.5 billion during 2020.

Our subscription business has become very large and diversified, covering many different categories from entertainment to health and fitness to lifestyle. In fact, more than 30,000 third-party subscription apps are available today on the App Store, and the largest of them accounts for only 0.3% of our total Services revenue.

Next, I'd like to talk about the Mac. We saw great response to the new MacBook Air and Mac mini that we introduced in October, which helped drive a 9% increase in Mac revenue over last year to a new all-time record. Mac revenue was up in the vast majority of countries we track with double-digit growth in many large markets such as the U.S., Western Europe, Central and Eastern Europe, Japan, Korea and South Asia. Our active installed base of Macs reached a new all-time high, and half of all the customers purchasing Macs in the December quarter were new to Mac.

 

We also had great results for iPad with revenue up 17% from a year ago. And strong performance of both iPad and iPad Pro had generated double-digit growth in 4 of our 5 geographic segments. Similar to the Mac, our installed base of iPads reached a new all-time high, and among customers purchasing iPad during the quarter, half were new to iPad.

The most recent consumer survey from 451 Research measured a 94% customer satisfaction rating for iPad overall with iPad Pro models scoring as high as 100%. Among business customers who plan to purchase tablets in the March quarter, 68% plan to purchase iPads.

Wearables, Home and Accessories revenue grew 33% to a new all-time record in each of our geographic segments. Revenue from this category was up over $1.8 billion compared to a year ago, thanks to the amazing popularity of Apple Watch and AirPods, both of which were supply constrained as we exited the quarter. Based on revenue over the past 4 quarters, our Wearables business is approaching the size of a Fortune 200 company.

Our retail and online stores generated strong results from Mac and iPad and all-time record performance from Services and from Wearables. Following the launch of the new iPhone trade-in campaign, our stores more than doubled the volume of iPhones traded in compared to last year, reaching an all-time high in Q1. We added Thailand to our footprint with a beautiful store in Bangkok, and we opened a stunning new store on Champs-Ã‰lysÃ©es in Paris, exiting the quarter with 506 physical stores in 22 countries.

In enterprise, across multiple industries, our technology continues to enable businesses to do their best work. In health care, iPhones and iOS apps continue to streamline and support clinical workflows, communications and care delivery across leading health systems, including Johns Hopkins Medicine, Massachusetts General Hospital, Stanford Health Care and St. Jude Children's Research Hospital.

In manufacturing, SKF, the world's largest producers of bearings and seals, have transformed their manufacturing processes on iOS and iPhone with incredible success. With custom iOS apps available to production operators across their worldwide locations, SKF has reduced production errors from 20% to 0 while saving 70% in system-related time. Apple technology has made possible a simplified user experience integrating the SAP Cloud Platform, yielding better accuracy, efficiency and employee experiences across the board.

We're also seeing great innovation in the construction industry with iPad and new third-party apps made for iOS. For instance, Procore Technologies has introduced an app to help decrease building errors on the job site. By using Metal and Split View with the iPad camera, construction workers can compare building plans and 3D models to what is actually being built in realtime. This new iOS app reduces wasted raw materials and helps keep building projects on time and on budget.

Let me now turn to our cash position. We ended the quarter with $245 billion in cash plus marketable securities. We also had $102.8 billion in term debt and $12 billion in commercial paper outstanding for a net cash position of $130 billion. As we explained in the past, it is our plan to reach a net cash neutral position over time.

As part of this plan, we returned over $13 billion to our investors during the December quarter. We repurchased 38 million Apple shares for $8.2 billion through open market transactions, and we paid $3.6 billion in dividends and equivalents. Consistent with our historical cadence, we plan to provide an update on our overall capital return program when we report our March quarter results.

As we move ahead into the March 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 $55 billion and $59 billion. This range reflects a negative year-over-year impact of $1.3 billion from foreign exchange, which represents about 210 basis points of last year's revenue and a more uncertain macroeconomic environment than a year ago, especially in emerging markets.

We expect gross margin to be between 37% and 38%. On a sequential basis, this range reflects seasonal loss of leverage and a 60 basis point unfavorable impact from foreign exchange, partially offset by commodity cost savings.

We expect OpEx to be between $8.5 billion and $8.6 billion. We expect OI&E to be about $300 million, and we expect the tax rate to be about 17%. Also, today, our Board of Directors has declared a cash dividend of $0.73 per share of common stock payable on February 14, 2019, to shareholders of record as of February 11, 2019.

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

NANCY PAXTON: Thank you, Luca. (Operator Instructions)

Questions and Answers

OPERATOR: Our first question will come from Katy Huberty with Morgan Stanley.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: Services growth did decelerate from the growth rates in recent quarters. So can you talk about the factors that played into that slower growth? And then appreciate the new disclosure around paid subscribers. But if you compare what you added in 2018 versus what you expect to add over the next 2 years, that implies a slowdown in annual net new subscribers. So should we be thinking about Services as a lower growth segment than what you experienced in 2018? And then I have a follow-up.

LUCA MAESTRI: Yes, Katy, let me take that one. First of all, when we talk about the Services business, it's very important to start from the momentum that we have. As you know, we have set an ambitious target for ourselves to double the size of our business from fiscal '16 to 2020, which implied, at the time, a 19% CAGR. So far, we've been able to grow about 20%. In fiscal '18, we grew 22%, so we are on track to achieve our objective. And it's important to understand what is driving the growth of the business. First of all, it's our installed base. As we just told you, the installed base continues to grow very nicely. It has reached 1.4 billion active devices at the end of December, and really, very little of our Services revenue is driven by what we sell in the last 90 days. The second factor for the growth of the Services business is that, within this installed base, the percentage of users who are paying for at least 1 service is growing very strongly. This is due to several factors. First of all, we're offering more and more services. During the last few years, as you know, we launched Apple Music, Apple Pay and advertising service for our developers on the App Store. All these businesses are growing very strongly. Second, we are making it easier for our customers to transact on our digital stores. We accept many more payment methods today, which are very common in certain countries around the world. We've also increased the distribution coverage for many of these services. We're bringing AppleCare to more points of sale around the world. We are launching Apple Pay in more and more markets and so on. Thirdly, as you mentioned, our subscriptions are becoming a very large portion of our business, and they're growing very well above Services average. And the fact that we are saying that we will surpass 0.5 billion during 2020, we're not putting a specific date during 2020, but I think you've seen over recent quarters that we've been adding about 120 million on a year-over-year basis for a number of quarters now. And this is an incredible staggering number, right, when you think about it. We're also broadening the scope of many of these services. You should take Apple Pay as an example. It started off as the most convenient, most private and most secure way to make a payment in a store or in an app. Then, we took Apple Pay to Safari. Then, we started a peer-to-peer service, and we're launching it in new markets across the world every quarter. So we are broadening that scope. And of course, similar to what we've done in the past in the last 3 years we launched several new services, we're also looking to launch new services going forward that we believe will provide great value to our users. And we're really very excited about the opportunities that we see in front of us. I think you're referring to the deceleration in the growth rate that we've seen in the December quarter, and I think you're referring back to the growth that we reported in September. I think an important point I need to make and I think it's helpful that you asked the question is that a portion of this deceleration is truly just a reclassification of the amortization of free services that we've made in connection with the adoption of the new revenue recognition standard. And as we explained 90 days ago, this amortization of free services in the past was reported under products and now gets reported under services. The reclassification is actually dilutive to our growth rate because the amortization of free services is a relatively stable number, which gets applied to our growing base. So this reclassification reduces our growth rate versus the previous classification. This factor, by itself, represents roughly 1/3 of the deceleration that you've seen. We talked about 27% growth in the September quarter. With the reclassification, that growth rate was about 24.5%. So that explains about 1/3 of that deceleration. There are, I would say, 3 factors that explain this difference between the 24.5% to the 19%. The first one is that foreign exchange plays a role. Roughly 60% of our Services business is outside the United States; and as you know, the U.S. dollar has appreciated in recent months. And in general, we tend not to reprice our services for foreign exchange on a very frequent basis. The second factor is a well-known issue around the App Store in China. The App Store in China is a large business for us. We believe this issue around the approval of new game titles is temporary in nature but clearly is affecting our business right now. And then thirdly, we are seeing some level of deceleration in AppleCare, which has had very, very strong growth during fiscal '18, where we're starting to lap some of the increase in distribution coverage that we put in place recently and the channel fill of Apple components that happened when we increased the distribution coverage. But in general, we are very, very pleased with 19% growth, and we think that the business will continue to grow nicely going forward.

KATHRYN LYNN HUBERTY: Just a quick follow-up, Luca. Share repurchases in the December quarter were well below the run rate from the June and September quarters. How much did the weaker quarter play into your ability to carry out the buyback at the same level? And what should we think about as the right run rate going forward?

 

LUCA MAESTRI: Well, Katy, we've always said that we're very committed to executing our program. We have done almost $250 billion of repurchases from the beginning of the program. But we've also said that we want to execute the program in an efficient, effective, I will say, disciplined manner. And that takes into account also overall market conditions. So that's what we did during the course of the December quarter. We -- our fundamental view remains the same. We are optimistic about our future, and we think there is great value in our stock. And so we will continue to execute the program. We will continue to report at the end of every quarter. And by the way, when we report our March quarter results, we will also talk about the next step in our capital return program, which is something that we do traditionally in the spring.

OPERATOR: The next question will come from Steve Milunovich with Wolfe Research.

STEVEN MARK MILUNOVICH, MD OF EQUITY RESEARCH, WOLFE RESEARCH, LLC: Some have the perception that you priced the new products, the new iPhones too high. What have you learned about price elasticity? And do you feel that perhaps you pushed the envelope a little bit too far and might have to bring that down in the future?

TIMOTHY D. COOK: Steve, it's Tim. If you look at what we did this past year, we priced the iPhone XS in the U.S. the same as we priced the iPhone X the year ago. The iPhone XS Max, which was new, was $100 more than the XS. And then we priced the XR right in the middle of where the entry iPhone 8 and entry iPhone 8 Plus have been priced. So it's actually a pretty small difference in the United States compared to last year. However, the foreign exchange issue that Luca spoke of in the call and -- made that difference or amplified that difference in international markets, in particular, the emerging markets, which tended to move much more significantly versus the dollar. And so what we have done in January and in some locations and some products is essentially absorb part or all of the foreign currency move as compared to last year and therefore, get close or perhaps right on the local price from a year ago. So yes, I do think that price is a factor. I think part of it is that, the FX piece. And then secondly, in some markets as I had talked about in my prepared remarks, the subsidy is probably the bigger of the issues in the developed markets. I had mentioned Japan; but also even in this country, even though the subsidy has gone away for a period of time, if you're a customer that your last purchase was a 6s or 6 or in some cases, even a 7, you may have paid $199 for it -- and now in an unbundled world, it's obviously much more than that. And so we are working through those, and we've got a number of actions to address that, including the trade-in and the installment payments, which I had mentioned as well.

STEVEN MARK MILUNOVICH: I know that you're not giving units going forward, but you said you might make qualitative comments. I was wondering if you have a comment particularly on the ASP on a year-over-year basis.

LUCA MAESTRI: Well, Steve, we did mention on the call last quarter that the different timing of our phone launches would affect the year-over-year compares. If you remember, our top models, the XS and XS Max shipped during the September quarter, which plays the channel fill and the initial sales in that quarter. While last year, the iPhone X shipped in Q1 in the December quarter but is in the channel fill and the initial sales in the December quarter. So we knew that this would create a difficult compare for Q1 of '19, and this is essentially what happened. It was pretty much in line with our expectations. To give you more color, I would say that the XR is our most popular model, and it's followed by XS Max and then the XS.

OPERATOR: The next question will come from Toni Sacconaghi with Bernstein.

A.M. SACCONAGHI, SENIOR ANALYST, SANFORD C. BERNSTEIN & CO., LLC., RESEARCH DIVISION: I have one for Luca and one for Tim. Luca, looks like the midpoint of your Q2 revenue guidance implies the steepest Q1 to Q2 sequential decline in iPhone revenues in history. It also implies a year-over-year deceleration in iPhone revenues. And I'm wondering if you can comment about whether that's conservatism, whether you're entering the quarter with a high level of channel inventory, and maybe you can comment explicitly on that, or whether you actually think the macroeconomic conditions are getting worse.

LUCA MAESTRI: Yes. I mean, 3 questions there. The first one is a question around conservatism. As we always do, when we provide a range, it's a range that we believe we're going to fall within. We've done pretty well with that up until the December quarter, right? I mean, we've been -- we didn't miss in years and years. So that's the idea. It's -- there is that specific level of conservatism. We believe that this is the range where we're going to fall within. On channel inventory, as you know, our historical pattern for iPhone channel inventory is that, typically, we increase inventory in Q1 and we decrease in Q2. And we think this year will be similar, and we've exited the December quarter with levels of inventory that we are comfortable with. So that leaves us with the reality that our iPhone performance in Q1, from a revenue standpoint, was minus 15%. And we expect that the key factors that Tim mentioned during the call affecting iPhone performance in Q1 will also have an effect on Q2 starting with the strong U.S. dollar environment. On a year-over-year basis, the negative impact from currency is going to be about $1.3 billion, so that's about -- a bit more than 2 points versus last year's revenue. And so that obviously plays a role. And the macroeconomic environment, particularly in emerging markets, will continue to be there. On the positive side, we expect that we will continue to grow revenue nicely from the rest of the business, which is not iPhone.

A.M. SACCONAGHI: Tim, at your September event, Lisa Jackson, an Apple VP, stated the company needed to "design products to last as long as possible." And Apple's clearly doing that by helping with the battery replacement program, iOS working on an older range of products, et cetera. But I guess, the question is why doesn't that mean that replacement or upgrade cycles for iPhones should continue to extend going forward, in part, because that's almost one of your objectives. And maybe to that end, maybe you can help us understand what iPhone's average replacement cycle might be today and how that may have changed over the last 3 to 5 years. And again, why wouldn't you expect it to elongate over time given some of the aforementioned things?

TIMOTHY D. COOK: We do design our products to last as long as possible. Some people hold onto those for the life of the product, and some people trade them in. And then that phone is then redistributed to someone else. And so it doesn't necessarily follow that one leads to the other. The cycles -- the average cycle has extended. There's no doubt about that. We've said several times, I think, on this call and before that the upgrades for the quarter were less than we anticipated due to the -- all the reasons that we had mentioned. So where it goes in the future, I don't know, but I'm convinced that making a great product that is high quality, that is the best thing for the customer and we work for the user. And so that's the way that we look at it.

OPERATOR: Next question will come from Shannon Cross with Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: I wanted to ask about the trajectory of Services gross margin, up about 500 basis points, it appears, year-over-year. You talked a little bit about sequential. But what's driving the improvement? Or will it be volatile as we go through the year depending on quarters and mix? Just whatever color you can give us as we start to forecast this.

LUCA MAESTRI: Yes, Shannon. I think you've seen that Services gross margins increased on a year-over-year basis by a significant amount. Let me start with sequential because I think it's probably most relevant for us. Sequentially, we increased 170 basis points. It's a business that is growing nicely, so we get good support from our scale. Some of these services are scaling quickly, and so we tend to expand gross margins there. And also, we had favorable mix. As you probably know, we have a very broad portfolio of services. Some of them tend to be accretive to the average gross margin for Services also because of the way we account for them. For example, you know that on the App Store, we book revenue on a net basis, and therefore, the gross margins tend to be accretive. But we also have services that are very successful that are below the average for the Services business. And so depending on how these separate businesses do in the marketplace, we're going to be seeing some level of movement going forward on Services margins. But you've seen that, for the last 12 months, they've gone up nicely, 450 basis points, and sequentially, they've gone up 170 basis points. But I wouldn't draw necessarily a conclusion on how this Services gross margin is going to move over time. We will report, of course, at the end of every quarter. But important to keep in mind, it's a broad portfolio with very different gross margin profiles within the portfolio. It is important for us to grow gross margin dollars. And if at times we grow services that are at a level of gross margins, which is below average, as long as this is good for the customer and as long as we generate gross margin dollars, we're going to be very pleased.

