EXHIBIT 11

Apple's CEO Discusses F4Q10 Results - Earnings Call Transcript

Executives

Nancy Paxton - Senior Director of IR

Peter Oppenheimer - CFO

Steve Jobs - CEO

Tim Cook - COO

Analysts

Richard Gardner - Citi

Gene Munster - Piper Jaffray

Mike Abramsky - RBC Capital Markets

Benjamin Reitzes - Barclays Capital

Katy Huberty - Morgan Stanley

Toni Sacconaghi - Sanford Bernstein

Shannon Cross - Cross Research

Chris Whitmore - Deutsche Bank

Apple Inc. (AAPL) F4Q10 (Qtr End 09/25/2010) Earnings Call October 18, 2010 5:00 pm ET

Operator

Good day everyone and welcome to this Apple Incorporated fourth quarter fiscal year 2010 earnings release. (Operator Instructions) At this time for opening remarks and introductions, I would like to turn the call over to Nancy Paxton, Senior Director of Investor Relations.

Nancy Paxton

Thank you. Good afternoon and thanks to everyone for joining us. 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, stock-based compensation expense, taxes, earnings per share, and future products. Actual results or trends could differ materially from our forecast.

For more information, please refer to the Risk Factors discussed in Apple's Form 10-K for 2009, as amended, the Form 10-Q for the first three quarters of fiscal 2010 and the Form 8-K filed with the SEC today along with the attached press release. Apple assumes no obligation to update any forward-looking statements or information which speaks as of their respective dates.

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

Peter Oppenheimer

Thank you, Nancy. Thank you for joining us. We're extremely pleased to report the conclusion of a great fiscal year for Apple with outstanding results for the September quarter. Our innovative product lineup is the best ever and customer response has been tremendous. As a result, we set new all-time records for Mac, iPhone and iPad sales in the September quarter, and we are thrilled to report the highest quarterly revenue and earnings in Apple's history.

Revenue for the quarter was $20.34 billion, an increase of more than $8.1 billion over the prior September quarter's result, representing growth of 67%. The very strong growth was fueled primarily by record iPhone sales, the tremendous popularity of iPad and our best Mac quarter ever.

Operating margin was $5.45 billion, representing 26.8% of revenue. Net income was $4.31 billion, which exceeded our previous quarterly earnings record by $930 million and represented 70% growth over the year-ago quarter's earnings. These results translated to earnings per share of $4.64.

Turning to the details of the quarter, I'd like to begin with our Mac products and services. We set a new quarterly record with sales of almost 3.9 million Macs, exceeding the previous record established in the June quarter by over 400,000. This represents 27% year-over-year growth, more than double IDC's latest published estimate of 11% growth for the market overall in the September quarter.

We experienced strong double-digit growth in both Mac desktop and portable categories led by very strong sales of iMac which was updated in July and the continued popularity of the MacBook Pro and MacBook. Mac growth was strong in each of our geographic segments, led by Asia-Pacific at 56% year-over-year and Japan at 49%. We began and ended the quarter with between three and four weeks of Mac channel inventory.

Moving to our music products, we sold nearly 9.1 million iPods compared to 10.2 million in the year-ago quarter. In September, we announced a great new lineup of iPods for the holiday season, including our redesigned iPod Shuffle featuring clickable buttons, the reinvented iPod Nano with multi-touch and the new iPod touch with Retina display and FaceTime video calling.

iPod's share of the U.S. market for MP3 players remains at over 70% based on the latest monthly data published by NPD. iPod also continues to be the top selling MP3 player and gained share internationally year-over-year in most of the countries we track based on the latest data published by GfK. We remain within our target range of four to six weeks of iPod channel inventory on a look-back basis.

The iTunes Store also had another strong quarter with revenue over $1 billion. In September, we launched iTunes 10, including a number of new features such as $0.99 TV rentals, AirPlay wireless music playback and Ping, which offers social music discovery to millions of iTunes users in 23 countries. We also introduced new Apple TV which provides a simple way to watch movies and TV shows on your HDTV for the breakthrough price of just $99.

I'd now like to turn to iPhone. We were extremely pleased to have sold 14.1 million iPhones compared to just under 7.4 million in the previous September quarter. This represents 91% year-over-year growth and is well ahead of IDC's latest published estimate of 64% growth for the global smart phone market overall in the September quarter.

Recognized revenue from iPhone handset and accessories sales was $8.82 billion during the quarter compared with $4.61 billion in the year-ago quarter, an increase of 92%. The sales value of iPhones alone was about $8.6 billion which yields an ASP of about $610.

At the end of the September quarter, we had iPhone distribution through 166 carriers in 89 countries. We continue to experience very strong year-over-year growth, particularly in Asia, Europe and Japan where iPhone sales more than doubled year-over-year. We were very happy to be shipping iPhone 4 in China as of the last day of the September quarter, and we've been very pleased with the customer response to date.

Last month, J.D. Power and Associates announced that for the fourth consecutive time, Apple ranks highest in its survey of customer satisfaction among manufacturers of smart phones, citing particularly strong performance and ease of operation, operating system, features and physical design.

