

# Apple Computer F4Q05 Conference Call Transcript - Prepared Remarks (AAPL)

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## Apple's Q4 2005 Conference Call, Wednesday October 13th 2005

[Operator]: Good Day and welcome to this Apple Computer Conference Call to discuss Fourth Quarter Financial Results. Today's call is being recorded. At this time for opening remarks and introduction I would like to turn the call over to Nancy Paterson, Senior Director of Investor Relations and Corporate Finance. Please go ahead ma'am.

Thank you. Good Afternoon and thanks to everyone for joining us today. Speaking is Apple CFO Peter Oppenheimer and he will be joined by EDT of Sales & Operations Tim Cook and BC and Corporate Treasurer Gary Whistler for the Q&A session with analyst. Please note that some of the information you will hear during this call consists of forward looking statements regarding revenue, gross margins, operating expenses, other income and expense, taxes, earnings per share, future products, Apple's retail initiative and non-cash share-based compensation expense. Actual results will tend to differ materially from our forecast. For information please refer to the risk factors contained in the company's Form 10K for 2004 and in Form 10Q for the first three quarters of 2005. Please also note that any non-GAAP financial measures included in today's call should be viewed in addition to and in not in lieu of Apple GAAP results. Our reconciliation in any GAAP and non-GAAP measures discussed will be posted on Apple's website at [www.apple.com/investor](http://www.apple.com/investor). I would like to remind you that the first quarter of Apple fiscal 2006 will end on December 31, 2005 and will span 14 weeks instead of the usual 13 weeks. In connection with FEC rules on corporate enclosure, Apple is making this analyst call open to the media and general public by broadcasting the call live over the internet. With that I would like to turn the call over to Peter Oppenheimer for introductory remarks.

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Thank you Nancy. Thank you for joining us. We are extremely proud that we've just completed the best year in Apple history. In fiscal '05 Apple generated nearly \$14 billion in revenue. More than doubling the company's top line in the last two years. We shipped 4.5 million Macs up 38% from last year and 22.5 million iPods up 409% from last year. As a result, we earned a record setting annual profit of over \$1.3 billion. For the Fourth quarter we are very pleased to report that another all time company record reporting revenue and earnings. Revenue of \$3.68 billion or 57% year-over-year, and operating margins increased to 11.4% from 5.4% in the year ago quarter. Net income of \$430 million grew 306% year-over-year, generating earnings per diluted share of \$0.60. Earnings per share benefited by \$0.12 from favorable tax adjustments that I will discuss later in my remarks. Recorded strong results were driven by very robust Mac sales, a highly successful back to school season and record iPod sales. As I've done in the past several quarters I will now provide highlights of our two businesses, Mac and Music.

Our Mac business generated 50% of total revenue and was up 28% from the year ago quarter. We shipped 1.236 million Macs during the quarter, which is the second highest quarterly total in the company's history. Mac shipment growth was 48% year-over-year, significantly higher than IDC's most recently published market growth broadcast of 13% for the September quarter. We are extremely pleased with our quarter-to-quarter sales. We shipped a combined total of 634,000 eBooks and powerbooks representing 41% year-over-year growth and beating last quarter's record shipment by a 139,000. We shipped 602,000 desktops systems representing very strong year-over-year growth of 56%. At the end of the quarter channel inventory of total Mac units was between 3 to 4 weeks, the lower target range of 4 to 5 weeks.

Our music business generated 40% of total Apple revenue in the quarter and was up a 133% compared to year ago quarter. We shipped 6.45 million iPods during the quarter representing the 10th quarter in a row sequential unit increase setting another new record of quarterly shipment.

We exited this quarter with total iPod channel inventory with a recorded range of 4-8. According to the latest data available in MTV tabloid iPods accounted for 75% of MP3 players sold in the US during the month of August. The last month we introduced the revolutionary iPod nano, which has already become a huge hit with the customers. We sold over 1 million of nanos in the first 17 days from its launch. The iPod economy continues to flourish with over a 1000 third party iPod accessories now available. 15 automobile manufacturers have announced support for direct iPod connectivity and the estimated feature will be offered in about 30% of new cars sold in the US in 2006. The iTunes music store continues to be the worlds leading online music service and currently operates in 20 country that represent about 85% of the global music market. We continue to add to great features in content and have over 10 million customer account. We opened the iTunes music store in Japan during the quarter and it has already become the leading music store in Japan. Based on the latest data from ((inaudible)) Apple continues to have more than 80% share of the US market for legally purchased and downloaded music. The Apple retail stores delivered another solid quarter, retail segment revenue grew to \$663 million up \$108 million sequentially and 76% from the prior year. The store has experienced very strong back to school business contributing for Mac sales of 250,000 a 106% increase over the prior year. Our most recent survey indicates that over 45% of the customers buying Macs in our stores are new to Mac. We opened 14 stores during the quarter bring our quarter in total to a 124. With an average of 168 stores opened during the quarter, average quarterly revenue per store was \$5.7 million