SHANNON SIEMSEN CROSS: And then, Tim, can you talk a bit about video? You've signed a myriad of deals. There was announcement about their TV app directly on Samsung. So perhaps when this comes out, you'll be multiplatform. I'm just curious how you view the opportunity in video. And I guess, assuming you can just leverage the costs that you've made already, it should be accretive to margin, I would think.

TIMOTHY D. COOK: Yes. Shannon, we see huge changes in customer behavior taking place now, and we think that it will accelerate as the year goes by to sort of the breakdown of the cable bundle that's been talked about for years. And I think that it'll likely take place at a much faster pace this year. And so we're going to participate in that in a variety of ways. One of those is through Apple TV, and you're well familiar with that product. The second way is the -- is AirPlay 2, which we have -- as you just pointed out, we have support on a number of different third-party TVs. And we're excited about that. It makes the experience in the living room with people using our products even better. We think that people are really going to like that. Another way is, of course, the -- all the third-party video subscriptions that are on the store. We're participating in this today. And I would guess that, that's going to accelerate into the future as the bundle breaks down and people begin to buy likely multiple services in place of their current cable bundle. And then finally, original content, where -- we will participate in the original content world. We have signed a multiyear partnership with Oprah. But today, I'm not really ready to extend that conversation beyond that point. We've hired some great people that I have a super amount of confidence in, and they're working really hard. And we'll have something to say more on that later.

 

OPERATOR: The next question will come from Walter Piecyk with BTIG.

WALTER PAUL PIECYK, CO-HEAD OF RESEARCH AND MD, BTIG, LLC, RESEARCH DIVISION: I just have a question on the free services. Can you just describe how the math works on that? Is it that the free services are noncash revenue that's getting booked in the services revenue with no cost and the costs come out of products? Can you just run us through what the current state is versus how you were accounting for that before?

LUCA MAESTRI: Yes. In essence, when we sell a product at a certain price, we make an assumption. We estimate the value that can be associated to providing free service. In our case, it's providing Maps services, providing Siri and providing free iCloud to all the customers that purchase our product. And so we calculate an estimated value. That value gets deferred and gets amortized over the estimated period of time that we deliver the free services. In the past, that deferral and the subsequent amortization was reported under products. Now in connection with the new revenue recognition standard, we are reclassifying essentially that amortization from products revenue to services revenue. So total revenue has not changed. We just report that estimated value under the services category. We also reclassify the cost that we need to incur to provide those services. So the gross margin rate of each services is clearly significantly dilutive to the overall Services margin. I hope I've answered that.

WALTER PAUL PIECYK: Yes, you're right. So it's in mixed services gross margin. Got it. And then my other -- my second question is just when you think about growth in Services, you have selling more to existing paid subscription customers or it's the 300 million going to 0.5 billion. If you can just talk, at a high level, as far as when you look at growth going forward, is it about -- what is the mix in terms of selling more to existing users, getting new users or -- and maybe some of the individual services that you see the biggest growth opportunity?

LUCA MAESTRI: Yes. I mean, as I said, I mean, essentially, what -- the services -- I said services too is our installed base. So the first driver is growing the installed base. Installed base has grown nicely over the last several years. We've added 100 million in the last 12 months alone. So that's the first step. Then within that installed base, of course, we want to make sure that there are more people that are so interested in our services that, in addition to transacting on those services on a free basis, they also are interested in paying for those services. And I mentioned that the percentage of paid accounts has increased strong double digits. So we want to continue to do that. We want to make it easier for our customers to actually use our services, and so we are accepting more and more payment methods around the world. And clearly, as you said, the idea of adding new services is very important to us. During the last 3 years, we've added Apple Pay, which has been incredibly successful and is a wonderful customer experience. We've added Apple Music, where we now have more than 50 million paid subscribers and continues to grow very nicely. And we've added a very useful service to our developers. We provide an advertising service for developers on the App Store. The way we've added these services in the past, obviously, we're also very interested in adding new services that can provide great value to our customers in the future. And we don't want to get into product announcements here, but obviously, that is part of our strategy.

NANCY PAXTON: Thank you all. A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor and via telephone. And the numbers for the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 2358120. These replays will be available by approximately 5 p.m. Pacific Time today.

Members of the press with additional questions can contact Kristin Huguet at (408) 974-2414. Financial analysts can contact Matt Blake or me with additional questions. Matt is at (408) 974-7406, and I'm at (408) 974-5420. And thanks again for joining us.

OPERATOR: That does conclude our conference for today. Thank you for your participation.

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Presentation

OPERATOR: Good day, and welcome to the Apple Inc. Fourth Quarter Fiscal Year 2018 **Earnings** 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, SENIOR DIRECTOR OF IR AND TREASURY, APPLE INC.: Thank you. Good afternoon, and thanks to everyone for joining us. Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation and future business outlook. Actual results or trends could differ materially from our forecast.

For more information, please refer to the risk factors discussed in Apple's most recently filed periodic reports on Form 10-K and Form 10-Q 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, CEO & DIRECTOR, APPLE INC.: Thank you, Nancy. Good afternoon, everyone, and thanks for joining us. I just got back from Brooklyn, where we marked our fourth major launch at the end of the year. In addition to being a great time, it put an exclamation point at the end of a remarkable fiscal 2018.

This year, we shipped our 2 billionth iOS device, celebrated the 10th anniversary of the App Store and achieved the strongest revenue and **earnings** in Apple's history. In fiscal year '18, our revenue grew by $36.4 billion. That's the equivalent of a Fortune 100 company in a single year. And we're capping all that off with our best September quarter ever.

Revenue was $62.9 billion, ahead of our expectations. That's an increase of 20% over last year and our highest growth rate in 3 years. We also generated record Q4 **earnings** with 41% year-over-year growth in EPS. Record results from iPhone, Services and Wearables drove our momentum, and we produced strong double-digit revenue growth in all of our geographic segments.

It was a big year and a big quarter for iPhone. Q4 revenue was up 29% over last year, an increase of over $8 billion to a new September quarter record, fueled by continued momentum for iPhone 8, 8 Plus and X and the very successful launch of iPhone Xs and iPhone Xs Max. These latest devices are our most advanced iPhones ever with the industry's first 7-nanometer A12 Bionic chip with an Apple-designed 8-core Neural Engine capable of executing an astounding 5 trillion operations per second.

The A12 Bionic is many years in the making and a huge technological leap forward. It sets the iPhone experience far apart from the competition using real-time machine learning to transform the way we experience photo, gaming, augmented reality and more. It makes full use of the dual-camera system that shoots portrait mode photos with Smart HDR and dynamic depth of field, and Face ID is even faster.

The response has been powerful. As one reviewer put it, "iPhone Xs and Xs Max are the perfect blend of design and craftsmanship as well as seamlessly intuitive user experience." We're not done yet. Just last week, we began shipping iPhone XR, bringing the latest iPhone breakthroughs to even more users. With an all-screen glass and aluminum design and the most advanced LCD in a smartphone, the product reviews had been overwhelmingly positive.

iOS 12 has gotten off to an incredible start. It's been installed on more systems in its first month than any version of iOS ever. iOS 12 is delivering system-wide performance enhancements, Siri Shortcuts and new tools to help people reduce interruption and manage screen time for themselves and their kids.

Siri Shortcuts, in particular, is already deeply integrated with some of the most popular apps out there. Whether you're tracking your workouts or rushing to catch a flight, you can be sure all of your most relevant apps are working together with Siri in the driver seat.

iOS 12 also features ARKit 2, a major upgrade to our augmented reality engine. ARKit 2 makes possible simultaneous multi-user experiences and real-world object incorporation. Our developer community is really running with this technology. From gaming to shopping, we're seeing great new use cases emerge. iOS devices deliver the best AR experiences of any products in the market today, and with the announcement of our new iPad Pro this week, we've made that gap even wider.

More powerful than the vast majority of PC laptops, the new iPad Pro is unrivaled in its versatility and performance. And paired with the beautifully refined Apple Pencil and a new streamlined full-size smart keyboard, iPad Pro will extend its lead as the ultimate creativity and productivity device. And finally, just this week, we delivered the hotly anticipated group FaceTime functionality to all FaceTime-enabled devices.

For Services, it was our best quarter ever with revenue at $10 billion. Excluding the impact of a favorable onetime accounting adjustment of $640 million a year ago, our Services growth was 27%.

We set new Q4 records in all of our geographic segments and new all-time revenue records for the App Store, cloud services, AppleCare, Apple Music and Apple Pay. We also continued to see strong growth in paid subscriptions, reaching over 330 million in our ecosystem.

I want to spotlight the exceptional performance of Apple Pay, which is, by far, the #1 mobile contactless payment service worldwide. Transaction volume tripled year-over-year, and to put that into perspective, Apple Pay generated significantly more transactions than even PayPal mobile with over 4x the growth rate.

As a testament to accelerating U.S. growth, Costco completed the rollout of Apple Pay to over 500 U.S. warehouses last quarter, while Neiman Marcus is now accepting Apple Pay at over 40 stores across the country. With these additions, 71 of the top 100 merchants and 60% of all U.S. retail locations support Apple Pay.

We continue to invest in our strategy to replace the wallet with the recent launch of student ID passes at several major U.S. universities. And 10 months following its launch, Apple Pay Cash is the highest-rated mobile peer-to-peer service by Consumer Reports based on exceptional payment authentication and data privacy.

We set an all-time quarterly record for Mac revenue, thanks to strong performance in MacBook Pro and the impact of the back-to-school season. In September, we delivered macOS Mojave, bringing powerful new features to Mac like dark mode, stack and a completely redesigned Mac App Store. Considered alongside the release of iOS 12, watchOS 5 and a new tvOS, macOS Mojave tells a powerful story of the seamless integration of world-class hardware, software and services that define the Apple ecosystem.

As I mentioned at the beginning of the call, earlier this week, we announced exciting updates to the Mac lineup. The all-new MacBook Air brings a stunning Retina display, Touch ID, the latest processors and an even more portable design to the world's most beloved notebook. We also unveiled the biggest update ever to Mac mini, the small yet muscular desktop that powers everything from the music and sound effects of Broadway shows to the developers who build some of the most popular apps in the App Store. The new Mac mini boasts an amazing 5x faster performance than before.

With revenue growth over 50%, it was another record quarter for Wearables, which includes Apple Watch, AirPods and Beats products. With the highest customer satisfaction in the industry, Apple Watch has become an essential part of people's lives. The customer response to the Apple Watch Series 4 has been overwhelmingly positive, driven by its all-new design, larger display, faster performance, fall detection, enhanced cellular reception and electrical heart sensor.

Later this year, the ECG app will be available to Apple Watch Series 4 customers in the U.S., giving them the ability to take an electrocardiogram anytime right from their wrists. And for U.S. customers with Apple Watch Series 1 and later, watchOS will soon enable periodic checks for irregular heart rhythms that may be suggestive of AFib. These are unprecedented and potentially life changing features, showing how Apple Watch is not only an indispensable communication and fitness companion but also an intelligent guardian for your health. More broadly, we see this as just one further example of the kind of contribution we can make in the health space, and we look forward to making more in the future.

We are proud to bring HomePod to new customers. I was in Spain last week as HomePod became available there and in Mexico. HomePod delivers the highest fidelity audio quality, working together with an Apple Music subscription to stream over 50 million songs into any room in your home.

Our retail team posted record Q4 results to conclude their biggest year ever. They are transforming our stores into places where customers come to connect, learn and be inspired together with people from their community. Our Today at Apple sessions are a terrific example of what that looks like in practice. We hosted over 250,000 Today at Apple sessions this quarter, connecting aspiring creators with local photographers, illustrators and other experts who can help them get the most out of their devices. Apple Stores also hosted 74,000 kids at Apple Camp.

The relationship Apple has with our customers is about more than just making a purchase. With the recent addition of beautiful new stores in Italy, Japan, China and in just a few weeks, Thailand, we will have 506 stores where we can further those relationships, almost half of which are outside United States.

Before I turn the call over to Luca, I'd like to touch on 2 items that may not show up in our financial statement but are just as integral to Apple's mission and our commitment to making the world a better place.

First, education. More than 5,000 schools, community colleges and technical colleges worldwide are now using Everyone Can Code, our free coding curriculum. Ideas, creativity and passion for technology's potential aren't limited by ZIP code or country, and we don't think opportunity should be either. We're also excited that educators in more than 350 schools around the world have started working with Everyone Can Create, the free collection of tools and project guides we introduced this spring designed to help unleash kids' creativity throughout their school day with the help of iPad.

Next is the environment. This was a milestone year for Apple's commitment to our planet. In April, we announced that 100% of our global operations are powered by renewable energy. We also made progress in doing the same in our supply chain. And just this week, we announced that the enclosures of new products like MacBook Air and iPad Pro will be made from 100% recycled aluminum, a strong, durable and beautiful new alloy designed by Apple.

This is a great example of how a commitment to do right on the issues that matter can drive once unimaginable innovation, new ways of approaching old problems and beautiful solutions that set us apart. I'd like to thank all of our employees, customers, developers and business partners for helping us deliver outstanding results across our fiscal 2018. We are headed into the holidays with our strongest product lineup ever, and we could not be more bullish about Apple's future.

And now Luca has more details to share with you on the September quarter. Luca?

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone. We are extremely pleased to report record results for our September quarter, which capped a tremendously successful fiscal 2018, a year in which we saw double-digit revenue growth in every geographic segment and established new revenue and **earnings** records in every single quarter.

Revenue in the fourth quarter was $62.9 billion, up 20% and more than $10 billion over last year with strong double-digit growth in each of our geographic segments and record Q4 revenue in the Americas, in Europe, Japan and rest of Asia Pacific. In fact, we set new revenue records in almost every market we track with especially strong growth in Germany, Italy, Sweden, Switzerland, Japan and Korea, all major markets where revenue growth was 25% or higher. We also set new fourth quarter revenue records for iPhone and Wearables and new all-time records for Services and Mac.

Gross margin was 38.3%, flat sequentially in line with our expectations as leverage from higher revenue offset seasonal transition costs. We set new September quarter records for net income, EPS and cash flow from operations. Net income was $14.1 billion, up $3.4 billion or 32% over last year. Diluted **earnings** per share were $2.91, up 41%. Cash flow from operations was $19.5 billion, up $3.8 billion from a year ago.

iPhone revenue grew 29% with growth of more than 20% in every geographic segment. iPhone ASP was $793 compared to $618 a year ago, driven by strong performance of iPhone X, 8 and 8 Plus as well as the successful launch of iPhone Xs and Xs Max in the September quarter this year, while we launched iPhone X in the December quarter last year.

We sold 46.9 million iPhones during the quarter with growth of 20% or more in several markets, including Japan, Australia, New Zealand, Sweden, Norway, Chile and Vietnam. Customer satisfaction with iPhone continues to be outstanding and is the highest in the industry. The latest survey of U.S. consumers from 451 Research indicates customer satisfaction of 98% for iPhone X, 8 and 8 Plus combined. And among business buyers who plan to purchase smartphones in the December quarter, 80% plan to purchase iPhones.