Adoption of iPhone within the enterprise continues to accelerate. In fact, since we've shipped iPhone 4, we've seen extraordinary growth from 60% to more than 80% of Fortune 500 companies deploying or piloting iPhone. Enterprise CIOs continue to add iPhone to their approved device list worldwide.

Most recently, Fortune 500 companies like Procter & Gamble, General Electric, Pfizer, Allstate, and Cardinal Health and Global 500 accounts such as Aviva Group, Total, Novartis, Roche and Sanofi-Aventis have made iPhone available to their employees.

We ended the quarter with about 3.3 million iPhones in channel inventory, a sequential increase of about 825,000 to support the launch of iPhone 4. We continue to have a sizeable backlog and believe we could have sold even more iPhones if we had been able to supply them.

Turning to iPad, we're thrilled with its momentum. In just the second quarter of availability, we sold almost 4.2 million iPads with distribution in 26 countries by the end of the September quarter. We're seeing great enthusiasm for iPad from consumers, educators and businesses.

Enterprise CIOs are adding iPad to their approved device list at an impressive rate. Since the launch of iPad, over 65% of the Fortune 100 is already deploying or piloting iPad. Some recent examples of companies approving iPad include, Procter & Gamble, Lowes, Hyatt, NBC Universal and Novartis.

Recognized revenue from sales of iPad and iPad accessories during the quarter was $2.8 billion. The sales value of iPads alone was about $2.7 billion, which yields an ASP of about $645. We were able to increase the supply of iPads over the course of the quarter, building channel inventory by about 500,000 units to end the quarter with between three and four weeks of channel inventory below our target range of four to six weeks.

We are expanding U.S. iPad distribution to include Wal-Mart, Target, Verizon and AT&T stores. We are also expanding distribution internationally.

Combining iPhone, iPad and iPod Touch, we surpassed cumulative iOS device sales by 125 million last month. During the September quarter, we released iOS 4.1, which builds on the innovations of iOS 4 bringing FaceTime video calling, multi-tasking, folders and Game Center to iPod Touch in addition to iPhone customers.

And in November, we plan to release iOS 4.2 which will bring many of the great new features of iOS 4 to iPad. iOS 4.2 will also include AirPrint, Apple's new printing architecture that automatically finds printers on local networks and enables printing from iOS devices over Wi-Fi without the need to install drivers or download software.

The App Store continues to be an unparalleled success. There are now over 200,000 registered iOS developers who continue to bring outstanding and creative new apps to the iOS platform, including over 65,000 game and entertainment titles and over 30,000 apps designed specifically for iPad.

And we launched iAd in July, which provides marketers with the ability to place interactive ads in popular apps for iPhone, iPod Touch and iPad. We were very happy with results so far. Customers are loving the media-rich ads and marketers are very pleased with viewer engagement.

I'd now like to turn to the Apple retail stores, which had a record-breaking quarter. Retail revenue was $3.57 billion compared to $2.04 billion in the year-ago quarter, an increase of 75%. Our stores sold a record 874,000 Macs compared to 670,000 Macs in the year-ago quarter, an increase of 30%. About half the Macs sold in our stores during the September quarter were to customers who had never owned a Mac before.

We opened 24 stores during the September quarter, 16 of which were outside the United States, including spectacular stores in Beijing, Shanghai, London and Paris. Our new Beijing and Shanghai stores opened on the last day of the quarter, and first-day sales from both stores exceeded all previous store openings. Our four China stores are our highest traffic stores in the world and are among our highest performing.

We also entered our eleventh country, with the opening of stores in Barcelona and Madrid. That brings us to a total of 317 stores worldwide as at the end of the quarter, with 84 of them outside the United States. With an average of 301 stores opened during the September quarter, average revenue per store was $11.8 million compared to $7.8 million in the year-ago quarter, an increase of 52%.

Retail segment margin was $917 million compared to $564 million in the year-ago quarter. We hosted a record 74.5

million visitors in our stores during the quarter compared to 45.9 million visitors in the year-ago quarter, an increase of 62%.

As we look ahead to fiscal 2011, we see great opportunity to continue our retail growth with our focus on international expansion. In total, we expect to open 40 to 50 stores in our fiscal 2011 with over 50% of them outside the United States. We will also begin replacing several stores in the United States to get them right-sized for Apple's current product line and to meet our service goals.

Total company gross margin was 36.9%, which was 190 basis points above our guidance. About two-thirds of this favorability was driven by lower commodity and other costs, and the remainder was mostly attributable to a better-than-planned mix of iPhone sales.

Operating expenses were $2.07 billion and included $185 million in stock-based compensation expense. OI&E was $14 million and the tax rate for the quarter was 21%, about five points below our guidance, largely a result of two factors. First, we had a higher mix of foreign earnings than we planned. Second, we had some discrete one-time tax benefits in the quarter as well. Our tax rate for fiscal 2010 was about 24.5%.

