

# Apple F2Q08 (Qtr End 3/29/08) Earnings Call Transcript

## Executives

Nancy Paxton - Senior Director, Investor Relations and Corporate Finance

Peter Oppenheimer - Chief Financial Officer, Senior Vice President

Timothy D. Cook - Chief Operating Officer

Gary Wipfler - Treasurer

## Analysts

Ben Reitzes - Lehman Brothers

Bill Fearnley - FTN Midwest

Mike Abramsky - RBC Capital Markets

David Bailey - Goldman Sachs

Katy Huberty - Morgan Stanley

Richard Gardner - Citigroup

Andrew Neff - Bear Stearns

Gene Munster - Piper Jaffray

Shannon Cross - Cross Research

Keith Bachman - Bank of Montreal

Shaw Wu - American Technology Research

Jeff Fidacaro - Merrill Lynch

Toni Sacconaghi - Sanford Bernstein

Charles Wolf - Needham & Company

Apple Inc. ([AAPL](#)) F2Q08 Earnings Call April 23, 2008 5:00 PM ET

## Operator

Good day, everyone and welcome to this Apple Incorporated second quarter 2008 quarterly results 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 Investor Relations and Corporate Finance. Please go ahead.

## Nancy Paxton

Thank you. Good afternoon and thanks to everyone for joining us. Speaking today is Apple CFO Peter Oppenheimer and he'll be joined by Apple COO Tim Cook and Treasurer Gary Wipfler for the Q&A session with analysts.

Please note that some of the information you will hear during our discussion today may consist of forward-looking statements regarding revenue, gross margin, operating expenses, other income and expense, stock-based compensation expense, taxes, earnings and future products. Actual results or trends could differ materially from our forecasts.

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For more information, please refer to the risk factors discussed in Apple's Form 10-K for 2007, the Form 10-Q for the first quarter of fiscal 2008, and the Form 8-K filed with the SEC today and the attached press release.

Apple assumes no obligation to update any forward-looking statements or information which speak as of their respective dates.

And with that, I would like to turn the call over to Peter Oppenheimer for introductory remarks.

### **Peter Oppenheimer**

Thank you, Nancy and thank you for joining us. We are very pleased to report the highest March quarter revenue and earnings in Apple's history. Revenue in the March quarter was \$7.51 billion, an increase of more than \$2.2 billion over the previous March quarter's revenue of \$5.26 billion. The tremendous growth in the quarter was driven by very strong demand for Macs, higher revenue from iPod and iTunes and the continued popularity of the iPhone.

Operating margin for the quarter was better than expected at 17.5%, primarily due to the higher-than-anticipated revenue and gross margin. Net income was \$1.05 billion, which was up 36% over the prior March quarter's results and translated to earnings per share of \$1.16.

Before going through the details of the March quarter, I would like to give you a few data points indicating just how exceptionally well Apple performed. Revenue growth in the March quarter accelerated to 43% year over year, which is more than twice the 21% growth rate we achieved in the March quarter last year.

We saw healthy growth in all regions, with the U.S. sales growing 40% and international sales growing 47%.

Sales in our 208 retail stores, most of which are in the U.S., were extremely strong, growing 74% year over year, driven in part by traffic of 33.7 million visitors, up 57% from the year-ago quarter.

In the retail stores, 50% of the CPUs we sold were to customers who were new to the Mac, adding growth to our platform.

And finally, our U.S. education business generated Mac unit growth of 35% year over year, its highest growth rate in any quarter in the last eight years.

I would now like to talk about our Mac products and services, which represented 59% of total quarterly revenue. We are extremely pleased to have shipped 2.29 million Macs, just shy of the record number of Macs we sold this past holiday quarter and representing 51% growth over the prior March quarter's results.

This is a 3.5 times the overall PC market rate of growth for the March quarter based on the latest forecast published by IDC, up from the 2 to 3 times market growth rate we have been reporting almost every quarter for the last three years.

Sales of desktops grew 37%, driven by strong demand for the iMac, as well as increased sales of Mac Pro, which we updated in January.

Sales of portables grew 61%, driven by continued strong demand for Macbook and Macbook Pros, both of which were refreshed during the quarter, as well as the successful launch of the Macbook Air. Macbook Air represents a new portable category for Apple and customers have responded very well to its breakthrough design and ultra portability.

We ended the quarter with between three and four weeks of Mac channel inventory.

Now I would like to discuss our music products and services, which accounted for 36% of total revenue during the quarter. We sold 10.6 million iPods, an increase of 1% from the year-ago quarter, and we experienced about the same seasonal rate of decline between the December and March quarters as we did last year.

iPod revenue grew 8% year over year from higher ASPs in every geographic segment due to the success of the iPod Touch. We continue to be very pleased with customer response to the iPod Touch and believe the introduction of the software development kit in late June will broaden this appeal even further as great new applications are developed.

After declining 17% year over year in the December quarter, Shuffle sales were also down significantly in the March quarter but the weekly rate of sales improved considerably following the February 19th price reduction.