Turning to Services. It was our best quarter ever in total and virtually in every market around the world with revenue of $10 billion. A year ago, we had a onetime $640 million favorable impact to Services revenue due to an accounting adjustment, and taking that into account, our Services growth in Q4 this year was 27%. As Tim mentioned, we reached new all-time quarterly revenue records for many Services categories, and we are well on our way to achieve our goal to double our fiscal 2016 Services revenue by 2020.

We now have over 330 million paid subscriptions on our platform, an increase of over 50% versus a year ago. We are very pleased not only with the growth but also with the breadth of our subscription business. In fact, 30,000 third-party subscription apps are available in the App Store today, and the largest of them all represents less than 0.3% of our total Services revenue.

Next, I'd like to talk about the Mac. We saw great response to our new MacBook Pro models that we launched in July with strong double-digit revenue growth driving an all-time quarterly record for Mac revenue. We were especially pleased with Mac momentum in emerging markets with strong growth in Latin America, in India, the Middle East and Africa and Central and Eastern Europe. At over 100 million units, our active installed base of Macs is at an all-time high, and the majority of customer purchasing Macs in the September quarter were new to Mac.

We sold 9.7 million iPads during the quarter, gaining share in nearly every market we track based on the latest estimates from IDC. We generated iPad growth in a number of key regions around the world, including Latin America, Europe, Japan, India and South Asia. Among customers around the world purchasing iPads during the quarter, nearly half were new to iPad, and our active installed base of iPads reached a new all-time high.

NPD indicates that iPad had 58% share of the U.S. tablet market in the September quarter, up from 54% share a year ago. And the most recent consumer survey from 451 Research measured iPad customer satisfaction ratings of 96% for both iPad and iPad Pro. And among business customers who plan to purchase tablets in the December quarter, 74% plan to purchase iPads.

Other products revenue grew 31% to a new September quarter record with an increase of over $1 billion compared to a year ago, thanks to Wearables growth of over 50% and the strong performance of Apple TV in addition to the introduction of HomePod earlier this year.

As we look back across fiscal 2018, we have made great progress in the enterprise market, where iOS is transforming how business gets done across multiple industries. In fact, over 450 airlines and 47 of the top 50 around the world have adopted iOS to help pilots fly safer, more efficient flights. And many airlines are also using iOS to support better customer experiences and improve maintenance operations.

We're also making great strides in the retail sector, where 9 of the top 10 global retailers use iOS devices to transform their customer and employee experiences. We are seeing industry-wide adoption of iOS at thousands of retailers from neighborhood boutiques to many of the best-known retailers in the world. Deployment of iOS devices is growing steadily as retailers replace their traditional point-of-sale systems and use custom iOS apps on iPhones and iPads to provide highly personalized shopping experiences.

Our success in enterprise is supported by our key partnerships. Since launching our first strategic partnership with IBM, 240 large customers have signed MobileFirst for iOS deals. Additionally, earlier in the year, we introduced 2 new technology offerings: IBM Watson services for Core ML and the IBM Cloud Developer Console for Apple that are enabling businesses to combine machine learning and cloud for a new generation of dynamic smart apps made for iOS. Over 60 new signings across numerous industries have been added since launching these new tools.

In our new partnership with Salesforce, we're excited to bring together the #1 customer relationship management platform and iOS. Together with Apple, Salesforce is redesigning its apps to embrace the native mobile platform with exclusive new features on iOS. The company can also provide tools and resources for millions of Salesforce developers to build their own native apps with a new Salesforce Mobile SDK for iOS.

 

And finally, we recently announced Apple business manager, a new way for IT teams to deploy Apple devices at scale. The response from companies around the world has been tremendous with over 40,000 companies currently enrolled.

Let me now turn to our cash position. We ended the quarter with $237.1 billion in cash plus marketable securities. We also had $102.5 billion in term debt and $12 billion in commercial paper outstanding for a net cash position of $122.6 billion. As explained earlier this year, it is our plan to reach a net cash neutral position over time. As part of this plan, we returned over $23 billion to investors during the quarter. We repurchased 92.5 million Apple shares for $19.4 billion through open market transactions, and we paid $3.5 billion in dividends and equivalents.

For our fiscal year 2018, revenue grew over $36 billion to $265.6 billion, an all-time record. Every geographic segment grew double digits with new records in the Americas, Europe, Japan and rest of Asia Pacific. We also set new all-time records for net income, up 23% versus last year and EPS, up 29%. And we returned a total of almost $90 billion to our investors during the year, including almost $14 billion in dividends and equivalents and over $73 billion in share repurchases.

Before we discuss our December quarter outlook, I'd like to describe a number of changes in our financial reporting that we're implementing as we enter our new fiscal year. First, given the increasing importance of our Services business and in order to provide additional transparency to our financial results, we will start reporting revenue as well as cost of sales for both total products and total services beginning this December quarter.

Second, also beginning this December quarter, we're adopting the FASB's new standard for revenue recognition. This will not result in any change to our total revenue, but it will impact the way we report the classification of revenue between products and services. In particular, the revenue corresponding to the amortization of the deferred value of bundled services such as Maps, Siri and free iCloud services was previously reported in product revenue. After adopting the new standards, this revenue will now be reported in Services revenue.

The change in classification between products and services will also apply to the costs that are associated with the delivery of such bundled services. After we file our 10-K, we will post a schedule to our Investor Relations website showing the reclassification of fiscal 2018 revenue from products to services in connection with the adoption of the new standard.

The size of this reclassification amounts to less than 1% of total company revenues. And for clarity, this reclassification was not contemplated in our previously stated goal of doubling our fiscal '16 Services revenue by 2020. That goal remains unchanged and excludes the revenue that is now shifting from products to services over that time frame.

Third, starting with the December quarter, we will no longer be providing unit sales data for iPhone, iPad and Mac. As we have stated many times, our objective is to make great products and services that enrich people's lives and to provide an unparalleled customer experience so that our users are highly satisfied, loyal and engaged. As we accomplish these objectives, strong financial results follow.

As demonstrated by our financial performance in recent years, the number of units sold in any 90-day period is not necessarily representative of the underlying strength of our business. Furthermore, our unit of sale is less relevant for us today than it was in the past given the breadth of our portfolio and the wider sales price dispersion within any given product line.

Fourth, starting with the December quarter, we will be renaming the other products category to wearables, home and accessories to provide a more accurate description of the items that are included in this product category.

As we move ahead to the December quarter, I'd like to review our outlook, which includes the types of forward-looking information that Nancy referred to at the beginning of the call. We have the strongest lineup ever as we enter the holiday season, and we expect revenue to be between $89 billion and $93 billion, a new all-time record. This range reflects a number of factors to be considered: First, we consider the effect on Q4 and Q1 of the launch timing of our new iPhones this year versus last year; Second, we expect almost $2 billion of foreign exchange headwinds; Third, we had an unprecedented number of products ramping, and while our ramps are going fairly well, we have uncertainty around supply and demand balance; and fourth, we also face some macroeconomic uncertainty, particularly in emerging markets.

We expect gross margin to be between 38% and 38.5%. We expect OpEx to be between $8.7 billion and $8.8 billion. We expect OI&E to be about $300 million. And we expect the tax rate to be about 16.5% before discrete items. Also, today, our Board of Directors has declared a cash dividend of $0.73 per share of common stock payable on November 15, 2018, to shareholders of record as of November 12, 2018.

 

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

NANCY PAXTON: Thank you, Luca. (Operator Instructions)

Questions and Answers

OPERATOR: Our first question will come from Wamsi Mohan with Bank of America Merrill Lynch.

WAMSI MOHAN, DIRECTOR, BOFA MERRILL LYNCH, RESEARCH DIVISION: Tim, there has been some real deceleration in some of these emerging markets, partly driven by some concerns around some of the rules the administration is contemplating and partly driven by things that are more specific to China, for instance, like some of the regulations around gaming. So can you talk about how you see the trajectory there for the business and what you think of the initiatives of some companies like Netflix and Fortnite trying to bypass the App Store around subscriptions? And I have a follow-up.

TIMOTHY D. COOK: Sure. Great question. Starting with emerging markets. The emerging markets that we're seeing pressure in are markets like Turkey, India, Brazil, Russia, these are markets where currencies have weakened over the recent period. In some cases, that resulted in us raising prices, and those markets are not growing the way we would like to see. To give you a perspective in -- at some detail, our business at India in Q4 was flat. Obviously, we would like to see that be a huge growth. Brazil was down somewhat compared to the previous year. And so I think -- or at least the way that I see these is each one of the emerging markets has a bit of a different story. And I don't see it as some sort of issue that is common between those for the most part. In relation to China specifically, I would not put China in that category. Our business in China was very strong last quarter. We grew 16%, which we're very happy with. iPhone, in particular, was very strong double-digit growth there. Our other products category was also stronger, in fact, a bit stronger than even the company -- overall company number. The App Store in China, we have seen a slowdown or a moratorium to be more accurate on new game approvals. There is a new regulatory setup in China, and there's -- things are not moving the way they were moving previously. We did see a few games approved recently, but it's very far below the historic pace. And as you're probably seeing, some of the larger companies there that are public have talked about this as they've announced their **earnings** as well. We don't know exactly when this will -- the approvals will sort of return to a normal pace. So I would not want to predict that. I do not view, just to try -- for avoidance of doubt here, I don't view that, that issue has anything to do with the trade-related discussions between the countries. I think that is strictly a domestic issue in China. In terms of larger developers, if you sort of step back and look at the value proposition for people from the App Store, there are 2 key constituencies in that equation. There's the user, and there's the developer. If you start with the user, what the App Store provides people is sort of the best and safest place for users to get apps. And we put a -- we have a tremendous process and infrastructure around achieving that. And where it is not perfect, we wind up reviewing 100,000 -- over 100,000 apps a week between new apps and updates for existing apps and then work with developers quickly to fix the issues. And we also provide the user a one-payment model for purchasing apps and subscriptions and in-app purchases, et cetera, so that they are not in a position that they have to share their private information across many companies. And so that's sort of the proposition for the user. For the developer, we obviously provide developers a tremendous amount of developer tools, programs, compilers, languages, of course, the operating system APIs, SDKs and have a huge developer relations team. And we do a tremendous amount of marketing for developers, including the new Today editorial that we just started in the past few months, personal recommendations search, tools and so on and so forth. And so if -- there will be -- there's no doubt, in my mind, there have already been some large developers that concluded that they could do something on their own. We're fine with that. I think Luca mentioned in his comments that the largest -- if I look at the largest developer, they make up less than 0.3% of the Services revenue. So it's probably good to think about that in that context, and there are millions of apps on the store obviously and 30,000 or so subscription apps. And so the subscription business itself is nearly as broad as the App Store itself is. And so that's the value proposition, I think, that the vast majority of people are very happy with it and including the most important people of all, which is the user.

WAMSI MOHAN: Appreciate that response. If I could just ask you really quick on Apple's role in health care. It's been growing significantly since the early introduction on the Watch and then the various kits for developers, including HealthKit, CareKit, et cetera. And when you combine that with your very staunch advocacy for privacy, I see Apple could become a really large disintermediating force in all the friction in the health care industry today in the way medical information is shared and distributed. Is this the way that you see the future for Apple in health care? And do you see a means to also grow your Services business through the health care offerings that could become subscriptions to your customers?

TIMOTHY D. COOK: I think Apple has a huge opportunity in the -- in health. And you can see from the -- our past several years that we have an intense interest in the space and are adding products and services, non-monetized services so far to that. And I don't want to talk about the future because I don't want to give away what we're doing. But this is an area of major interest to us.

OPERATOR: Shannon Cross from Cross Research has the next question.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: Given the $4 billion range in revenue that you're giving for the quarter and all of the -- all the things that are going on in the world right now, can you maybe give a little detail about the variables that you took into account when you were coming up with this, geopolitical trade, macro component costs, I don't know, if you can just give it some ideas as -- on what the puts and takes were?

LUCA MAESTRI: Yes. Shannon, I'll take this one. And at the revenue level, we started from the fact that we are very, very excited about the lineup of products and services that we have getting into the holiday season. It's the strongest lineup that we've ever had. And our guidance range, by the way, represents a new all-time quarterly revenue record, right? As I explained in my prepared remarks, there are a number of things that need to be considered as part of this guidance range, right? The first one is the fact that the launch timing of the new iPhones this year is essentially in reverse order versus last year. And that has had an effect on Q1 -- on Q4 and will have an effect on Q1. Last year, we launched the top end of our iPhone lineup, which was iPhone X during Q1, and placed the entirety of the channel fill for iPhone X in Q1. This year, we launched the top end of the lineup, which is the Xs and the Xs Max during Q4. Obviously, this resulted in a more pronounced ASP growth in Q4 of '18 and obviously a tougher compare for Q1. So I think it's important to keep that in mind as you look at the revenue guidance that we provided. The second point that needs to be kept in mind, it is a fact of life and we've dealt with it for a number of years now, is the fact that when I look at currencies around the world, virtually every foreign currency has depreciated against the U.S. dollar in the last 12 months. And when we look at the impact of foreign exchange on our revenue for the December quarter, we're looking at 200 basis points of headwinds, which translate, given our -- the size of our business, to almost $2 billion of headwind to our revenue. The third point that I think is important to keep in mind, and Tim has talked about this, we are launching -- in the last 6 weeks, we've launched an unprecedented number of new products. They're all ramping right now. The ramps are going fairly well, but obviously, we have some uncertainty around supply-demand balance for some of these products. And then finally, the last point that we've taken into account is what Tim's talked about in terms of some level of uncertainty at the macroeconomic level in some emerging markets, where, clearly, consumer confidence is not as high as it was 12 months ago. So take that into account, and that's how we got to the range.

SHANNON SIEMSEN CROSS: Okay. And then I just want to talk a little bit about the pullback in terms of guidance from a unit perspective. I understand you don't want to give guidance because 90 days is a short period of time and can be -- fluctuate. But what kind of qualitative commentary do you think you'll be able to provide? Because it's -- obviously, investors have spent the last however many years going P times Q. So how should we think about what we can expect? And sort of how are you going to manage this process as we go through? I know it's all our job to forecast but...

LUCA MAESTRI: Yes, let me walk you through the rationale that we've used, and then I'll talk about this qualitative commentary that you were mentioning. As I said, right, our objective is to make great products, provide the best customer experience and get our customers satisfied, engaged and loyal to our ecosystem. When you look at our financial performance in recent years, take the last 3 years, for example, the number of units sold during any quarter has not been necessarily representative of the underlying strength of our business. If you look at our revenue during the last 3 years, if you look at our net income during the last 3 years, if you look at our spot price during the last 3 years, there's no correlation to the units sold in any given period. As you know very well, in addition, our product ranges for all the major product categories have become wider over time, and therefore, a unit of sale is less relevant for us at this point compared to the past because we got this much wider sales price dispersion. So unit of sale per se becomes less relevant. As I know you're aware, by the way, our top competitors in smartphones, in tablets, in computers do not provide quarterly unit sales information either. But of course, we understand that this is something of interest. And when we believe that providing qualitative commentary on unit sales offers additional relevant information to investors, we will do so.

TIMOTHY D. COOK: Let me make one additional point there just for clarity, is that, Shannon, our intention is to continue to give revenue guidance at the company level and gross margin guidance in the other categories that we've been providing. And so the -- our guidance isn't changing. It's the actual report that changes.

OPERATOR: Our next question comes from Mike Olson with Piper Jaffray.