Turning to cash, our cash flow short term and long term marketable securities totaled $51 billion at the end of the September quarter compared to $45.8 billion at the end of the June quarter, an increase of $5.2 billion. Cash flow from operations was $5.7 billion. The September quarter was the culmination of a monumental year for Apple. In fiscal 2010, we launched several new Macs; establishing record sales of over $13.6 million and achieving 31% year-over-year sales growth, significantly outpacing the growth of the overall pc market.

We introduced the tremendously popular iPhone 4 with breakthrough features including FaceTime and Retina display fueling full-year sales of 40 million iPhones, an increase of 93% over fiscal 2009. We launched the groundbreaking iPad, selling nearly 7.5 million to delighted customers in two quarters alone. We also brought great new features to iOS and iTunes, and continue to innovate with completely new designs for iPod.

And as a result, we generated record revenue of over $65 billion, an increase of over $22 billion year-over-year or 52%. Earnings of $14 billion grew even faster at 70% year-over-year. To put this growth in a perspective, in fiscal 2010, Apple generated almost five times the revenue and more than 10 times the earnings it did just five years earlier in fiscal 2005.

As we move ahead into 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 expect revenue to be about $23 billion compared to $15.7 billion in the December quarter last year. We expect gross margins to be about 36% reflecting approximately $52 million related to stock-based compensation expense. We expect OpEx to be about $2.325 billion including about $250 million related to stock-based compensation.

We expect OI&E to be about $65 million. And we expect the tax rate to be about 25.5%. We're targeting EPS of about $4.80. In closing, we're thrilled with our record September quarter and fiscal year 2010 results. We're very enthusiastic about our innovative product line-up and our significant opportunities for growth as we head into fiscal 2011.

And we remain extremely confident in our new product pipeline. Before taking your questions, I would like to turn the call over to our CEO, Steve Jobs.

Steve Jobs

As most of you know, I don't usually participate in Apple's earnings calls since you are all in such capable hands with Peter and Tim. But I just couldn't help dropping by for our first $20 billion quarter. I would like to chat about a few things and then stay for the rest of the Q&A if that's alright.

First, let me discuss iPhone. We sold 14.1 million iPhones in the quarter which represents a 91% unit growth over the year-ago quarter and was well ahead of IDC's latest published estimate of 64% growth for the global smartphone market in the September quarter. And it handily beat RIM's 12.1 million Blackberry's sold in their most recent quarter ending in August. We've now passed RIM, and I don't seem them catching up with us in the foreseeable future. They must move beyond their area of strength and comfort into the unfamiliar territory of trying to become a software platform company.

I think it's going to be a challenge for them to create a competitive platform and to convince developers to create apps for yet a third software platform after iOS and Android. With 300,000 apps on Apple's App Store, RIM has a high mountain ahead of them to climb.

Well, what about Google? Last week, Eric Schmidt reiterated that they are activating 200,000 Android devices per day. And have around 90,000 apps in their App Store. For comparison, Apple has activated around 275,000 iOS devices per day on average for the past 30 days with a peak of almost 300,000 iOS devices per day on a few of those days. And Apple has 300,000 apps on its App Store.

Unfortunately, there is no solid data on how many Android phones are shipped each quarter. We hope that manufacturers will soon start reporting the number of Android handsets they ship each quarter. But today that just isn't the case. Gartner reported that around 10 million Android phones were shipped in the June quarter and we await to see if iPhone or Android was the winner in this most recent quarter.

Google loves to characterize Android as open, and iOS and iPhone as closed. We find this a bit disingenuous and clouding the real difference between our two approaches. The first thing most of us think about when we hear the work open is Windows which is available on a variety of devices. Unlike Windows, however, where most pc's have the same user interface and run the same app, Android is very fragmented. Many Android OEMs, including the two largest, HTC and Motorola install proprietary user interfaces to differentiate themselves from the commodity Android experience. The users will have to figure it all out. Compare this with iPhone, where every handset works the same.

Twitter client, Twitter Deck, recently launched their app for Android. They reported that they had to contend with more than 100 different versions of Android software on 244 different handsets. The multiple hardware and software iterations present developers with a daunting challenge. Many Android apps work only on selected Android handsets running selected Android versions. And this is for handsets that have been shipped less than 12 months ago. Compare this with iPhone, where there are two versions of the software, the current and the most recent predecessor to test against.

In addition to Google's own app marketplace, Amazon, Verizon and Vodafone have all announced that they are creating their own app stores for Android. So there will be at least four app stores on Android, which customers must search among to find the app they want and developers will need to work with to distribute their apps and get paid. This is going to be a mess for both users and developers. Contrast this with Apple's integrated App Store, which offers users the easiest-to-use largest app store in the world, preloaded on every iPhone. Apple's App Store has over three times as many apps as Google's marketplace and offers developers' one-stop shopping to get their apps to market easily and to get paid swiftly.

Even if Google were right, and the real issue is closed versus open, it is worthwhile to remember that open systems don't always win. Take Microsoft's PlaysForSure music strategy, which use the PC model, which Android uses as well, of separating the software components from the hardware components. Even Microsoft finally abandoned this open strategy in favor of copying Apple's integrated approach with their Zoom Player, unfortunately leaving their OEMs empty-handed in the process. Google flirted with this integrated approach with their Nexus One phone.