We continue to achieve our objectives of maintaining our high MP3 market share in the U.S. and gaining share internationally. Our share of the U.S. MP3 market was 73% according to the latest data published by NPD. Outside

the U.S., we gained share in nearly every market we have data for based on the latest information from GFK and BCN.

We began and ended the quarter within our target range of four to six weeks of iPod channel inventory.

Sales from iTunes were very strong in the quarter and NPD reported that we have surpassed Wal-Mart to become the largest music retailer in the U.S. The iTunes store has over 50 million customers and over 85% share of the U.S. market for legally purchased and downloaded music based on the latest information from Nielsen Soundscan.

Our movie rental service has been well-received by customers and we have also just begun selling TV shows in Germany and will continue to expand video content internationally.

We are very pleased with iPhone momentum and customer feedback continues to be outstanding. We remain confident in achieving our goal of selling 10 million iPhones in calendar 2008.

We sold 1.7 million iPhones during the March quarter and expanded our sales presence to include Austria and Ireland. Total revenue recognized during the quarter from sales of iPhone, iPhone accessories, and payments from carriers was \$378 million. Total deferred revenue from iPhone and Apple TV was \$1.93 billion at the end of the March quarter, compared to \$1.44 billion at the end of the December quarter.

Developer response to the iPhone 2.0 beta software we announced on March 6th has been tremendous. Over 200,000 developers have signed up and downloaded the software development kit. Interest in the iPhone enterprise beta program has also been off the charts. We have received applications from over one-third of the Fortune 500 and over 400 higher ed institutions. Hundreds of companies and institutions have been accepted into the program and more are being added each week.

Because we announced the specific new features to be included in the iPhone 2.0 release and plan to provide them to iPhone customers as a free upgrade in late June, we will delay the start of revenue recognition for all iPhones sold on or after our March 6th announcement date until the iPhone 2.0 software is delivered.

The revenue and cost of sales associated with these iPhones will be recognized ratably over the remaining terms of their respective 24-month estimated lives. Revenue recognition of handsets sold prior to March 6th and payments from carries has not changed as a result of our announcements.

I would now like to turn to the Apple retail stores which had another terrific quarter with revenue growing 74% year over year to \$1.45 billion. The stores sold 458,000 Macs during the quarter, an increase of 67% year over year. We opened four stores during the quarter to end with 208. With an average of 205 stores opened during the quarter, average revenue per store was \$7.1 million, compared to \$4.8 million in the year-ago quarter, an increase of 48%.

Operating profit doubled year over year to \$334 million from \$164 million. A primary objective in our stores has been helping people to get more out of their Macs and the stores delivered 580,000 one-hour personal training sessions during the quarter.

We opened our 15th store in the United Kingdom during the March quarter and we looked forward to opening our first stores in Australia, China, and Switzerland in the coming months. We expect to open about 45 stores during fiscal 2008 and continue to be very confident in the investments we are making in the stores and the asset we are building.

Total company gross margin was 32.9%, which was a little stronger than our guidance due to a more favorable commodity environment, higher overall revenue, and a weaker dollar.

Operating expenses were \$1.16 billion, including \$112 million in stock-based compensation expense. OI&E was \$162 million, below our guidance due to the lower interest rate environment.

The tax rate for the quarter was about 29%, below the expected 32% due to higher foreign earnings and lower interest income. We expect the tax rate for the second half of fiscal 2008 to be 31%.

We generated \$1 billion in cash during the quarter, ending with \$19.4 billion. Cash flow from operations was \$1.2 billion. In the first half of fiscal 2008, we generated \$4 billion in cash from \$2.6 billion in net income, the difference being driven largely by the iPhone and strong working capital management.

Looking ahead to the June quarter, I would like to review our outlook which includes the types of forward-looking information that Nancy referred to at the beginning of the call.

For the quarter, we are targeting revenue of about \$7.2 billion, or approximately 33% growth over the prior June quarter. We expect the total quarterly costs of non-cash stock-based compensation to be approximately \$135 million.

Okay. Thank you very much.

**Operator**

We'll move to Charles Wolf with Needham & Company.

**Charles Wolf - Needham & Company**

I have a couple of questions; one is do you have any color that you can provide on the demographics of Macbook Air purchases? You know, I originally thought it would be for road warriors but the numbers suggest it is selling far better than that.

And sort of in the same vein, do you have any sense of how many Window users purchased a Macbook Air?

**Timothy D. Cook**

We don't on the latter, Charlie. What we would share is that it is appealing to all sorts of people, from college professors to students to people that travel a lot. It seems to have universal appeal and also the cannibalization factor was extremely low to the other portables, which is one of the key reasons we were able to have a very minor sequential decline from Q1, where usually it would be much deeper.

**Charles Wolf - Needham & Company**

Thank you.

**Nancy Paxton**

Thanks, Charlie and thanks to everyone for joining us. 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](http://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 7414725. These replays will be available beginning at approximately 5:00 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. Thanks again.

**Operator**

That does conclude today's conference call. We do thank everyone for their participation.

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