MICHAEL JOSEPH OLSON, MD & SENIOR RESEARCH ANALYST, PIPER JAFFRAY COMPANIES, RESEARCH DIVISION: With the staggered iPhone launch, were you able to discern any impact on the Xs and Xs

 

Max from buyers potentially waiting for the XR? And what, if anything, can we take away from the December quarter guidance related to what you're seeing for early demand on the XR? And then I have a follow-up.

TIMOTHY D. COOK: Mike, it's Tim. The Xs and Xs Max got off to a really great start, and we've only been selling for a few weeks. The XR, we've only got out there for, I guess, 5 -- 5 days or so at this point and so that it's -- we have very, very little data there. Usually, there is some amount of wait until a product shows -- another product shows up in look, but in -- that -- in looking at the data, on the sales data for Xs and Xs Max, there's not obvious evidence of that in the data as I see it.

MICHAEL JOSEPH OLSON: Got it. And you mentioned record levels for various components of the Services business. As we look forward, if growth of Services is to maintain something close to the recent pace, what are the components of Services that you're particularly excited about that could drive that and be the strongest drivers? And maybe an offshoot to that, it seems like the news flow around augmented reality slowed a little bit in recent months. Is that potentially materially contributor to services in the near future?

LUCA MAESTRI: Like as we said, during the September quarter, we set new records for many, many Services categories, right, from Apple Music to cloud services to the App Store to AppleCare and Apple Pay really has an exponential trajectory right now. When we look at our Services business, we think about the fact that we have a very large and growing installed base. The installed base of all our major product categories is at an all-time high and has been growing over the last several quarters. So the opportunity for us to monetize our Services business continues to grow over time. Of course, we are also improving the quality of the services that we provide, and if you look back during the last 3 years, we've added new services to our portfolio. We added Apple Pay. We added Apple Music. We added this advertising business on our App Store. And clearly, we will want to continue to offer new services over time. So there are a number of vectors that allow us to continue to grow the business over time. We have stated that we want to double the size of the Services business from the level that we had in fiscal '16 by 2020. We are well on pace to achieve that, and we feel very, very confident about the future of -- and the opportunities that we have in the Services space.

TIMOTHY D. COOK: Mike, in terms of your question on AR, I have a different view than you do on this one. We -- just a year ago -- practically, a year ago, we came out with ARKit 1. 6 months or so after that, we came out with 1.5. We then recently came out with ARKit 2. The number of things that you can do are growing significantly. The number of developers that either have done something or even more the case that are working on things that I've seen are growing tremendously. There's a lot of interest out there. And the number of categories that I'm seeing from gaming to shopping to -- I was in China a few weeks ago and saw AR in the -- in an art sense, an art exhibit. I was in Berlin last week and saw it being used in a historical educational kind of sense. I'm seeing it sort of everywhere I go now. And so I think we are in the early days, and it'll keep getting better and better. But I'm really happy with where things are at the moment.

OPERATOR: Next, we'll go to Katy Huberty with Morgan Stanley.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: Tim, given the current trade negotiations and broader geopolitical risk, do you have any plans to consider diversifying the supply chain? And if you were to do that, either on your own or sort of forced, do you think it would have significant impact on the business or profitability?

TIMOTHY D. COOK: Katy, if you look at the products that we've created and are manufacturing, they're really manufactured everywhere. We have significant content from the U.S. market. We have content from Japan to Korea to many countries, and we have great content from China as well. And so there are many hands in the products. The vast majority or almost all of the R&D is in the United States as well as a lot of the support organization. And I -- so as -- I think that, that basic model where you look around the world and find the best in different areas, I don't expect that model to go out of style so to speak. I think there's a reason why things have developed in that way, and I think it's great for all countries and citizens of countries that are involved in that. And I'm still of the mindset that I feel very optimistic and positive that the discussions that are going will be fruitful. The -- these relationships, these trade relationships are big and complex, and they clearly do need a level of focus and a level of updating and modernization. And so I'm optimistic of -- that the countries, the U.S. and China and the U.S. and Europe and so forth can work these things out and work for the benefit of everyone.

KATHRYN LYNN HUBERTY: That's helpful color. And Luca, as a follow-up, NAND prices fell significantly during the September quarter. Why aren't we seeing that flow through to margin expansion to the overall company?

LUCA MAESTRI: You're referring to the guidance that we provided for Q1, I imagine. And let me give you the puts and takes, Katy. You're correct, we are going to be getting some benefits from commodities in general and memory in particular. Memory, on a sequential basis, it's about 30 basis points favorable for us going into the

 

December quarter. And obviously, we're going to be benefiting from the leverage, which is typical of our seasonality in the December quarter. On the other hand, as I mentioned before, currencies have weakened against the U.S. dollar. And the impact that we expect at the gross margin level from foreign exchange is a 90 basis points headwind sequentially. And of course, at this point in the cycle, we also have higher cost structures because, as I said, we've launched so many new products in the last 6 weeks. So those are the puts and takes, leverage and commodity savings on one side and FX and the new products on the other side.

OPERATOR: Next, we'll go to Jim Suva with Citigroup.

JIM SUVA, DIRECTOR, CITIGROUP INC, RESEARCH DIVISION: A question for Tim and a question for Luca, and I'll ask them at the same time, so you can decide to answer the first or second. But operationally, Tim, I think your company is at a disadvantage relative to others in India giving where items are produced versus shipped versus taxed versus installed as well as ability to own stores. So can you help us address that? Is India going to potentially be a big area as I think you've got about only 1% market share, but it sounded like things may be softened there? And then for Luca, there'd probably be a lot of pushback about not giving iPhone unit data. It sounds like you're still going to give revenue data if I heard that correctly. But some people may fear that this now means that the iPhone units are going to start going negative year-over-year because it's easy to talk about great things and not show the details of things that aren't so great.

TIMOTHY D. COOK: Okay. I'll start with India. We've had really great productive discussions with the Indian government, and I fully expect that, at some point, they will agree to allow us to bring our stores into the country. We've been in discussions with them, and the discussions are going quite well. There is -- as you point out, there are import duties in some or most of the product categories that we're in. In some cases, they compound. And this is an area that we're giving lots of feedback on. We do manufacture some of the entry iPhones in India, and that project has gone well. I am a big believer in India. I am very bullish on the country and the people and our ability to do well there. The currency weakness has been part of our challenge there as you can tell from just looking at the currency trend. But I sort of view these as speed bumps along a very long journey, though, in that the long term is -- I think is very, very strong there. There's a huge number of people that will move into the middle class. The government has really focused on reform in a major way and made some very bold moves, and I applaud them for doing that and sort of can't wait for the future there.

LUCA MAESTRI: And Jim, let me take the question on units. First of all, as Tim said, our approach to guidance -- providing guidance doesn't change at all, and we continue to provide the same metrics that we were providing before. In terms of reporting results, one of the things that we are doing, and it's new and it's an addition to the information that we provide to investors because we've heard some significant level of interest around this, is starting with the December quarter, for the first time, we're going to be providing information on revenue and cost of sales and therefore, gross margins for both products and services. And this will be the first time that we're going to provide gross margin information for our Services business, which we believe it is an important metric for our investors to follow. Given the rationale on why we do not believe that providing unit sales is particularly relevant for our company at this point, I can reassure you that it is our objective to grow unit sales for every product category that we have. But as I said earlier, a unit of sale is less relevant today than it was in the past. To give you an example, the unit sales of iPhone at the top end of the line have been very strong during the September quarter. And that's very important because we are attracting customers to the most recent technologies and features and innovation that we bring into the lineup, but you don't necessarily see that in the number that is reported. And so therefore, we will -- as I said, we'll provide the qualitative commentary when it is important and relevant, but at the end of the day, we make our decisions to -- from a financial standpoint, to try and optimize our revenue and our gross margin dollars. And that, we think, is the focus that is in the best interest of our investors.

TIMOTHY D. COOK: Jim, let me just add a couple things to that for color. Our installed base is growing at double digit, and so there's no -- and that's probably a much more significant metric for us from an ecosystem point of view and customer loyalty, et cetera. The second thing is this is a little bit like if you go to the market and you push your cart up to the cashier and she says or he says, "How many units you have in there?", it sort of -- it doesn't matter a lot how many units there are in there in terms of the overall value of what's in the cart.

NANCY PAXTON: A replay of today's call will be available for 2 weeks on Apple Podcasts, as a webcast on apple.com/investor and via telephone. And the numbers for the telephone replay are (888) 203-1112 or (719) 457-0820, and please enter confirmation code 3699080. These replays will be available by approximately 5 p.m. Pacific Time today.

 

Members of the press with additional questions can contact Kristin Huguet at (408) 974-2414, and financial analysts can contact Matt Blake or me with additional questions. Matt is at (408) 974-7406, and I'm at (408) 974-5420. Thanks again for joining us.

OPERATOR: That does conclude our conference for today. Thank you for your participation.



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**Q3 2018 Apple IncEarnings Call - Final**

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OPERATOR: Good day, and welcome to the Apple Inc. Third Quarter Fiscal Year 2018 **Earnings** 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, SENIOR DIRECTOR OF IR AND TREASURY, APPLE INC.: Thank you. Good afternoon, and thanks to everyone for joining us. Speaking first today is Apple's CEO, Tim Cook; and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenue, gross margin, operating expenses, other income and expense, taxes, capital allocation, share repurchases, dividends and future business outlook. Actual results or trends could differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed periodic reports on Form 10-K and Form 10-Q 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, CEO & DIRECTOR, APPLE INC.: Thank you, Nancy, and thanks to everyone for joining us. Today, we're proud to report our best June quarter revenue and **earnings** ever, thanks to the strong performance of iPhone, Services and Wearables. We generated $53.3 billion in revenue, a new Q3 record. That's an increase of 17% over last year's results, making it our seventh consecutive quarter of accelerating growth, our fourth consecutive quarter of double-digit growth and our strongest rate of growth in the past 11 quarters.

Our team generated record Q3 **earnings** per share of $2.34, an increase of 40% over last year. We are extremely proud of these results, and I'd like to share some highlights with you.

First, iPhone had a very strong quarter. Revenue was up 20% year-over-year, and our active installed base grew by double digits, driven by switchers, first-time smartphone buyers and our existing customers whose loyalty we greatly appreciate. iPhone X was the most popular iPhone in the quarter once again with a customer satisfaction score of 98% according to 451 Research. Based on the latest data from IDC, iPhone grew faster than the global smartphone market, gaining share in many markets including the U.S., Greater China, Canada, Germany, Australia, Russia, Mexico and the Middle East and Africa.

Second, we had a stellar quarter in Services, which generated all-time record revenue of $9.5 billion fueled in part by double-digit growth in our overall active installed base. We feel great about the momentum of our Services business, and we're on target to reach our goal of doubling our fiscal 2016 Services revenue by 2020.

Our record Services results were driven by strong performance in a number of areas, and I'd like to briefly mention just some of these. Paid subscriptions from Apple and third parties have now surpassed 300 million, an increase of more than 60% in the past year alone. Revenue from subscriptions accounts for a significant and increasing percentage of our overall Services business.

What's more, the number of apps offering subscriptions also continued to grow. There are almost 30,000 available in the App Store today. The App Store turned 10 years old this month, and we set a new June quarter revenue record. The App Store has exceeded our wildest expectations, igniting a cultural and economic phenomenon that has changed how people work, learn and play. Customers around the world are visiting the App Store more often and downloading more apps than ever before. And based on third-party research estimates, the App Store generated nearly twice the revenue of Google Play so far in 2018.

The app economy is thriving, and thanks to the App Store, it's generating jobs for tens of millions of people around the world. Our developers have earned over $100 billion from the App Store since its launch, and we couldn't be more proud of them and what they've accomplished. We're hearing lots of developer excitement around our upcoming OS releases, which I'll talk about more in a moment, and can't wait to see what they can come up with next.

We've experienced rapid growth in our App Store search ad service. And as we announced earlier this month, we are expanding our geographic coverage to Japan, South Korea, France, Germany, Italy and Spain.

We're also seeing strong growth in many of the other services as well. Just a few examples. Apple Music grew by over 50% on a year-over-year basis. AppleCare revenue grew at its highest rate in 18 quarters, partly due to our expanded distribution initiative. Cloud services revenue was also up over 50% year-over-year. Our communication services are experiencing record usage, which hit all-time highs for both the number of monthly active users of Messages and the number of FaceTime calls made, with growth accelerating from the March to June quarters. Siri requests have already exceeded 100 billion so far this fiscal year. And the number of articles read on Apple News more than doubled year-over-year.

Apple Pay continues to expand with well over 1 billion transactions last quarter, triple the amount from just a year ago, with growth accelerating from the March quarter. To put that tremendous growth into perspective, this past quarter, we completed more total transactions than great companies like Square and more mobile transactions than PayPal. Apple Pay is now live in 24 markets worldwide with over 4,900 bank partners, and we look forward to adding Germany later this year. We're excited to share that in the U.S., eBay is beginning to enable its sellers to accept Apple Pay, and CVS Pharmacy and 7-Eleven will roll out Apple Pay acceptance in locations nationwide this fall.

Transit is another important area of growth, and Apple Pay can be used with iPhone and Apple Watch to quickly and conveniently ride public transit in 12 metropolitan areas. Apple Pay Cash, our peer-to-peer payment service, is already serving millions of customers across the U.S. less than 8 months following its launch.

Our third highlight of the quarter is the outstanding results in Wearables, which comprises Apple Watch, AirPods and Beats and was up over 60% year-over-year, with growth accelerating from the March quarter. Our Wearables revenue exceeded $10 billion over the last 4 quarters, a truly remarkable accomplishment for a set of products that has only been in the market for a few years.

Apple Watch delivered record June quarter performance with growth in the mid-40% range. And we're thrilled to see so many customers enjoying AirPods. It reminds me of the early days of iPod when I started noticing white earbuds everywhere I went.

A number of other notable events in the quarter. We expanded distribution of HomePods, 3 additional markets, and we added new immersive listening features with support for HomePod stereo pairs and a new multiroom audio system.

In June, we hosted an extremely successful developers' conference that previewed many major advances coming this fall to our 4 operating systems: iOS, macOS, watchOS and tvOS. Developer and customer reaction has been very positive, and we have over 4 million users participating in our new OS beta programs.

Starting with iOS 12. Siri will take a major step forward with Siri Shortcuts, which deliver a new, much faster way to get things done and allow any app to work with Siri. We believe this will make Siri even more useful and significantly expand its adoption.

We've also designed performance improvements across iOS 12 to make everyday tasks faster and more responsive. Camera launches up to 70% faster, the keyboard appears up to 50% faster and apps can launch up to twice as fast. It's always been about empowering users to get the most from our products but not about spending all of their time using them. And so we're adding tools to iOS 12 to help our customers understand and take control of the time both they and the family spend interacting with their iOS devices.

 

Activity Reports will provide information on the amount and nature of time spent on iPhones and iPads, and Screen Time will enable parents to monitor and limit their children's activity from their own iOS devices using Family Sharing in iCloud.

Developers will be able to build even more intelligent apps with just a few lines of code using the power of machine learning with Core ML 2 and Create ML. We've also included our third release of ARKit in only 1 year. With ARKit 2, iOS 12 will provide an even more powerful platform to make dynamic AR apps, integrating shared and persistent AR experiences, object detection and image tracking. We believe AR can enable profound experiences, and Apple is uniquely positioned to provide the best AR experience because of the seamless integration of our hardware and software.

The new capabilities of ARKit 2 will build on the potential of the thousands of AR apps already available in the App Store that are changing the way iPhone and iPad users see and experience the world.