In reality, we think the open versus closed argument is just a smokescreen to try and hide the real issue, which is, what's best for the customer, fragmented versus integrated. We think Android is very, very fragmented and becoming more fragmented by the day. And as you know, Apple's strives for the integrated model so that the user isn't forced to be the systems integrator.

We see tremendous value in having Apple rather than our users' be the systems integrator. We think this is a huge strength of our approach compared to Google's. When selling to users who want their devices to just work, we believe integrated will trump fragmented every time. And we also think our developers can be more innovative if they can target a singular platform rather than a hundred variants. They can put their time into innovative new features rather than testing on hundreds of different handsets.

So we are very committed to the integrated approach, no matter how many times Google tries to characterize it as closed. And we are confident that it will triumph over Google's fragmented approach, no matter how many times Google tries to characterize it as open.

Second, I'd like to comment on the avalanche of tablets poised to enter the market in the coming months. First, it appears to be just a handful of credible entrants, not exactly an avalanche. Second, almost all of them use seven-inch screens as compared to iPad's near 10-inch screen. Let's start there. One naturally thinks that a seven-inch screen would offer 70% of the benefits of a 10-inch screen. Unfortunately, this is far from the truth. The screen measurements are diagonal, so that a seven-inch screen is only 45% as large as iPad's 10-inch screen. You heard me right; just 45% as large

If you take an iPad and hold it upright in portrait view and draw an imaginary horizontal line halfway down the screen, the screens on the seven-inch tablets are a bit smaller than the bottom half of the iPad display. This size isn't sufficient to create great tablet apps in our opinion.

Well, one could increase the resolution of the display to make up for some of the difference. It is meaningless, unless your tablet also includes sandpaper, so that the user can sand down their fingers to around one quarter of the present size. Apple's done extensive user-testing on touch interfaces over many years, and we really understand this stuff. There are clear limits of how close you can physically place elements on a touch screen before users cannot reliably tap, flick or pinch them. This is one of the key reasons we think the 10-inch screen size is the minimum size required to create great tablet apps.

Third, every tablet user is also a smartphone user. No tablet can compete with the mobility of a smartphone, its ease of fitting into your pocket or purse, its unobtrusiveness when used in a crowd. Given that all tablet users will already have a smartphone in their pockets, giving up precious display area to fit a tablet in our pockets is clearly the wrong tradeoff. The seven-inch tablets are tweeners, too big to compete with a smartphone and too small to compete with an iPad.

Fourth, almost all of these new tablets use Android software, but even Google is telling the tablet manufacturers not to use their current release, Froyo, for tablets, and to wait for a special tablet release next year. What does it mean when your software suppliers does not (inaudible) to use their software in your tablet? And what does it mean when you ignore them and use it anyway?

Fifth, iPad now has over 35,000 apps on the App Store. This new crop of tablets will have near zero.

And sixth and last, our potential competitors are having a tough time coming close to iPad's pricing, even with their far smaller, far less expensive screens. The iPad incorporates everything we have learnt about building high value products from iPhones, iPods and Macs. We create our own A4 chip, our own software, our own battery chemistry, our own enclosure, our own everything. And this results in an incredible product at a great price. The proof of this will be in the pricing of our competitor's products which will likely offer less for more.

These are among the reasons we think the current crop of seven-inch tablets are going to be DOA, Dead on Arrival. Their manufacturers will learn the painful lesson that their tablets are too small and increase the size next year, thereby abandoning both customers and developers who jumped on the seven-inch bandwagon with an orphan product. Sounds like lots of fun ahead.

So thank you, and let me turn it back to Peter for the Q&A session.

Question-and-Answer Session

Operator

(Operator Instructions) And your first question will come from Richard Gardner with Citi.

Richard Gardner - Citi

I had two quick ones, if I could. One is the supply constraints on iPad. Could you talk about how severe the supply constraints are on that product and how quickly you expect it to improve? And then a follow-up for Peter on gross margin please.

Tim Cook

Relative to iPad supply/demand, we've got into a balanced situation in September with the limited number of distribution points in the 26 countries where we sold the iPad. And so we exited the quarter in a supply position that allows us to expand distribution prior to the holidays as we've planned for sometime. And hopefully you've seen some of the recent announcements of added partners in the United States. We're also expanding internationally, and will be launching additional countries as the quarter goes on.

Richard Gardner - Citi

And then Peter, you mentioned several sequential tailwinds for gross margin during the September quarter. Could you talk about the headwinds in the quarter and what impact they had on gross margin sequentially, please?

Peter Oppenheimer

I'm sorry, Rich, for the September quarter?

Richard Gardner - Citi

For the September quarter, yes.

Peter Oppenheimer

In our last conference call, we talked about several things that we thought would cause margins to come down some. And all those things did play out, but margins came down actually about half of what we thought that they would. And we did a bit better in the quarter because commodity and other costs were better than we thought, and we sold more iPhones than we had planned to.

