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Conference Call Transcript

AAPL - Q2 2007 Apple Inc. Earnings Conference Call

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Apple Inc. - CFO

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PRESENTATION

Apr. 25. 2007 / 2:00PM PT, AAPL - Q2 2007 Apple Inc. Earnings Conference Call

Thank you very much.

Nancy Paxton - Apple Inc. - Sr. Director, IR and Corporate Finance

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

Operator

Certainly. We'll hear from Tony Sakanagi, Sanford Bernstein.

Tony Sakanagi - Sanford Bernstein - Analyst

Yes. Thank you. Typically your revenues from Q2 to Q3 are flat to slightly up. You're guiding for them to be down despite tremendous enthusiasm for the iPhone, for your Mac lineup, which you just mentioned, on the aforementioned question and your confidence in the iPod line. Can you talk about some of the puts and takes for revenue in your revenue guidance for next quarter?

Peter Oppenheimer - Apple Inc. - CFO

Sure, Tony, this is Peter. We are guiding revenue down slightly, sequentially as a result of a couple factors. First, last year, iPod sales declined sequentially from the March to June quarters despite supply being constrained at the beginning of the March quarter. This year, we were not in good supply and demand balance in the March quarter, so we would expect to see a bigger sequential decline. We see this as a market seasonality issue -- excuse me -- and not an iPod specific issue. We are very pleased with our market share. Second, it's the beginning of the education buying season, which typically sees higher K-12 purchases in the June quarter and at lower ASPs.

Tony Sakanagi - Sanford Bernstein - Analyst

Is the second point any different from normal seasonality though? In the sense that, don't you always see that, and, accordingly, if we're comparing this quarter versus previous quarters, why would that be any notably different?

Peter Oppenheimer - Apple Inc. - CFO

That is true, but really underneath this what you're seeing is that the June quarter is not as strong from a consumer perspective. We had a really strong March quarter. I think you may see a bit more pronounced effect this year going from March to June in part upon what we saw from the consumer sales in March and heading into the education buying season.

Tony Sakanagi - Sanford Bernstein - Analyst

I also have a question about margins. I know historically you've qualitatively discussed about margins between relative categories in your business, so specifically on a qualitative basis, could you help us understand if iPod hardware margins, just the hardware portion of iPod was higher than your Mac hardware margins this quarter?

Peter Oppenheimer - Apple Inc. - CFO

We have a long standing practice of not releasing specific gross margins, however, the corporate gross margin was over 35%, which exceeded our guidance. And iPod was key in achieving that result.

Tony Sakanagi - Sanford Bernstein - Analyst

Apr. 25. 2007 / 2:00PM PT, AAPL - Q2 2007 Apple Inc. Earnings Conference Call

Can you, I understand your policy of not specific gross margins, but historically you've given a range, it was, obviously, much lower than it is now, at above or below 20% and you have made relative comments, so can you at least provide any further details on a relative basis, Peter?

Peter Oppenheimer - Apple Inc. - CFO

What I can tell you is that both our Mac and iPod hardware margins were quite strong in the quarter. They've both benefited from a very favorable commodity environment and, but also we had better service costs and leverage from the revenue and a good mix.

Tony Sakanagi - Sanford Bernstein - Analyst

And then, finally, on the, on the R&D side, your revenues have been growing at about 20% a quarter. Your R&D expense has been remarkably flat for the last six quarters. Is there an inflection point or a bend where, particularly with some of the ostensible increased functionality that you're going to hope to bring in the form of software to both your Apple TV platform and your phone offerings? Should we be expecting an inflection point in R&D and why hasn't it gone up somewhat commensurately with sales, especially given all the new product initiatives that you have?

Peter Oppenheimer - Apple Inc. - CFO

First of all, we are very confident in not only in what we plan to do with iPhone and Apple TV, but also OS X and our applications. We have just fantastic folks in our software and hardware engineering areas. In the last quarter or so, we have capitalized our software development. I talked about that in my prepared remarks.

So that played into this quarter. And the R&D as a percent of our revenue was 3% this quarter. It had been running at 4%, and without the capitalization you would have seen a trend that was similar to the past. The dollars are going up, just along with our revenue. We're going to continue to invest in our business, particularly in engineering and you'll continue to see our spending go up and I think continue to see just a great flow of products from the team.

Tony Sakanagi - Sanford Bernstein - Analyst

Thank you.

Nancy Paxton - Apple Inc. - Sr. Director, IR and Corporate Finance

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

Operator

Next question is from Citigroup, Richard Gardner.

Richard Gardner - Citigroup - Analyst

Thank you. I wanted to go back to the earlier question, Peter, on passing favorable component prices to customers. I realize it's been your longstanding practice to do this when you introduce new products, but I was wondering why you wouldn't make an exception in an environment like the one that we're in in the first quarter where you had dramatic declines in prices? Is it because you don't believe that there would be enough elasticity there to justify it or is it because of the intricacies of managing price protection and channel inventories and so forth? What is your strategy there?

Timothy Cook - Apple Inc. - COO