Turning to Mac. We want to empower our developers to bring their innovative apps from the iOS ecosystem to the Mac with minimal effort. Though iOS and macOS are different, they've shared common foundations from the very beginning. So we've taken key frameworks from iOS and adapted them to specific Mac behaviors like using a mouse or trackpad, resizing windows, copy and paste and drag and drop. We started with some of our own apps. So this fall, News, Stocks, Voice Memos and Home will be available on the Mac for the first time with macOS Mojave, and we'll be bringing these great new tools to our developers next year. We believe this will dramatically broaden the ecosystem to benefit all Mac users, creating even more great reasons to choose Mac. Also this fall, the Mac App Store is getting a full redesign with rich editorial content to help customers discover great Mac apps from our developers.

We believe privacy is one of the most important issues of the 21st century, and we're always working to make our products more private and more secure for our users. As we announced at WWDC, beginning this fall, Safari will prevent share buttons and comment widgets on web pages from tracking users without their permission. Safari already protects personal data as users browse the web, so they won't be retargeted by ads.

For Apple Watch, users will see a significant expansion of features and functionality in watchOS 5. Apple Watch will become an even stronger companion for fitness, communication and quick access to information with features including new workouts, activity sharing competitions, auto workout detection, advanced running features, walkie-talkie, podcast and third-party apps on the Siri watch face.

For Apple TV, we've seen major growth in sales since the introduction of Apple TV 4K last fall as video providers around the world choose Apple TV 4K to deliver their subscription services. Later this year, Charter Communications will begin offering Apple TV 4K to its customers in nearly 50 million U.S. households, providing access to live channels and tens of thousands of on-demand programs via the Spectrum TV app on Apple TV 4K, iPhone and iPad.

In tvOS, we'll take the cinematic experience of Apple TV 4K to the next level this fall with support for Dolby Atmos audio and new features to easily find popular shows and movies. Apple TV 4K already offers customers the largest collection of 4K HDR movies. And this fall, iTunes will be the home to the largest collection of Dolby Atmos-supported movies anywhere.

I'm proud that our team's hard work has an impact even beyond these innovative industry-leading products and services. We are always working to leave the world better than we found it. And as part of our commitment to address climate change and increase the use of renewable energy in our supply chain, we recently announced a first-of-its-kind investment fund in China.

Initially, 10 suppliers will join us in investing nearly $300 million over the next 4 years into the China Clean Energy Fund. The fund will invest in and develop clean energy projects totaling more than 1 gigawatt of renewable energy in China, the equivalent of powering nearly 1 million homes.

We're seeing great momentum in our Everyone Can Code and Everyone Can Create initiatives. More than 5,000 schools and community colleges are now teaching Everyone Can Code, and more than 350 schools have committed to incorporating Everyone Can Create into their curricula for the upcoming school year. Coding skills are opening doors for students and job seekers around the world as tremendous growth in the app economy creates opportunity everywhere we look. We're also teaming up with leading educators for blind and deaf communities across the United States, who will start teaching Everyone Can Code this fall.

Looking ahead, we couldn't be more excited about the products and services in our pipeline as well as limitless applications for augmented reality and machine learning technology. We're working with key partners in the enterprise to change the way work gets done with iOS and Mac. We're welcoming communities and offering learning opportunities at our retail locations through hundreds of thousands of Today at Apple sessions each quarter. We're expanding our reach into emerging markets and seeing strong double-digit growth in revenue, and we're making great progress toward our goal of significantly expanding our Services business.

And now for more details on the record June quarter results, I'd like to turn the call over to Luca.

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone. We are very pleased to report the financial results of our best June quarter ever. As we have done in every quarter this fiscal year, we set new quarterly records for both revenue and **earnings** per share with revenue up 17% year-over-year and EPS up 40%.

We generated $53.3 billion of revenue with year-over-year growth in all of our geographic segments and new June quarter records in the Americas, Europe, Japan and rest of Asia Pacific. We grew in each of our top 15 markets with especially strong performance in the U.S., Hong Kong, Russia, Mexico, the Middle East and Africa, all places where revenue was up by more than 20%.

Gross margin was 38.3%, flat sequentially, as cost improvements and foreign exchange offset the seasonal loss of leverage. Net income was $11.5 billion, up $2.8 billion or 32% over last year, and it was also a new June quarter record. Diluted **earnings** per share were $2.34, up 40%, and also a new record for the June quarter. And cash flow from operations was very strong at $14.5 billion.

iPhone revenue grew 20% year-over-year, with iPhone ASP increasing to $724 from $606 a year ago, driven by the strong performance of iPhone X, iPhone 8, iPhone 8 Plus across the world.

During the quarter, we sold 41.3 million iPhones, with double-digit unit growth in several markets including the U.S., Canada, Germany, Switzerland, Mexico, Hong Kong, Russia, the Middle East and Africa. Our performance from a customer demand standpoint was stronger than our reported results as we reduced iPhone channel inventory by 3.5 million units during the quarter. We exited the June quarter towards the lower end of our target range of 5 to 7 weeks of iPhone channel inventory.

Customer satisfaction with iPhone continues to be outstanding and is the highest in the industry. The latest survey of U.S. consumers from 451 Research indicates that across all the iPhone models, customer satisfaction was 96%, and combining iPhone 8, 8 Plus and iPhone X, it was even higher at 98%. And among business buyers who plan to purchase smartphones in the September quarter, 81% plan to purchase iPhones, up 3 points from the last survey.

Turning to Services. We had our best results ever with all-time record revenue of $9.5 billion. Services revenue included a favorable $236 million onetime item in connection with the final resolution of various lawsuits. Excluding this amount, Services revenue was still an all-time record, and the underlying growth rate of our Services business was a terrific 28% over last year. We generated double-digit Services growth in all our geographic segments, and the App Store, AppleCare, Apple Music, cloud services and Apple Pay all set new June quarter records.

Our other product category also set a new record for the June quarter with revenue of over $3.7 billion. That's up 37% from last year with great sales momentum for both Apple Watch and AirPods. Apple Watch continues to be the best-selling smartwatch by a wide margin, and units and revenue grew dramatically during the quarter. AirPods continue to be a runaway success, and we've been selling them as fast as we can make them since their launch 1.5 years ago.

Next, I'd like to talk about the Mac. We were very happy to see double-digit year-over-year growth in our active installed base of Macs to a new all-time high, with nearly 60% of purchases during the quarter coming from customers who are new to Mac. Our year-over-year sales performance was impacted by the different timing of the MacBook Pro launch, which did not occur until early Q4 this year as opposed to June last year, with the subsequent channel fill during the June quarter. Even with the difficult launch comparison, we saw great momentum in many emerging markets with growth well into double digits, and we established new June quarter records for Mac sales in India, Turkey, Chile and Central and Eastern Europe.

iPad unit sales grew for the fifth consecutive quarter, and we gained significant share of the global tablet market based on the latest estimates from IDC. We recorded double-digit iPad unit growth in both our Greater China and rest of Asia Pacific segments with a new June quarter record for iPad sales in mainland China. Almost half of iPad purchases in the quarter were by customers new to iPad, and our active installed base of iPads reached a new all-time high. Our overall performance compared to last year was impacted by the introduction of new iPad

 

Pro models in June of last year, which resulted in both a different mix with higher ASPs in channel sales a year ago.

NPD indicates that iPad has 60% share of the U.S. tablet market in the June quarter, up from 51% share a year ago. And the most recent consumer survey from 451 Research measured iPad customer satisfaction ratings of 94%. And among business customers who plan to purchase tablets in the September quarter, 75% plan to purchase iPads.

We continue to make great strides with enterprise customers across multiple industries. For example, financial services institutions are increasingly using iPads to deploy digital signature solutions for customer consent, compliance requirements, new account openings and services transactions. In the railway industry, businesses around the world are using iPhone and iPads to support operations, training, passenger engagement and maintenance activities.

And leading global automotive companies are deploying iPads in dealerships for sales enablement and end-to-end customer service management and are choosing iPhone as the standard mobile device for their employees around the world.

More and more companies are giving their teams a choice when it comes to the devices they use at work. And enterprises, including Salesforce and Capital One, are deploying Macs based on employee preference. In fact, at Salesforce, the majority of their 35,000 employees are using Macs. And companies tell us that Mac has been instrumental in helping them attract and retain talent while providing strong security, streamlined deployment workflow and significantly lower total cost of ownership.

We're also seeing great interest in Business Chat, our powerful new way for organizations to connect with customers. Business Chat lets customers get answers to questions, resolve issues and complete transactions directly from within Messages by starting a conversation on their iPhone or iPad and even continue that conversation on their Mac or Apple Watch.

Dish Network is making Business Chat available to customers across the U.S. to enhance the customer service experience for pay-TV. Customers can instantly reach a live agent with their questions, make account changes, schedule an appointment or order a pay-per-view movie or sporting event, all without leaving the Messages conversation.

And Citizens Bank Park, home of the Philadelphia Phillies, is testing Business Chat with Aramark to handle beverage orders during games. Fans simply use their iPhone camera to scan a QR code on the back of their seats, taking them directly to a Business Chat conversation in Messages. From there, they can order drinks, pay quickly and securely with Apple Pay and have them delivered directly to their seats without missing a moment of on-field play.

Our retail and online stores had a great quarter, thanks to very strong growth from iPhone, AirPods and Apple Watch and the expansion of HomePod to Canada, France and Germany. Our stores hosted more than 250,000 of our very successful Today at Apple sessions. We continue to have content across all Today at Apple topics, including popular new sessions on music and photography. We opened our 50th retail store in Greater China during the quarter, and we just opened a beautiful new store in Milan this month, putting the number of stores located outside the U.S. to 46% of the total.

Let me now turn to our cash position. We ended the quarter with $243.7 billion in cash plus marketable securities. We retired $6 billion of debt during the quarter, leaving us with $102.6 billion in term debt and $12 billion in commercial paper outstanding for a net cash position of $129.1 billion. As we explained in February, we plan to reach a net cash neutral position over time.

We returned almost $25 billion to investors during the quarter, including $3.7 billion in dividends and equivalents. We repurchased $20 billion worth of Apple shares, of which $10 billion related to the completion of our previous $210 billion buyback program and $10 billion to the beginning of the new $100 billion authorization we announced 3 months ago for a total of 112.8 million shares repurchased through open market transactions during the quarter.

As we move ahead into the 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 $60 billion and $62 billion. As you will recall, our September quarter results last year included a onetime favorable adjustment of $640 million to our Services revenue. Taking that adjustment into account, our revenue guidance implies year-over-year growth of about 16% to 19%.

 

We expect gross margin to be between 38% and 38.5%. We expect OpEx to be between $7,950,000,000 and $8,050,000,000. We expect OI&E to be about $300 million, and we expect the tax rate to be about 15% before discrete items.

Also today, our Board of Directors has declared a cash dividend of $0.73 per share of common stock payable on August 16, 2018, to shareholders of record as of August 13, 2018.

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

NANCY PAXTON: Thank you, Luca. (Operator Instructions)

Questions and Answers

OPERATOR: Our first question comes from Katy Huberty with Morgan Stanley.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: I'll ask both my questions upfront. First, for Tim, you're on track to hit your Services revenue target even earlier than planned. So how are you thinking about the next legs of Services growth as you move into the next 3 to 5 years? And then for you Luca, NAND prices are falling this year. Services mix is rising. Those should both positively influence gross margins. And yet, we're seeing gross margin sort of hang out here at 38%. What are the offsetting headwinds? And is it possible that we could see the tailwinds start to overpower those headwinds in the next couple of quarters and see gross margins drift higher?

TIMOTHY D. COOK: Yes, Katy, thanks for your questions, it's Tim. On the Services side, we're thrilled with the results. They were very broad-based. We had double-digit Services growth in all of the geographic segments. And the App Store, AppleCare, Apple Music, cloud services, Apple Pay all set new June quarter records. And then, of course, subscriptions have now passed 300 million as I've mentioned before. And so we're -- we couldn't be happier with how things are going. In terms of the next leg of this, we're -- given the momentum that we're seeing across the board, we feel great about our current services. But obviously, we're also thrilled about our pipeline that have some new services in it as well. And so with the combination of these, we feel great about hitting our objectives and maybe even doing a little better.

LUCA MAESTRI: Katy, for margins, let me tell you about the puts and takes for the June quarter, then I'll talk about the guidance for Q4 and make some general observations for the future. Starting with the June quarter, typically, we see a decline in gross margin going from the March quarter to the June quarter. Last year, we were down 40 bps, 2 years ago, we were down 140 bps. This year, we were able to keep GM flat sequentially. During the quarter, we always have some loss of leverage because of our typical seasonality. This year, we were able to offset that with some cost improvements, and also we had some favorability in foreign exchange on a sequential basis. Unfortunately, as you know, the U.S. dollar has already appreciated again recently, so we do not expect to see that favorability to repeat during the September quarter. But those are the puts and takes for June, and we're very happy to see gross margin sequentially flat for June. For September, we're also guiding about flat sequentially at the midpoint. As you know, we typically have what we call product transition costs during the September quarter. And this year, we also have about 30 bps of headwind from foreign exchange, again because the dollar has appreciated recently. We expect those 2 factors to be offset by positive leverage because we've seen the revenue guidance that we provided and the mix to Services that you've actually mentioned during your question. So we feel pretty good about most of the guidance for the fourth quarter. Looking forward, you know we don't provide guidance beyond the current quarter, but I think we have a pretty good record over the last several years to make good business decisions, balancing units, revenue and margins. As you know, foreign exchange has been a very significant headwind over the last 3-plus years, but we've been able to manage that. On the memory front, it is true that prices have started to decline. It has been a significant headwind for the last 12 to 18 months and still in the June quarter was negative. We believe that we're going to start seeing some improvement from here on.

OPERATOR: Our next question will come from Shannon Cross with Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: Tim, can you talk a bit about trends within your iPhone sales? ASPs were above expectations. And now that you've had -- and that was clearly better than some of the comments from some of your competitors. Now that you've had about 9 months of experience with the high-end fully featured phone, can you talk a bit about what you think customers want, what the elasticity of demand is and how you're sort of thinking about your competitive position? And then I have a follow-up.

 

TIMOTHY D. COOK: Yes. Shannon, we feel great about the results on iPhone, up 20%. And if you look for the cycle -- by the cycle, I mean Q1, Q2 and Q3, we've had, on an average weekly basis, growth in units of sort of mid-single-digit and ASP growth of double-digit. And so if you -- and look at iPhone X in particular, it's the most innovative smartphone on the market. We priced it at a level that represented the value of it, and we're really -- we could not be happier that it has been the top-selling iPhone since the launch, and so we feel terrific about iPhone X. If you look at the -- sort of the top of our line together, and by that I mean the iPhone X, the 8 and the 8 Plus, they are growing very nicely as you can probably tell from looking at the ASP, and we couldn't be happier with how that's gone. And so I think in this cycle, we've learned that customers want innovative products. And we sort of already knew that in other cycles and other points in times, but it just puts an exclamation point by that, I believe, with looking at the results. On the -- at the unit level, the iPhone SE had a difficult comp to the year-ago quarter, and so -- when we changed some of the configurations -- the memory configurations in the year-ago quarter. If you look at it on a geographic basis, the top 3 selling phones in urban China were iPhone, where iPhone X was #1 and has been for a couple of quarters. And iPhones make up 3 of the top 5 smartphones in the U.S., U.K. and Japan. And so it's difficult sometimes to get a read over exactly what's happening in the market. But given the industry numbers that we've seen, it's clear that we picked up global market share and picked up market share in several countries, not only iPhone but iPad as well.