Operator

From Piper Jaffray, we have Gene Munster.

Gene Munster - Piper Jaffray

If you can talk a little bit about the iPad opportunity you went through, and gave us some good insight in terms of the competitive landscape. But as analysts, we're here kind of trying to put some estimates out there and we're not doing a great job of trying to figure out this trajectory in the iPad.

Can you help us understand how you think about the business a year or two years down the road in terms of size of your overall business, impact on enterprise, education, anything you can give to help us on that front? And then a follow-up question.

Steve Jobs

Well, the iPad is clearly going to affect notebook computers. And I think the iPad proves, it's not a question of if, it's a question of when. And I think a lot of development and progress that will occur over the next few years. But we're already seeing tremendous interest in iPad from education, and much to my surprise, from business.

We haven't pushed it real hard in business, and it's being grabbed out of our hands. And I talk to people everyday in all kinds of businesses that are using iPads, all the way from Boards of Directors that are shipping iPads around instead of board books, down to nurses and doctors in hospitals and other large and small businesses.

So the more time that passes, the more I am convinced that we've got a tiger by the tail here. And this is a new model of computing which we've already got tens of millions of people trained on with the iPhone. And that lends itself to lots of different aspects of life both personal, educational and business.

So, I see it as very general purpose, and I see it as really big. And the timing, one could argue about the timing endlessly, but I don't think one could argue that it's going to happen anymore.

Gene Munster - Piper Jaffray

Do you think this could be your second-biggest business in iPhone?

Steve Jobs

I try to not predict, I try to just report. So, we'll keep you posted. As you know, we're already shipping more of them than Macs after just a few quarters.

Gene Munster - Piper Jaffray

On the Flash side, any updates on your stance on Flash?

Steve Jobs

Flash memory; we love Flash memory.

Gene Munster - Piper Jaffray

Peter, just one quick question. Our tracks were that you had about three weeks lead-time in most of your countries on the iPhone throughout the quarter. You mentioned you could have sold more iPhones. How do you think about what the true demand could have been in the quarter?

Tim Cook

I think that which you're referring to is the quote that's on the Apple Online Store. What I would say is that the demand in all countries is absolutely staggering. And at this point I can't predict when supply will meet demand. I feel great about our ability to move the supply and the sales up from an 8 million kind of number to over 14 million. But it's clear, last quarter that wasn't enough. And we are obviously working on that, but it will take some time to increase further.

Gene Munster - Piper Jaffray

Were you more supply-constrained in the September quarter versus the June quarter? Totally different dynamics in the quarter, but any perspective on the two quarters?

Tim Cook

It's clear that the iPhone 4 and the announcement of iPhone 4 and the demand for it took the demand to an entirely different level. And we had anticipated a very different level, but it's even higher than that.

Operator

From RBC Capital Markets, we'll go to Mike Abramsky.

Mike Abramsky - RBC Capital Markets

Steve, appreciate your commentary. You know, you are the tablet market right now. And this is I think the second time now you've come on to talk about or certainly at one time during your presentation to talk about competition. And I am just wondering, if much like Apple encroaching on whims, monopoly and enterprise, if you think that Apple's going to able to sustain share growth for tablets amid some of those new competitive headwinds?

Some of those players may try different things and strategies like tethering and Flash, multi-tasking, less content and app restrictions and subsidized pricing. And just wondered if you think that, that may create itself a more fragmented market and how you see that rolling out with regard to Apple?

Steve Jobs

I have a hard time envisioning what those strategies you mentioned are. I mean, in terms of pricing, so far, the little we've seen, the tablets with far less functionality are having a hard time matching us in price. Flash hasn't presented any problem at all. As you know, most of the video on the web is now available in HTML 5. And having the iTunes media store and over 35,000 apps on the App Store for iPad dwarfs anything else. And we think we have a very good product here that's going to be hard to match, and we're not done. We're working on a lot of things for the future.

So I don't know exactly what these strategies are. And we've priced iPad pretty aggressively. So we're out to win this one.

Mike Abramsky - RBC Capital Markets

And just lastly, the smartphones, do you see that as a zero sum game?

Steve Jobs

Well, as you know the largest market of phones today around the world are non smartphones. And so over the next several years, many of those non-smartphones are going to convert to smartphones. And the pie is going to continue to grow, and I think there will be room for some number of companies to be successful. But eventually, as most of those phones do convert to smartphones, it will turn into a zero sum game or at least a lot closer to that.

But I think right now it's a battle for developers and a battle for the mindshare of developers and a battle for the mindshare of customers. And right now iPhone and Android are winning that battle.

Operator

It's Benjamin Reitzes with Barclays Capital.

Benjamin Reitzes - Barclays Capital

First, for Peter, can you just talk a little bit about gross margins? You have gross margin guidance of 36. With component prices still favorable and probably more iPhone's being sold sequentially, can you just talk about why margins would go down sequentially, which seems also that you released the revenue on the bumper program? And then I have a follow-up for Steve, if you don't mind.