up from \$4.6 in the year ago quarter. The retail stores segment profit was \$35 million and the associated manufacturing profit was a \$133 million. Traffic to our stores continues to grow. Last quarter 14.8 million people visited our stores translating into 9,800 visitors per store per week. This compares to about 7,400 per store per week in the year ago quarter. We just completed the fourth full fiscal year since launching our retail initiative.

Retail segment revenue for fiscal '05 nearly doubled \$2.35 billion and segment profit grew to a \$151 million. We are very pleased with the continued growth and success of our retail initiative and expect to add 35 to 40 stores in fiscal '06.

Our US education channel had an outstanding quarter, generating 34% year over year unit growth and 24% revenue growth. Our US education channel for more Mac systems in Q4 than in any other quarter in the last 10 years. ((inaudible) unit growth was 31% and included a 30,000 units laptop purchase by the Broward County Public Schools in Florida. Higher education momentum continued on with Mac units growing 38% year-over-year thanks to a very successful back to school season.

In terms of geographic result including sales from our retail stores quarterly revenue in Europe, The America, and Japan was up year-over-year by 92%, 53% and 30% respectively. Gross margin of 28.1% about 40 basic points above our guidance, primarily due to a better than expected commodity environment and product mix. Operating expense was \$617 million, in line with our guidance. Included an operating expense of approximately \$10 million in non-cash share based compensation.

((inaudible) was \$60 million, \$7 million higher than guidance primarily due to higher than expect interest income. In terms of passes, there were number of factors that collectively befitted the quarter results by \$0.12. First, there were several items of a unique nature related to our net differed tax assets and tax reserves, including adjustments evaluation allowances as a result of the favorable tax court ruling. These items benefited the quarters results by \$0.09. Second, notwithstanding these unique items our tax rates for the full year was slightly lower than estimated in prior quarters further benefiting the quarter's earnings by \$0.03. We expect the effective tax rate to be 32% in the December quarter.

Cash grew by \$735 million during the quarter to \$8.261 billion and was up almost to \$2.8 billion for the full fiscal year. Cash flow from operation during the quarter was about \$750 million. Total capital expenditures for the quarter were \$96 million including \$49 million for the retail initiatives. Looking ahead for the December quarter I would like to review an outlook to which includes types of forward-looking information that Nancy referred to at the beginning of the call. For the quarter new we are targeting revenue of about \$4.7 billion. This target represents 35% year-over-year growth and an increase of over \$1.2 billion year-over-year.

As we have mentioned before we would be adopting slab 123R in the December quarter which will require that we reflect the theoretical value of stock options and the option value of employee stock purchase shares as expense in our income statement. For the last few quarters we had been providing a reconciliation of GAAP and non-GAAP operating results in order to present a view of our financial performance excluding such items of non-cash share based compensation and gain. We think presenting such non-GAAP details provides meaningful information about our core operating results and facilitates comparison of results over multiple reporting period. Beginning in Q1 this reconciliation will include the impact of 123R option.

We think that this reconciliation will be particularly helpful in viewing our fiscal '06 results given that our prior results have not reflected the expense impact by 123R. In Q1 we expected total non-cash share base compensation expense to be about \$45 million or about \$0.03 per share. Some of this expense will be reflected in cost of good flow while most of it will be reflected in operating expenses. We expect Q1 GAAP gross margins to be about 27.3%. We expect cost of good flow to include about \$5 million related to non-cash share based compensation expense and therefore except non-GAAP gross margins to be about 27.4%. We expect GAAP profits to be about \$760 million including about \$40 million related to non-cash share based compensation. We expect non-GAAP profits to be about \$720 million. We expect ((inaudible) to be about \$55 million and we expect tax rate to be 32%. We expect to generate GAAP EPF of about \$0.46, which includes anticipated \$0.3 per share related to non-cash share based compensation expense. We expect non GAAP EPF to be about \$0.49. We've just completed the best year in Apple's history which we attribute to our focus on innovation and the immense talent in creativity at Apple. We remain very enthusiastic about our product pipeline and we will have some very exciting announcements to share with you tomorrow. With that I would like open the call to questions.

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