SHANNON SIEMSEN CROSS: Great. And then can you talk a bit about China, up 19% -- Greater China, up 19% year-over-year during the quarter, I believe? Obviously, iPhone doing well, but -- there was some concern that maybe some of what's going on in the trade world might have impacted, it doesn't seem like that. So I'm just curious as to what you're seeing in China and how you're thinking about it as you look forward.

TIMOTHY D. COOK: Yes, it's a good question. Thank you. This is the fourth consecutive quarter that we've had double-digit growth in Greater China. I mentioned how iPhone X and sort of the iPhones were selling. We did pick up share in iPhone and iPad. But if you look more holistically at our complete line, we had a double-digit growth from Services to iPad to iPhone and to our other product category, which the Watch did extremely well. And so there are lots of good things happening there. In terms of the tariffs themselves, maybe I could sort of take a step back because I'm sure that a lot -- some people have questions on this. And our view on tariffs is that they show up as a tax on the consumer and wind up resulting in lower economic growth and -- sometimes can bring about significant risk of unintended consequences. That said, the trade relationships and agreements that the U.S. has between -- between the U.S. and other major economies are very complex, and it's clear that several are in need of modernizing. But we think that in the vast majority of situations that tariffs are not the approach to doing that, and so we're sort of encouraging dialogue and so forth. In terms of the tariffs that have been imposed or have exited the comment period, I think that there's one that's exiting today, there have been 3 of those. And maybe I could walk through those briefly just to make sure everybody's on the same page. The first was the U.S. imposed a tariff on steel and aluminum that was -- many, many different countries, that started, I believe, at the beginning of June. There have been 2 other tariffs that have totaled about $50 billion of goods from China that have either been implemented or are exiting the comment period in this month. I think the latest one is today. If you look at those 3 tariffs, none of our products were directly affected by the tariffs. There is a fourth tariff, which includes goods valued at $200 billion, also focused on goods that are imported from China. That one is out for public comment. Probably like everyone else, we're evaluating that one, and we'll be sharing our views of it with the administration and so forth before the comment period for that one ends. It's actually a tedious process in going through it because you not only have to analyze the revenue products, which are a bit more straightforward to analyze, but you also have to analyze the purchases that you're making through other companies that are not related to revenue. Maybe they're related to data centers and this sort of thing. And so we're going through that now, and we'll be sharing our results later on those and feeding back from the comment. Of course, the risk associated with more of a macroeconomic issue, such as an economic slowdown in one or more countries or currency fluctuations that are related to tariffs is very difficult to quantify. And so that -- and we're not even trying to quantify that, to be clear about it. All of this said, we're optimistic, as I've been the whole time, that this will get sorted out because there's an inescapable mutuality with -- between the U.S. and China that sort of serves as a magnet to bring both countries together. Each country can only prosper if the other does. And of course, the world needs both U.S. and China to prosper, for the world to do well. That said, I can't predict the future, but I am optimistic that the countries will get through this. And we are hoping that calm heads prevail.

OPERATOR: And that will come from Brian White with Monness, Crespi.

BRIAN JOHN WHITE, RESEARCH ANALYST, MONNESS, CRESPI, HARDT & CO., INC., RESEARCH DIVISION: Yes. Tim, I'm wondering if you could talk a little bit about the multiyear partnership with Oprah Winfrey and what that says about your original content strategy. And also Apple Music, if you can give us a little more color, sort of an update maybe around paid subscribers or total subscribers around Apple Music and how you feel that's rolled out.

 

TIMOTHY D. COOK: Yes, sure, Brian. Thanks for the question. We're very excited to work with Oprah. We think that her incomparable ability and talent to connect with audiences around the world are -- there's no match. And we think that we can do some great original content together, and so we could not be happier in working with Oprah. As you know, we hired 2 highly respected television executives last year, and they have been here now for several months and have been working on a project that we're not really ready to share the -- all the details about it yet. But I couldn't be more excited about what's going on there. And we've got great talent in the area that we've sourced from different places and feel really good about -- felt really good about what we will eventually offer. In terms of the sort of the key catalysts and the changes -- the cord-cutting, in our view, is only going to accelerate and probably accelerate at a much faster rate than is widely thought. We're seeing the things that we have on the periphery of this like Apple TV units and revenue grew by very strong double digits, very, very strong double digits in Q3. As I mentioned in my opening comments, we're seeing different providers pick up the Apple TV and use it as their box to go to market with their subscription service. There are -- within the 300 million-plus paid subscriptions, some of these are third-party video subscriptions, and we see the growth that is going on there. It's like 100% year-over-year. And so all the things from a -- all the forcing functions here from the outside all point to dramatic changes speeding up in the content industry. And so we're really happy to be working on something but just not ready to talk about it in, in depth today. In terms of Apple Music, we're well over 50 million listeners now when you add the -- our paid subscribers and the folks in the trial. And so we're moving along at a very, very good rate. It appears to us and what we've been told is that we took the leadership position in North America during the quarter, and we had leadership position in Japan. And so in some of the markets that we've been in for a long period of time, we're doing quite well. But really, the key thing in Music is not the competition between companies that are providing music, it's the -- the real challenge is to grow the market because if you add everyone up that's providing subscription music today or streaming music, it's -- outside of China, it's less than 200 million probably around the world. And so it does seem to me, there's an extraordinary opportunity in that business to grow the market well. And I think if we put our emphasis there, which we're doing, that -- we'll be a beneficiary of that as other people will as well. But I like where we are. Our revenues on Apple Music grew over 50%, as I'd mentioned earlier, during the quarter. And so it's really, really strong, strong results. Thanks for the question.

OPERATOR: Toni Sacconaghi with Bernstein has our next question.

A.M. SACCONAGHI, SENIOR ANALYST, SANFORD C. BERNSTEIN & CO., LLC., RESEARCH DIVISION: I have one for Luca and one for Tim, please. Luca, I'm wondering, as we think about modeling Q4, iPhone ASPs are typically up sequentially about 2% to 4%, sort of low single digits. Perhaps you can help us think through how we should be thinking about Q4. I know you provided some commentary last quarter on how we should be thinking about Q3 ASPs.

LUCA MAESTRI: Toni, as you know, we do not provide guidance for either units or ASPs for any product category. But of course, we provide a guidance on revenue. And the guidance range implies growth of 16% to 19%. We expect the growth to come from strong growth from iPhone, from Services and from Wearables, which has been a bit of our pattern during the course of the year. On iPhone ASP, the only thing that I would point out is that, obviously, we're exiting the June quarter at a significantly higher level than in the past. And so that, I think it's important to keep in mind -- as we move into the September quarter, it's important to keep in mind the type of revenue growth that we've implied in our guidance.

A.M. SACCONAGHI: Okay. Tim, I was wondering if you could just comment a little bit about the health of the smartphone market. Apple's smartphone iPhone units have been relatively flat for 4 years. And I think you've probably been a share gainer during the period, which would suggest, at least at the high end of the market, that is perhaps flat to down. And I'm wondering if you can comment on, a, whether you believe that and what you think might be happening with replacement cycles and specifically also what impact, if any, you've seen from wider availability and less expensive replacement batteries for iPhones.

TIMOTHY D. COOK: I think the smartphone market is very healthy. I think it's actually the best market in the world to be in for someone that is in the business that we're in. So it's an enormous-sized market and whether it grows -- from our point of view, whether it grows 1% or 2% or 5% or 6% or 10% or shrinks 1% or 2%, it's a great market because it's just huge. And so that's kind of the way that I view that. iPhone revenues are up 20% for the quarter over last year. We're really pleased with that. And if you look at the sort of this cycle, which I'll define as Q1, Q2, Q3 for ease, you'll see that we've grown like mid-single digits and -- on an average weekly sales point of view and, of course, double-digit on ASP. And so I think it's really healthy. In terms of replacement cycles, as I've mentioned I think on a previous call, some replacement cycles are lengthening. I think that the major catalyst for that was probably the subsidy plans becoming a much smaller percentage of total sales around the world than they were at one time. And so I think that some are lengthening and -- but I think for us, the thing that we always have to do is come out with a really great innovative product. And I think that iPhone X shows that when you deliver great innovative product, there's enough people there that would like that, and it can be a really good business. And so that's how I look at that. In terms of the -- our installed base, which is something very important for us as it is one of the key drivers of Services, our active installed base on iPhone grew double digits over last year during the quarter. And so we're thrilled with that. And you can see that carrying through to the Services line, in the -- and the growth that we have there. In terms of batteries, we have never done an analysis internally about how many people decided to get a lower-priced battery than buy another phone because it was never about that for us. It was always about doing something great for the user. And I think if you treat the users and customers well, then you have a good business over time, and so that's how we look at that.

OPERATOR: Next, we'll take a question from Laura Martin from Needham.

LAURA ANNE MARTIN, SENIOR ANALYST, NEEDHAM & COMPANY, LLC, RESEARCH DIVISION: Yes, can you hear me okay?

NANCY PAXTON: Yes.

TIMOTHY D. COOK: Yes.

LAURA ANNE MARTIN: Great, okay. Super. I'd like to focus on product road map and strategy. There is a war going on for the home, the connected home, over the Internet of Things. And with 2 products, the HomePod and Apple TV in the home, my question is, strategically, how do you feel about the importance of being in the home and whether it threatens your dominance outside the home, with your core business in the mobile devices, if you sort of lose that battle? I'm just trying to figure out strategically, when you think about where the puck's going, how important is it for you to have a beachhead in the home as well as out of home?

TIMOTHY D. COOK: I think the home business, Laura, is bigger than the HomePod and Apple TV. They're both important products clearly. But everybody has their iPhone at home as well and everybody has their Mac at home and everyone has their iPad at home. And so in terms of the -- Siri access points, there -- as you can tell from the 100 billion number I quoted in the script, there's an extraordinary amount of usage of these products that are used to perform home-related functions. I do that every day with controlling all my home automation and so on and so forth. Part of that is on HomePod, but part of it is with the Apple Watch and the iPhone and the iPad. And so I think home is important. Home is important. Work is important. The movement between the 2 are important. Health is important. So the smartphone has become the repository that goes across the whole of your life, not something that is just meant for a portion of it. And so I think all of those are important, and we're focused on all of them. Thanks for your question.

LAURA ANNE MARTIN: That's helpful actually. Yes, sort of. I mean, I'll watch your product road map and be able to tell what the answer is. The other thing, the thing I get in fights with investors about the most is this, and I'd love your insight on this. I love the expansion of the new products. The question I have is, are they actually on-ramped into the Apple ecosystem, the Beats, the Watch, the AirPods, subscriptions? Are they on-ramped into the ecosystem? Or is the on-ramp to the ecosystem the iPhone, and then these new products add revenue per member once you get somebody into the ecosystem via the iPhone?

TIMOTHY D. COOK: The -- a lot of people that buy Apple products buy for the whole ecosystem even though they might not currently use all the different products. And so the way that I think about those products are they're products within the ecosystem itself. And there's a -- the AirPods have really gone through the roof, and the Apple Watch has hit an air pocket and has gone to a whole different level, as I had mentioned earlier, with our overall Wearables revenue. And so in my view, this is a part of the -- they are a core part of the ecosystem.

LAURA ANNE MARTIN: And so they attract a new person to the ecosystem. Or does the person have to have an iPhone first?

TIMOTHY D. COOK: It is -- well, but on your point though, it is clear from communications that I've had with users that some of them were attracted to iPhone because of the Apple Watch. And so the Apple Watch led them to the iPhone. The reverse of that is also true is that somebody got the iPhone and then decided, "I really want something to coach me in fitness and to curate some of the communications and so forth like the Watch does so well." And so it's not always a linear path. I see these things as being somewhat fluid and different for each user.

LAURA ANNE MARTIN: So they're complementary and self-reinforcing. Okay, that makes sense. All right.

TIMOTHY D. COOK: Exactly right. Thank you for the questions.

 

NANCY PAXTON: Thank you, Laura. A replay of today's call will be available for 2 weeks on Apple podcast, as a webcast on apple.com/investor and via telephone. And the numbers for the telephone replay are (888) 203-1112 or (719) 457-0820. Please enter confirmation code 5838188. And these replays will be available by approximately 5 p.m. Pacific Time today.

Members of the press with additional questions can contact Josh Rosenstock at (408) 862-1142. And financial analysts can contact Matt Blake or me with additional questions. Matt is at (408) 974-7406, and I'm at (408) 974-5420. Thanks again for joining us.

OPERATOR: That does conclude our conference for today. Thank you for your participation.



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**Q2 2018 Apple IncEarnings Call - Final**

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Presentation

OPERATOR: Good day, everyone, and welcome to the Apple Inc. Second Quarter Fiscal Year 2018 **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, SENIOR DIRECTOR OF IR AND TREASURY, APPLE INC.: (technical difficulty)

and he'll be followed by CFO, Luca Maestri. After that, we'll open the call to questions from analysts.

Please note that some of the information you'll hear during our discussion today will consist of forward-looking statements, including, without limitation, those regarding revenues, gross margins, operating expenses, other income and expense, taxes, capital allocation, share repurchases, dividends and future business outlook. Actual results or trends could differ materially from our forecast. For more information, please refer to the risk factors discussed in Apple's most recently filed periodic reports on Form 10-K and Form 10-Q 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, CEO & DIRECTOR, APPLE INC.: Thank you, Nancy, and to everyone joining us, welcome. We're proud to announce the results of a very successful quarter today, setting new March quarter records for both revenue and **earnings**.

We generated $61.1 billion of revenue. That's up 16% from last year, making it our sixth consecutive quarter of accelerating revenue growth. Our performance was broad based with iPhone revenue up 14%, Services up 31% and Wearables up almost 50%. We grew in each of our geographic segments, and in Greater China and Japan, revenue was up more than 20%.

iPhone's second quarter performance capped a tremendous fiscal first half with $100 billion in iPhone revenue, an increase of $12 billion over last year, setting a new first half record and achieving our highest first half growth rate in 3 years. iPhone gained share during the quarter based on IDC's latest estimates for the global smartphone market. And customers chose iPhone X more than any other iPhone each week in the March quarter just as they did following its launch in the December quarter. Since we split the line with the launch of iPhone 6 and 6 Plus in 2014, this is the first cycle in which the top of the line iPhone model has also been the most popular.

Q2 was our best quarter ever for Services, and momentum there continues to be incredibly strong. Revenue topped $9 billion for the first time, up more than $2 billion over last year's March quarter. We had all-time record revenue from the App Store, from Apple Music, from iCloud, from Apple Pay and more, all of which are a powerful illustration of the importance of our huge active installed base of devices and the loyalty and engagement of our customers.

Across all our services, paid subscriptions surpassed 270 million, up over 100 million from a year ago and up 30 million in the last 90 days alone, contributing to the overall increase in Services revenue. Apple Pay continues its strong growth with active users more than doubling and transactions tripling year-over-year. We believe the availability of Apple Pay at major transit systems have been a key driver of adoption among commuters. And in March, we launched Express Transit with Apple Pay in Beijing and Shanghai, the second and third largest transit systems in the world. Apple Pay is already the most successful mobile transit payment system in Tokyo, which has the busiest transit system of all. With the launch of Brazil in April, Apple Pay is now available in 21 markets, and we expect Norway, Poland and Ukraine to launch in the next several months.

This was another outstanding quarter for our Wearables business, which includes Apple Watch, Beats and AirPods with combined revenue of almost 50% year-over-year. Looking at its revenue over the last 4 quarters, our Wearables business is now the size of a Fortune 300 company.