Peter Oppenheimer

Ben, in providing our guidance we thought about each of those factors that you cited, and we do see a small sequential decline. This has been primarily driven by a higher than expected mix of new iPod's that we just recently announced, and more iPad sales, and which as Steve said, we've been very aggressive with our pricing and are delivering great value to customers. So it's the higher mix of those on a sequential basis that I see impacting the gross margin slightly.

Benjamin Reitzes - Barclays Capital

Okay. And then Steve, can you just comment on how your hobby is doing, Apple TV? You took the hard drive out of there, and it seems like Apple is moving more to a streaming model work, you know, potentially a lot of other things, and I was just wondering what your thoughts were for the Apple TV, maybe that kind of business model proliferating into more products. But I was wondering how Apple TV is doing and what's your thoughts going forward?

Steve Jobs

Well, we don't talk about unannounced products, but I'm happy to tell you what I know about Apple TV. We have gone to streaming model on Apple TV; it's complete streaming. So all the content is rented from the iTunes store or is streamed from your computer, or soon to be streamed from your iPhone or iPad with AirPlay. And so how is our new model of Apple TV doing? Well, I can report that in just a very short amount of time we've already sold a quarter million of them, over 250,000, and we're thrilled with that.

I think that it's a great product and I think its $99 price point is very enticing. And I think when we get the AirPlay stuff in place before the end of this year, it's going to give another big reason for people to buy it. So we're really happy with how it's turned out.

Operator

The next question will come from Katy Huberty with Morgan Stanley

Katy Huberty - Morgan Stanley

First, for Peter, how much of the sequential decline in gross margin related to the iPhone in the September quarter and particularly the bumper program?

Peter Oppenheimer

Katy, we've recorded a revenue deferral of just over $100 million in the September quarter for the bumper program. We would expect to record that in revenue in the December quarter. We did ship a number of bumpers in the September quarter, and that is reflected in our gross margin, as is the number that we expect to ship in the December quarter. That's reflected in our guidance as well.

Katy Huberty - Morgan Stanley

And just to be clear, is the iPhone the product segment that dropped the most sequentially as it relates to gross margins? I guess people are just asking what drove the sequential down tick which we haven't seen for some time.

Peter Oppenheimer

You mean in the September quarter?

Katy Huberty - Morgan Stanley

Yes, in the September quarter.

Peter Oppenheimer

Well again, this was not a surprise to us. And we, on our last conference call highlighted that we would have a higher mix of iPhone 4 sales, and we were very aggressive with feature function there. So it had a different gross margin than its predecessor product. We also sold more iPads. Again, we were very aggressive there with our pricing. And we had the bumper program and some one-time items that occurred in June that we said wouldn't occur in September.

So these were sort of the factors we saw bringing down gross margin. To some extent, each of them did occur in the September quarter, but we ended up doing about 50% better than we thought as a result of the commodity market and selling more iPhones.

Katy Huberty - Morgan Stanley

And then Steve, just as a follow-up. It seems like you fundamentally believe that Apple should be able to out-ship Android if you add up all the mobile devices over time. What are the key risks you're managing the company to make sure you don't lose that lead, whether it's distribution, or pricing, or features? What do you think the biggest risks are that you need to watch carefully?

Steve Jobs

Well, our goal is to make the best devices in the world. It's not to be the biggest; as you know, Nokia is the biggest. And we admire them for being able to ship the number of handsets that they do. But we don't aspire to be like them. They are good at being like them. We want to be like us, and we want to make the best ones.

So in our part of the market, Android is our biggest competitor. They out-shipped us in the June quarter as we were transitioning to iPhone 4. They out-shipped us for the first time according to Gartner's numbers, which we think are pretty accurate. And so we're waiting to find out what happened in this quarter. We'll find out. I don't know how we'll find out, but Gartner will put out some new numbers, and maybe others will, so one of these days we'll eventually learn.

And I imagine we'll be competing with them for quite some time. But we have very different approaches. And we believe in our approach very strongly is providing users products that just work. And we think there is lots of users that want that in the world, and their approach is very different than that. And there maybe lots of users that want that their approach as well. But we're going to pursue ours and we think that's the winning approach in the end.

Operator

And that will come from Toni Sacconaghi with Sanford Bernstein.

Toni Sacconaghi - Sanford Bernstein

I guess this is for both Steve and Tim. I wanted to just better understand your aspirations for iPhone and iPad. Tim, I think I've heard you say, "Look, we think about the Mac business as being one where we make the best products, but we're competing against kind of strong income and power in Microsoft. And we don't aspire to have high market share."

In your iPod business it was kind of the opposite. You had very high volume, you drove price points down to entry points in the marketplace. And you have more than 50% market share globally. I think when we've talked about it in the past, you've actually said that you view the iPhone business as being more akin to the iPod business in terms of your aspiration.

Steve, it sounded like that wasn't really consistent with what you said. You said very clearly, we don't want to be Nokia, we just to want to make good phone. So perhaps, you can help me better understand how we should think about your aspiration for both the iPhone and the iPad. Steve, you also made a comment about seven inch screens aren't going to cut it, and implying that you're not going to go down to those lower price points.

Is your aspiration for iPhone and iPad to be volume players and market leaders? Or is it simply to make good products? And if you have smaller share like you do in Mac, that's fine. Can you help me with that, please?

Steve Jobs

Sure, and I'll let Tim say what he's going to say too. First of all, Nokia makes $50 handsets, and we don't know how to make a great smartphone for $50. We're not smart enough to figure that one out yet, but believe me I'll let you know, when we do. So our goal is to make a really breakthrough great product. Make the best products in every industry that we compete in and to drive the cost down, while constantly making the products better at the same time. That's what we did with iPod.

We updated our products many times every year, with better functionality oftentimes at the same price, and sometimes at a lower price. And it was this relentless improvement, and in some cases a lower price that was able to beat our competition and yield the market share that it did. And as you know, we have a very low market share in the phone market in the single digits, in terms of all the handsets. And we have a very high market share now in tablets, because we're the first mover.

But we don't think about it that way. The reason we wouldn't make a seven inch tablet isn't because we don't want to hit a price point, it's because we don't think you can make a great tablet with a seven inch screen. We think it's too small to express the software that people want to put on these things. And we think as a software driven company, we think about the software strategies first.

And we know that software developers they're not going to deal real well with all these different size products, when they have to redo their software, every time a screen size changes. And they're not going to deal well with products where they can't put enough elements on the screen to build the kind of apps they want to build.

So when we make decisions on seven inch tablets, it's not about cost, it's about the value of the product when you factor in the software. You see what I'm getting at? So we're all about making the best products at aggressive prices. And that's what we will do and that's what we've done with the iPod, and that's what we will do with the iPad as well.

Toni Sacconaghi - Sanford Bernstein

Tim, maybe you want to comment, if I could push you on that Steve. So if the market starts to move towards somewhat lower functionality smartphones in that migration of non-smartphones to smartphones that you talked about. If the market starts to move to dramatically lower price points, you feel you can't make an appropriate product that is good at those price points, you will cede share under those circumstances. Do I hear you correctly?

Steve Jobs

You're looking at it wrong. You're looking at it as a hardware person in a fragmented world. You're looking at it as a hardware manufacturer that doesn't really know much about software, who doesn't think about an integrated product, but assumes the software will somehow take care of itself. And you're sitting around saying, "Well, how can we make this cheaper? Well, we can put on a smaller screen on it and a slower processor, and less memory." And you assume that the software will somehow just come alive on this product that you're dreaming of, but it won't. Because these app developers have taken advantage of the products that came before with faster processors, with larger screens, with more capabilities that they can take advantage of to make better apps for customers.

And it's a hard one because it throws you right back into the beginning of that chicken and egg problem again to change all the assumptions on those developers. Most of them will not follow you, most of them will say, "I'm sorry, but I'm not going to go back and write a watered down version of my app just because you've got this phone that you can sell for $50 less and you're begging me to write software for it."

Toni Sacconaghi - Sanford Bernstein

One more if I may, please, Steve? You now have more than $50 billion in cash. You're generating more than $20 billion a year in cash; it rests very comfortably on your balance sheet, earning less than 1% interest. What is your aspiration for that cash? And why are you not more open to returning some of that cash to shareholders in the form of buybacks or dividend?

Steve Jobs

Of course that's been suggested to us. We strongly believe that one or more very strategic opportunities may come along that we're in a unique position to take advantage of because of our strong cash position. And I think we've demonstrated a really strong track record of being very disciplined with the use of our cash. We don't let it burn a hole in our pocket, we don't allow it to motivate us to do stupid acquisitions.

And so I think that we'd like to continue to keep our powder dry because we do feel that there are one or more strategic opportunities in the future. That's the biggest reason. And there are other reasons as well that we could go into. But that's the biggest one.

Operator

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

Shannon Cross - Cross Research

Steve and Tim, could you talk a little bit about the corporate opportunity? And what I'm looking for is sort how you're thinking about Apple as it's been positioned over the last several years, sort of more of a consumer focused, SMB focused company, but clearly there is a huge opportunity here with the iPad and the iPhone and probably at some point the Macs into the corporate world.

So how do you think about your position from a marketing standpoint, a sales standpoint? Any changes you need to make, or how are you sort of addressing that?

Tim Cook

On the iPad, there have been some comments about this earlier, but just to give you some stats here, about two-thirds of the Fortune 100 are deploying or piloting iPad. And I don't know about you, but I've never seen an adoption like this in my life in enterprise. Enterprise is historically much slower moving on adoption. We're also seeing the iPad begin to pick up interest in K12 which is another market that historically adopts very, very slowly. And so the early data points look great. And as a matter of fact, we have built and are building additional capacity internally in the sales organizations, to call on businesses and obviously we have a huge amount of sales people already there calling on education institutions.

We're also enabling in training our carrier partners to do the same. You probably saw a announcement last week with AT&T, and that's a direct result of customers wanting to buy the iPad on a postpaid type plan. And so we're putting a lot of energy in those. iPhone has followed a trajectory that gets into same kinds of numbers as I pointed on iPad where, or a little bit higher by now, is 85% of the Fortune 100 are deploying are deploying or piloting iPhone.