Apple Watch had another great quarter with revenue growing by strong double digits year-over-year to a new March quarter record. Millions of customers are using Apple Watch to help them stay active, healthy and connected, and they have made it the top-selling watch in the world. We launched carrier support for Series 3 with cellular in mainland China, Hong Kong and Thailand during the quarter with more markets on the way.

And now with watchOS 4.2, there are more features than ever before. For example, in addition to tracking your workouts and heart rate, skiers and snowboarders can record runs, see vertical descent and calculate speed as well as contribute data directly to the Apple Watch Activity app.

AirPods are incredibly popular, and we're seeing them in more and more places: in the gym, in coffee shops, wherever people are enjoying music on their Apple devices. This product is a runaway hit, and we're working hard to meet the incredible demand.

We started shipping HomePod in February, and it's widely recognized as having the best audio quality for its size and class. HomePod is a breakthrough speaker that delivers amazing sound, and we believe it will change the way people listen to music at home. It's currently available in the United States, the United Kingdom and Australia, and we're looking forward to adding new features to HomePod and introducing it to more markets around the world soon.

In March, we announced new products for the education community, including updating our most popular iPad with support for Apple Pencil. It empowers students to be even more creative and productive from learning to code to sketching ideas and jotting down handwritten notes to making up screenshots -- marking up screenshots. And the new iPad's gorgeous Retina display, advanced chip and enhanced cameras and sensors are designed to support the next generation of apps for immersive augmented reality experiences in the classroom.

In addition to our successful Everyone Can Code initiative, we've launched Everyone Can Create. It's a new free curriculum that makes it fun and easy for teachers to integrate drawing, music, filmmaking or photography into their existing lesson plans for any subject. We believe education is the great equalizer, and whether it's through our coding programs, our unrivaled augmented reality platform or the creativity both can unleash, we're proud to help students everywhere reach new frontiers of learning with Apple technology.

In March, we also released iOS 11.3, a major update, offering new immersive augmented reality experiences, access to personal health records in the Health app and more. Apps can now deliver AR experiences that use vertical walls and doors in addition to tables and chairs and can make more accurately mapped irregular shaped surfaces. The update to ARKit that made this possible came just 6 months after we launched the world's largest AR platform.

Also in iOS 11.3, patients in nearly 40 health systems representing hundreds of hospitals and clinics can now consolidate their medical records from multiple sources and view them all in one place right from their iPhone. This data is encrypted and protected with the user's iPhone passcode, and it can help them better understand their health history, have informed conversations with doctors and family members and make future health care decisions.

Consistent with our long-term focus, privacy is a key element of these initiatives for education and personal health. We're relentless about making the best products and experiences in the world while fiercely protecting our users' privacy because we believe privacy is a fundamental human right.

Our environmental initiatives recently passed an important milestone. All of our global facilities across 43 countries are now powered with 100% clean energy. We work with communities around the world to build clean power sources. Apple now has 25 renewable energy projects operational and 15 more under construction. We're also driving our supply chain to use clean energy. As of last month, 23 of our suppliers are committed to operating on 100% renewable energy.

We're now halfway through our fiscal 2018 with nearly $150 billion in revenues and double-digit growth in all of our geographic segments. We generated almost $34 billion in **earnings** in 6 months, and we're very bullish on Apple's future. We have the best pipeline of products and services we've ever had. We have a huge installed base of active devices that is growing across all products, and we have the highest customer loyalty and satisfaction in the industry.

 

Our Services business is growing dramatically. Our balance sheet and our cash flow generation are strong, and that allows us to invest significantly in our product road map and still return a very meaningful amount of capital to our shareholders.

Recent corporate tax reform enables us to deploy our global cash more efficiently. In the United States, we expect our direct investment in the economy to exceed $350 billion over the next 5 years, including $30 billion in capital expenditures, and we expect to create over 20,000 U.S. jobs at Apple over that time frame. We're narrowing the site selection for a new U.S. campus, and we look forward to sharing more information on that later this year.

Consistent with our annual cadence, today, we're providing an update on our capital return program. Tax reform makes it possible for us to execute our program more efficiently, both through share repurchases and payment of dividend to the tens of millions of investors who own Apple stock either directly or indirectly from large pension funds to individuals with retirement accounts.

So today, given our strong confidence in Apple's future, we're announcing a significant update to our capital return program. Our Board of Directors has approved a new $100 billion share repurchase authorization as well as a 16% increase in our quarterly dividend effective with our next dividend payable later this month.

Luca will provide more details about our program as well as a more in-depth discussion of the quarter's results. So I'll now turn the call over to him. Luca?

LUCA MAESTRI, CFO & SENIOR VP, APPLE INC.: Thank you, Tim. Good afternoon, everyone. We're very pleased to report record financial results for our March quarter with revenue growth of 16%, EPS up 30%.

Starting with revenue. We generated $61.1 billion, our highest ever for a March quarter. Revenue grew in all of our geographic segments, setting new Q2 records in most countries we track. Performance was very strong in emerging markets where revenue was up 20%, and we were especially pleased to see 21% year-over-year growth in Greater China, our strongest growth rate from that segment in 10 quarters.

We also set Q2 revenue records in the Americas, in Europe and in Japan. Gross margin was 38.3%, essentially flat sequentially as we offset the seasonal loss of leverage with cost improvements and a shift in mix towards services. Operating margin was 26% of revenue. Net income was $13.8 billion, up $2.8 billion over last year and a March quarter record. Diluted **earnings** per share were $2.73, up 30% to a new record for Q2, and cash flow from operations was very strong at $15.1 billion.

iPhone revenue grew 14% year-over-year with iPhone ASP increasing to $728 from $655 a year ago, driven primarily by the performance of iPhone X, iPhone 8 and iPhone 8 Plus. During the quarter, we sold 52.2 million iPhones, up 3% over last year, and we grew iPhone units by double digits in several markets, including Japan, Canada, Switzerland, Turkey, Central and Eastern Europe, Mexico and Vietnam.

Our performance from a customer demand standpoint was even stronger than our reported results as we reduced iPhone channel inventory by 1.8 million units, 600,000 units more than the March quarter reduction last year. We exited the March quarter within our target range of 5 to 7 weeks of iPhone channel inventory.

Our customers are extremely happy with their iPhones. The latest survey of U.S. consumers from 451 Research indicates that across all iPhone models, the customer satisfaction rating was 95%, and combining iPhone 8, 8 Plus and iPhone X, customer satisfaction was even higher at 99%. And among business buyers who plan to purchase smartphones in the June quarter, 78% plan to purchase iPhones.

Turning to Services. We had a sensational quarter with all-time record revenue of $9.2 billion, and that's up more than $2 billion from last year, an increase of 31% and double the Services revenue we generated in the March quarter just 4 years ago. Our Services business is growing at a very fast pace all around the world with revenue up more than 25% year-over-year in each of our 5 geographic segments. The App Store set a new all-time revenue record in the March quarter, and Apple Music reached a new record for both revenue and paid subscribers, which have now passed 40 million.

iCloud storage revenue was up by over 50% year-over-year to a new all-time record, and AppleCare revenue grew at its highest rate in 5 quarters, setting a new March quarter record. Our other product category also set a new record for the March quarter with revenue of almost $4 billion. We began shipping HomePod in February, and unit sales of both Apple Watch and AirPods reached a new high for the March quarter. When we combine all our wearables and home products, they accounted for over 90% of the total growth in the other products category.

 

Next, I'd like to talk about the Mac, which set a new March quarter revenue record, including new records in both the Americas and Greater China. We sold 4.1 million Macs, generating year-over-year growth in many emerging markets, including Latin America, the Middle East and Africa, Central and Eastern Europe and India. We were happy to see double-digit growth in our active installed base of Macs to a new all-time high with almost 60% of March quarter purchases coming from customers who are new to Mac.

iPad grew both units and revenue for the fourth consecutive quarter. We sold 9.1 million iPads, and about half of purchases were by customers new to iPad. Growth was particularly strong in Japan, in Latin America, Middle East and Africa and Central and Eastern Europe, all markets where iPad sales were up double digits compared to a year ago. We gained share of the global tablet market based on the latest estimates from IDC, and our active installed base of iPads reached an all-time high. NPD indicates that iPad has 53% of the U.S. tablet market in the March quarter, up from 40% share a year ago. And the most recent customer survey from 451 Research measured iPad customer satisfaction ratings of 95%. And among business customers who plan to purchase tablets in the June quarter, 73% plan to purchase iPads.

We continue to make great strides in the enterprise market. In February, we announced a new cyber risk management solution for businesses with Cisco, Aon and Allianz. This combined approach is an industry first that integrates the most secure technology from Apple and Cisco, cyber resilience evaluation services from Aon and options for enhanced cyber insurance coverage from Allianz. Organizations will now be able to better manage and protect themselves from cyber risks associated with ransomware and other malware-related threats. We are thrilled that insurance industry leaders recognize that Apple products provide superior security.

In March, we announced 2 new services with IBM to bring more dynamic and intelligent insights into apps. IBM Watson services for Core ML and IBM Cloud Developer Console for Apple will enable developers to more easily build native iOS apps that bring together machine learning with artificial intelligence and cloud services.

In health care, iPhones are being used across leading health systems, including Cedars-Sinai, the Mayo Clinic and HCA Healthcare with iOS apps to support clinical workflows, communications and care delivery. In fact, HCA Healthcare recently announced they plan to deploy 100,000 iPhones across their hospital sites within the next 3 years.

We had great performance from our retail and online stores, which produced their highest March quarter revenue ever. Year-over-year growth was led by iPhone as well as strong performance from AirPods and introduction of HomePod. Our stores hosted more than 250,000 of our very popular Today at Apple sessions with a particular emphasis on coding and app design.

During the quarter, we opened beautiful new stores in South Korea and in Austria, our first in both countries. And 3 weeks ago, we opened our newest store in Tokyo, bringing us to 502 stores across the world today.

Let me now turn to our cash position. We ended the quarter with $267.2 billion in cash plus marketable securities, and we had $110 billion in term debt and $12 billion in commercial paper outstanding for a net cash position of $145 billion. We returned nearly $27 billion to investors during the quarter. We paid $3.2 billion in dividends and equivalents and spent $23.5 billion on repurchases of 137 million Apple shares through open market transactions. We also retired 5.7 million shares upon the completion of our 13 ASR during the quarter.

We have now completed over $275 billion of our current $300 billion capital return program, including $200 billion in share repurchases against our cumulative $210 billion buyback program. We will complete the $210 billion program during the June quarter, 3 full quarters sooner than initially planned.

The biggest priorities for our cash have not changed over the years. We want to maintain the cash we need to fund our day-to-day operations, to invest in our future and to provide flexibility so that we can respond effectively to the strategic opportunities we encounter along the way.

As we said 90 days ago, the new tax legislation enacted in December gives us increased financial and operational flexibility from the access to our global cash. It allows us to invest for growth in the United States more efficiently, and it also provides us the opportunity to work towards a more optimal capital structure. As we said in February, our goal is to become approximately net cash neutral over time.

Given our strong confidence in Apple's future and the value that we see in our stock, our board has authorized a new $100 billion share repurchase program, which we will start executing during the June quarter. Considering the unprecedented size of this new authorization, we want to be particularly thoughtful and flexible in our approach to repurchasing shares. Our intention is to execute our program efficiently and at a fast pace. As in the past, we will provide regular updates on our capital return activities at the end of every quarter.

 

We're also raising our dividend for the sixth time in less than 6 years. As we know, it is very important to our investors' who value income. The quarterly dividend will grow from $0.63 to $0.73 per share, an increase of 16%. This is effective with our next dividend, which the board has declared today payable on May 17, 2018, to shareholders of record as of May 14, 2018.

With over $13 billion in annual dividend payments, we are proud to be among the largest dividend payers in the world, and we continue to plan for annual dividend increases going forward. We will continue to review our capital allocation regularly, taking into account the needs of our business, our investment opportunities and our financial outlook. We will also continue to solicit input on our program from a broad base of shareholders. This approach will allow us to be flexible and thoughtful about the size, the mix and the pace of our program. We expect to provide a new update to our capital allocation plans approximately 12 months from 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 $51.5 billion and $53.5 billion. We expect gross margin to be between 38% and 38.5%. We expect OpEx to be between $7.7 billion and $7.8 billion. We expect OI&E to be about $400 million, and we expect our tax rate to be about 14.5%.

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

NANCY PAXTON: Thank you, Luca. (Operator Instructions)

Questions and Answers

OPERATOR: (Operator Instructions) Your first question will come from Shannon Cross of Cross Research.

SHANNON SIEMSEN CROSS, CO-FOUNDER, PRINCIPAL & ANALYST, CROSS RESEARCH LLC: I wanted to ask about your thoughts on sort of iPhone and positioning. Now that we're a couple of quarters out from the launch of the iPhone X, given the $1,000 price point, it's clearly selling, but there's been a lot of questions in the market about sustainability of that price point and how you're thinking about it as you go look out sort of holistically across your lineup. So if you could talk a bit about what you're hearing from your customers on that and then I have a follow-up.

TIMOTHY D. COOK: Sure. Shannon, it's Tim. As Luca mentioned earlier, our revenues are up 14% year-over-year on iPhone, and that's a combination of single-digit unit growth and ASP growth that is mainly driven by iPhone X. I think that our iPhone line shows that there's a variety of different customers in a market that is as large as the smartphone market, and so we're going to continue to provide different iPhones to -- for folks to meet their needs. On iPhone X specifically, I think it's important to maybe emphasize again one of the things I mentioned in my opening comments that customers chose iPhone X more than any other iPhone each and every week in the March quarter just as they did following the -- following its launch in the December quarter. Also, since we split the line with the launch of iPhone 6 and 6 Plus back in 2014, this is the first cycle that we've ever had where the top of the line iPhone model has also been the most popular. And so with the customer sat that Luca referenced as well, the 99%, the iPhone X is a beloved product, and so it's -- I think that it's one of those things where like a team wins the Super Bowl. Maybe you want them to win by a few more points, but it's a Super Bowl winner. And that's how we feel about it. I could not be prouder of the product.

SHANNON SIEMSEN CROSS: And then, Luca, can you talk about working capital, specifically inventory, which went up pretty significantly quarter-over-quarter? What's driving that? And how are you thinking about -- I mean, it's one of the uses of cash obviously. So how are you thinking about inventory and maybe working capital in general as you're going forward?

LUCA MAESTRI: Yes. Shannon, you know that we've always generated a significant amount of cash through working capital. We've got a negative cash conversion cycle, and we plan to continue to have that. Our inventory level has gone up. It's just a temporary event. We have decided to make some purchasing decision given current market conditions, and that should unwind over time.

SHANNON SIEMSEN CROSS: So that was essentially component purchases?

LUCA MAESTRI: Correct.

OPERATOR: From Morgan Stanley, Katy Huberty.

KATHRYN LYNN HUBERTY, MD AND RESEARCH ANALYST, MORGAN STANLEY, RESEARCH DIVISION: The Services growth acceleration is really the highlight this quarter in my mind. Can you talk about what the biggest driver is, whether it be products or regions that drove the acceleration? And do you think that we can continue to see growth north of 30%? Then, I have a follow-up.

TIMOTHY D. COOK: It's Tim. The -- Services grew 31%. We hit an all-time record at $9.2 billion, first time we cleared $9 billion. The great news about it is it's not a single geo or a single service. If you look at it, each of the geos, the minimum was at 25%. So each of the geos were -- had -- did extremely well, and we set records from the App Store to the Apple Music, to iCloud, to Apple Pay and more. And underneath that, if you look at the subscriptions, the number of subscriptions, I think I mentioned this in my comments, paid subscriptions have moved up over 100 million on a year-over-year basis to over 270 million by the end of the quarter. And so it's very broad based in terms of type of service and geographic region. It's sort of exactly what we would like to see. In terms of forecasting moving forward, we've obviously made assumption for our guidance that Luca provided earlier, and in terms of longer term, we're on target to our 2020 goal of doubling the Services revenue of '16 as we had talked about previously.