And so this isn't a hobby or something we're doing lightly. We put enormous energy in the company, in engineering, in software to build a number of enterprise features in the OS. You've seen that, it gets better and better as we step through the different OS releases. And we're building the sales capability for those groups as well. It's clear that both the phone and the iPad have an enormous opportunity.

The Mac is also increasingly getting pulled into an enterprise where the employees are able to select. And of course, this is a trend that we like to see, and that we think will continue in larger ways. But when people are given the choice, they would prefer a Mac, so Macs are being pulled in as well.

We don't have as much distribution effort on that, but as we see if it gets any larger, we will move accordingly. The great thing is that we're maintaining our focus on the consumer, and the consumer is a forefront on thinking of all our products. And it's these consumers in the enterprise so to speak that are pulling these products in.

And so we're not developing two different lines like many companies do and have enterprise versions and consumer versions. This is another part of our simplistic approach to things that I think will pay us great dividend and is already starting to do so.

Shannon Cross - Cross Research

And I had a follow-up for Peter, I am getting substantial questions, as I am sure everybody on the call is, just about gross margin. So one of the questions I have is, as you're seeing the increase in volume, is there any kind of a change in terms of sort of the scale leverage you have from a manufacturing standpoint? I know you guided to lower gross margins, but the Street of course was higher?

So, just anything you can give us in terms of color on the gross margins with the iPhone 4 in terms of how that's panning out and how we should think about start up costs that were associated with, both that as well as the iPad, just any color would be great?

Peter Oppenheimer

We don't provide product specific gross margins but we are always working aggressively to lower our costs whether it's the iPhone or any of our other products. I think we have a very good track record in this regard. And we were happy with our gross margins in the September quarter, they were ahead of what we thought. And we see them being just down slightly in the December quarter as we ship more iPods where we've been quite aggressive and continue to ship more iPads as well.

Operator

And our next question will come from Chris Whitmore with Deutsche Bank.

Chris Whitmore - Deutsche Bank

I am interested in understanding demand from new carriers to take up iPhone 4 and whether or not you're seeing any pressure on subsidies as you look to expand your distribution networks on the phone business?

Tim Cook

Chris, the pressure that I am getting is on supply. Virtually everyone we're doing business with wants more supply. So that's the pressure that I feel.

Chris Whitmore - Deutsche Bank

Can you give us some color, sorry if I missed this, I jumped on late, but some color in terms of where you are from a number of carriers with iPhone 4, how did you end the quarter? Do you have targets for the December quarter in terms of carrier penetration with existing relationships?

Tim Cook

We have, if you count at the country level, we have about 166 relationships that we ended the quarter with in about 89 countries. And so that's a significant expansion across from last year as we in many countries went from a single carrier relationship to more than one carrier.

The latest country that we have done that in or that we've announced that in is Germany and we will be launching both with Vodafone and O2 together with our existing partner T-Mobile in Germany later this month.

Chris Whitmore - Deutsche Bank

And all 166 of the carriers have the phone 4 by year end, is that the target?

Tim Cook

With iPhone 4, we're in 85 of those 89 countries. And I believe that we will be in all 89 by the end of the year.

Chris Whitmore - Deutsche Bank

And what is your experience then when you've gone non-exclusive from a subsidy and margin standpoint on the phone, have you had to give anything up in the past?

Tim Cook

We don't give specific information out on the margins. But I think you can look at our ASPs and see that they've generally stayed above $600, and that's despite opening up several markets from an exclusive market to a non-exclusive market.

Chris Whitmore - Deutsche Bank

Steve, you discussed competitors not matching Apple's price point so far on the tablet space. Why do you think you have an advantage on the price point for iPad versus the PC manufacturers?

Steve Jobs

Well, I think part of it is because we engineer so much of it ourselves. The A4 chip inside it is an Apple creation; everything, again, as I mentioned from the battery chemistry to the enclosures. And we've learned a lot. We've learned a lot from the miniaturization we've done on iPods and iPhones. And we're a very high volume consumer electronics manufacturer.

So I think we've learned a lot. We've developed a lot of our own components where other have to buy them on the market with middlemen, getting their cut of things. I think we're systems architects and know how to build systems in a very efficient way. So I think this is a product we've been training for, for the last decade.

Nancy Paxton

Thanks to everyone for joining us today. A replay of today's call will be available for two weeks as a podcast on the iTunes Store, 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 the confirmation code is 1034928. These replays will be available beginning at approximately 5 p.m. pacific time today.

Members of the press with additional questions can contact Steve Dowling at 408-974-1896. And financial analysts can contact Joan Hoover or me with additional questions. Joan is at 408-974-4570. And I am at 408-974-5420. And thanks again for joining us.

Operator

Ladies and gentlemen, that does conclude today's presentation. We do thank everyone for your participation.

If you have any additional questions about our online transcripts, please contact us at: transcripts@seekingalpha.com. Thank you!

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