KATHRYN LYNN HUBERTY: And it doesn't look like the threat of a trade war with China slowed down that business. In fact, growth accelerated. But anything anecdotally that you see in the business in recent weeks that would suggest that, that is having an impact on demand? And any actions that Apple is taking as a company to preempt any risk of tariffs going forward?

TIMOTHY D. COOK: Yes. I think my own view is that China and the U.S. have this unavoidable mutuality where China only wins if the U.S. wins and the U.S. only wins if China wins, and the world only wins if China and the U.S. win. And so I think there's lots of things that bind the countries together. And I'm actually very optimistic. I think history shows us that countries that embrace openness and diversity do much, much better than the ones that are closed. And so I'm a big believer that the 2 countries together can both win and grow the pie, not just allocate it differently. And so that's our focus, and I'm optimistic that -- I don't know every play by play that will happen, but over time, I think that view will prevail.

OPERATOR: The next question will come from Mike Olson with Piper Jaffray.

MICHAEL JOSEPH OLSON, MD AND SENIOR RESEARCH ANALYST, PIPER JAFFRAY COMPANIES, RESEARCH DIVISION: Just following on the Services question. I'd be curious what the next drivers of Services revenue are? Will it be continued penetration of Music and Pay that you see as kind of the largest future categories of incremental growth? Or maybe when could augmented reality become a material part of Services? And then I have a follow-up.

TIMOTHY D. COOK: Well, Mike, it's Tim. The -- again, the great thing about Services is there are several services that make up the total that are growing nicely. And I think the other good news is that because our active installed base has -- is at such a level at -- last quarter, we said that we had exceeded $1.3 billion. This year, we're -- we're not going to release this number every quarter, but we've obviously grown again. And it's growing at a double-digit number on a year-over-year basis. And so with that kind of change in the installed base and with the services that we have now and others that we are working on, I think that this is just a huge opportunity for us and feel very good about the track that we're on.

MICHAEL JOSEPH OLSON: And then any potential tariff issues aside, what's working for Apple in China right now? You talked about it being the strongest year-over-year growth in 10 quarters. I guess, what's driving that? Is it iPhone X specifically or something else that's behind that improvement?

TIMOTHY D. COOK: A good question. IPhone X was the most popular smartphone in all of China last quarter. And so iPhone X has done well there. In order to hit a number like 21% on the growth that you see on your data sheet there, there has to be several things working well. And the things that have huge growth rates there are the other products category, which is our Wearables business in China and the Services business, which you and I just spoke about. The iPhone obviously had to do extremely well to get a 21% number, and we gained share in the market for the Mac as well. And so there's actually several vectors there that are working well for us. We also -- more broadly on the iPhone, the iPhone was the top 3 selling phones in China. And so it's iPhone X was #1, but we had several in the top.

OPERATOR: From RBC Capital Markets, Amit Daryanani.

AMIT JAWAHARLAZ DARYANANI, ANALYST, RBC CAPITAL MARKETS, LLC, RESEARCH DIVISION: Two questions from me as well. I guess, first one, just touching on the gross margin dynamics. If I look at the guidance for June on a year-over-year basis, I think sales are up double digit, but gross margins are still flat at the high end, maybe down 20 basis points at the midpoint. Can you just talk about what's driving the lack of leverage on the gross margin basis on a year-over-year basis for June?

 

LUCA MAESTRI: Yes. Amit, it's Luca. We tend to look at the -- our gross margin dynamics on a sequential basis, and essentially, we're guiding to about flat on a sequential basis. On a year-over-year basis, it's less relevant for our business, but in general, I would say that this year we are seeing a more difficult cost environment. Particularly, we're still dealing with about 70 basis points of the impact from the memory pricing environment that we're working through.

AMIT JAWAHARLAZ DARYANANI: Got it. And if I could just follow up, Tim, you've been fairly vocal, I think, talking about the need for better privacy protection and well-crafted regulation over time. Could you just maybe help us understand how does Apple protect consumer data? And how does this ongoing debate around data protection translate into a positive for Apple over time?

TIMOTHY D. COOK: We protect it by encrypting it, and we keep the bulk of information or a significant amount of information on the device so that the user is in control of it. We also collect much less overall than others do because our -- if you look at our model, if we can convince you to buy an iPhone or an iPad, we'll make a little bit of money. You're not our product, and so that's how we look at that. In terms of benefit, we don't really view it like that. We view that privacy is a fundamental human right and that it's an extremely complex situation if you're a user to understand a lot of the user agreements and so forth. And we've always viewed that part of our role was to sort of make things as simple as possible for the user and provide them a level of privacy and security. And so that's how we'd look at it.

OPERATOR: We'll go to Steve Milunovich with UBS.

STEVEN MARK MILUNOVICH, MD AND IT HARDWARE AND EMS ANALYST, UBS INVESTMENT BANK, RESEARCH DIVISION: Luca, could you talk a bit more about the capital allocation? The dividend increase of 16% was relatively low relative to what you could have done. So are you really thinking the stock price is attractive here? And you said you would execute the buyback at a fast pace. Can you give us any time frame of that $100 billion? And how much debt do you think about in terms of net cash 0?

LUCA MAESTRI: Yes. Let's start with the dividend. We're increasing it by 16%. This is the largest increase that we've done since we've reintroduced the dividend back in August of 2012. So we think it's a very meaningful increase for all the investors that value income. Obviously, when we come down to capital allocation decisions, we obviously also keep in mind that -- the opportunity for us to do some M&A activities, which we do in an ongoing basis. But when it comes down between dividends and buyback, our view is that for a variety of reasons, the -- we see a lot of value in the stock. We believe the stock is undervalued, and so we have a bias towards the buyback. So the dividend is a very large component of capital return because we're going to be returning more than $13 billion a year to investors through dividends. But we believe that given where we are with the valuation of the stock, we think that we continue to do the buyback primarily. We are not giving an end date to the program this time because the amount is very, very large. And so we will -- we would try to execute it. As you've seen from our track record during the last 5 years, we will do that at a very fast pace. But we also want to do it efficiently. We want to make sure that we buy back the stock at the right time. And so with that in mind, we have done $23.5 billion of repurchases during the March quarter. We will give you an update to our activities at the end of every quarter. And then 12 months from now we will actually talk about an update to the entire program. So you will be able to keep track of our progress every 90 days.

STEVEN MARK MILUNOVICH: And Tim, could you talk a bit about your health care opportunity? Is it merely selling watches over time? Or do you think more broadly about? Is there a services play? You're doing some things for your employees. Could that potentially broaden out? How do you think about the opportunity there?

TIMOTHY D. COOK: We think about it very broadly, and you can tell that a bit by some of the things that we've had going with ResearchKit and CareKit and most recently, the health records that I had referenced in my initial comments. And those all came out of getting significantly engaged in the Apple Watch and sort of pulling the strings so to speak. And we also have a Heart Study that is going on currently. And so I don't want to give too much away, but it's an area of great interest where we think we can make a big difference. And so it's a major strategic thrust of ours.

OPERATOR: We'll go to Brian White with Monness, Crespi.

BRIAN JOHN WHITE, RESEARCH ANALYST, MONNESS, CRESPI, HARDT & CO., INC., RESEARCH DIVISION: Yes. Tim, I think there's -- China numbers were actually phenomenal in the quarter and third consecutive quarter of growth. I think there's been a lot of concerns, just Apple in China and maybe misinformation out there. But what do you see as the drivers for Apple in both Mainland China and Greater China over the next few years? And also, if you could just give us an update on what you're seeing in India.

 

TIMOTHY D. COOK: Yes, good question. Let me start with India, and then I'll talk more about China. India, we set a new first half record. So we continue to put great energy there and try to -- our objective over time is to go in there with all of our different initiatives from retail and everything else. And so we're working toward those things. It's a huge market, and it's clear that many people will be moving into the middle class over time as we've seen in other countries. China, I continue to believe is a phenomenal country with lots of opportunity from a market point of view but also lots of opportunity from an app developer point of view. We have almost 2 million application developers in China that are writing apps for iOS and the App Store, and they're doing unbelievably creative work and innovative work. And so we sort of -- we look at China holistically, not only as a market. On the market side, we've seen iPhone X, as I had mentioned before, as being the top-selling smartphone during the quarter. We gained share during the quarter. And I read some notes here and there about the market itself not being good. I think on -- in any kind of -- on a 90-day clock, lots of different things can happen, but my own personal view of China is that it's a great market. And I would -- I'm -- we are certainly looking far beyond 90 days and feel very bullish on the opportunity and the environment there. I would say that the market for us is more than iPhone. The Mac gained share there as well. The Watch is getting some traction there. Services is doing extremely well. And so it has several catalysts, and I'm very pleased with the results that we were able to show during the quarter.

OPERATOR: Next we'll hear from Wamsi Mohan with Bank of America Merrill Lynch.

WAMSI MOHAN, DIRECTOR, BOFA MERRILL LYNCH, RESEARCH DIVISION: Tim, can you comment on the price elasticity of demand at the high end for iPhones, if that was in line with your expectations? Do you have a preference for unit growth versus ASP growth when it comes to maximizing the gross profit dollar growth? And I have a follow-up for Luca, please.

TIMOTHY D. COOK: We price for the value that we're delivering. And iPhone X is the most innovative product on the market, and as I've said a few times, we have -- they're sort of jam-packed with technologies that really set up the smartphone for the next decade. And so that's how we priced it. We were surprised somewhat that through all of this period of time that the iPhone X winds up at the most selling -- most popular for every week of the time since the launch, and so that's, I think, a powerful point. And it's #1 in China, which is another powerful point. And so obviously, at some point, if those technologies move to lower price points and that -- there's probably more unit demand. But the way we think about it is trying to price a reasonable price for the value that we deliver, and I feel that we did that.

WAMSI MOHAN: And Luca, your gross margins have been very robust despite the headwinds that you absorbed on commodities, which you quantified, and frankly, also from the FX hedges that are limiting some of the FX upside that a lot of other companies are seeing. So as you -- one, when do you expect these to turn into tailwinds? And when they do turn into tailwinds, do you -- would you consider reinvesting some of those into pricing? Or would you -- like should we think about you flowing those through to the bottom line?

LUCA MAESTRI: Well, Wamsi, I think let me start with where we are right now. I think you're right. I think we've been able to navigate a difficult foreign exchange environment for a number of years. And now as you know, because we have this hedging program, as the dollar has weakened a bit in recent months, although during the last week, it actually started to turn the other way again, we've got the hedging program that works both ways. And also on the memory front, we feel that for NAND, we're going to be turning the corner very soon. For DRAM, we also think that we are near the peak, possibly at the end of this year. And so that should provide some level of stability. As I said earlier this year, I think we are experiencing in total a more difficult cost environment. And so hopefully, that can turn into a positive for us. At the same time, it's very difficult for me to give you an indication of what is going to happen in the future because every product cycle is different, and as you know, we don't provide guidance past the current quarter. There are some elements that we understand quite well and we tend to manage well over the course of the cycle, for example, our cost structures that we are able to manage during -- throughout the year. But there are also elements that are not entirely under our control like foreign exchange. And the mix of products and services that we sell to our customers also has an impact on the overall gross margin. Our primary consideration is always around maximizing gross margin dollars, and that is the approach that we take around, for example, pricing decisions.

OPERATOR: From Citi, we'll hear from Jim Suva.

JIM SUVA, DIRECTOR, CITIGROUP INC, RESEARCH DIVISION: And I'll ask actually both my questions at the same time, one for Tim and one for Luca. Tim, strategically, when we talk to investors, they often say, "Oh, iPhone market is saturated. There's not much room for growth." Yet when we do our analysis, we kind of still see emerging markets like India and all those still a growth. When you think about India and those markets, do you kind of believe that some of those markets could get to much higher or a more normalized market share that you have in some of the developing countries over time? And can you talk a little bit about some of those efforts you may be doing? And then, Luca, the question for you is about the gross margin. When we think about if component prices start to stabilize, seeing how Apple Services have been so successful and accretive to margins, should we start to look for some potential margin -- gross margin upside, again, should components stabilize?

TIMOTHY D. COOK: Yes. Jim, thanks for the question. In terms of the -- let me address the smartphone market a bit, and then I'll mention iPhone. In terms of the market in general, if you look at last year, which was the last data point we have on the full market, was -- there were still 0.5 billion feature phones sold in the world. Now many of those were sold into emerging markets, not all of them but many of them, and we still believe that, over time, every phone sold will be a smartphone. And so it seems to us that with that many feature phones being sold, that's a pretty big opportunity. In terms of the iPhone itself, even though we sell quite a few phones across the course of a year, our market share globally is low compared to the -- our sales are low compared to the full market of smartphones. And so the -- our task is to convince people that currently -- or have another type of phone to switch while really taking care of people that have an iPhone so that they choose, when they elect to buy another phone, that they buy another iPhone. And so we spend quite a bit of time on that as you might guess. I do think that India -- India is the third largest smartphone market in the world. There's obviously huge opportunities there for us, and we have extremely large share in that market overall. And so we're putting a lot of energy there and working with the carriers in that market. And they're investing enormously on the LTE networks, and the infrastructure has come quite a way since we began to put a lot of energy in there because of their leadership and so forth. And so I do think -- I don't buy the view that the market's saturated. I don't see that from a market point of view or -- and certainly not from an iPhone point of view. I think the smartphone market is sort of like the best market for a consumer product company in the history of the world. And so that's how I feel about it. It's a terrific market, and we're very happy to be a part of it.

LUCA MAESTRI: Jim, on the gross margin side, I think I'll repeat what I said earlier, but we -- you're right. Our Services business, and I've said it in the past, is accretive to company margins, and so as we're able to grow the Services business, that should provide a positive, a tailwind. At the same time, within the Services portfolio that we have, we have services that have different levels of profitability, so we also need to take into account the mix of services that we're going to be selling. At a macro level, because about 2/3 of our company is outside the United States, a weak dollar is a positive for our gross margins. A strong dollar, as it's been during the last 4 years, has been a bit of a headwind for the company. We try to make it more stable through the hedging program. And in general, when we look at our process to innovate our products, typically, when we launch a new product, that product tends to have a higher cost structure than the product it replaces. And so that is something that we need to work through every time we launch a new product, and we have a pretty good track record and history of taking those cost structures down over time. So we need to balance all these different elements. I think we've done a pretty remarkable job during the last several years at managing all these different variables and coming up with a level of gross margins that we think is really good for investors. And certainly, it is our plan to continue to manage them that way, but it's very difficult for me to give you a prediction of where gross margins are going to be 6 months or 12 months from now.

TIMOTHY D. COOK: Thank you.

NANCY PAXTON: A replay of today's call will be available for 2 weeks on Apple podcast as a webcast on apple.com/investor and via telephone. And the numbers for the telephone replay are (888) 203-1112 or (719) 457-0820, and please enter confirmation code 5253762. These replays will be available by approximately 5 p.m. Pacific Time today.

Members of the press with additional questions can contact Kristin Huguet at (408) 974-2414. Financial analysts can contact Matt Blake or me with additional questions. Matt is at (408) 974-7406, and I'm at (408) 974-5420. Thanks again for joining us.

OPERATOR: Ladies and gentlemen, that does conclude today's presentation. We do thank everyone for your participation, and you may now disconnect.

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